The Irish Economic Update:

Economy will take time to recover from very deep Covid-19 recession

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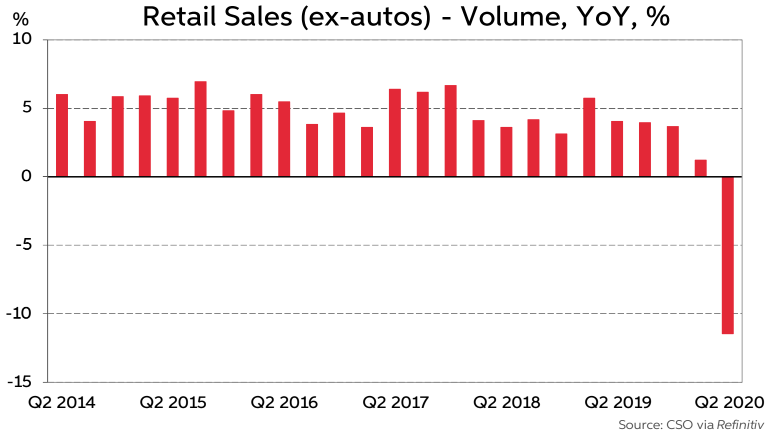
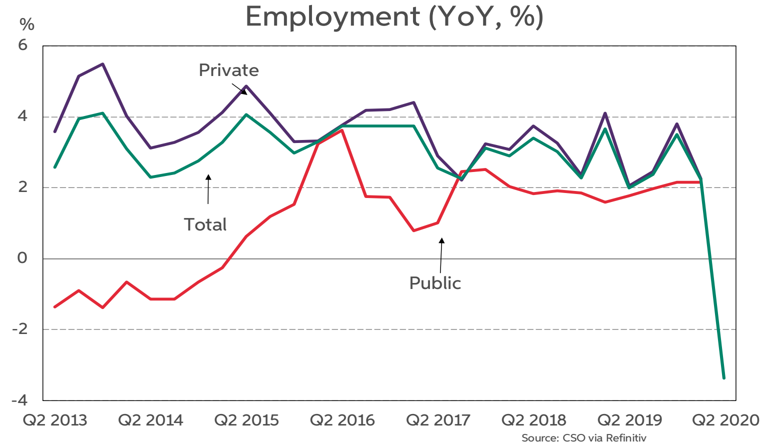
Oliver Mangan
Chief Economist
AIB

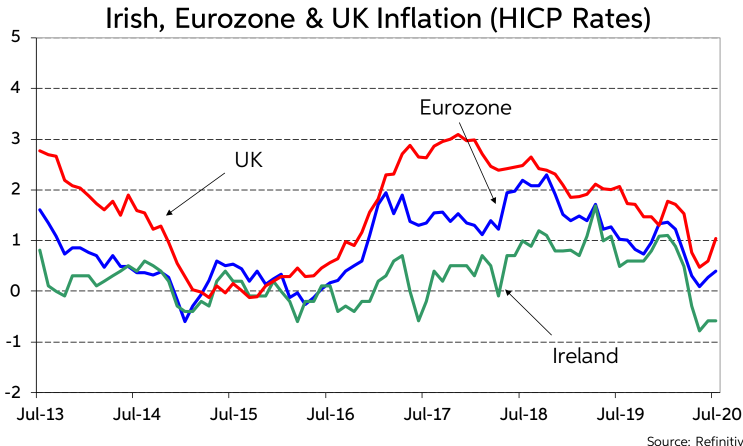
Economy entered Covid recession in very strong shape

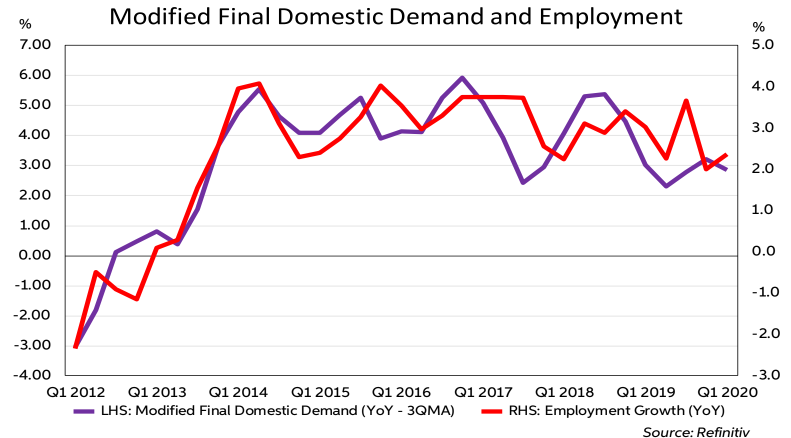
- Irish economy was in very strong shape ahead of being hit by very deep Covid 19 recession
- Economy had recovered strongly from severe recession of 2009-2012 period
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain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





