



# The Irish Economic Update

*Performing well, but risks ahead*

January 2019

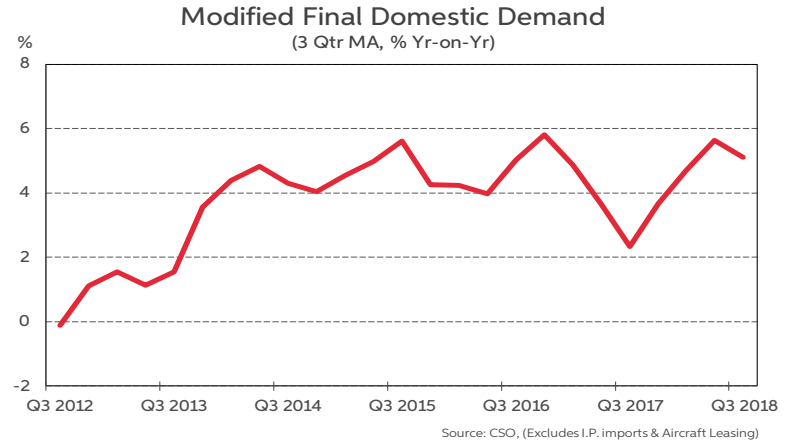
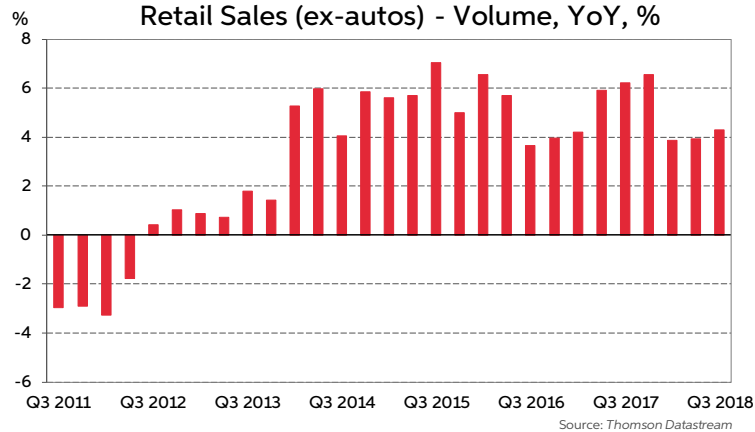
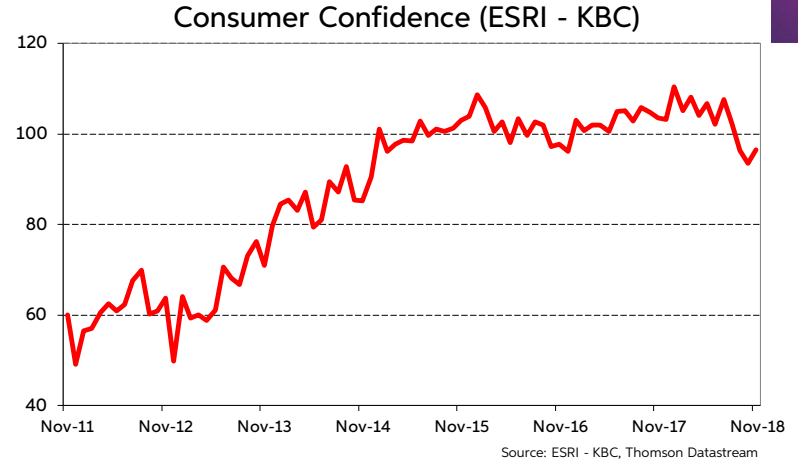
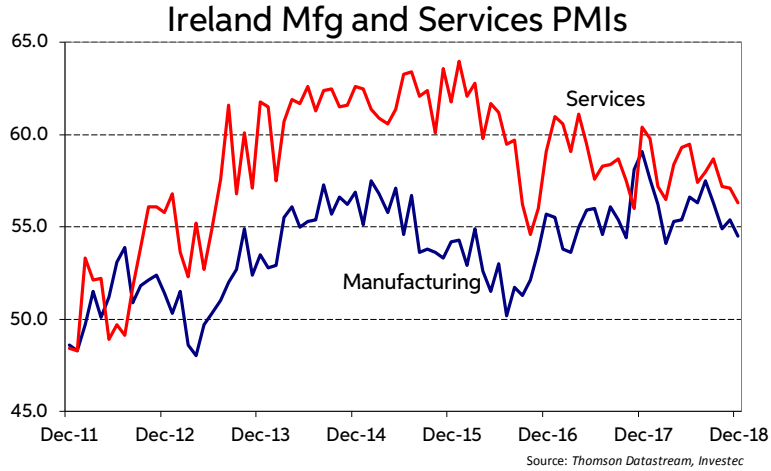
Oliver Mangan  
Chief Economist  
AIB

# Strong growth by Irish economy over past 6 years



- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8.5% and GNP down 11%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance programme from 2010-2013
- GDP at end of 2008-09 recession was still over 25% higher than in 2001, highlighting that the economic crash came after a long period of very strong growth, unlike in other countries
- Ireland tackled its problems aggressively in the public finances, banking sector and property market. Imbalances in economy unwound – housing, debt levels, competitiveness, BoP
- Ireland focused on generating growth via its large export base as the route to recovery
- Economy grows very strongly over 2013-18 – underlying growth averages 4.5% for the period
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Strong jobs growth. Unemployment rate fell from 16% in early 2012 to 5.3% in November 2018
- Budget deficit has declined at a quicker than expected pace. Public finances now in balance

