



# The Irish Economic Update

*Economy Continues To Perform*

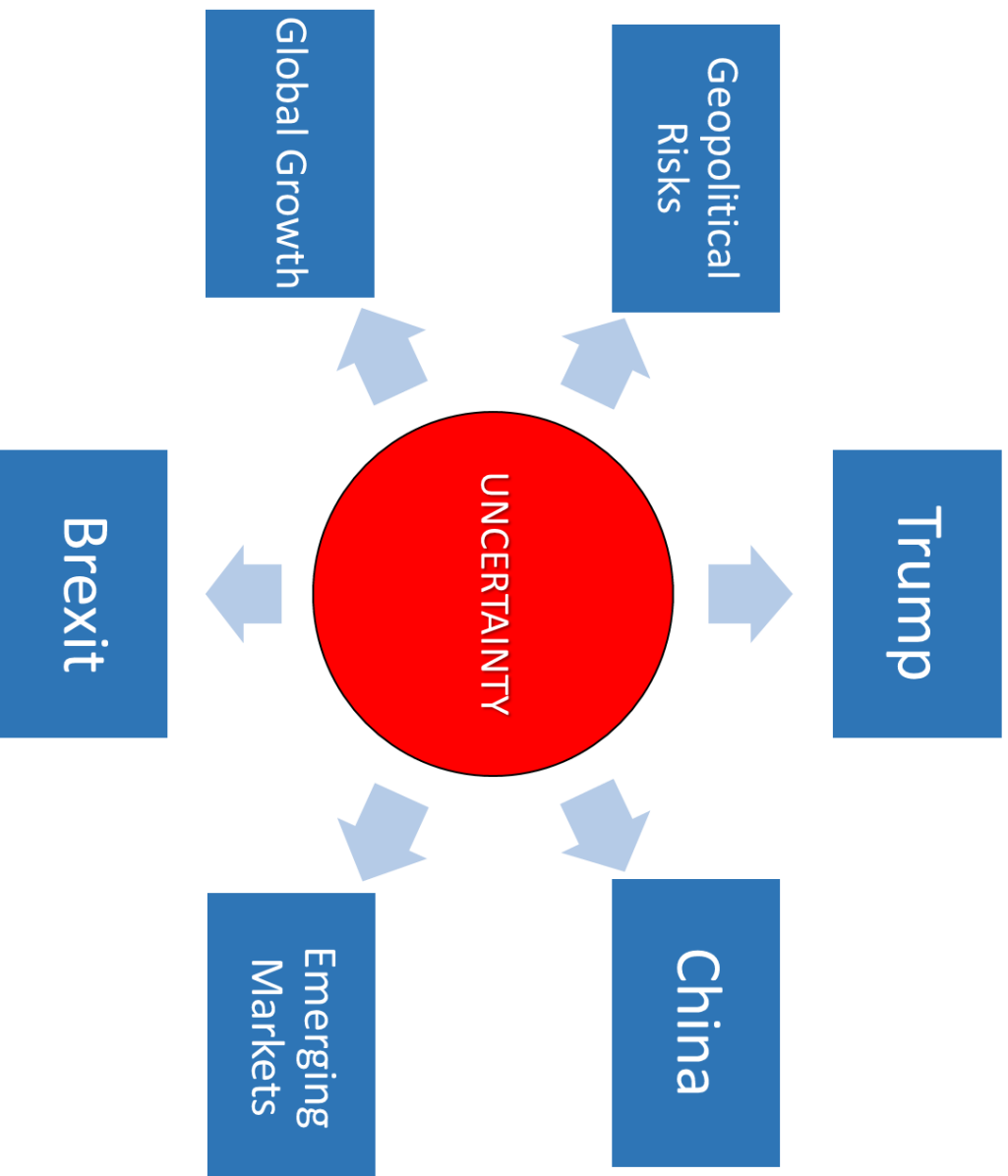
*Well Despite Concerns Over Brexit*

January 2017

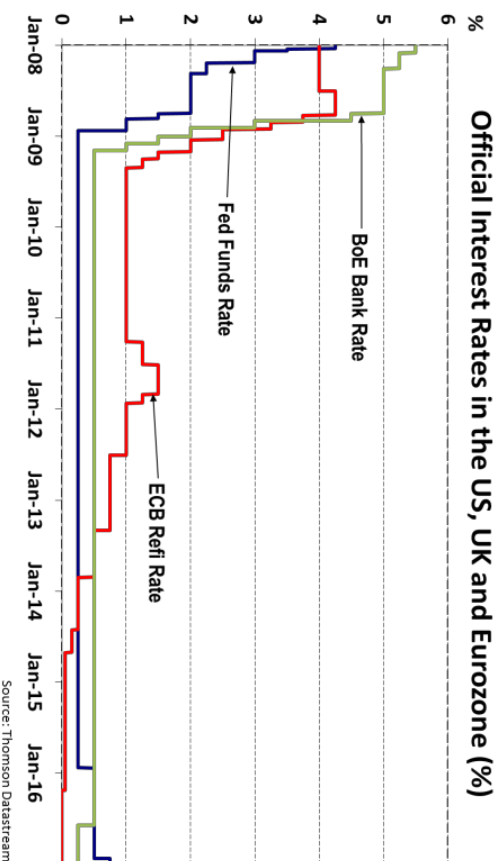
Dara Turnbull

Economist

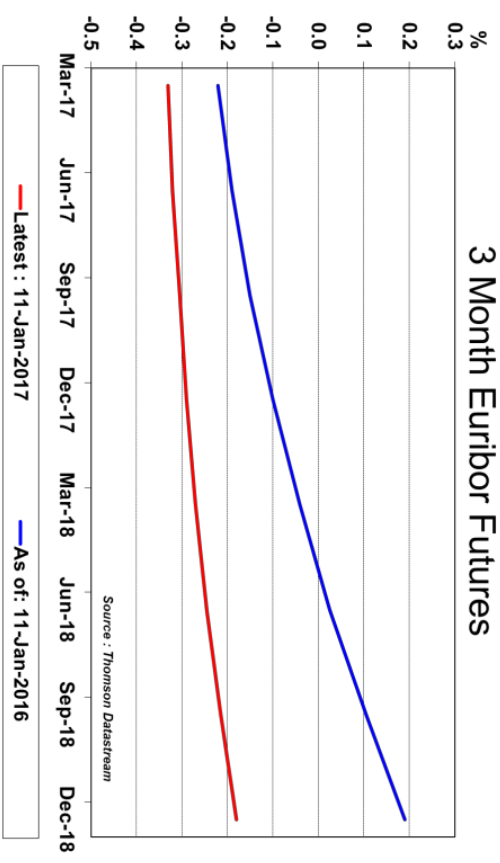
AIB



# Interest rates expected to remain very low for years



Source: Thomson Datastream

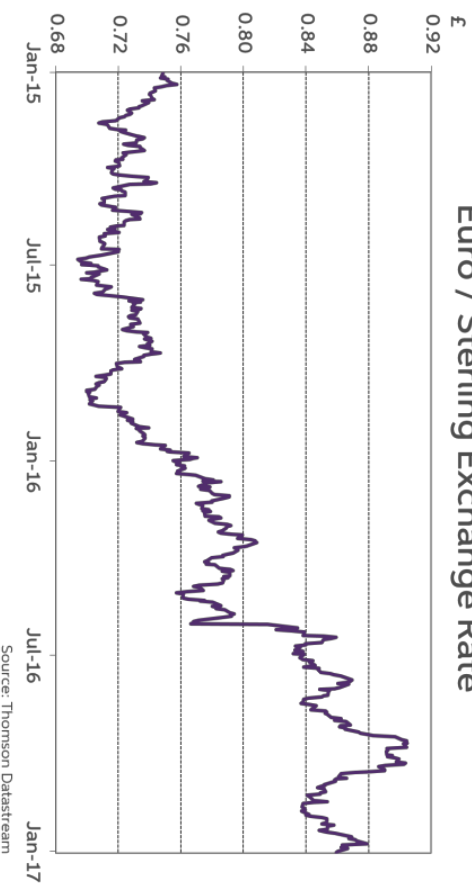


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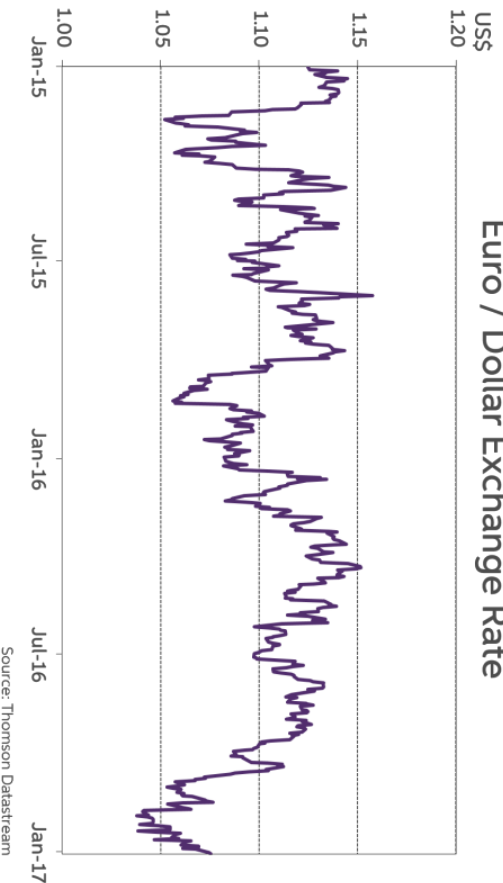
- Global interest rates at **historic lows** of close to or below zero, with QE in some countries
- **BoE cut interests rates** and expanded its QE programme in Aug '16.
- Rate cuts in Australia, New Zealand, India also
- **Fed slow to tighten** – two rates hikes per annum expected by end 2019
- BoJ eased policy further last year – rates go negative. Retains easing bias
- Further monetary **easing** by **ECB** in 2016 – deposit rate cut to -0.4%. **Retains easing bias**
- Futures contracts suggest Eurozone money market rates will **stay negative until mid 2019**
- Long term rates remain very low as markets expect loose monetary policy to last for years

# Sterling takes a big hit on Brexit fears

Euro / Sterling Exchange Rate



Euro / Dollar Exchange Rate



- Sterling weakened in lead up to the referendum and then fell sharply on the result
- EUR/GBP hits 2010/11 level of **90p**, up from 70p a year ago. GBP/USD **down below \$1.25** - 30 year lows
- Trumps win and rising political risks in Eurozone see sterling short positions cut. Euro falls back to 84-86p
- **Risks remain for sterling**, though, as exit talks with EU this year are likely to prove difficult
- Sterling could come under pressure again - **euro may rise back up to 90p on renewed hard Brexit fears**

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q1 2017	End Q2 2017	End Q3 2017
EUR/USD	1.0746	1.05	1.03	1.02
EUR/GBP	0.8546	0.88	0.89	0.90
EUR/JPY	122.10	121	121	122
GBP/USD	1.2571	1.19	1.16	1.13
USD/JPY	113.63	115	117	120

