The Irish Economic Update:

Economy starts to recover from deep Covid recession in H1 2020

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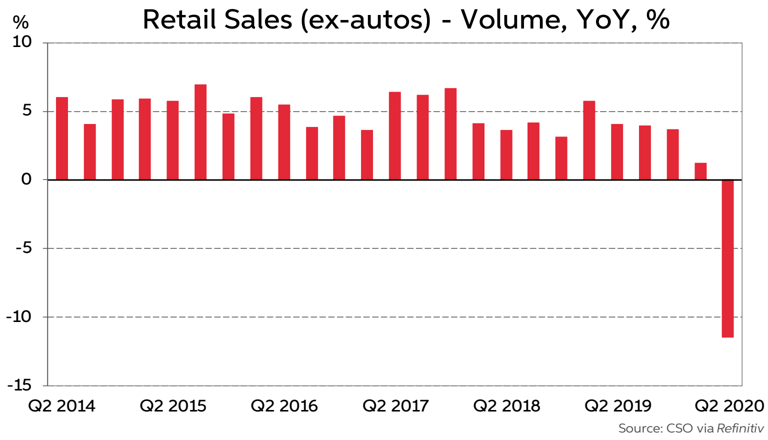
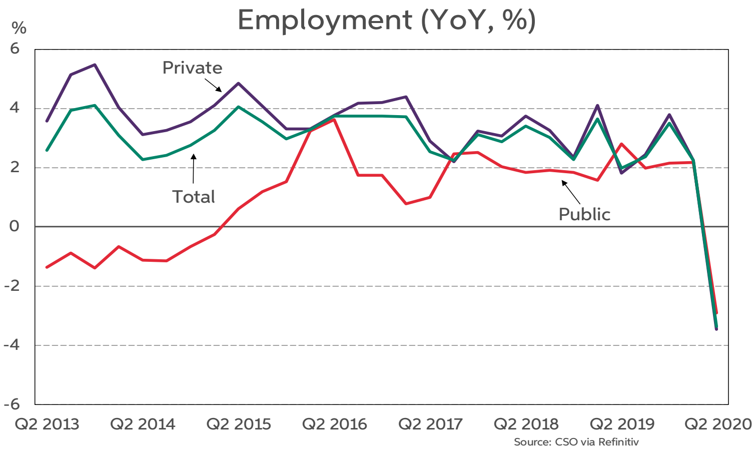
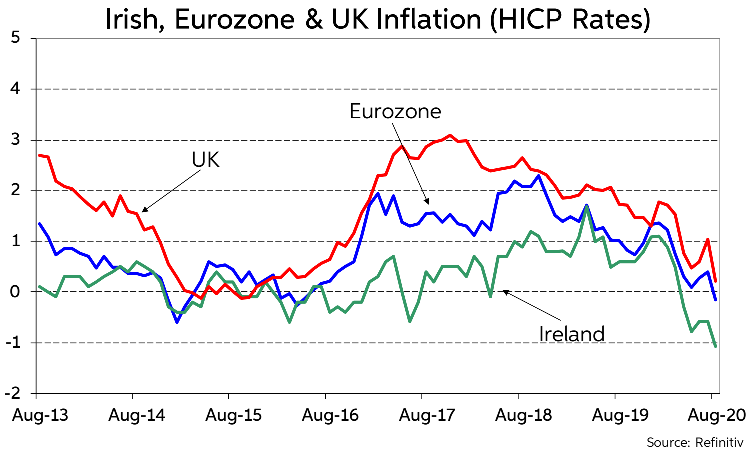
Economy entered Covid recession in very strong shape

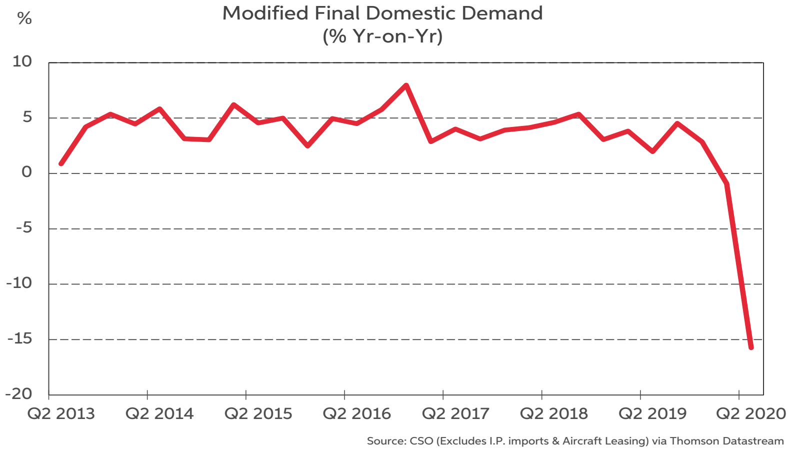
- Irish economy was in very strong shape ahead of being hit by very deep H1 Covid recession
- Economy had recovered strongly from severe recession of 2009-2012 period
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain 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

