



# The Irish Economic Update

## *Continuing Robust Growth*

September 2018

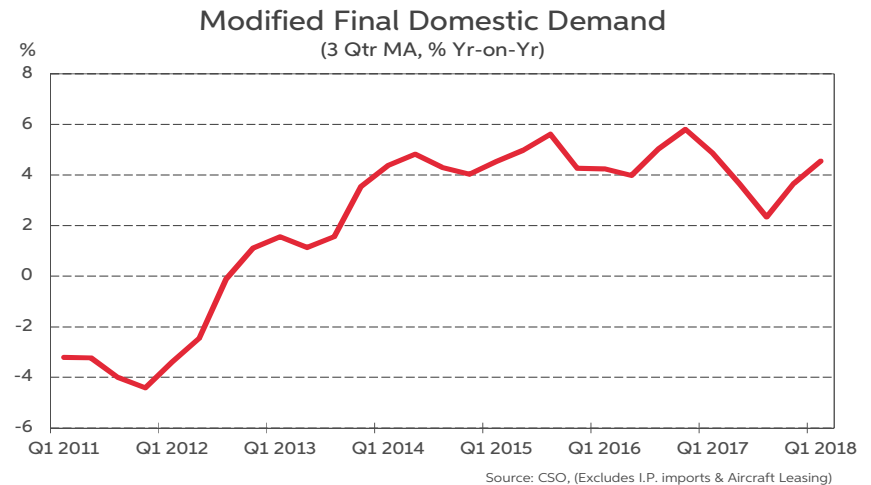
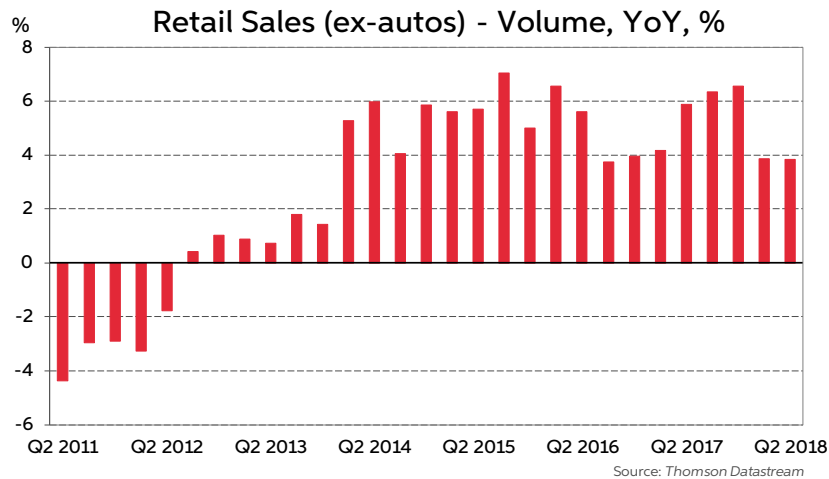
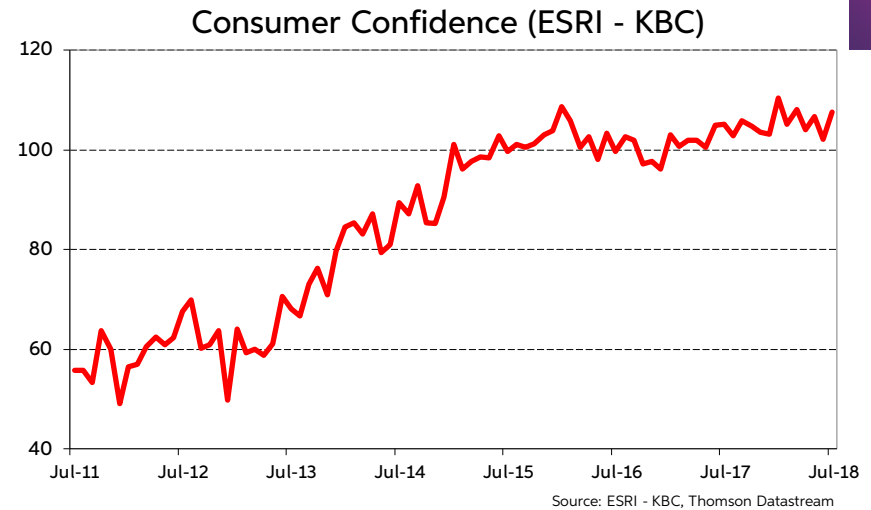
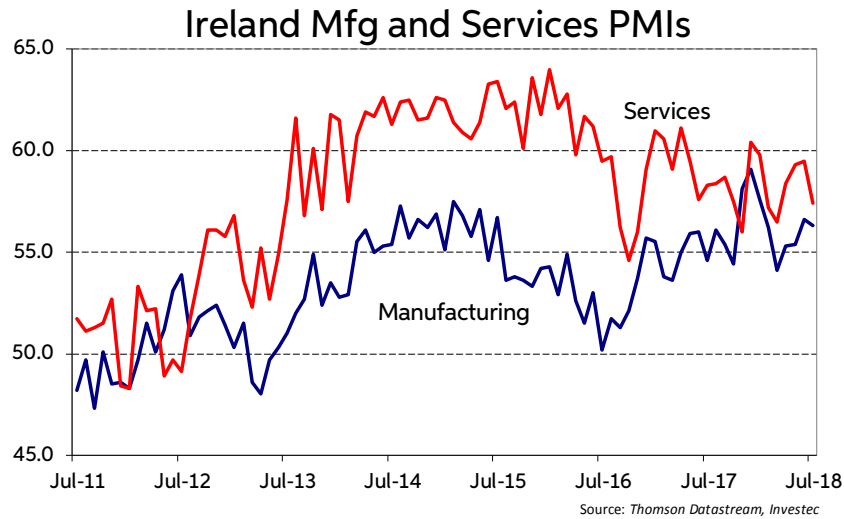
Oliver Mangan  
Chief Economist  
AIB