# Economic indicators remained upbeat in 2018



# Economy continued to perform strongly in 2018



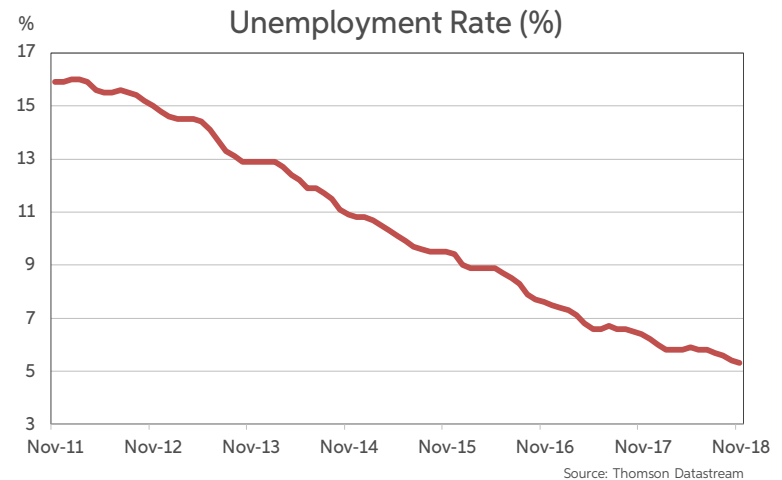
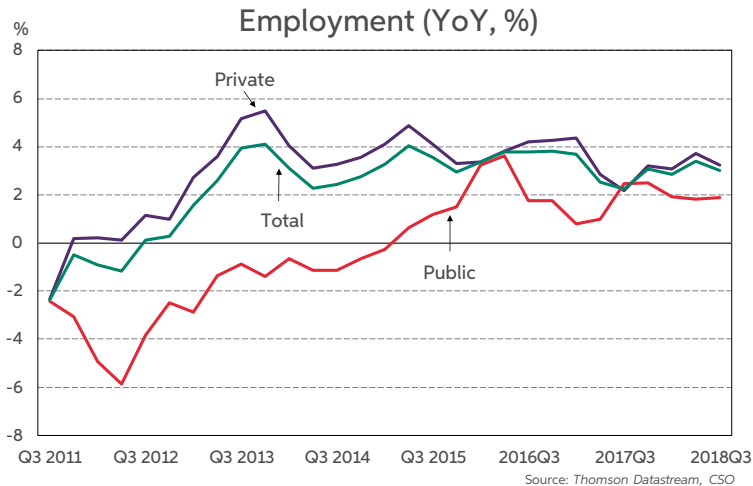
- Modified final domestic demand grew by 5% yoy in Q1-Q3 2018
- Mfg PMI remained high through out 2018 – at 55.4 in November and 54.5 in December
- Services PMI also stayed very strong in 2018 – at 57.1 in November and 56.3 in December
- Construction PMI at strong levels throughout 2018 – at 55.5 in November
- Consumer confidence remained high in 2018 but dipped over the autumn on Brexit concerns
- Retail sales (ex-motor trade) rose strongly again last year, up 4.3% yoy in Q3
- Total car regs (new + used imports) steady at very high level in 2018 – surged over 2014-17
- Further strong rise in housing completions – up 28% yoy to September
- Mortgage lending up by 20% yoy to end September, after rising by 29% in 2017
- Continuing strong job growth – employment rose by over 3% yoy in Q1-Q3 2018
- Live Register continued its sharp decline in 2018. Jobless rate fell to 5.3% in November 2018
- Budget moved into balance in 2018. Tax receipts up 8.3% in the year, well ahead of target



# Robust jobs growth; unemployment rate falls to 5.3%

Year Average	2015	2016	2017	2018(f)	2019(f)	2020(f)
<b>Unemployment Rate %</b>	10.0	8.4	6.8	5.7	5.2	5.0
<b>Labour Force Growth %</b>	1.2	1.9	1.1	1.8	2.0	1.8
<b>Employment Growth %</b>	3.5	3.7	2.9	3.0	2.5	2.0
<b>Net Migration : Year to April ('000)</b>	5.9	16.2	19.8	34.0	38.0	40.0