Covid hits consumer spending, employment & inflation







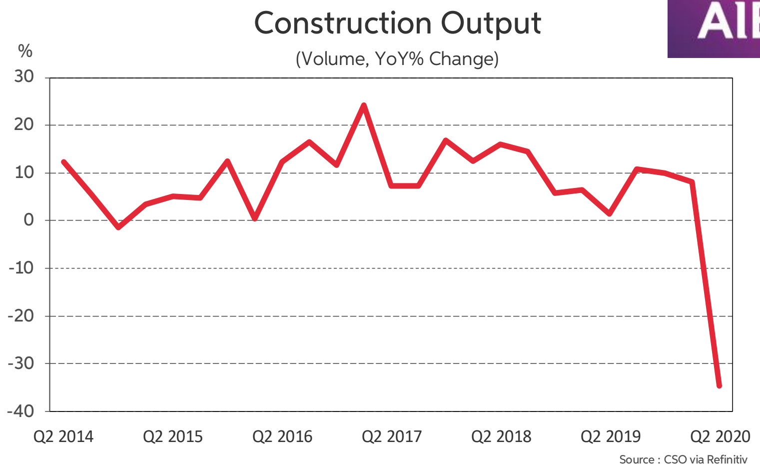


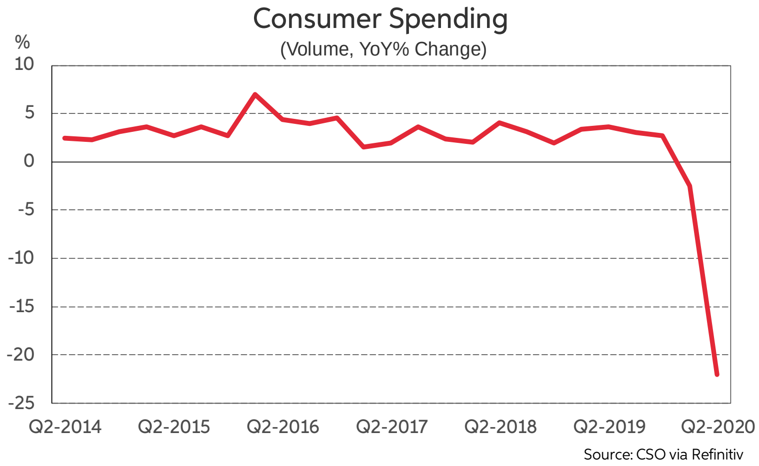
Steep contraction in domestic activity during Q2 lockdown

- GDP fell by 2.1% in Q1 and 6.1% in Q2, so economy entered a deep recession
- Modified final domestic demand fell by a very steep 16.4% in Q2 after 1.3% fall in Q1
- Sharp declines of 20% in consumer spending and 28% in domestic fixed investment in Q2
- Strong performance by exports (pharma +28% yoy) and lower Royalties on IP boost net trade in H1
- Jobless rate soared in March-May; COVID-19 adjusted unemployment rate rose to near 29%
- Big fall of 6.3% in employment in Q2, especially in part-time jobs – but understates real decline
- Hours worked fell by 22% yoy in Q2, which shows real impact of COVID-19 on activity
- PMIs sank to very low levels in April and May, especially for services and construction
- 67% drop yoy in number of cars licensed for first time (new + 2nd-hand imports) in 3 months to May
- Retail sales (ex motor trade) fell by 12% in Q2 - sales plunged by 24% in April
- But tax receipts held up better than expected – rose 0.7% yoy in H1 2020: Corpo tax well up
- Activity started to rebound from June as virus brought under control and restrictions were relaxed