## Strong growth by Irish economy since 2013



- 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 rebounded strongly over 2013-17 – underlying growth averaged 4.4% 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 below 6% in H1 2018
- Budget deficit has declined at a quicker than expected pace. Down to 0.3% of GDP in 2017

# Economic indicators remain upbeat in 2018



## Economy continuing to perform strongly



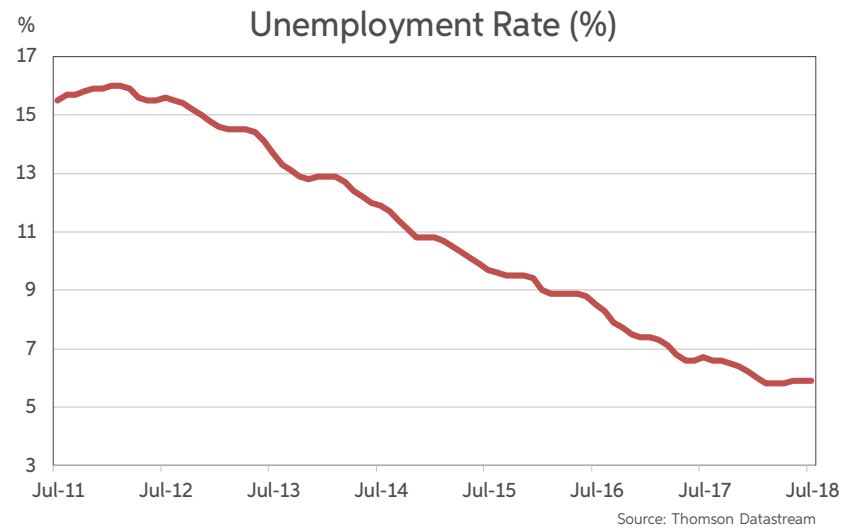
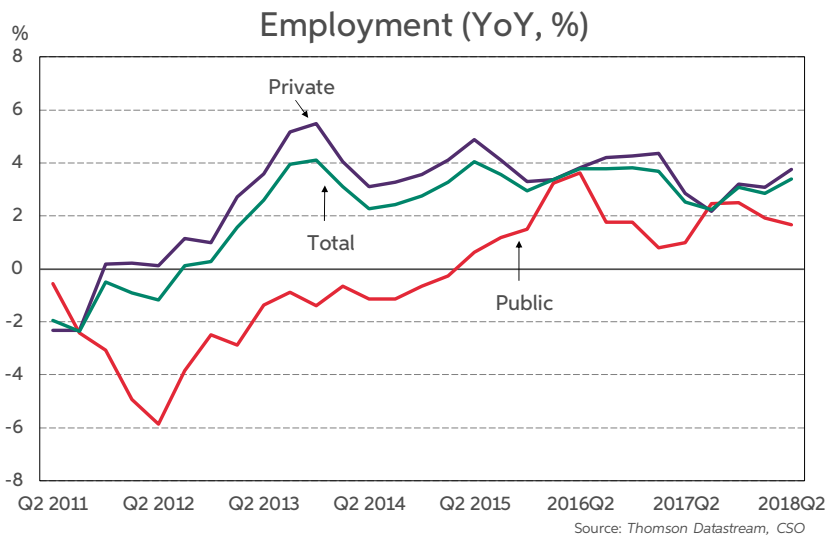
- Modified final domestic demand grew by 4.8% yoy in Q1 2018
- Mfg PMI remains at high level in 2018 – at 56.3 in July and 55.6 in June
- Services PMI also very strong to date in 2018 – at 57.4 in July and 59.5 in June
- Continuing very high construction PMI – at 60.7 in July and 58.4 in June
- Consumer confidence at very robust levels in 2018 – near 17 years highs
- Retail sales (ex-motor trade) rose by 4.5% yoy in H1 2018 – increased by 4.3% in 2017
- Total car regs (new + used imports) steady at high level in 2018 – surged over 2014-17
- Further strong rise in housing completions in H1 2018 – up 31% yoy
- Mortgage lending rose by 22% yoy in value terms in H1 2018, after rising by 29% in 2017
- Continuing strong job growth – employment rose by 3.2% yoy in H1 2018
- Live Register continues its sharp decline in 2018. Jobless rate drops below 6% in H1 2018
- Budget deficit fell to 0.3% of GDP in 2017. Solid 2018 figures – tax receipts up 5.5% yoy to July

# Robust jobs growth; unemployment rate falls below 6%



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	1.9	2.0	1.7
<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