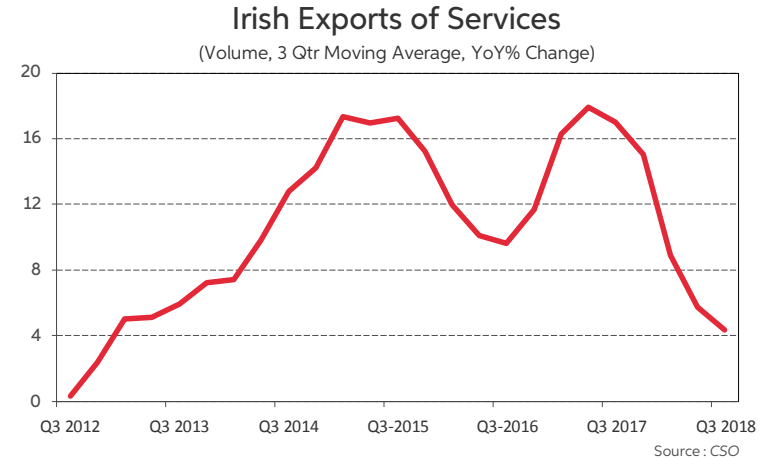
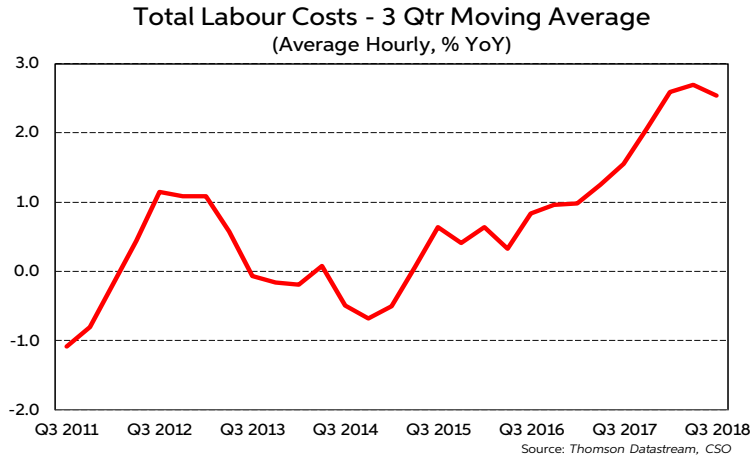
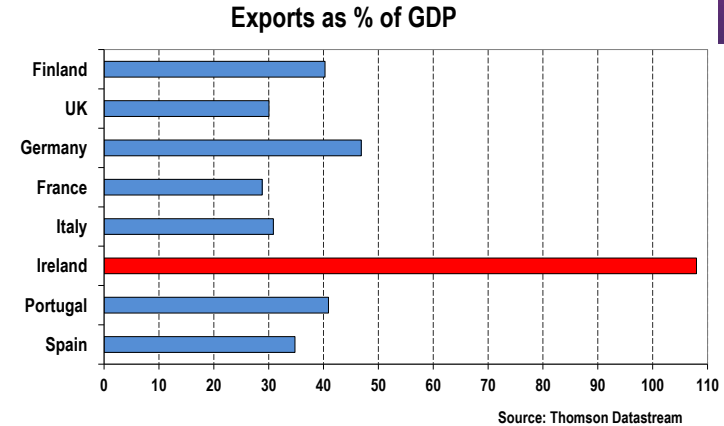
Source: CSO and AIB ERU forecasts



# Large Irish export base performing very well



- Ireland a very open economy – exports, driven by huge FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness in past decade - weakening of euro in 2014/15 helpful
- Exports have risen strongly, helped by large FDI inflows and recovery in global economy
- Very weak sterling a challenge for exports to UK, but total exports still up 9% yoy in Q1-Q3 2018



# FDI and the Irish economy



## WHAT ATTRACTS FDI TO IRELAND?

- Access to European markets
- Low corporate tax rate of 12.5%
- English speaking country
- Well educated, flexible workforce
- Common law legal system
- Stable political framework
- Long history of successful FDI
- Access to decision makers

## KEY FDI IMPACTS ON THE IRISH ECONOMY

- Over 1,200 multinational companies
- €189bn in Exports
- 230,000 Jobs in FDI, 390,000 in total
- €7bn in Corporation Tax ( 67% of total )
- 33% of State's income tax/PRSI/USC
- €13.2bn Spending on Irish services/materials
- €11.7bn in Payroll
- 67% of Business R&D expenditure

## WORLD LEADERS CHOOSE IRELAND

- 8 of the top 10 in ICT
- 9 of the top 10 in Pharmaceuticals
- 17 of the top 25 in Medical Devices
- 3 of the top 5 Games companies
- 10 of the 'top born on the Internet' firms
- More than 50% of the world's leading Financial firms
- UK becoming less attractive for FDI owing to Brexit

## US TAX CHANGES SHOULD NOT HIT FDI

- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates
- Very strong year for FDI in 2018

# Many top global companies have big operations in Ireland

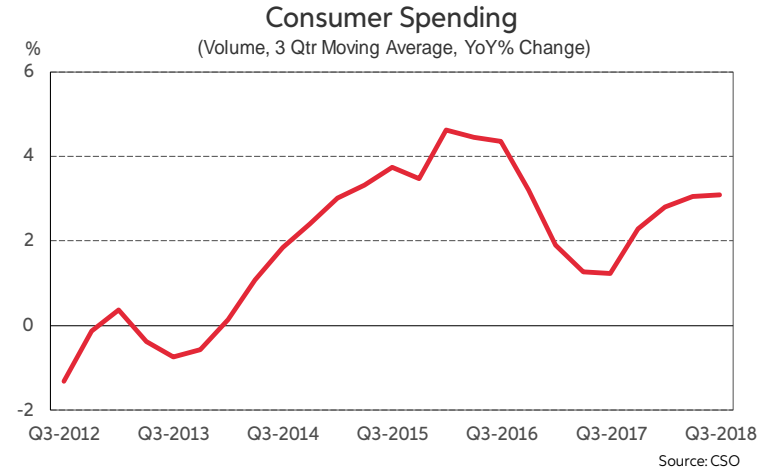
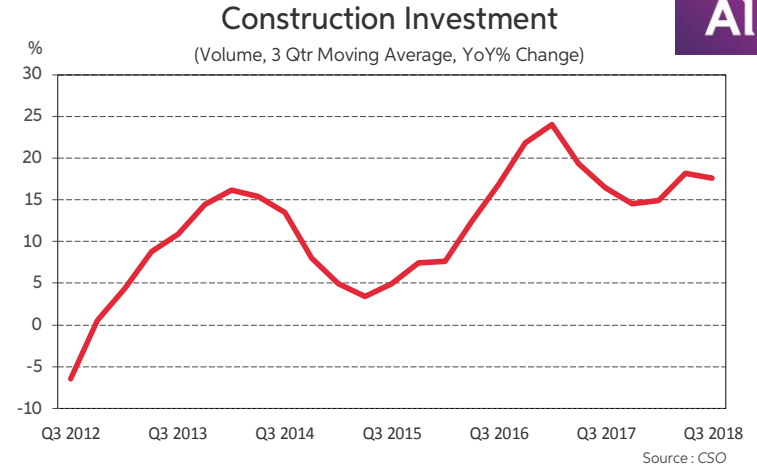