Domestic spending falls sharply in H1 on Covid impact

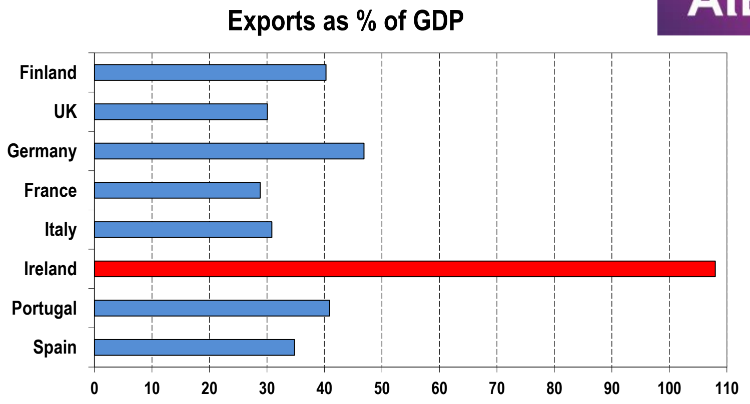
- Average growth rate of 4.25% in modified final domestic demand in period 2014-19
- Covid hit sees modified FDD fall by 16.4% in Q2 2020, after decline of 1.3% in Q1
- Consumer spending contracted by 3.6% in Q1 and then fell by 19.6% in Q2
- Core retail sales down by 12% in Q2, with very sharp fall 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 down by 30% in Q2
- Consumer spending rebounded over summer with core July retail sales back above pre-Covid levels
- New car sales up in August on year-on-year basis – first such monthly rise in 2020