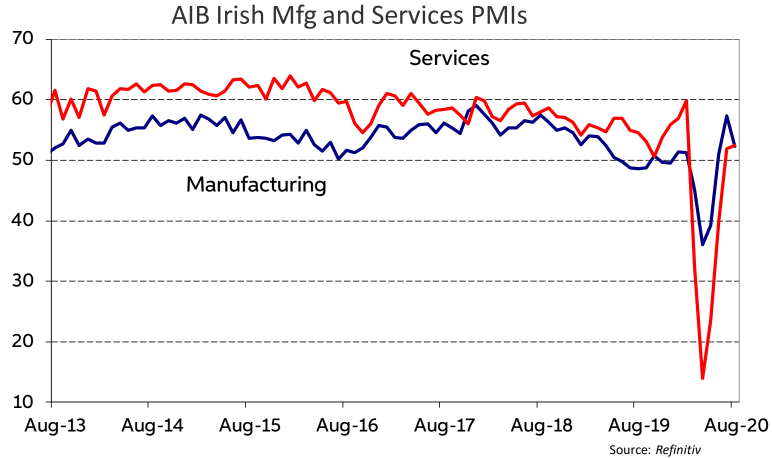


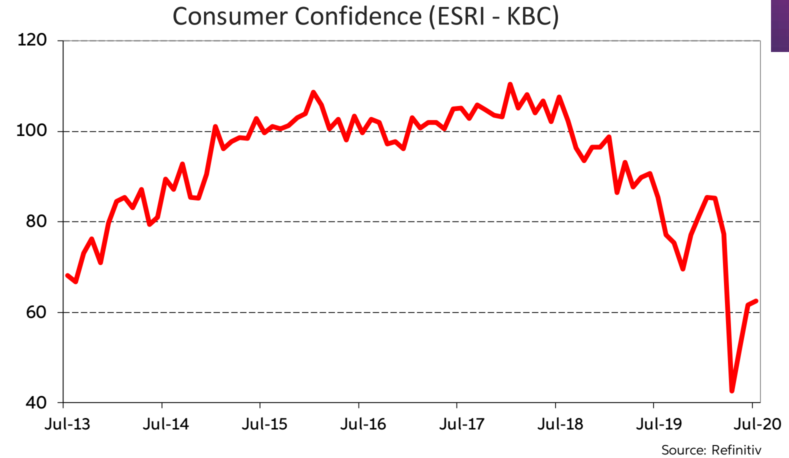


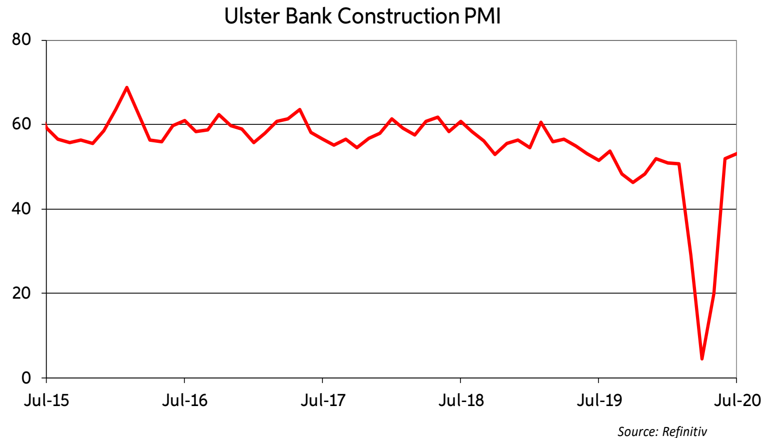
Steep contraction in activity during March-May lockdown