# Strong recovery by domestic economy in place since 2013



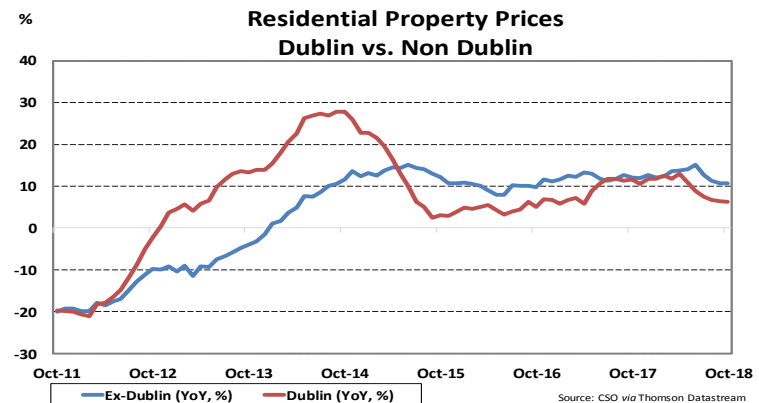
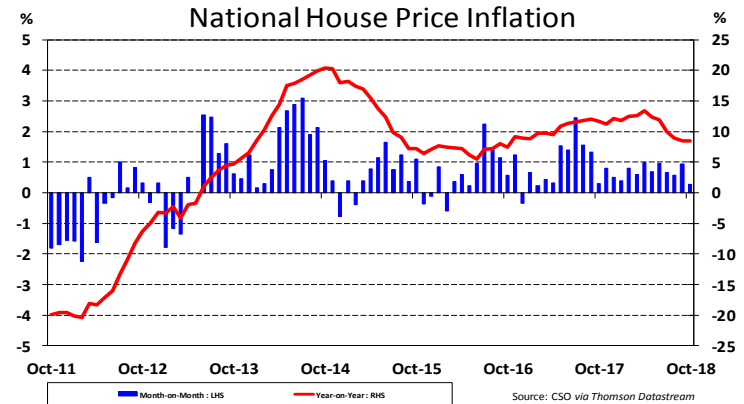
- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction sees strong recovery since 2013. Output up by 15% in 2016 & 2017 and 17% in Q1-Q3 2018
- Difficult year in agricultural sector in 2018, but comes after very strong growth in 2014-17 period
- Modified final domestic demand up 5% yoy in Q1-Q3 2018, after averaging growth of 4.4% in 2014-17
- Core business investment (ex aircraft/intangibles) has rebounded since 2013. Rose by 18.5% in Q1-Q3 2018
- Consumer spending grew by close to 3% on average over 2014-2017 period. Up 3% yoy in Q1-Q3 2018
- Core retail sales rose by 4% yoy in Q1-Q3 2018
- Total car regs (new + used imports) remained at very high level in 2018, having surged over 2014-17 period



# High house price inflation moderates during 2018



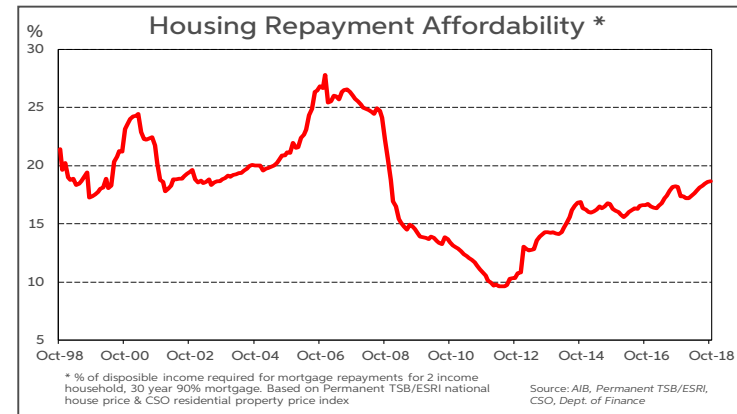
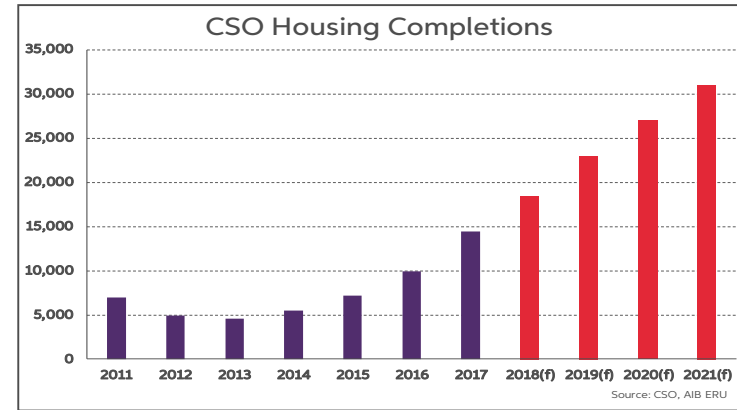
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building
- Little stock for sale, house building remains low
- Prices up 84% by October from low in March 2013 – Dublin prices up by 98%, non-Dublin rise 78%
- House prices nationally still 18% below 2007 peak
- House price inflation moderated last year as Central Bank lending rules and affordability impact
- Prices up 8.4% yoy nationally in October 2018, down from recent peak of 13.3% in April
- Dublin up 6.3% vs recent peak of 13% in April, while non-Dublin slows from 15.4% in June to 10.6% yoy
- Rents have also rebounded strongly – now over 26% above previous peak reached in 2008 per CSO data