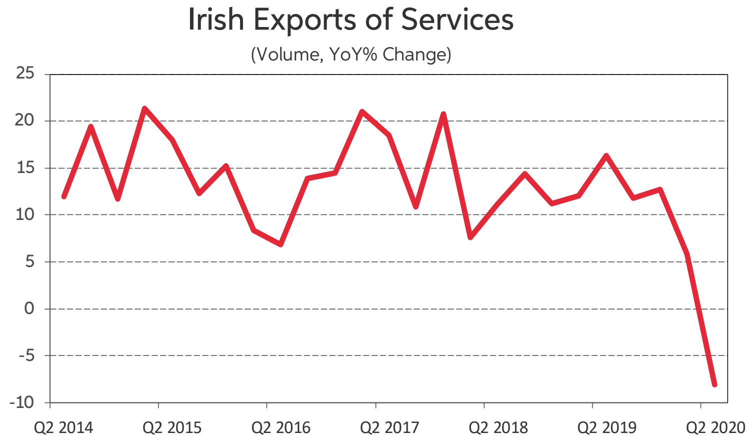


Goods exports perform well in H1, Services exports fall

- 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

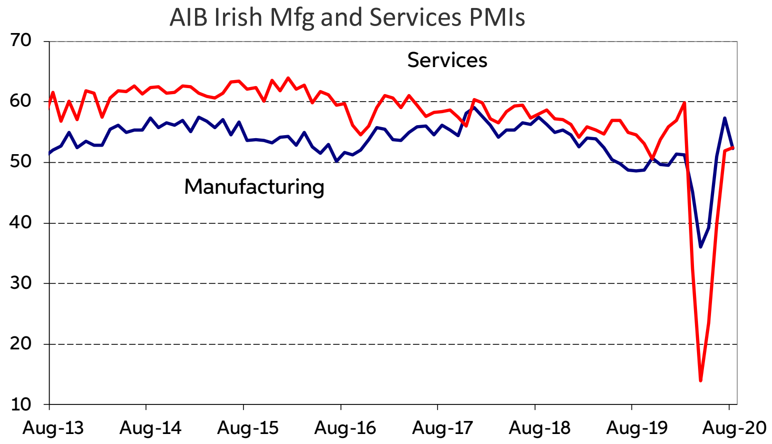


Source: Thomson Datastream

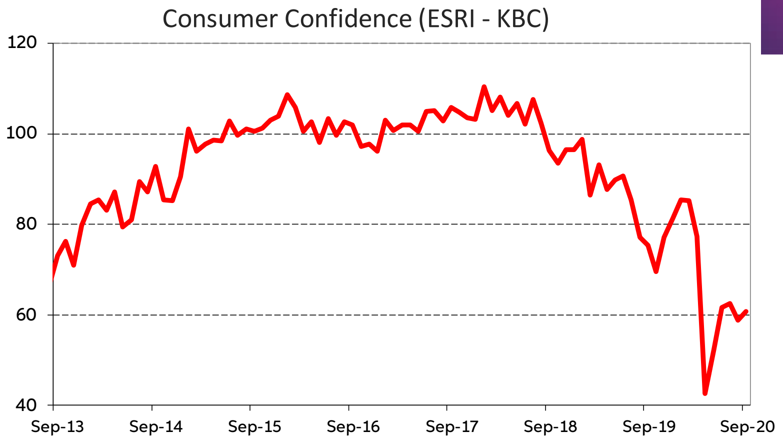


Source : CSO

Activity picks up over summer as lockdown lifted



Source: *Refinitiv*



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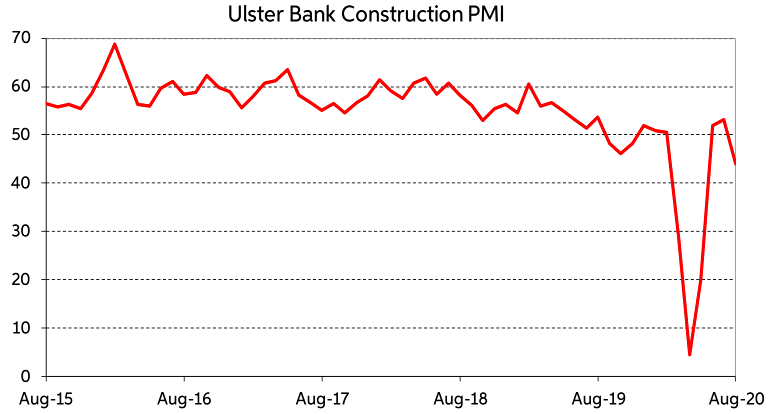

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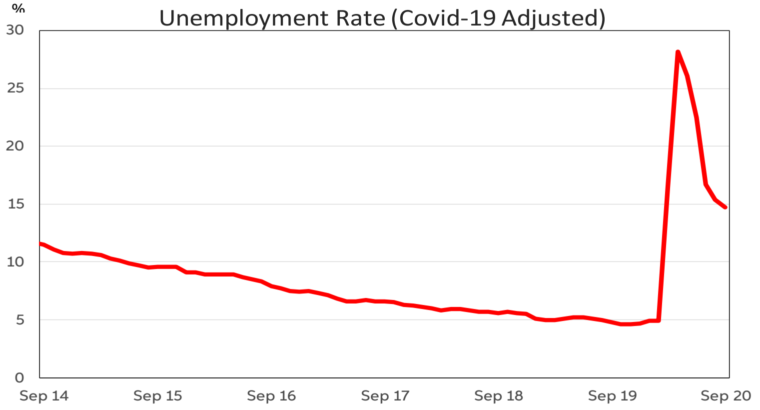


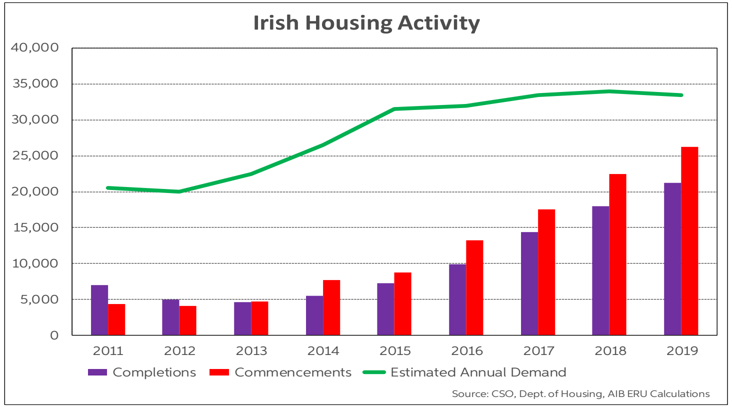
Source: CSO via Refinitiv

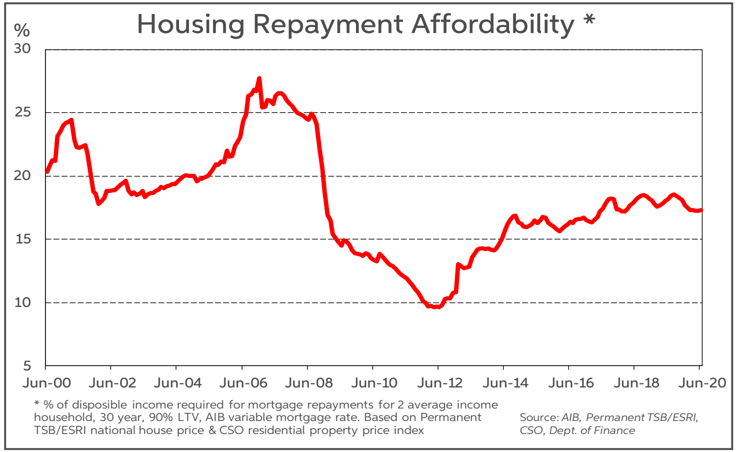
GDP to rebound in Q3 as economy opens up again