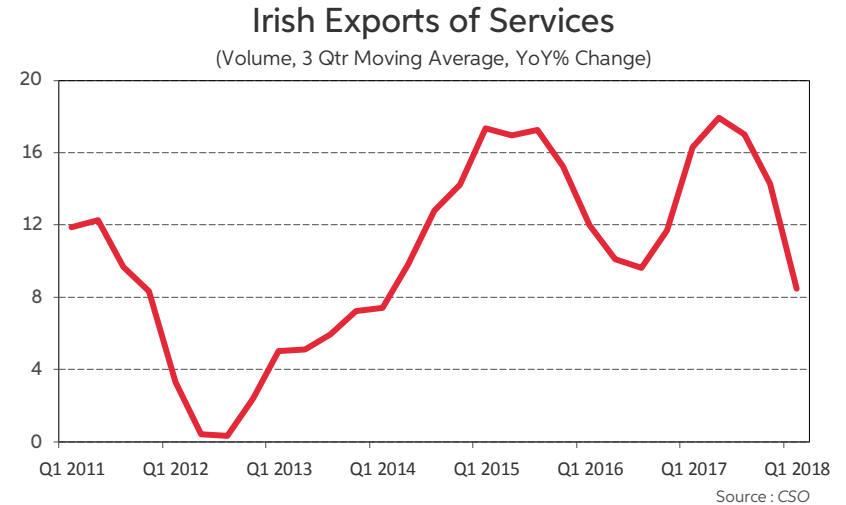
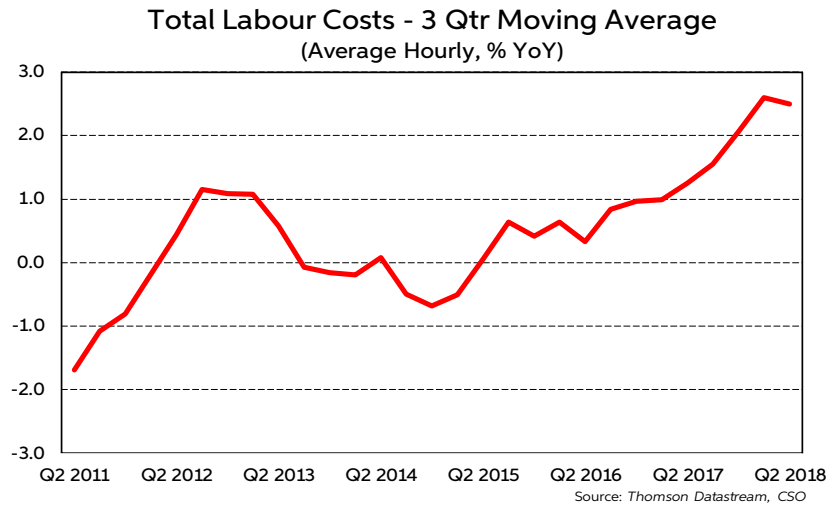
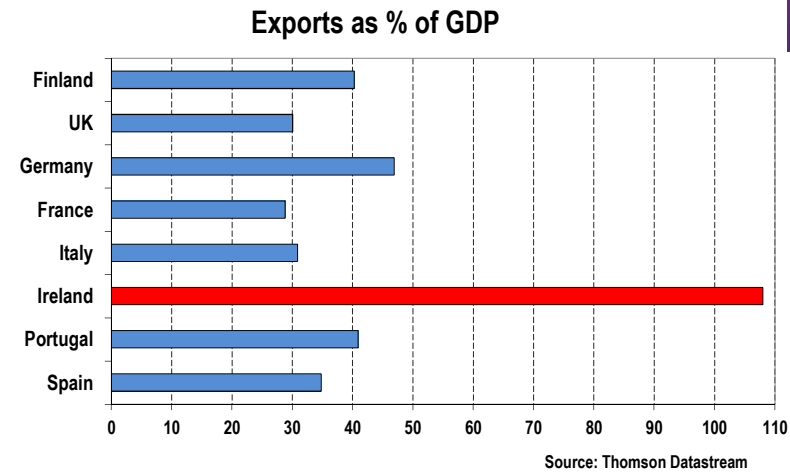
Source: CSO and AIB ERU forecasts



# 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
- Sterling’s sharp fall a challenge for exports to UK but total exports still up by 7.8% in 2017



# 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

- 1,200 multinational companies
- €150bn Exports (64% of Irish exports)
- 200,000 Jobs in FDI, 340,000 in total
- 70% of Corporation Tax
- €8.7bn Spending on Irish services/materials
- €10bn 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

# Many top global companies have big operations in Ireland

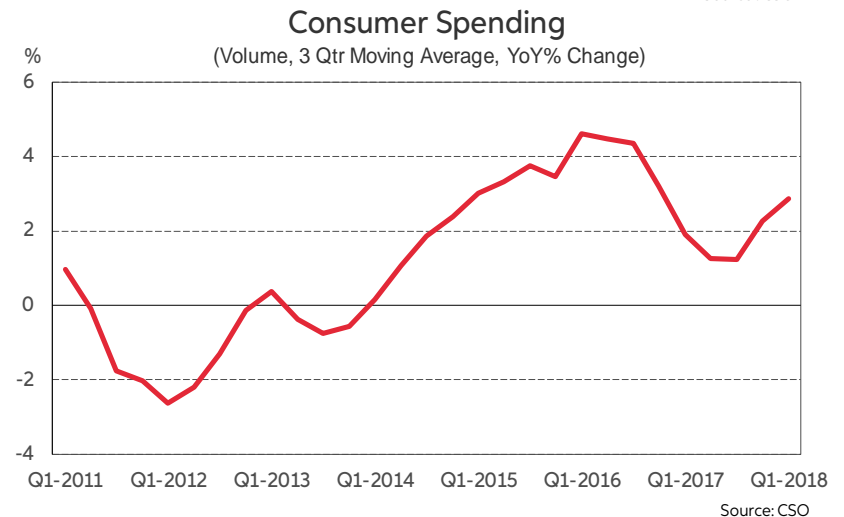
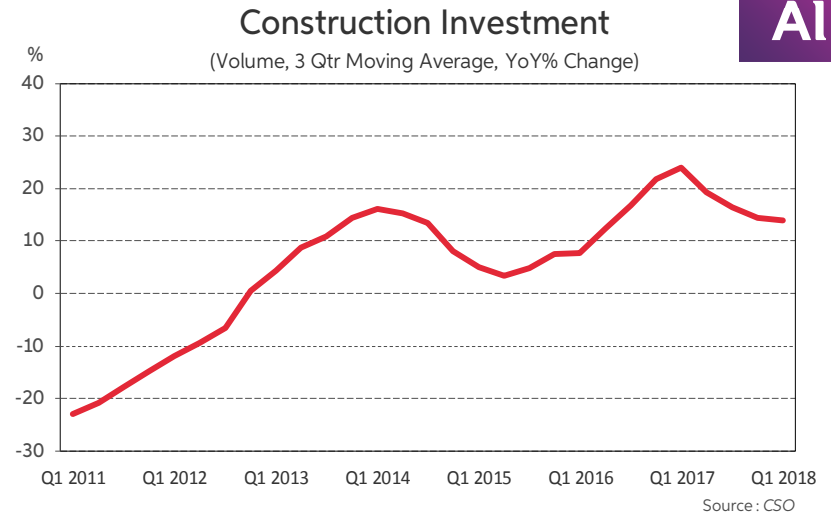