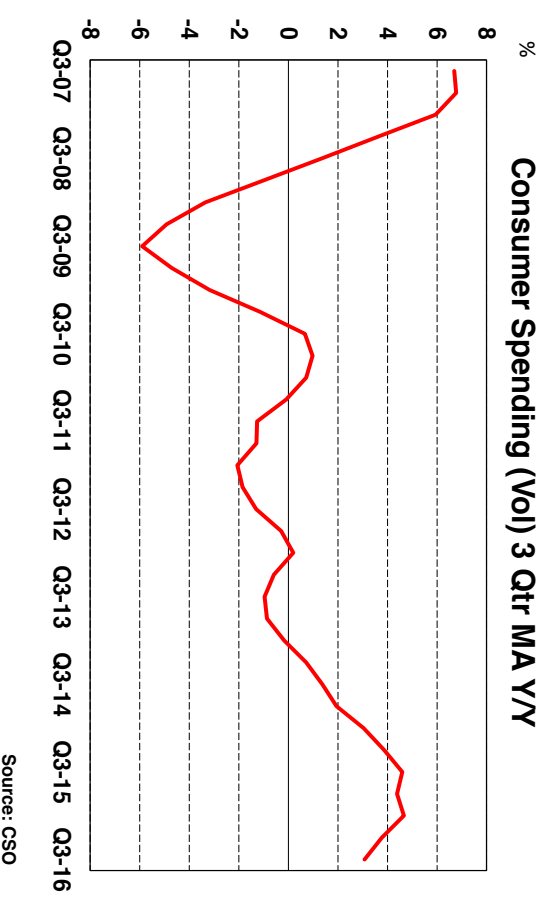
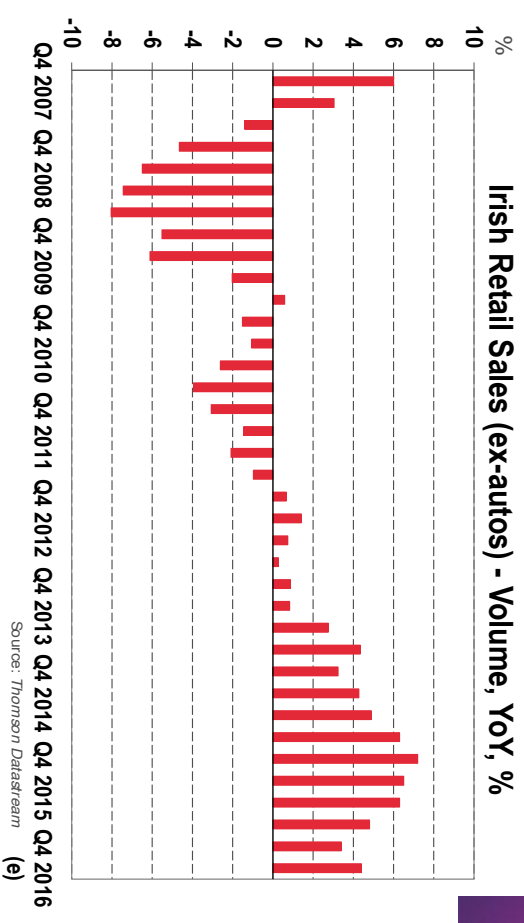
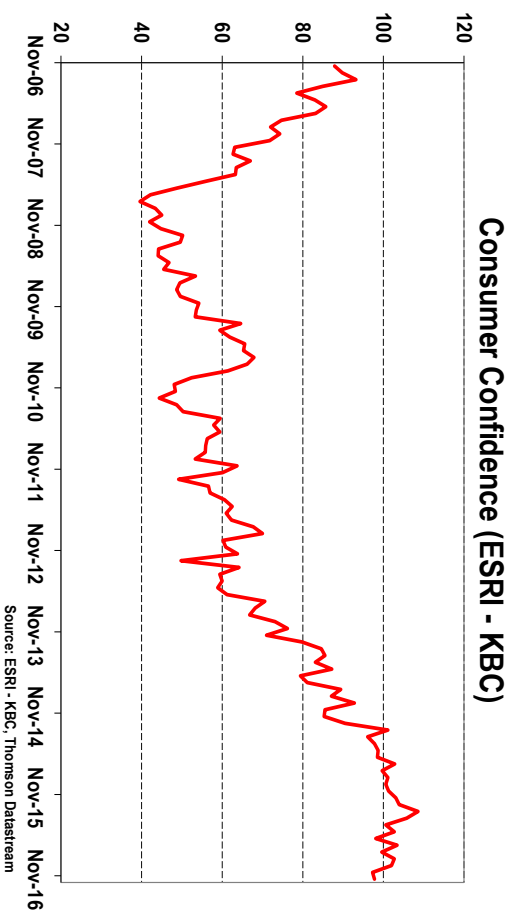
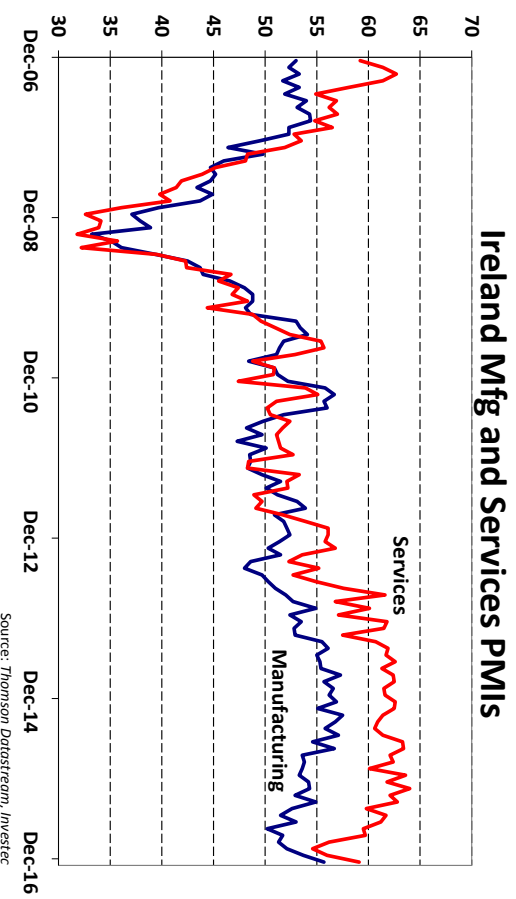
Current Rates Reuters, Forecasts AIB's ERU