- Unemployment rate spiked to Covid-19 adjusted figure of 28.8% in April, but falls to 14.7% by Sept
- Core retail sales fall by 12.3% in Q2. But rebound strongly; up 20% in July/Aug vs Q2 level, +6%yoy
- New car registrations rise 2% yoy in August after very weak H1 2020 – down 30% year-to-date
- Modest pick-up in consumer sentiment during the summer, but remains well below pre-Covid levels
- Manufacturing PMI rebounds strongly to 57.3 by July before easing to 52.3 in August
- Services PMI pick-ups to 52.4 in August - hit record lows of 13.9 in April and 23.4 in May
- Construction PMI at 53.2 in July, up from low of 4.4 in April, but fell back to 44.0 in August
- GDP decline in 2020 will not be as bad as the forecasts falls of between 7% and 10%
- Broad array of government supports announced to help household incomes and businesses
- Strong growth expected in 2021 given depressed base for this year
- Blow-out in public finances this year, with budget deficit of circa 7.5-8% of GDP forecast

New house building activity falls back in 2020

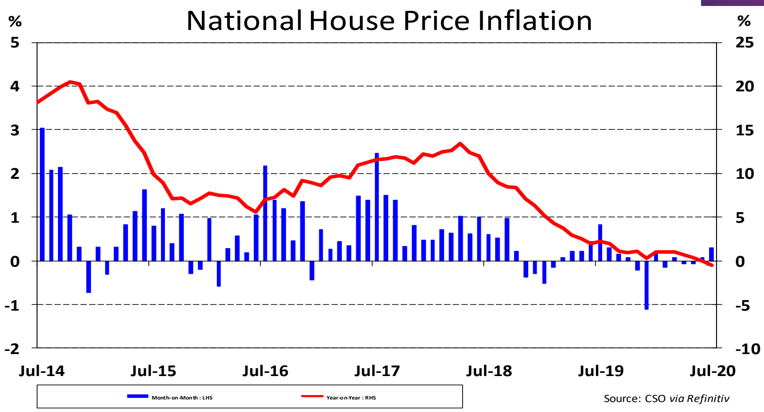
- Housing completions up 18% yoy to over 21,000 units in 2019, a moderation on 2018's 25% growth rate
- Housing commencements increase by further 17% in 2019 to 26,000 units
- Planning permissions jump by 38% to over 40k in 2019. Surge 97% yoy in Q1'20, but fell back by 29% in Q2
- Housing completions rose by 17% yoy in Q1 2020, before declining by 32% yoy in Q2 on lockdown impact
- Completions expected to be down by 15-20% in 2020 to 17,000-18,000 – were forecast at 24,000
- 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 Covid impact sees lending fall by 16% yoy in H1 2020
- Housing affordability metrics remain quite stable



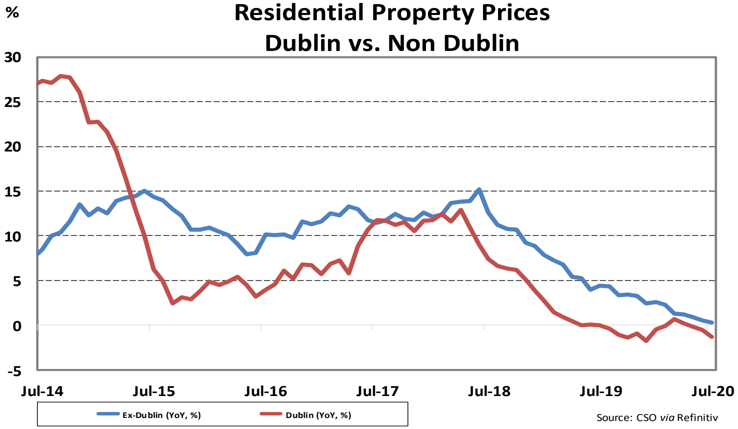


House prices stable to date this year

- 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 83.5% by July 2020 from March 2013 trough
- But house prices still nearly 18% below 2007 peak
- House price inflation slowed sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices down 0.5% yoy nationally in July 2020: Dublin down 1.3% while non-Dublin up 0.3% yoy
- House prices flat overall in H1 2020 – up 0.3% in July
- Covid crisis could yet see price falls as lagged data, but declines may be limited given low supply
- Annual growth in rents had slowed before virus
- Rents stabilise after falling by 3.5% over March to June