# Strong recovery by domestic economy in place since 2013



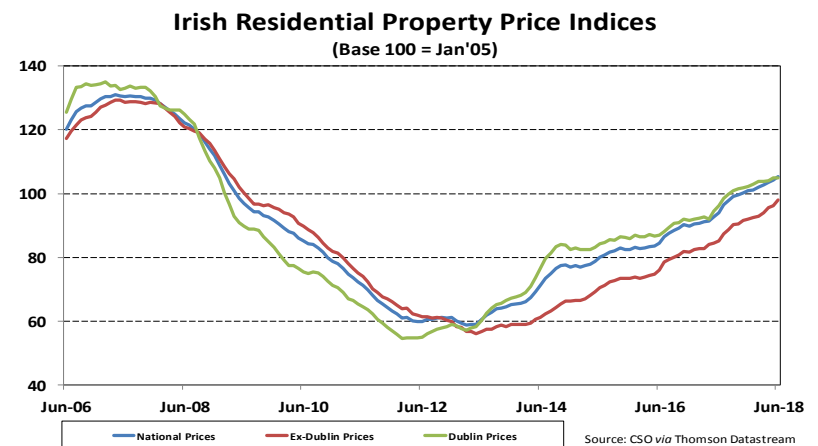
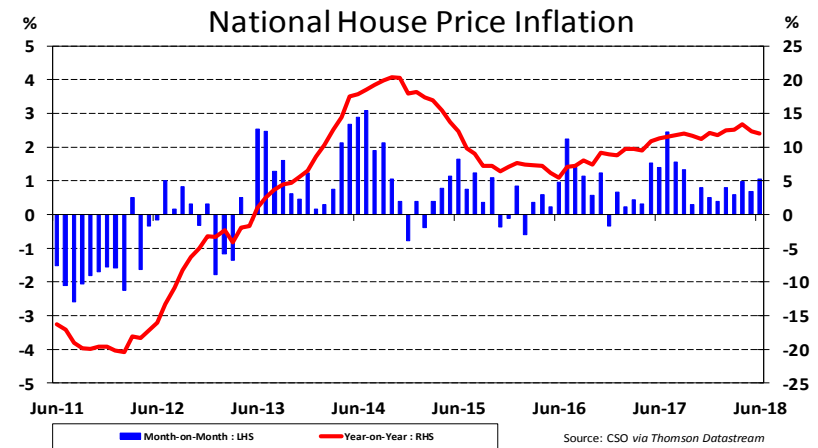
- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction has seen good recovery since 2013, with output up over 15% in both 2016 and 2017
- Core business investment (ex aircraft/intangibles) grew by average 22% in 2012-2016. Fell back in 2017
- Consumer spending grew by close to 3% on average over 2014-2017 period. Up 2.7% yoy in Q1 2018
- Core retail sales up by strong 4.5% yoy in H1 2018
- Total car regs (new + used imports) remain at high level in 2018, having surged over 2014-17 period
- Modified final domestic demand (excludes IP imports & aircraft leasing) grew at a 4% rate over 2013-2017
- Modified final domestic demand up 4.8% yoy in Q1 2018



# House prices rising strongly as big supply shortage persists



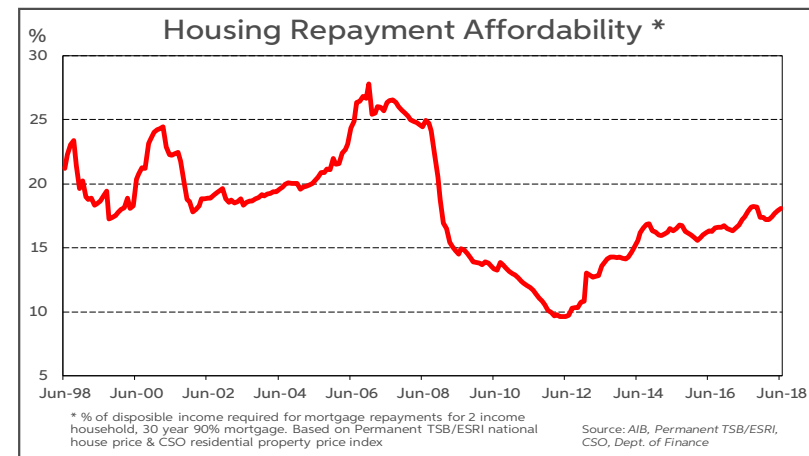
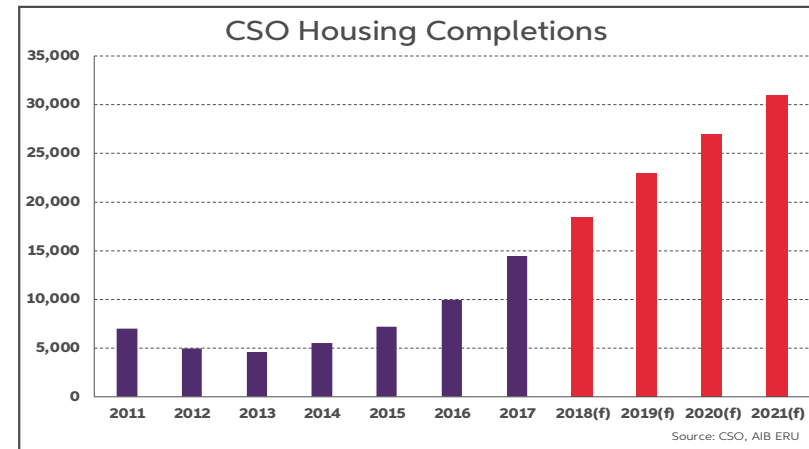
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building
- Little stock for sale, house building remains low
- Prices up 80% by June 2018 from low in March 2013
- Dublin prices up by 93% from their trough in Feb 2012, while non-Dublin prices have risen by 74.5%
- House prices nationally are still some 20% below their peak levels hit in 2007
- Prices up 12% yoy nationally in June 2018. Dublin up 9%, with non-Dublin rising 15% yoy
- Dublin house price inflation moderating as Central Bank lending rules and affordability impact
- Rents have also rebounded strongly – now over 22 % above previous peak reached in 2008 per CSO data