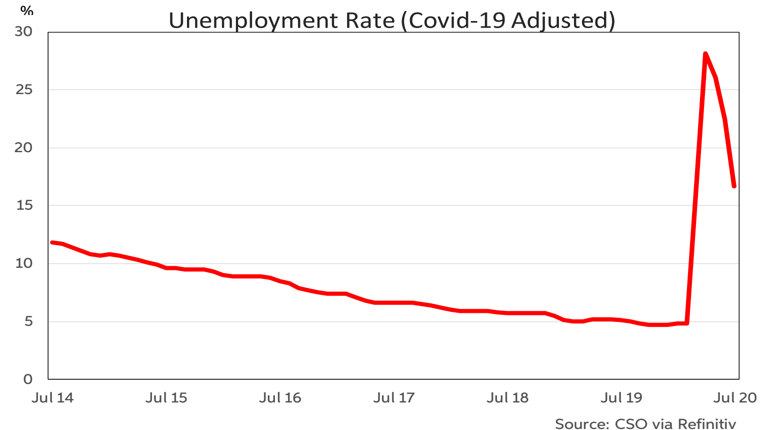
- GDP grew in Q1 by 1.2% on high-tech exports. Modified final domestic demand fell by 2.8%
- Sharp decline in GDP on cards for Q2 as economy put into lockdown to contain coronavirus
- At peak, c.1.2 million or 50% of labour force enrolled on various State income support schemes
- Jobless rate soared 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, as sales plunged by 24% in April
- But tax receipts hold up better than expected – rose 0.7% yoy in H1 2020
- Activity started to rebound in June as virus brought under control and restrictions were relaxed

Economy starts to rebound from March-May shutdown







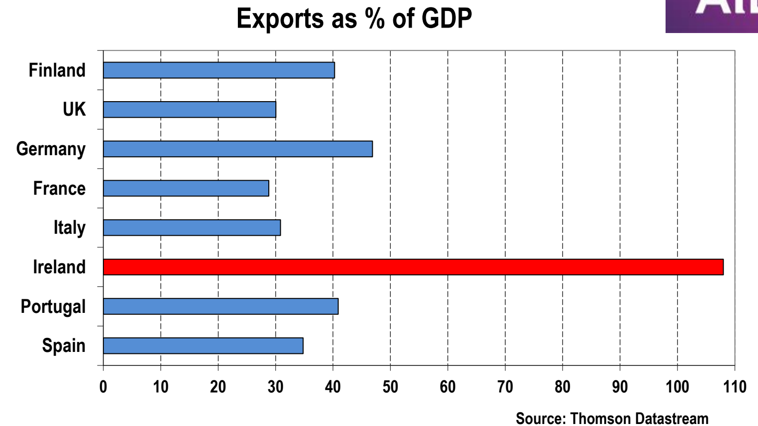


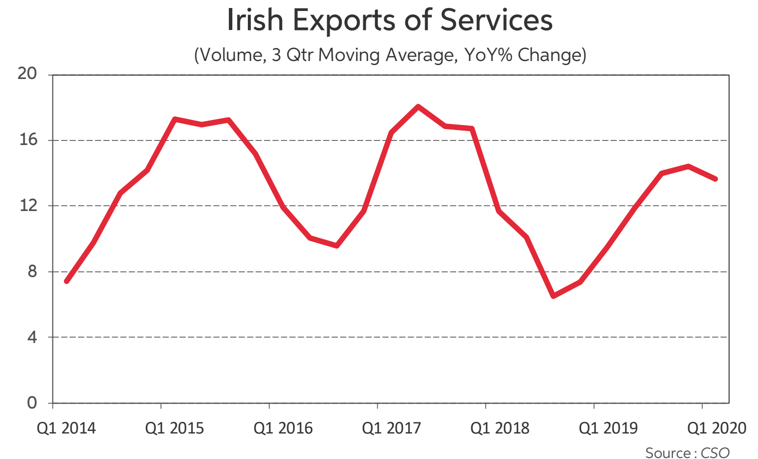
GDP to rebound in Q3 as economy opens up again