Source: CSO *via Refinitiv*



Source: CSO *via* Refinitiv

AIB Model of Estimated Housing Demand

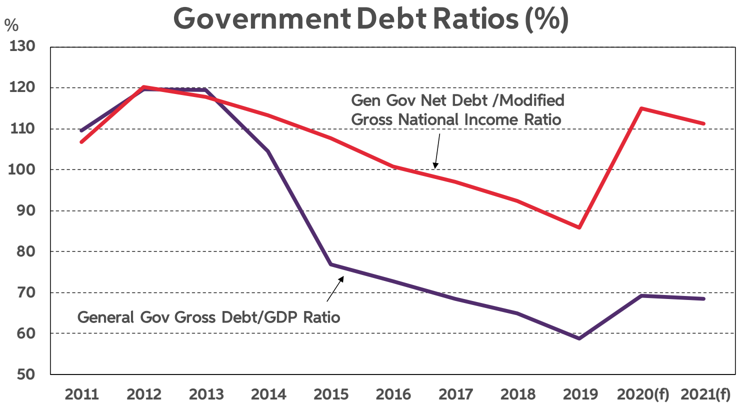
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2021 – 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	32,000	31,000	25,000	25,000
of which					
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**	**18,000**	**20,000**
Shortfall in Supply	*-19,100*	*-19,400*	*-15,250*	*-12,500*	*-10,500*

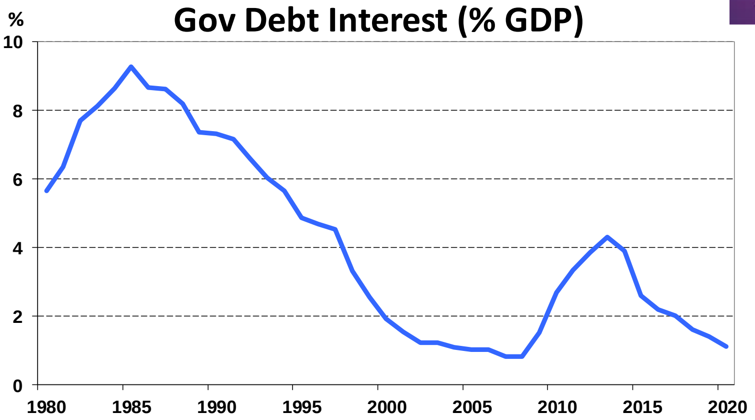
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU.

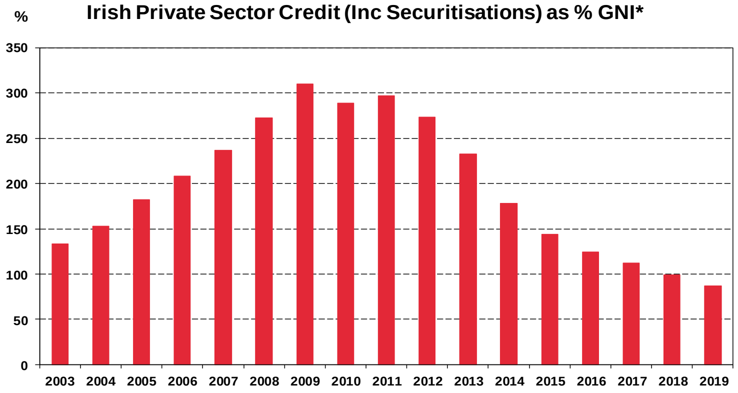
Govt. debt ratios had fallen, private sector deleverages