# House building rising slowly from very low levels



- New CSO data show housing completions increased by 45% to 14,500 in 2017
- Housing commencements rose by 33% in 2017 to 17,500, pointing to continuing rising supply
- Completions rose by 31% yoy in H1 2018
- Output still running well below annual new housing demand estimated at circa 33,000 units
- Measures put in place to boost new house building. More Local Authority and NAMA building
- Mortgage lending growing strongly: up by 22% yoy in H1 2018 after rising by 29% in 2017
- 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>

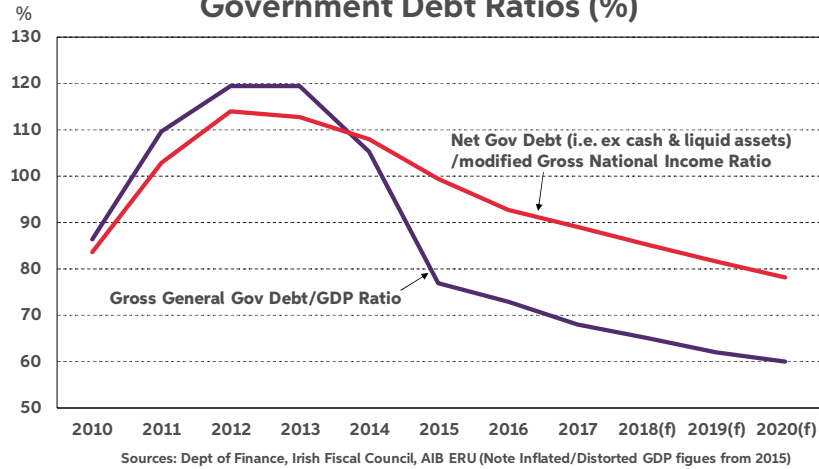
\*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU

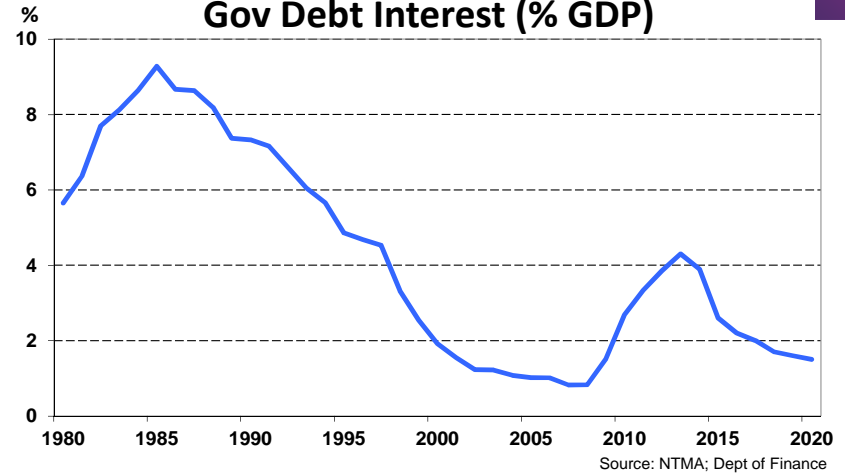
# Govt debt ratios fall, private sector deleverages



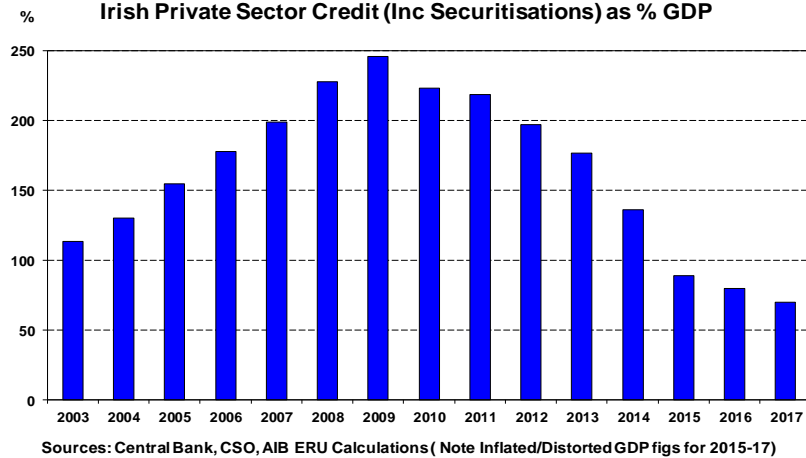
### Government Debt Ratios (%)



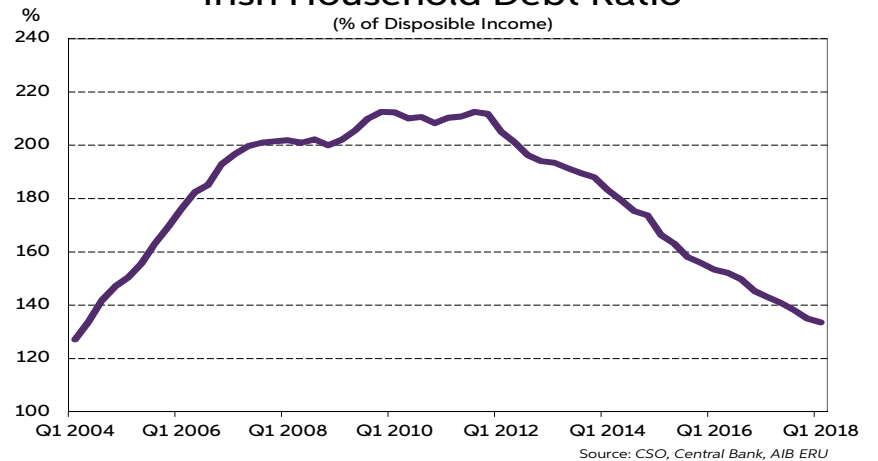
### Gov Debt Interest (% GDP)