## Economy performed well again in 2016



- GDP growth averaged strong 4.5% year-on-year in Q1-Q3 2016
- Manufacturing PMI weakened appreciably around mid-year but rebounded strongly in Q4'16
- Strong rebound by services PMI at end 2016 after marked decline post Brexit vote in UK
- Slower growth in service exports of 6.5% yoy in Q1-Q3 2016 after a big rise in 2015
- Construction PMI performed strongly in 2016 – averaged around 60.
- Consumer confidence strong but has fallen back somewhat from 15 year highs hit in Q1'16
- Consumer spending up 3.2% yoy in Q1-Q3 2016 – strong retail spending last year
- New car sales rose by 17.5% in 2016 after 30% jump in both 2014 and 2015
- Housing completions up by 17% yoy in first ten months of 2016
- Mortgage lending picks up strongly in 2016 after slowing in 2015 on new CB lending rules
- Strong employment growth in 2016 – up 2.9% yoy in both Q2 and Q3
- Live Register continues to fall. Jobless rate down to 7.2% in December – peaked at 15.1%
- Slower growth in tax receipts since early summer but finished well ahead of target in 2016

# UK Brexit vote had limited impact on Irish data



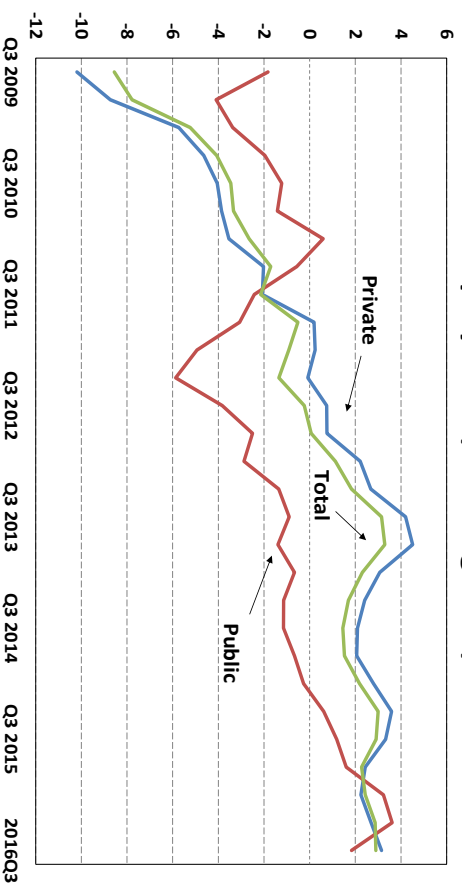
# Strong jobs growth continues; unemployment falls

Year Average	2013	2014	2015	2016(f)	2017(f)	2018(f)
<b>Unemployment Rate %</b>	13.1	11.3	9.5	8.1	7.2	6.6
<b>Labour Force Growth %</b>	0.4	-0.3	0.5	1.2	1.2	1.1
<b>Employment Growth %</b>	2.4*	1.7	2.6	2.8	2.1	1.7
<b>Net Migration : Year to April ('000)</b>	-33.1	-21.4	-11.6	3.0	10.0	15.0