# House building rising slowly from very low levels



- Housing completions increased by 45% to 14,500 in 2017. Heading for over 18,000 in 2018
- Housing commencements rose by 33% in 2017 to 17,500. Could reach near 23,000 in 2018
- Very big jump in planning permissions in 2018. Up 70% year-on-year in Q3
- Housing output still running well below annual new housing demand, estimated at circa 35,000 units
- Measures put in place to boost new house building. More Local Authority and NAMA building
- Mortgage lending up by 20% yoy to end September, though mortgage approvals slowed in 2018
- Housing affordability hit by rising house prices, especially Dublin, but helped by low mortgage rates
- Could be 2022 before housing output rises to 35,000 units – around level of estimated annual demand



# AIB Model of Estimated Housing Demand



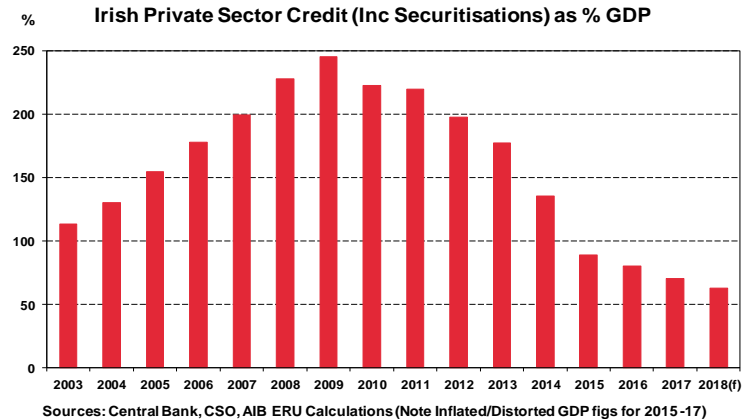
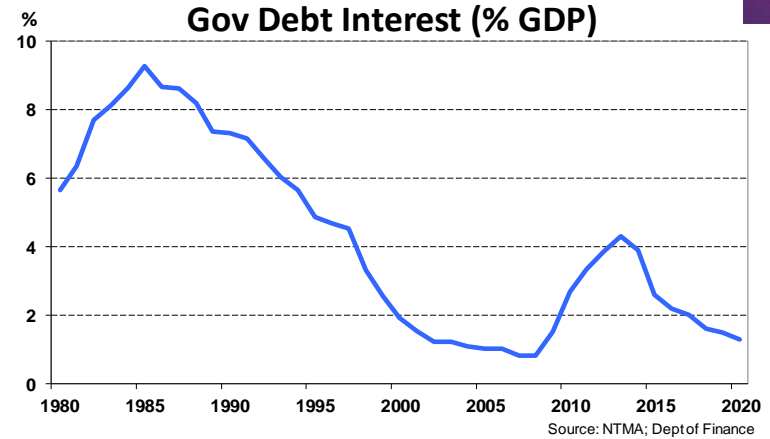
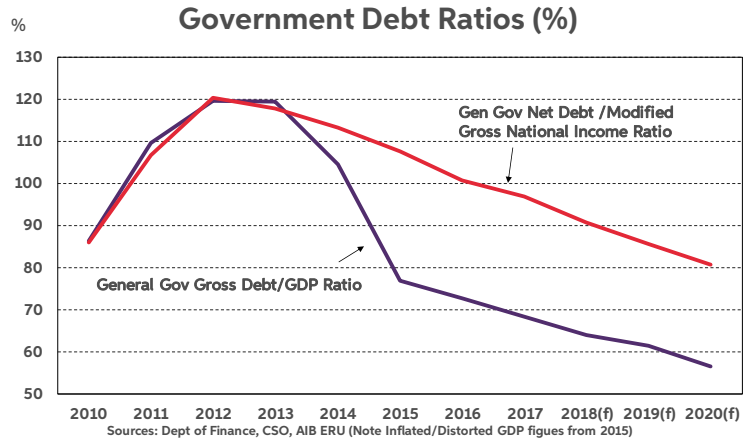
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – 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 2016-20

Calendar Year	2016	2017	2018	2019	2020
<b>Household Formation</b>	26,500	26,500	26,500	27,500	27,500
<i>of which</i>					
<b>Indigenous Population Growth</b>	18,000	18,500	17,500	16,500	14,500
<b>Migration Flows</b>	8,500	9,500	12,000	13,000	13,000
<b>Headship Change*</b>	0	0	0	0	0
<b>Second Homes</b>	500	500	500	500	500
<b>Replacement of Obsolete Units</b>	5,000	5,000	5,000	5,000	5,000
<b>Estimated Demand</b>	<b>32,000</b>	<b>33,500</b>	<b>35,000</b>	<b>35,000</b>	<b>33,000</b>
<b>Completions</b>	<b>9,900</b>	<b>14,500</b>	<b>18,500</b>	<b>23,000</b>	<b>27,000</b>
<b>Shortfall in Supply</b>	<b>-22,100</b>	<b>-19,000</b>	<b>-16,500</b>	<b>-12,000</b>	<b>-6,000</b>