### Irish Private Sector Credit (Inc Securitisations) as % GDP



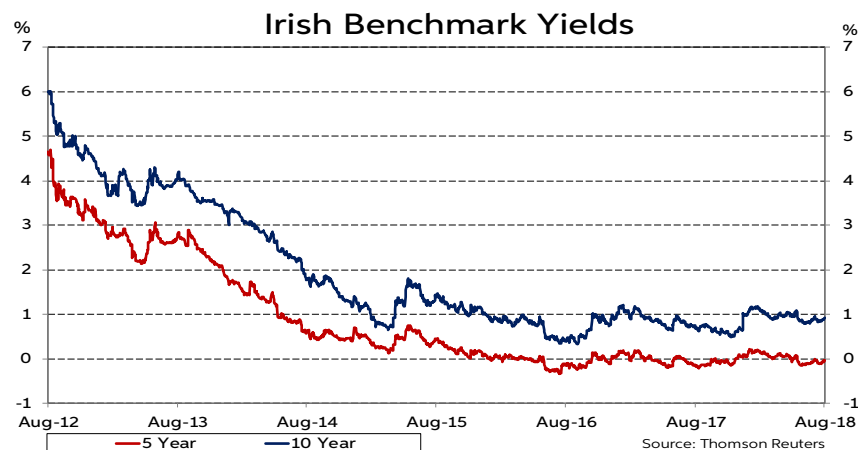
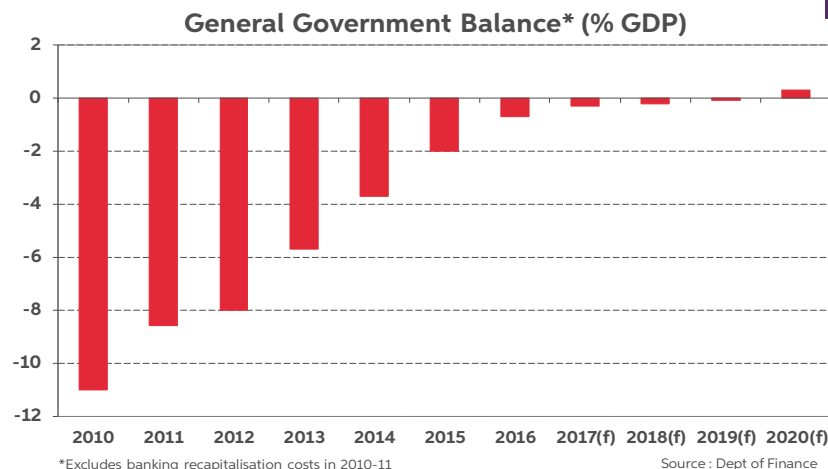
### Irish Household Debt Ratio (% of Disposable Income)



# Budget deficit falls sharply – now close to balance



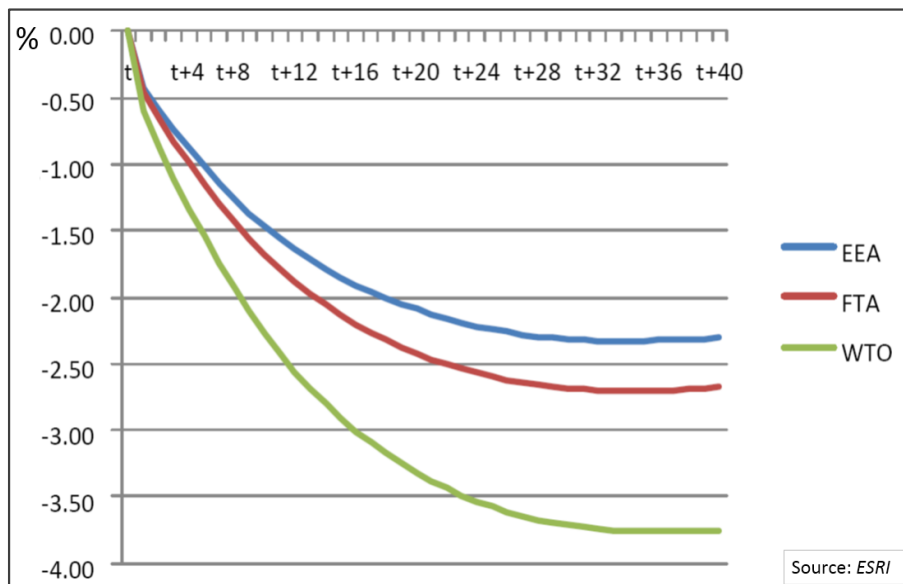
- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit has fallen sharply over the course of this decade
- The deficit fell to 0.3% of GDP in 2017 and is forecast at 0.2% of GDP for 2018
- Primary budget surplus (i.e. excluding debt interest) of 1.6% of GDP in 2017
- Debt interest costs low – at 2% of GDP in 2017
- Exchequer finances on target year-to-date, with tax receipts up by 5.5% to end July
- Gross Gov Debt/GDP ratio has fallen sharply
- Irish bonds yields have fallen to 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