\* Employment ex Agriculture +1.3% in 2013

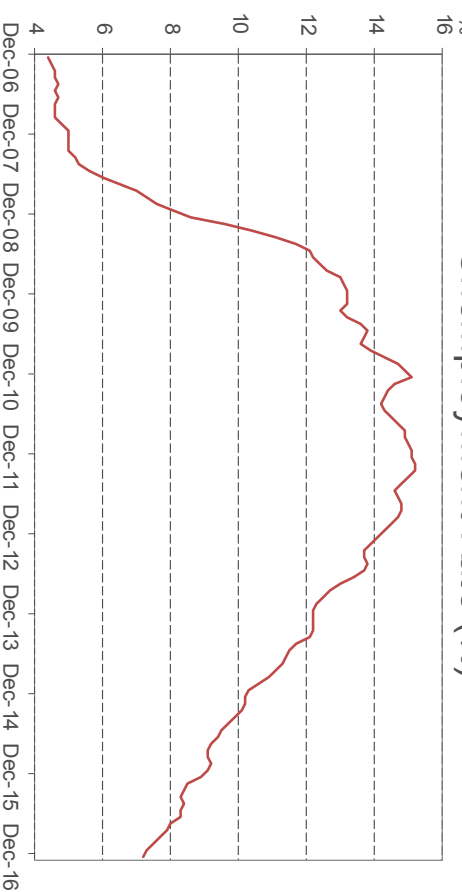
Source: CSO and AIB ERU forecasts

**Employment (% Change YoY)**



Source: Thomson Datastream

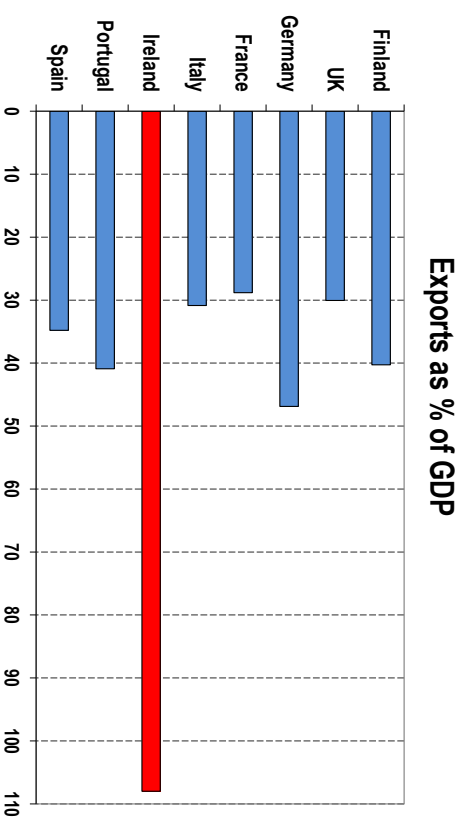
**Unemployment Rate (%)**



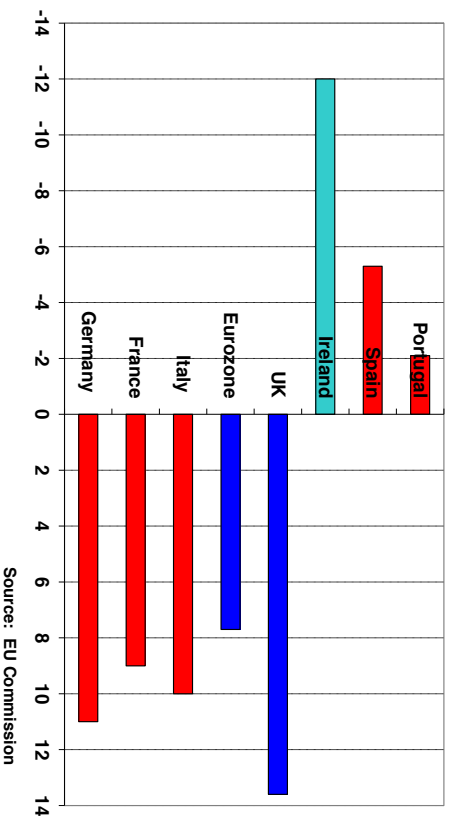
Source: Thomson Datastream

# Large Irish export base performs well

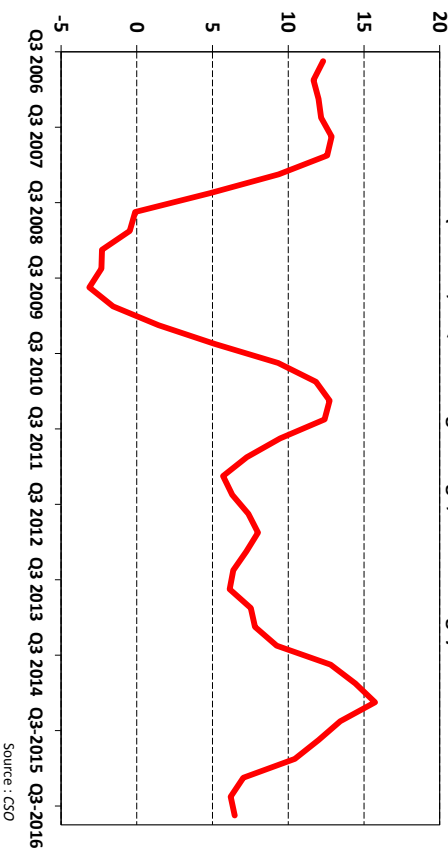
- Ireland a very open economy – exports, driven by huge FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness since 2009, with weakening of euro also helpful
- Exports have risen strongly, helped by large FDI inflows and recovery in global economy
- Sterling’s sharp fall a challenge for exports to UK



Unit Labour Costs 2009-2013 (% Change)



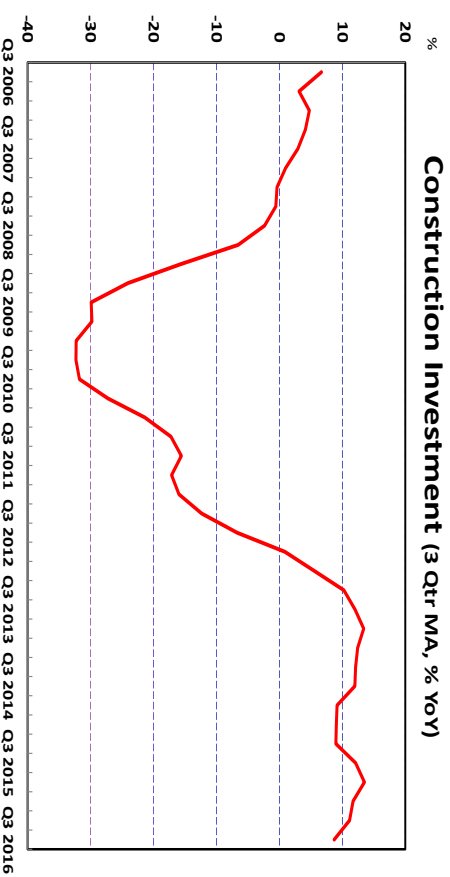
Irish Exports of Services  
(Volume, 3 Qtr Moving Average, YoY% Change)