- Unemployment rate spiked to COVID-19 adjusted figure of 28.8% in April, but falls to 16.7% by July
- Core retail sales fall by 12.3% in Q2. But rebounded strongly in May-July - up 20% in July vs Q2
- Pace of decline in new car sales eases considerably in June-Aug after collapsing in March-May period
- Consumer sentiment recovers over May-July period, but still well below pre-Covid levels
- Manufacturing PMI rebounds strongly to 57.3 by July before easing to 52.3 in August
- Services PMI pick-up 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, as activity resumes following lockdown
- Range of projections for fall in GDP in 2020 – most are for between 7% and 10% contraction
- Broad array of government supports announced to help household incomes and businesses
- Strong growth expected in 2021 given depressed base for this year – GDP rise of circa 6% forecast
- Blow-out in public finances this year, with budget deficit likely to hit circa 8% of GDP

Exports perform strongly in Q1, before falling back in Q2

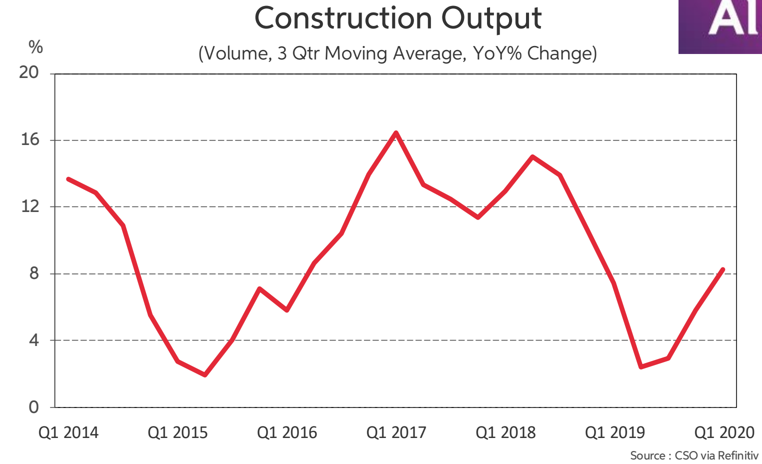
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose by 10.4% in 2018 and 11.1% in 2019.
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Total exports rise 6.8% yoy in Q1 2020 – goods up 7.6% and services increase 5.9% yoy
- Big jump in pharma exports in March from Covid, which boosted Q1 trade surplus
- Goods exports fall sharply in Q2 as stockpiling effect dissipates, weak global demand impacts