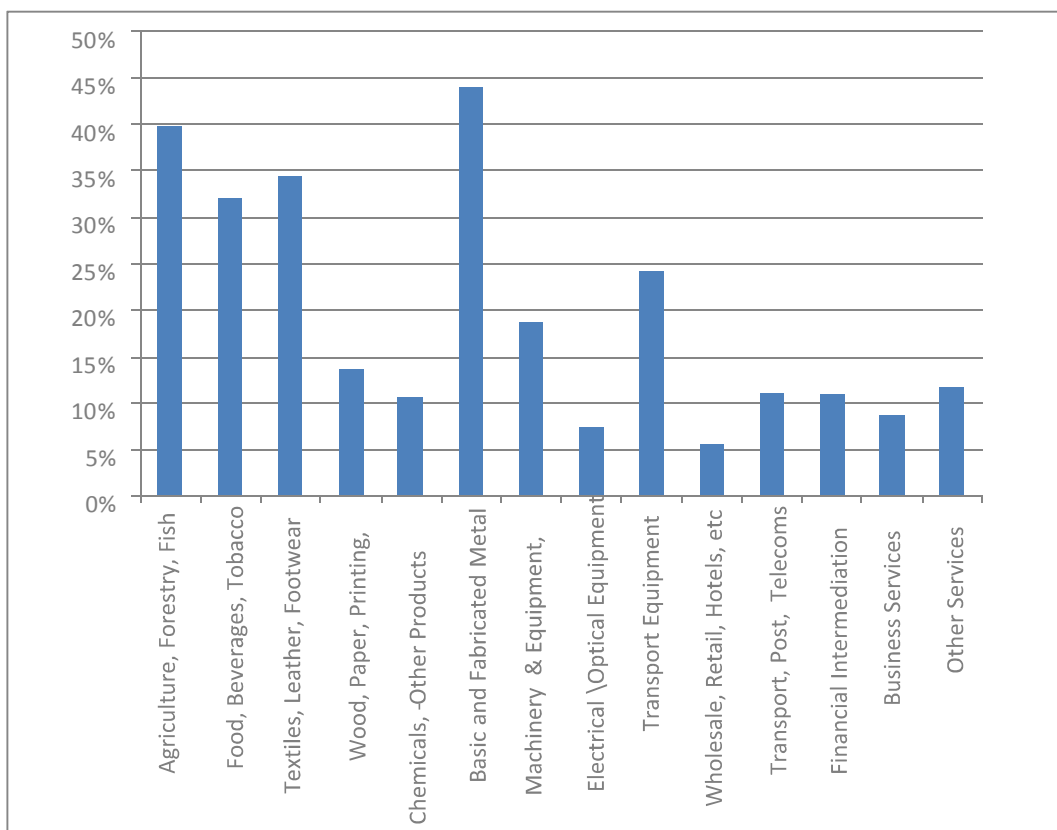
- Copenhagen Economics Report considers costs of regulatory divergence for goods and services and of border checks, as well as tariffs in assessing impact of Brexit
- Estimates impact by 2030 is to reduce Irish GDP by 2.8% under a soft Brexit (EEA), 4.3% in a FTA and 7% in a no-deal, hard Brexit WTO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

# Agri. sector would be severely impacted by hard Brexit



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

- 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

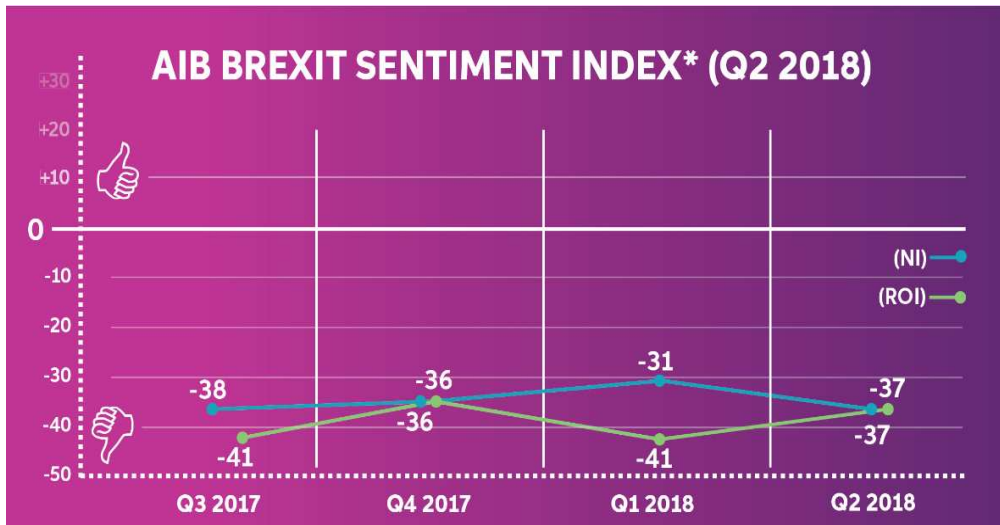




# AIB Brexit Sentiment Index – Q2 2018

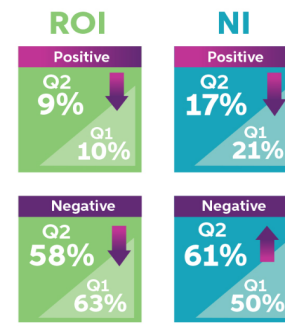


- A total of **700 SME's (with up to 250 employees)** across the island of Ireland



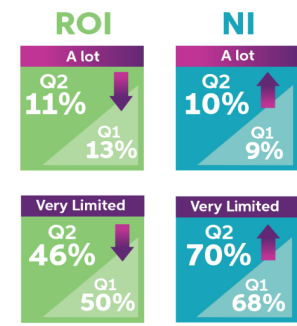
- Brexit is having little impact on businesses now
- SMEs surveyed more concerned about its impact on the future, both on their own business and wider economy
- SMEs operating in the Food & Drink, Manufacturing and Retail sectors most concerned about impact of Brexit