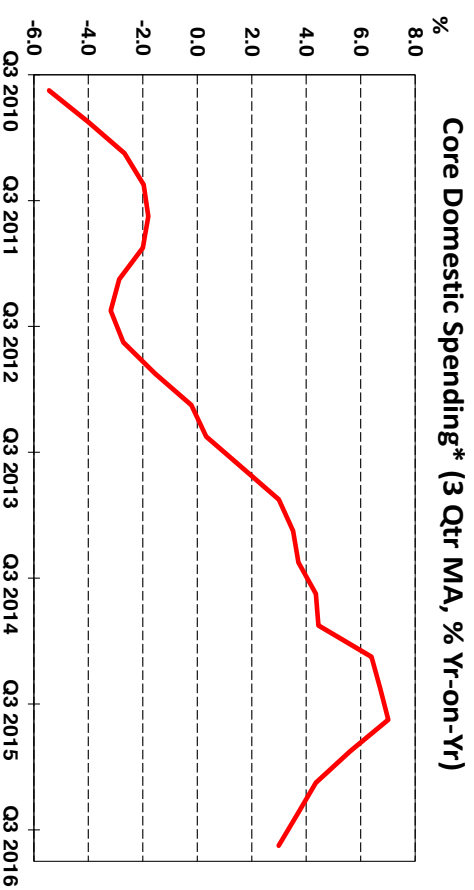


# Slower growth by domestic economy last year

- Domestic economy contracted by 20% from 2008-12
- Collapse in construction was big drag on GDP - fell from 13.5% of GDP in 2005-07 to 5.3% by 2012
- Construction has seen steady growth since 2013 of circa 10% per annum – continued in 2016
- Business investment (ex planes/R&D) more than doubled in 2013-2015 but fell back in 2016
- Consumer spending grew by 1.7% in 2014, 4.5% in 2015 and 3.2% yoy in Q1-Q3 2016
- Core domestic spending (ex aircraft, R&D, Intangibles) averaged growth of 4.4% in 2013-2015
- Slower growth of 3% yoy in core domestic spending in Q1-Q3 2016 as business investment declined
- Core retail sales rising strongly again towards end 2016 after slowing on Brexit vote around mid-year



Source : CSO

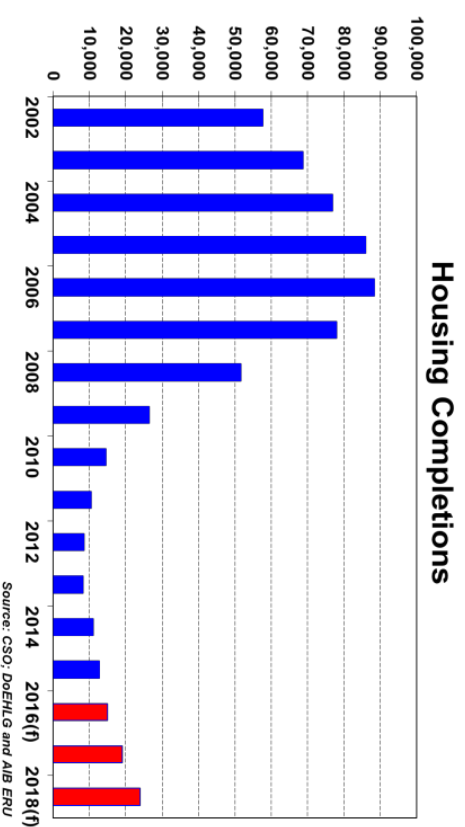
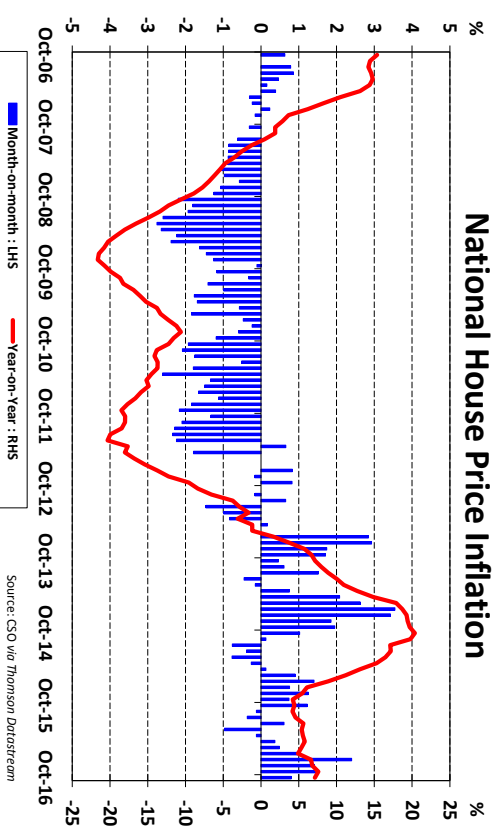


\*Domestic Spending excluding Investment in aircraft and intangibles

Source: CSO, AIB ERU Calculations

# House prices rebound as big housing shortage emerges

- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices rebound: up 48.5% by Oct 2016 from low in early 2013 as big housing shortage emerges
- 90% decline in housing output. Supply overhang eliminated and low level of stock for sale now
- Dublin prices up by 65% from trough, with non-Dublin prices up by 45%
- House prices, though, including in Dublin, are still some 32% below peak levels hit in 2007
- Central Bank mortgage rules cooled Dublin house price inflation in 2015—fell from 25% to 3% yoy
- House prices inflation picked up somewhat in 2016. Prices up 7% yoy nationally in October, Dublin 5.5%
- Rents have also rebounded strongly – now 11.5% above previous peak reached in 2008



## Brexit is a major headache for Ireland

- Brexit has serious implications given close economic/trade links with UK
- Trade with UK equates to **35% of Irish GDP**. Thus, it is a key trading partner
- UK takes over **40% of Irish indigenous firm exports**, so very important trading partner
- Expected negative impact of Brexit on UK economy will have **knock-on effect** on Irish exports to there
- Agri, tourism, energy, retailing, financial sector most likely to be impacted by Brexit