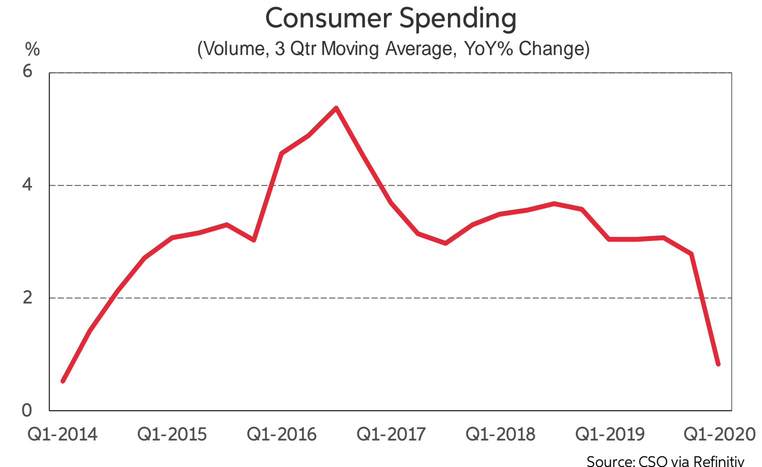




Domestic spending falls sharply in H1 on Covid impact

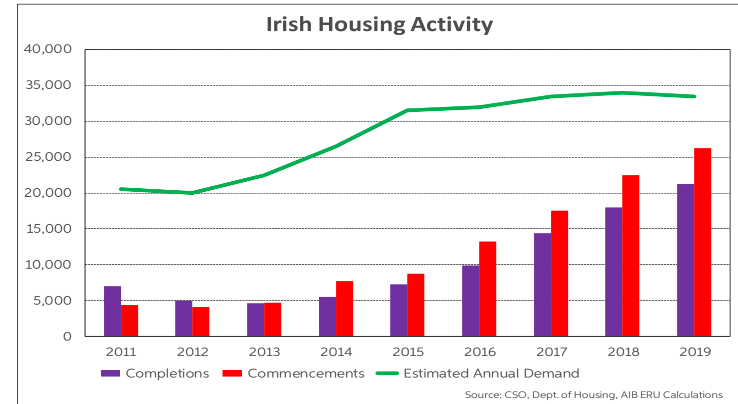
- Construction sees strong recovery since 2013. Output grows over 10% on average in 2016-19
- Fall of 1.6% in construction sector output in Q1
- Business investment (ex aircraft/intangibles) has recovered strongly since 2013
- Total domestic investment fell by 3.6% in Q1
- Consumer spending grew by 4.2% on average over 2015-2019 period
- Car sales returned to very high levels in 2018-19, with notable rise in direct imports from UK
- Modified final domestic demand grew at 4.2% rate in 2014-2019 period. Declined by 2.8% in Q1
- Initial rollout of Covid-19 restrictions saw consumption drop by 3.1% in Q1 as a whole
- Collapse in retail spending & car sales in Q2 2020
- Recovery in spending underway- good June/July

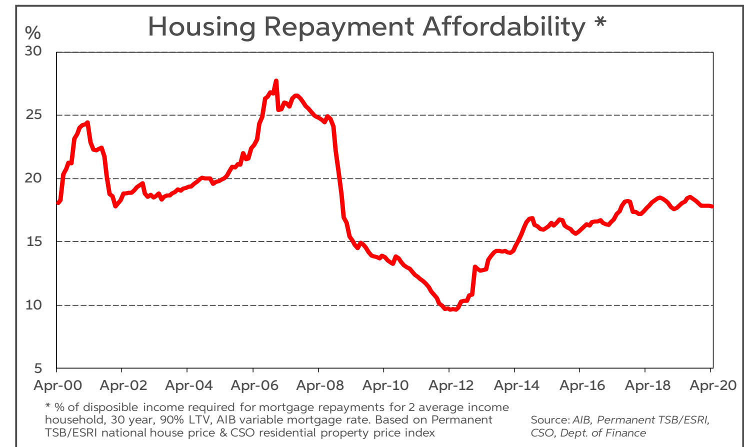




New house building activity set for big fall in 2020

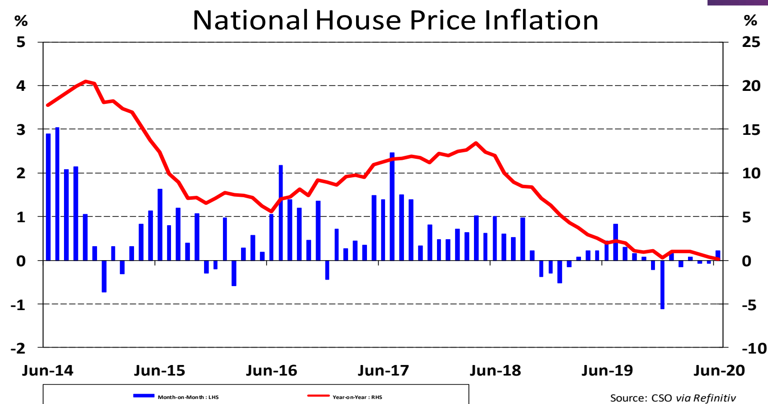
- Housing completions up 18% yoy to over 21,000 units in 2019, a moderation on 2018's 25% growth rate
- Housing commencements increase by further 17% in 2019 to 26,000 units
- Planning permissions jump by 38% to over 40k in 2019. Surge 97% yoy in Q1'20, led by apartments
- Housing completions rose by 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

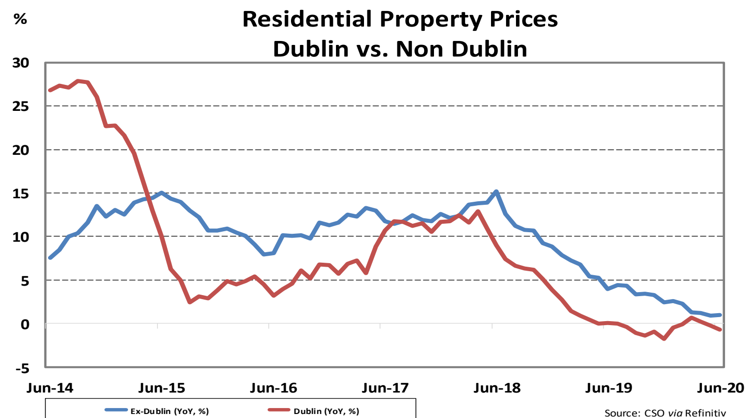




House price inflation has slowed sharply

- 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% by June 2020 from March 2013
- But house prices still nearly 18% below 2007 peak
- House price inflation slowed sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices up 0.1% yoy nationally in June 2020: Dublin down 0.7% while non-Dublin up 1% yoy
- House prices flat overall in H1 2020 – up 0.3% in June
- Economic 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 fall by 3.2% over the course of H1 2020