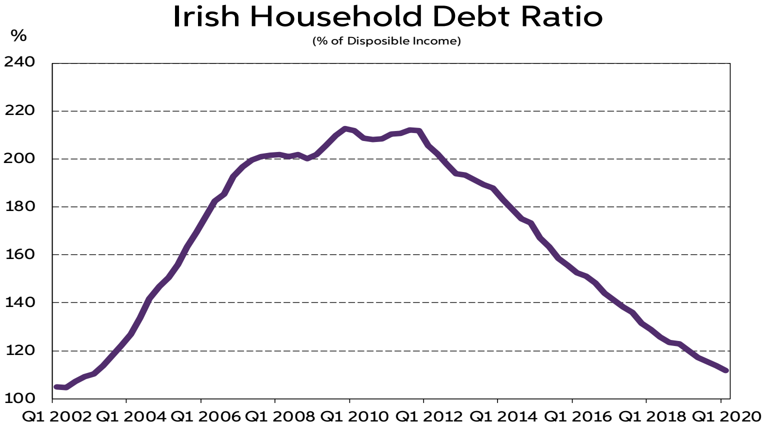
Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figues from 2015)



Source: NTMA; Dept of Finance (Pre Coronavirus)



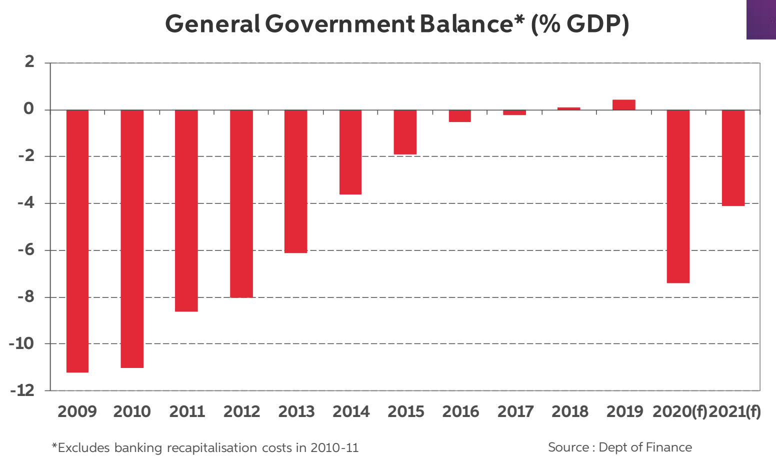
Sources: Central Bank, CSO, AIB ERU Calculations

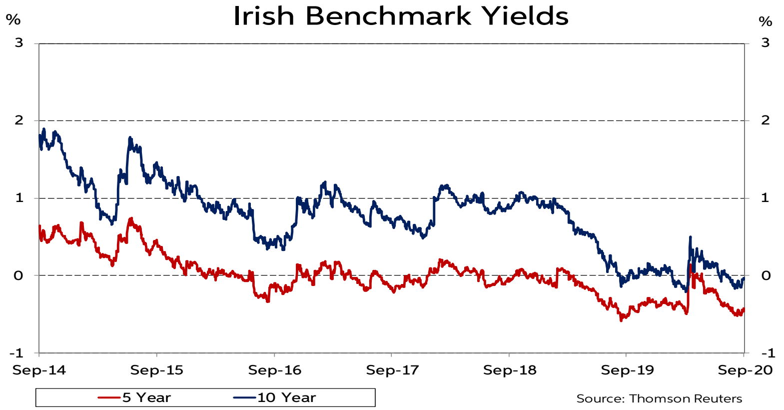


Source: CSO, Central Bank, AIB ERU

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 near 2% of GDP in 2019
- However, Covid-19 and efforts to mitigate it see the public finances deteriorate during 2020
- Tax receipts down 2.3% to end August, while voted government spending soars by 28%
- Budget deficit at €9.5bn at end August, up from €0.6bn a year earlier
- Dept. of Finance forecasting budget deficit of 7.4% of GDP this year. Could be a bit higher
- Gov Debt/GDP ratio had fallen in past decade, but will move higher this year
- 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 enter crucial phase

- 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
- Little progress on key issues made in talks to date, with time running out
- EU wants considerable regulatory alignment; UK government puts focus on ‘taking back control’
- State aid rules emerging as key stumbling block; UK wants full discretion in this area
- Mood soured in talks recently when UK Bill breached some terms of EU Withdrawal Agreement
- Some type of FTA still seems on the cards as it’s the best outcome for both the UK and EU
- Any trade deal likely to be limited to goods, mainly based on no tariffs or quotas
- Deal would need to be agreed by late October to allow time to ratify before year end
- Talks now entering crucial phase in October when deal needs to be done. Some signals of progress
- 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