- Sterling has fallen sharply on Brexit concerns, which hits **exports to UK**
- Also impacts Irish firms **competing with UK exports** to Ireland and third country markets
- Many Irish exporters are small firms with no Treasury function so don't hedge currency exposure
- **Cross border trade** picks up as shoppers head North following sterling's big fall
- **Sterling weakness** also has a significant impact on cross-border businesses like hotels, restaurants

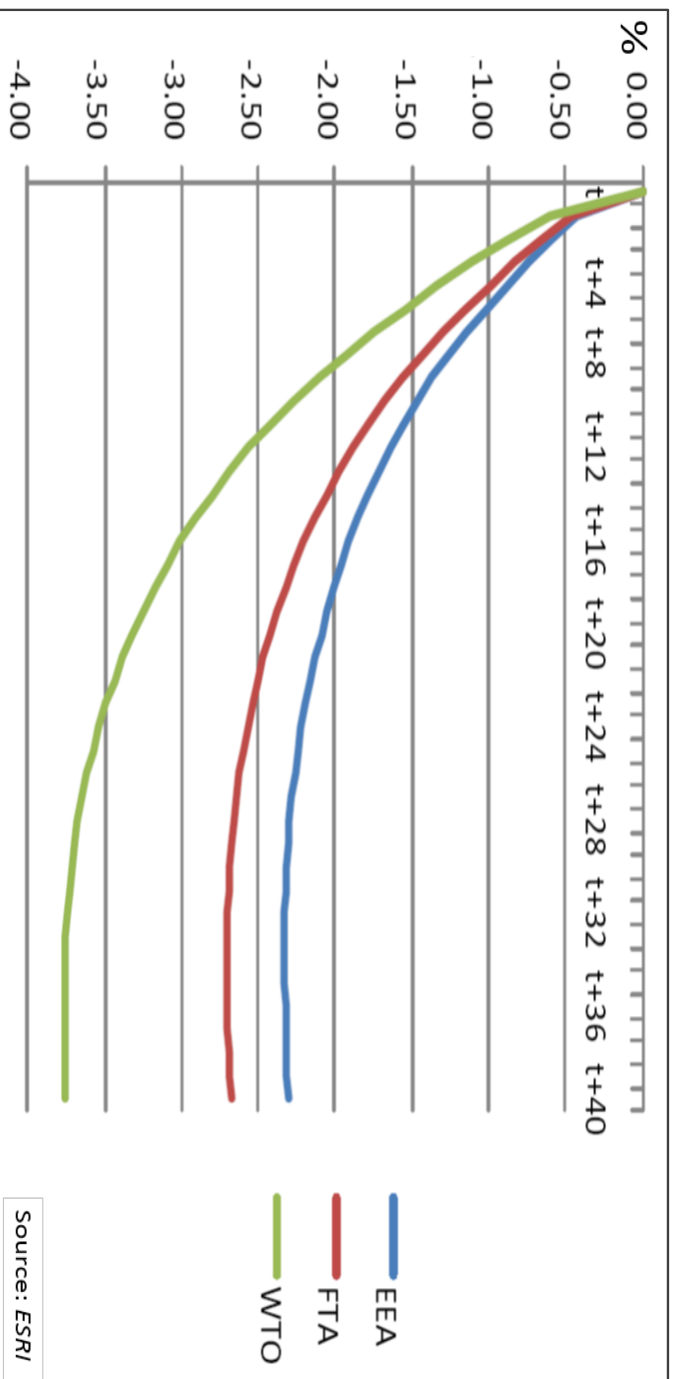
- **Higher trading costs** from more administration, differing trade rules and regulations, compliance costs, possible customs duties and tariffs when UK leaves EU
- Brexit could impact considerable **cross-country investment** between UK and Ireland.
- **Border** with Northern Ireland will become an external EU land border, with possible Customs checks etc
- Ireland will **lose key ally** within EU when UK leaves as share similar views on taxation, regulation, state involvement in economy etc.

## Ireland will be impacted by a hard Brexit



- Unclear what trade arrangements will be put in place between EU and UK post Brexit
- UK to leave Single Market and possibly Customs Union – does not want common tariffs
- Ireland and UK want to preserve common travel area but need will EU agreement on this
- Indications from EU are that talks on new trade deal can only begin after UK leaves
- UK wants exit deal to contain transition arrangements on trade to avoid economic disruption
- Hard Brexit - leaving the Customs Union and Single Market – makes this difficult to achieve
- UK says “no deal better than bad deal” on Brexit so could lose free access to EU markets
- Thus, UK may well have to fall back on WTO rules post Brexit, which require a common set of tariff rates to be applied to all countries where no free trade deals exists
- This would be bad news for Irish/UK trade as could see imposition of tariffs, customs duties
- Likely to have impact on the border with Northern Ireland – Customs checks?
- Main upside is that Brexit would make Ireland more attractive for FDI vis-à-vis the UK
- Somewhat lower Irish growth likely in 2017-18 in run-up to Brexit
- Hard Brexit in 2019 will depress Irish growth even further if no transition deal on trade