AIB Model of Estimated Housing Demand

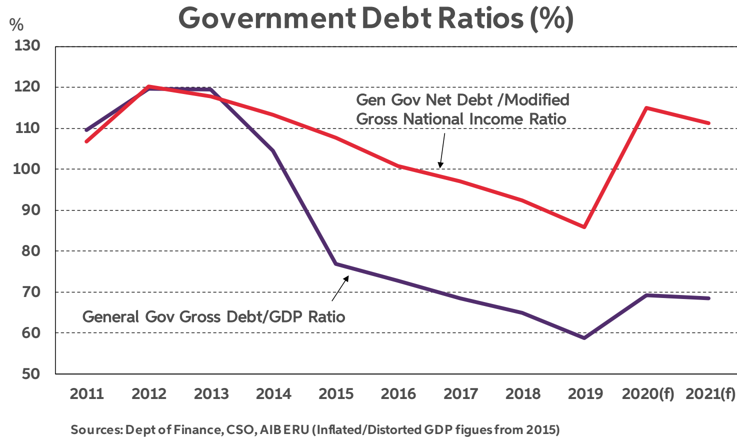
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2021 – 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

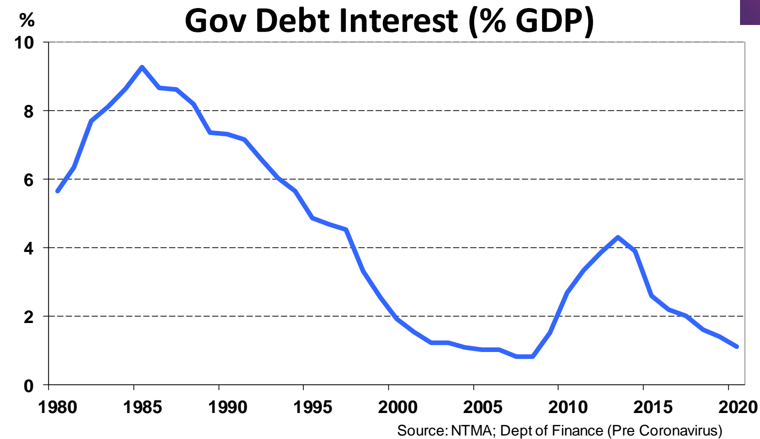
Calendar Year	2017	2018	2019	2020	2021
Household Formation	28,000	28,500	28,000	26,500	25,000
of which					
Indigenous Population Growth	*18,500*	*17,500*	*16,500*	*16,500*	*16,000*
Migration Flows	*9,500*	*11,000*	*11,500*	*10,000*	*8,500*
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	500	500
Replacement of Obsolete Units	5,000	5,000	5,000	5,000	5,000
Estimated Demand	**33,500**	**34,000**	**33,500**	**32,000**	**30,000**
Completions	**14,400**	**18,100**	**21,250**	**18,000**	**20,000**
Shortfall in Supply	***-19,100***	***-15,900***	***-12,250***	***-14,000***	***-10,000***

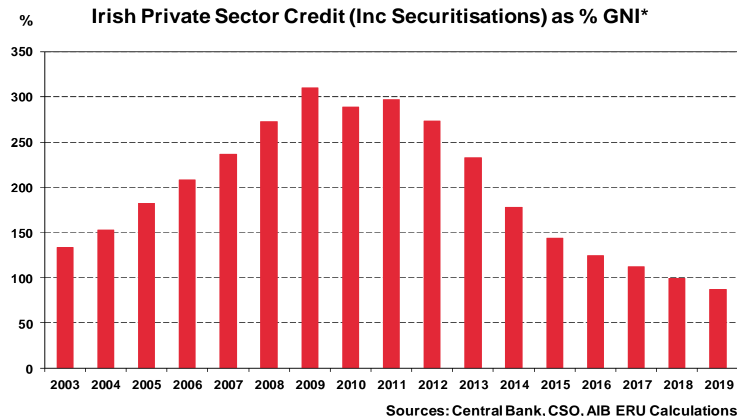
*Headship is % of population that are heads of households.