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

Sources: CSO, DoECLG, AIB ERU

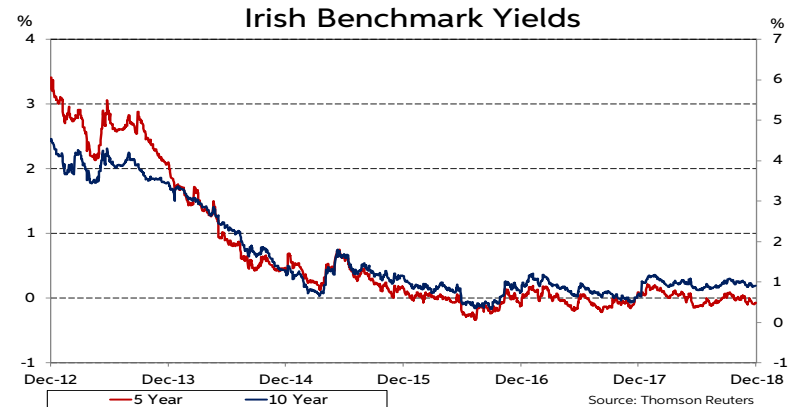
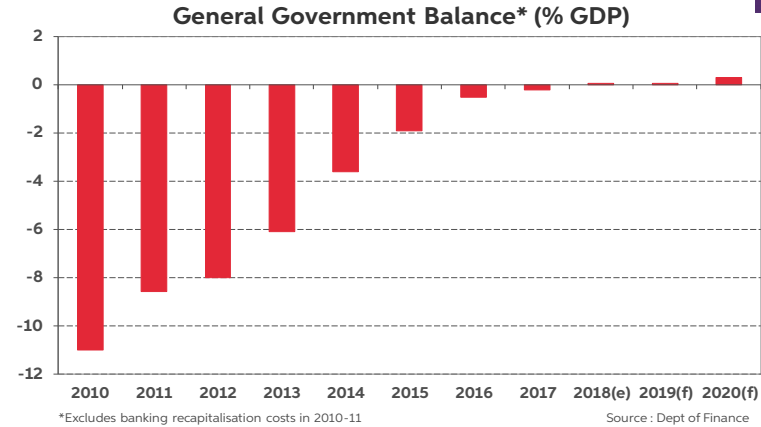
# Govt debt ratios fall, private sector deleverages



# Budget deficit eliminated in 2018



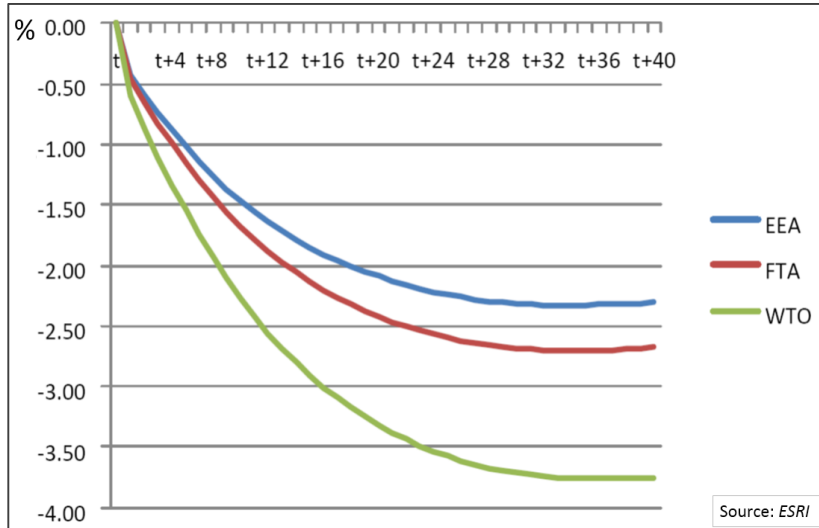
- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit has fallen sharply over the course of this decade
- The deficit declined to 0.2% of GDP in 2017 and budget in balance in 2018 (surplus of €100m)
- Primary budget surplus (i.e. excluding debt interest) of 1.5% of GDP in 2018
- Debt interest costs low – at 1.5% of GDP
- Government aims for balanced budget again in 2019 and budget surpluses from 2020
- Gross Gov Debt/GDP ratio has fallen sharply
- Irish bonds yields at very low levels
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A+, Moody's A2



# Brexit expected to lower growth rate of Irish economy



## Impact of Brexit on Output (% deviation from base)



- ESRI estimate that Irish output would be reduced over time by 2-2.5% on a soft Brexit
- Sharp fall-off in trade with UK likely on a no-deal, hard Brexit
- Output almost 4.0 % lower over time if there is hard Brexit and a fall back on WTO rules and tariffs
- Employment 2% lower and unemployment rate nearly 2% higher in hard Brexit

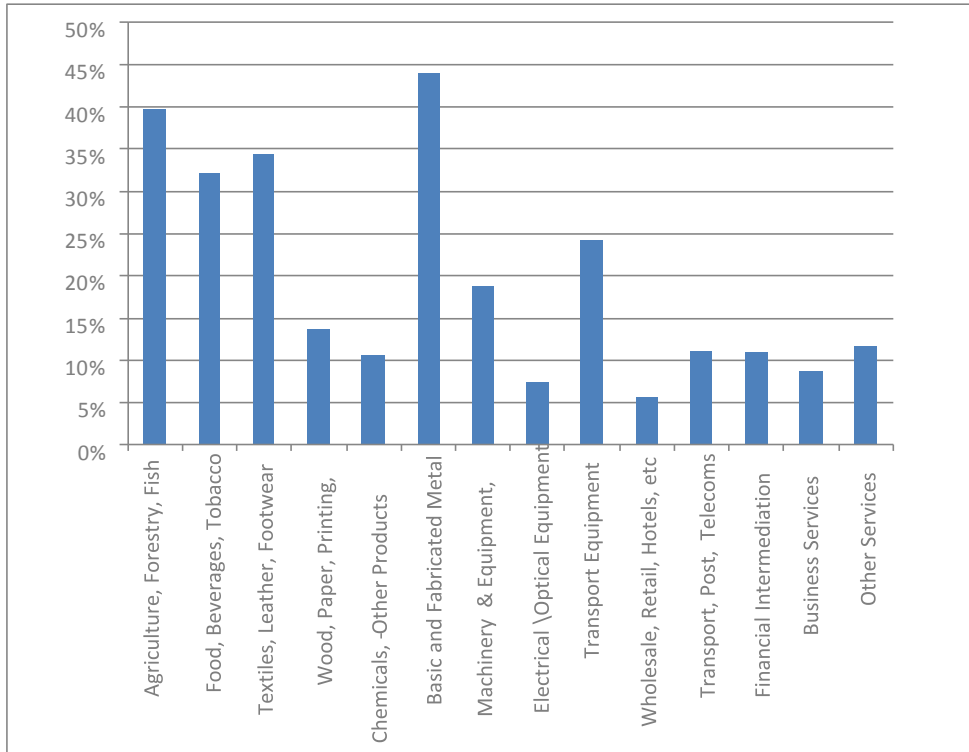
- Copenhagen Economics Report considers costs of regulatory divergence for goods and services and of border checks, as well as tariffs in assessing impact of Brexit
- Estimates impact by 2030 is to reduce Irish GDP by 2.8% under a soft Brexit (EEA), 4.3% in a FTA and 7% in a no-deal, hard Brexit WTO scenario