## Brexit expected to lower growth of Irish economy

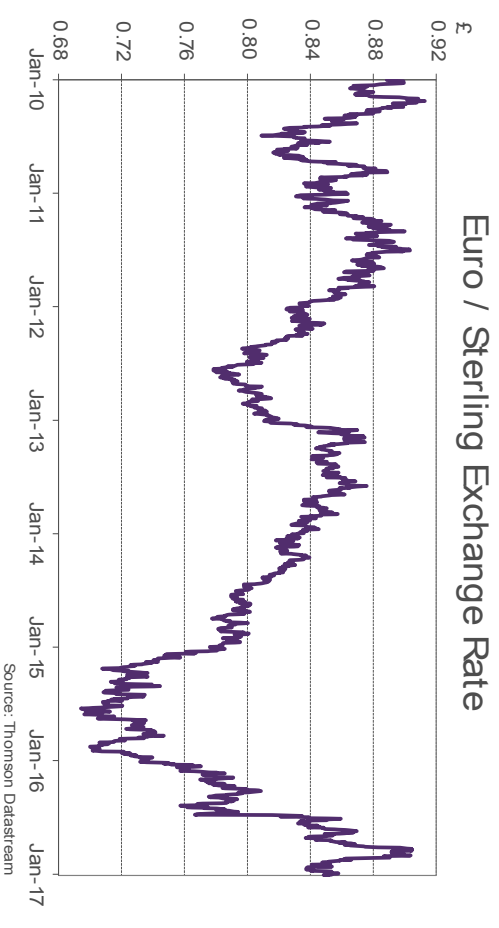
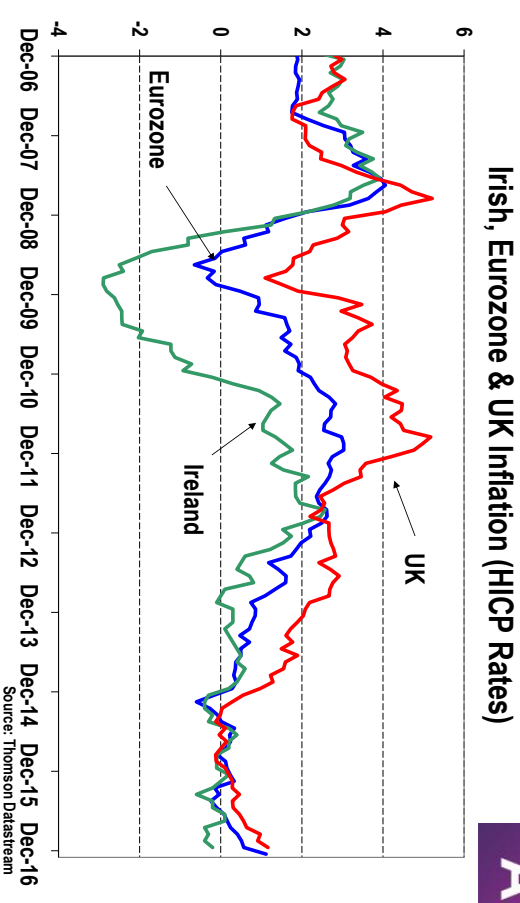


- ESRI-D/Finance estimate Irish output would be reduced by over 2% on a soft Brexit
- Sharp fall-off in trade with UK likely on a hard Brexit
- Output almost 4.0 % lower over time if there is hard Brexit and a fall back on WTO rules
- Employment 2% lower and unemployment nearly 2% higher

# Solid Irish growth still likely ahead of Brexit



- Rebound by Irish economy should continue
- 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
- Irish inflation remains very low, below that of the Eurozone and UK
- OECD and IMF forecasting that global growth will improve in 2017 and 2018
- However, Brexit is a major challenge for economy
- Sharp fall in sterling impacting exports to UK, tourism from UK, firms competing with UK imports
- Irish economy slowed somewhat in 2016 on weaker global activity, sterling's fall and Brexit uncertainty
- Irish GDP growth forecast to slow further to 3.0-3.5% in 2017-18 as Brexit continues to impact on activity



# AIB Irish Economic Forecasts

<i>% change in real terms unless stated</i>	2013	2014	2015	2016 (f)	2017 (f)	2018 (f)
<b>GDP</b>	<b>1.1</b>	<b>8.5</b>	<b>26.3</b>	<b>4.5</b>	<b>3.5</b>	<b>3.0</b>
GNP	4.7	9.2	18.7	8.0	3.5	3.0
Personal Consumption	-0.8	1.7	4.5	3.2	3.0	2.5
Government Spending	0.1	5.4	1.1	4.5	1.5	1.5
Fixed Investment	-5.4	18.2	32.7	6.0	6.0	5.5
Core Fixed Investment*	22.6	14.4	18.3	-1.0	6.0	5.5
<b>Core Domestic Spending*</b>	<b>2.3</b>	<b>4.2</b>	<b>6.6</b>	<b>3.0</b>	<b>3.7</b>	<b>3.3</b>
Exports	3.1	14.4	34.4	2.5	4.0	4.0
Imports	1.1	15.3	21.7	2.5	4.0	4.0
HICP Inflation (%)	0.5	0.3	0.0	-0.2	0.5	0.8
Unemployment Rate (%)	13.1	11.3	9.5	8.1	7.2	6.7
Budget Balance (% GDP)	-5.5	-3.7	-1.8	-0.9	-0.5	-0.3
Gross General Gov Debt (% GDP)	119.5	105.2	78.7	76	73	70

\*Excludes investment in aircraft and intangibles

Source: CSO, AIB ERU Forecasts

# Risks to the Irish economic recovery



- 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
- Recovery in the global economy still quite fragile, with on-going risks and headwinds, including weakness of emerging economies. Ireland vulnerable to any shocks that impacts its exports
- Possibility of reduced FDI from US if a new Trump administration slashes corporate taxes
- Questions around corporation tax regime (eg Apple ruling) could impact FDI but seems unlikely
- Supply constraints in the construction sector, especially new house building, which is recovering at a very slow pace and remains at depressed levels
- Competitiveness issues - high house prices, high rents, high personal taxes
- Continuing credit contraction – fewer banks, tighter credit conditions, 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.