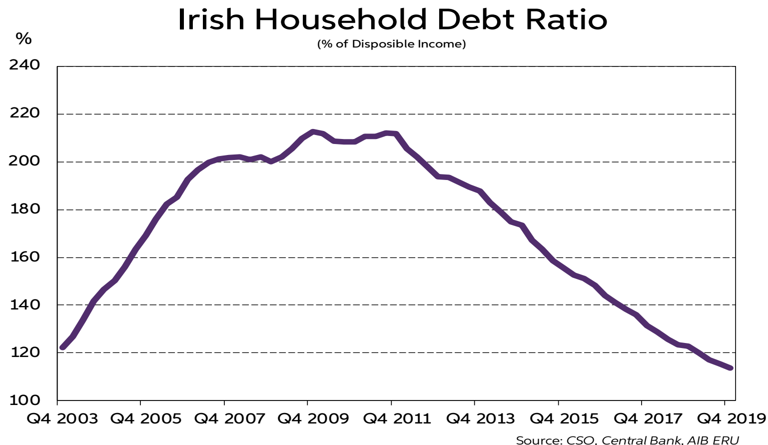
Sources: CSO, DoECLG, AIB ERU.

Govt. debt ratios had fallen, private sector deleverages



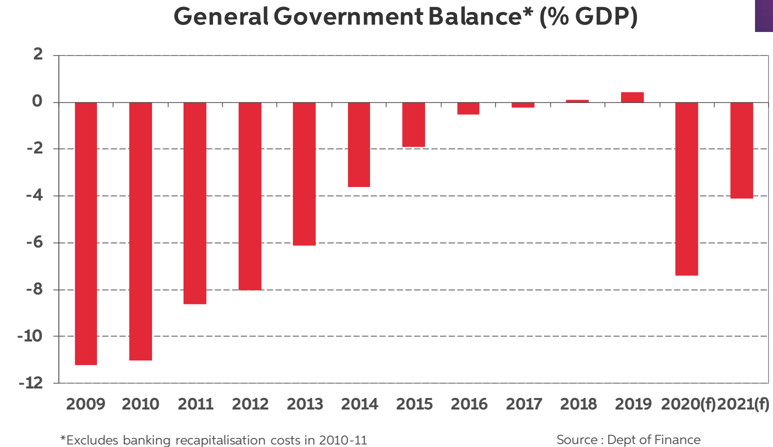


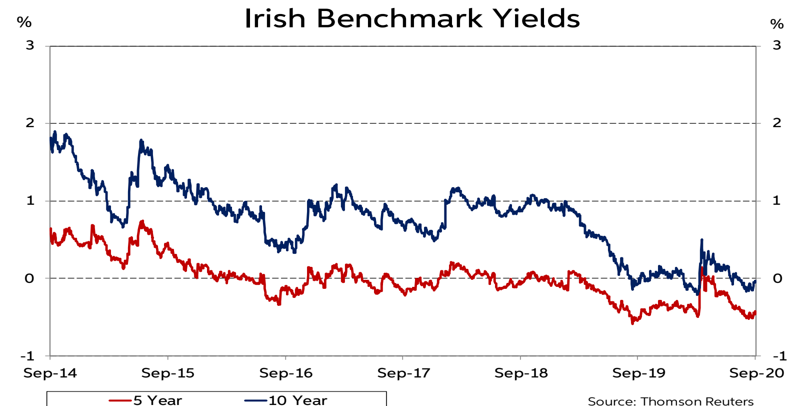




Blowout budget deficit in 2020 despite resilient tax take

- 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
- Debt interest costs very low – at 1.4% of GDP
- However, Covid-19 and efforts to mitigate see the public finances deteriorate during 2020
- Tax receipts up 0.7% in year to end June, but gov. spending rises by a significant 27%
- Dept. of Finance forecasting budget deficit of 7.4% of GDP this year. Could be a bit higher
- Gov Debt/GDP ratio has fallen sharply, as have Irish bond yields, in recent years
- Debt ratio will move higher this year
- Bond yields stable despite blow-out in budget deficit and much larger debt issuance in 2020
- Ireland's sovereign debt ratings hold steady; S&P at AA-, Fitch at A+, Moody's A2