# Agri. sector would be severely impacted by hard Brexit



- Main EU tariffs relate to food products, keeping prices up. UK may not maintain these post-Brexit
- Food and Beverages account for 25% of total Irish exports to UK
- Around 40% of Irish food exports go to the UK
- Other sectors very dependent on UK market include machinery and transport, metal products, textiles
- Some 40% of indigenous Irish exports go to UK compared to 10% for foreign owned companies

Share of Exports by Industry Destined for the UK (ESRI)

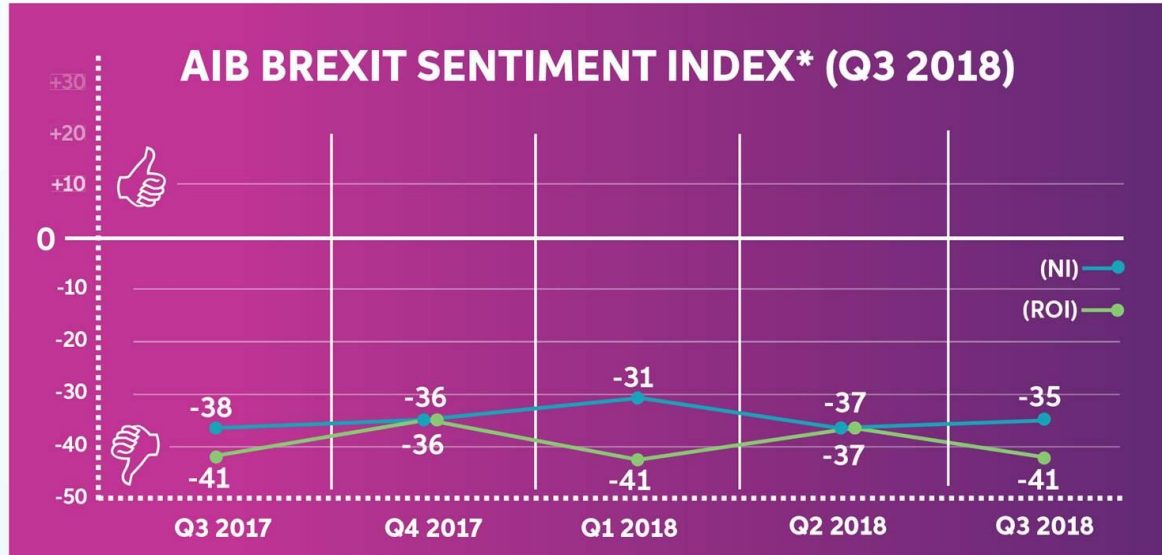




# AIB Brexit Sentiment Index – Q3 2018



- A total of **700 SME's (with up to 250 employees)** across the island of Ireland



Source: Ipsos MRBI

\*The Index reflects and measures the sentiment of Irish SMEs in the Republic of Ireland and Northern Ireland towards Brexit, summarised as a single number, with a potential range from +100 to -100. It takes the difference between the positive and negative responses across four key measures: Impact on business now, Impact on future business (next 5 years), Level of visibility and, finally, the Wider economic impact of Brexit.

- Very negative sentiment readings, but firms say Brexit is having little impact on businesses now
- SMEs surveyed are most concerned about its impact in the future, both on their own business and wider economy, as well as lack of clarity on Brexit
- Tourism, Manufacturing, Retail sectors most worried

# Still much uncertainty about Brexit



- UK preparing to leave EU, Single Market and Customs Union at end March 2019
- Withdrawal Agreement reached between UK and EU allows for orderly UK departure from EU. Will be the basis for a legally binding Treaty but needs to be ratified by UK Parliament
- It includes a transition period to allow for continuing EU-UK free trade while a new trade deal is being negotiated. This will last until at least end 2020
- Provides for a backstop to be triggered if new EU-UK trade deal can't be agreed in order to avoid a hard border in Ireland
- Backstop allows unfettered access for NI to both EU and UK markets. UK will remain within a customs territory with EU under the backstop. NI in deeper EU customs regime
- Exit deal also includes a political declaration on future EU-UK relationship
- Getting Withdrawal Agreement through UK Parliament proving a major challenge
- Still a lot of uncertainty about Brexit. Wide variety of possible outcomes