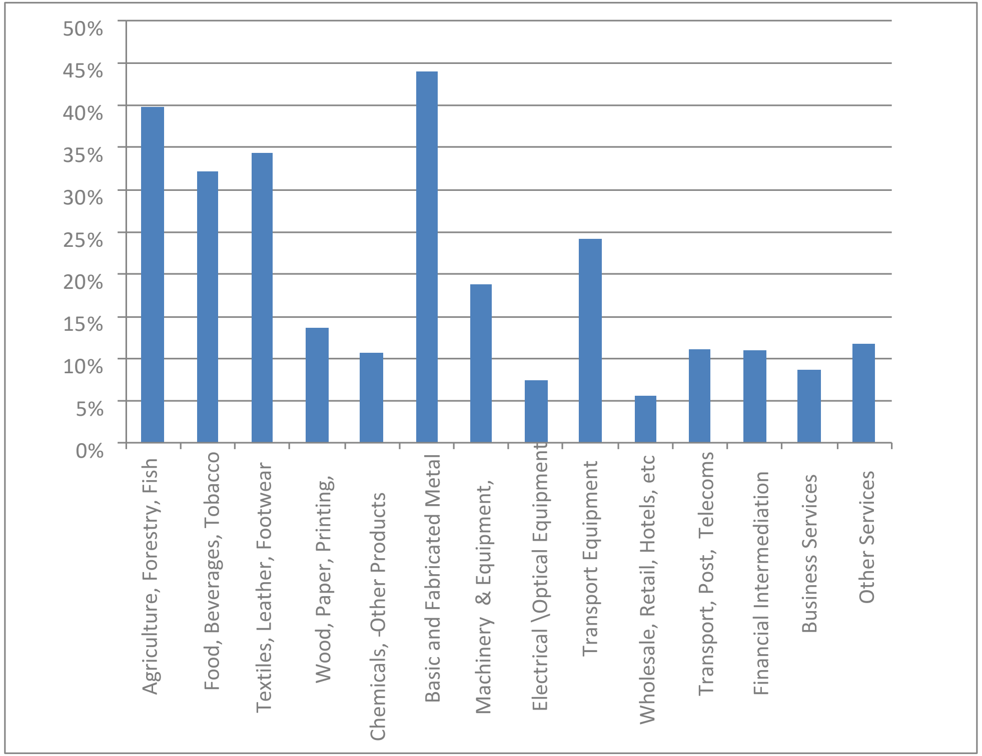
Key points about any EU-UK Free Trade Agreement

- 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

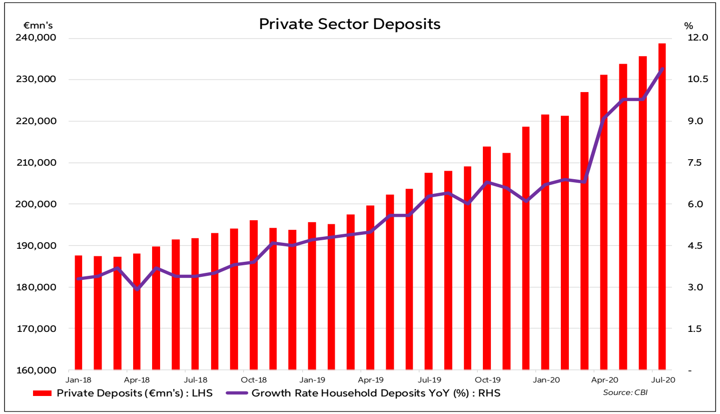
- **Multiple hits to the Irish economy if there is a no EU-UK Trade deal** at end of transition period: further sharp fall in sterling, weak UK economy, disruption to trade/supply lines, tariffs, new administrative and regulatory costs etc.
- Sharp fall-off in trade with UK likely if there is no trade 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
- Strong Irish growth to be expected next year 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**

% 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	10.0	9.0	7.1
Budget Balance (% GDP)	0.1	0.4	-8.0	-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

**Forecasts as of mid-2020, basis for AIB mid-year results

Source: CSO, D/Finance; AIB ERU Forecasts

Risks to the Irish economy

- Main risk is obviously the coronavirus – will weigh heavily on growth & employment this year
- Persistence of 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 remains a major risk given uncertainty about future EU-UK trading relationship
- Questions around Ireland's corporation tax regime (Apple case, 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