Brexit: EU-UK trade talks making little progress

- 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, but to continue in September
- EU insisting on level playing field for trade, with considerable regulatory alignment, common rules
- UK government puts focus on 'taking back control' and non-alignment with EU
- Rules around State aids emerge as a major stumbling block in talks, as well as fisheries
- UK could opt for 'no deal' rather than have close alignment with EU rules – still risk of Hard Brexit
- Some type of FTA seems likely as it's the best outcome for both the UK and EU
- Trade deal may be limited to goods, mainly based on no tariffs or quotas
- Deal would need to be agreed by October to allow time to ratify before year end
- Already agreed NI to remain within Single Market for goods and have dual EU-UK customs system
- A deal could eventually lead to further negotiations on improving trade relations, e.g. in services

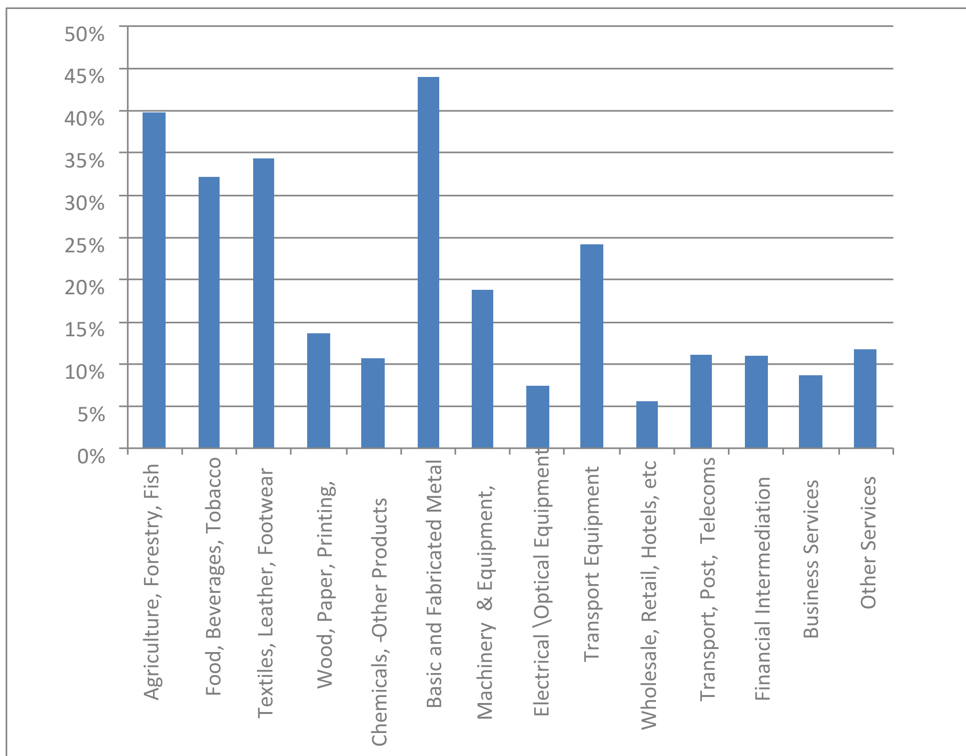
Key points about any EU-UK Free Trade Agreement

- 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 of circa 6% possible next year after sizeable fall in GDP in 2020
- An UK-EU FTA will lower Irish growth somewhat, possibly by around 0.5% per annum for some years

Irish GDP Forecasts		
% Vol	2020	2021
IMF	-6.8	6.3
OECD	-6.8	4.8
Department of Finance	-10.5	5.8
Central Bank of Ireland	-9.0	5.7
European Commission	-7.9	6.1
AIB	-7.5	6.3

OECD: Irish Forecasts (June 2020)*		
%	2020	2021
GDP	-6.8	4.4
Unemployment Rate	10.8	8.5
CPI	0.2	0.6
Budget Balance (% GDP)	-8.4	-5.4
Gen Gov Debt (% GDP)	71.2	74.3

*Based on single virus outbreak in 2020

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

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 challenge 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

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.