## IMPACT ON FUTURE BUSINESS



Source: Ipsos MRBI

## LEVEL OF VISIBILITY



Source: Ipsos MRBI

ROI	BREXIT'S NEGATIVE IMPACT ON FUTURE BUSINESS (5 YEARS +)	NI
71%	Impact On Economy	59%
58%	Tariffs	57%
52%	Forex Movements	51%
46%	Regulations	47%
36%	Ability to Plan / Working Capital	38%

Source: Ipsos MRBI

# Much uncertainty still about Brexit

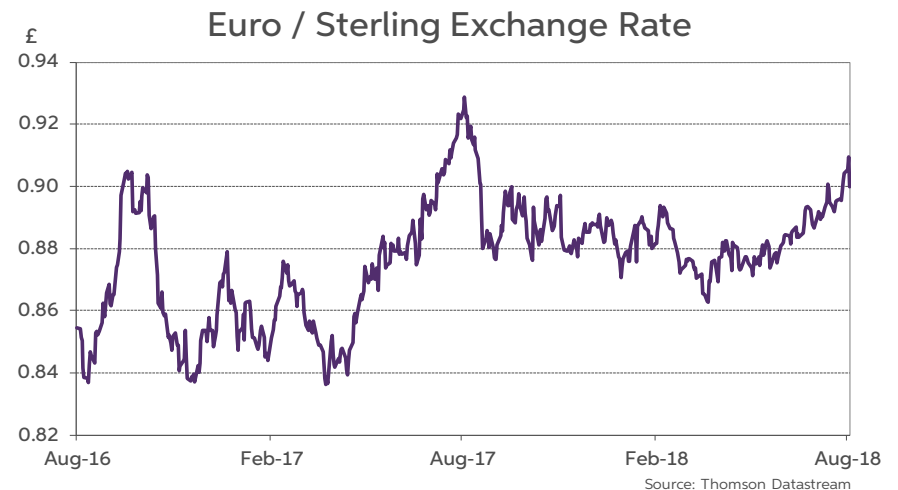
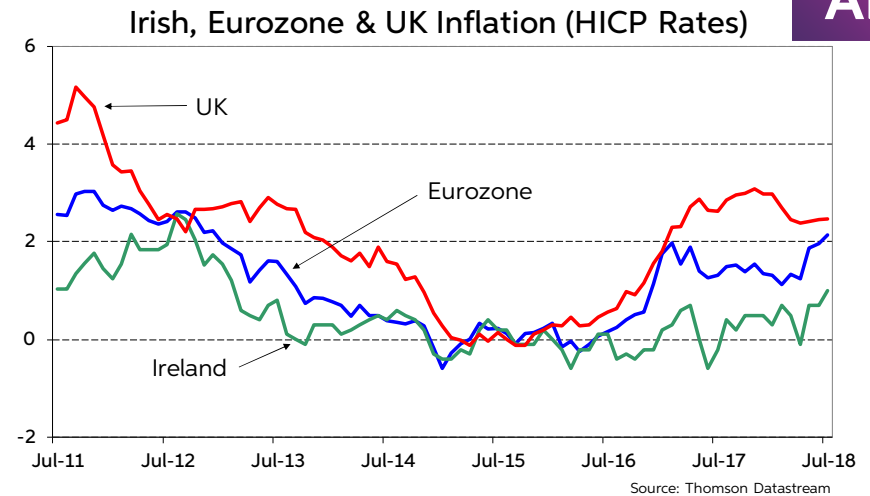


- UK set to leave EU, Single Market and Customs Union in March 2019
- Transition period to end 2020 would be key part of a soft Brexit - avoid disruption after UK leaves EU while a new free trade deal is being negotiated. Keeps the current trading arrangements in place
- Withdrawal Agreement needs be completed later this year to allow for orderly UK departure from EU. It will provide for the transition period
- Future customs arrangements are proving problematic. Deep divisions in UK between those who want clean break with EU and others favouring close alignment and access to EU Single Market
- All agree that there should not be a hard ROI/NI border, but this will prove difficult to avoid without similar EU\UK customs arrangements and continuing regulatory alignment
- Getting Withdrawal Agreement through UK Parliament could prove very difficult as Conservative Party badly split over Brexit. Government could fall on the issue
- A no-deal, hard Brexit unlikely to be supported by UK Parliament either. Majority favour soft Brexit
- Still a lot of uncertainty about Brexit and what will happen next year. Another referendum possible

# Irish growth forecast to remain strong



- Strong growth by Irish economy continuing in 2018
- Construction picking up from still low output levels
- Budgetary policy turns mildly expansionary
- Activity supported by low interest rate environment
- FDI strong despite concerns on corporate tax
- Very low Irish inflation, well below that of the Eurozone and especially the UK
- Global economy has picked up momentum, helping Irish exports
- However, Brexit is a challenge for the economy
- GDP growth forecast at 4.5% for 2018 and 4% in 2019, assuming that a no-deal, hard Brexit avoided
- 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>4.5</b>	<b>4.0</b>	<b>3.5</b>
<b>GNP</b>	11.5	4.4	4.2	3.7	3.2
<b>Personal Consumption</b>	4.0	1.6	2.7	2.5	2.5
<b>Government Spending</b>	3.5	3.9	2.5	2.0	2.0
<b>Fixed Investment</b>	51.7	-31.0	7.0	7.0	6.0
<b>Core Fixed Investment*</b>	11.2	6.2	7.0	7.0	6.0
<b>Exports</b>	4.4	7.8	5.5	4.5	4.3
<b>Imports</b>	18.5	-9.4	5.0	4.5	4.5
<b>HICP Inflation (%)</b>	-0.2	0.2	0.7	1.1	1.4
<b>Unemployment Rate (%)</b>	8.4	6.8	5.7	5.2	5.0
<b>Budget Balance (% GDP)</b>	-0.5	-0.3	-0.2	-0.1	0.2
<b>Gross General Gov Debt (% GDP)</b>	72.8	68.0	65.0	62.0	60.0

\*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
- 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.