# Parliamentary arithmetic major hurdle to Brexit deal

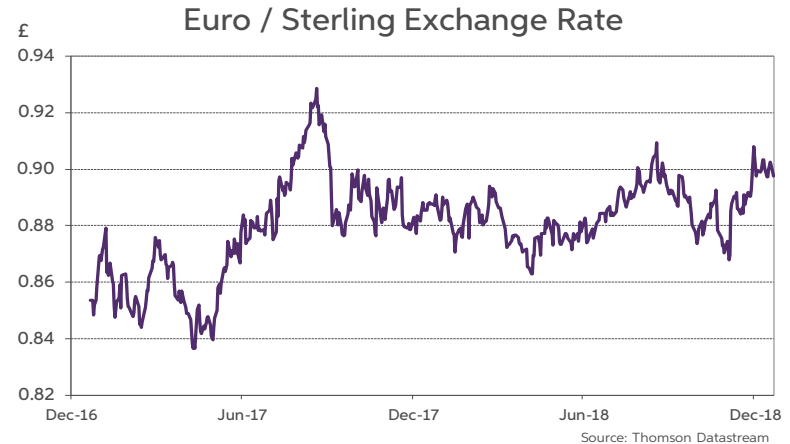
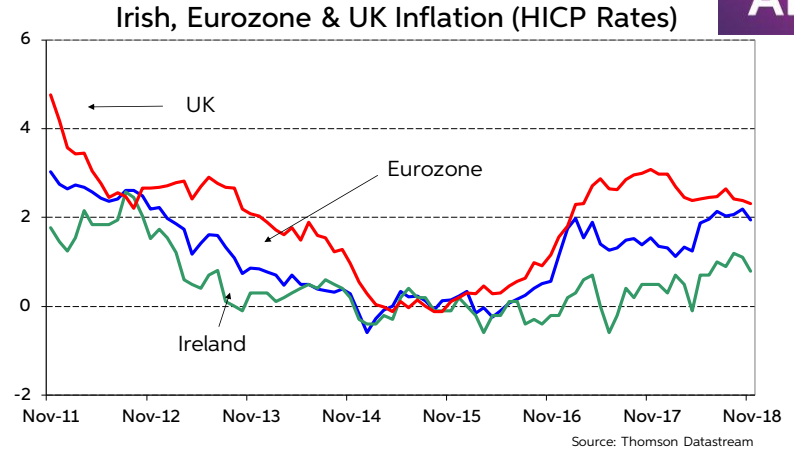


- Tory Party badly split over Brexit. DUP strongly opposed to current deal. No support from opposition parties for Withdrawal Agreement
- Withdrawal Bill was set to be defeated by a large margin in a Commons vote before Christmas, so vote has been delayed until mid-January
- Parliamentary logjam possible whereby no Brexit option- Withdrawal Agreement, No-Deal or Remain can command majority support
- Large majority of MPs are against a no-deal hard Brexit
- EU not entertaining any renegotiation of Withdrawal Agreement
- UK Government likely to play hardball and leave Parliament facing option of hard Brexit or supporting the deal. Bill may eventually be passed to avoid a hard Brexit
- Other options include a general election or another Brexit referendum. This would require extension of Article 50 i.e. delay March Brexit date until probably end 2019
- UK may seek to defer March exit date anyway to avoid a hard Brexit

# Irish growth to remain strong if external risks avoided



- Strong growth by Irish economy should continue
- Construction picking up from still low output levels
- Big rise in public spending next year
- Activity supported by low interest rate environment
- Continuing FDI despite concerns on corporate tax
- Low Irish inflation still low, well below that of the Eurozone, UK and US
- However, Brexit is a challenge for the economy
- Important also that global economy holds up given importance of export markets to Ireland
- GDP growth forecast at 4.0-4.5% for 2019 and circa 3.5% in 2020, assuming a no-deal, hard Brexit is avoided and the global economy holds up
- ESRI estimates medium-term growth rate of economy at around 3.25% in the period 2020-2025



# AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2016	2017	2018 (f)	2019 (f)	2020 (f)
<b>GDP</b>	<b>5.0</b>	<b>7.2</b>	<b>7.0</b>	<b>4.0</b>	<b>3.5</b>
<b>GNP</b>	11.5	4.4	7.0	3.7	3.2
<b>Personal Consumption</b>	4.0	1.6	3.0	2.5	2.5
<b>Government Spending</b>	3.5	3.9	4.8	3.0	3.0
<b>Fixed Investment</b>	51.7	-31.0	3.0	7.0	6.0
<b>Modified Final Domestic Demand*</b>	5.6	3.2	5.0	4.0	3.8
<b>Exports</b>	4.4	7.8	8.0	4.5	4.3
<b>Imports</b>	18.5	-9.4	4.0	4.5	4.5
<b>HICP Inflation (%)</b>	-0.2	0.2	0.7	1.0	1.5
<b>Unemployment Rate (%)</b>	8.4	6.8	5.7	5.2	5.0
<b>Budget Balance (% GDP)</b>	-0.5	-0.2	0.0	0.0	0.3
<b>Gross General Gov Debt (% GDP)</b>	72.8	68.0	64.0	61.0	56.5

\*Excludes investment in aircraft and intangibles

Source: CSO, AIB ERU Forecasts

# Risks to the Irish economy



- Main risks to Irish recovery no longer internal but external, in particular Brexit
- Brexit major issue for Ireland given its strong trading links with UK and sharp fall by sterling
- Uncertain external environment with growing downside risks to global growth from increasing protectionism/tariffs, tightening monetary conditions, problems in some emerging economies
- Questions around Irish corporation tax regime (Apple ruling, moves on tax harmonisation in EU, cuts in US/UK rates) could impact FDI. Note that Ireland has the right to set its own tax rates
- Supply constraints in new house building activity, which is recovering at a slow pace with output still at very low levels
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, rising wages
- Credit constraints – tightening of lending rules, on-going deleveraging

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.