



The Irish Economic Update

Continuing Robust Growth

January 2018

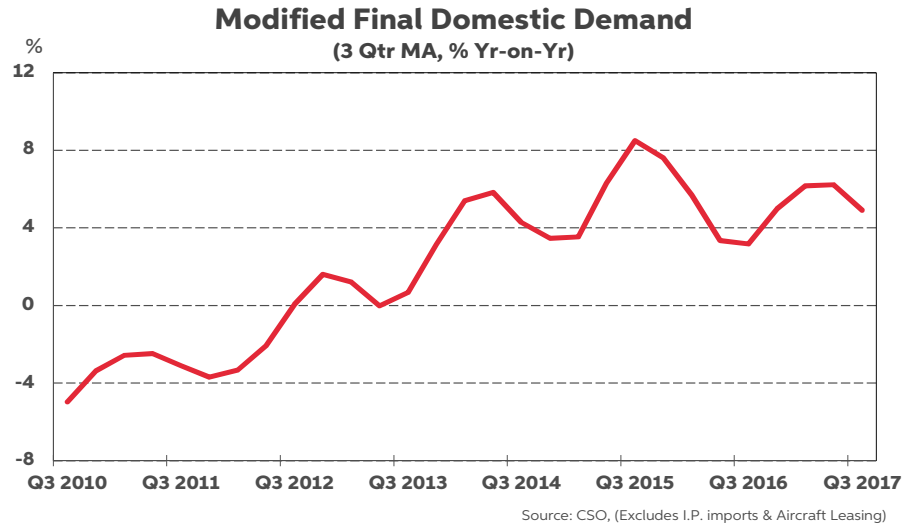
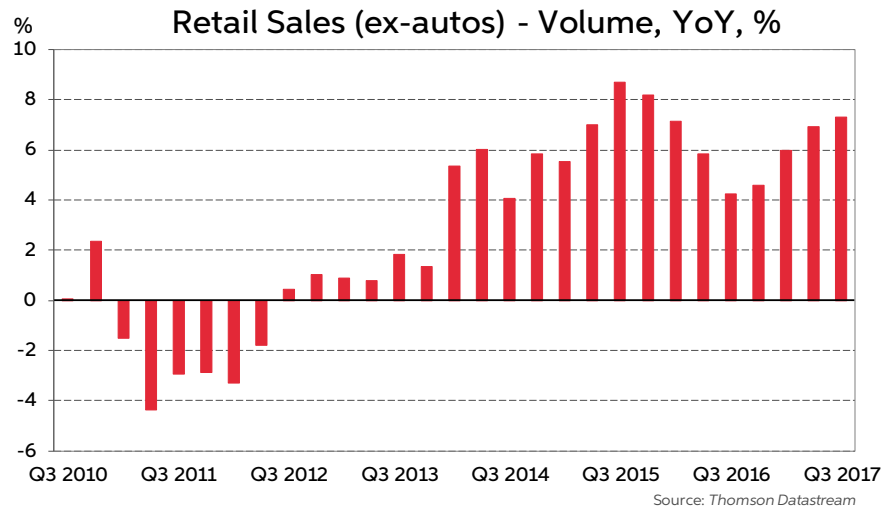
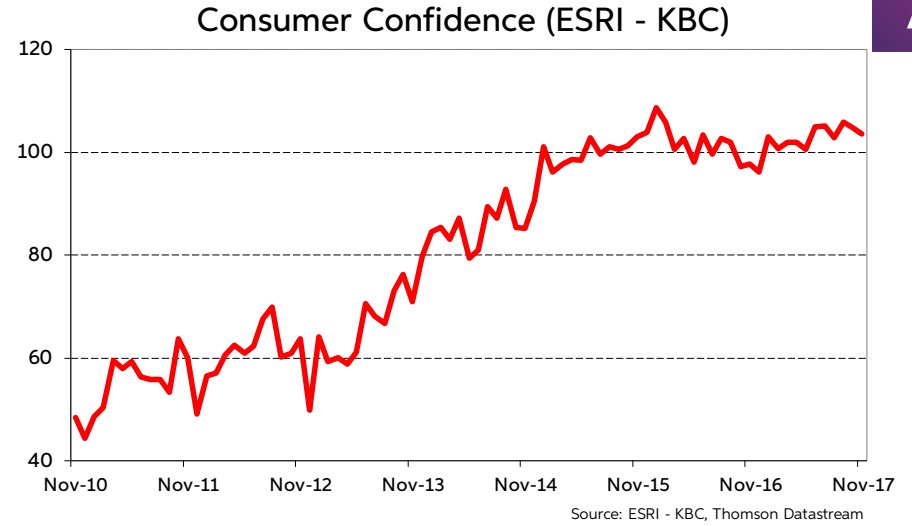
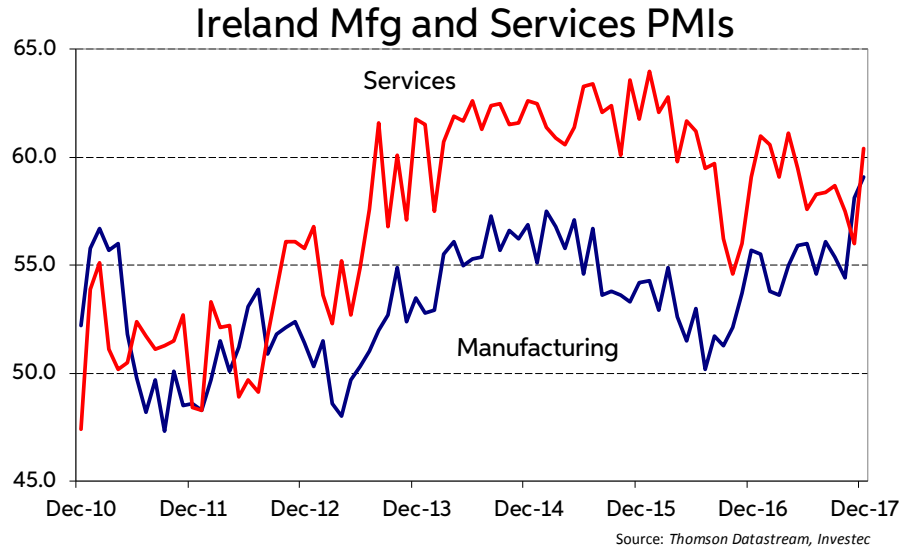
Oliver Mangan
Chief Economist
AIB

Strong recovery 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 rebounds strongly in 2013-17 period. GDP growth of 5.1% in 2016, 6.5% in 2017
- 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 circa 6% by end 2017
- Budget deficit has declined at a quicker than expected pace. Down to 0.3% of GDP in 2017

Indicators remain upbeat despite concerns over Brexit



Strong growth again in 2017



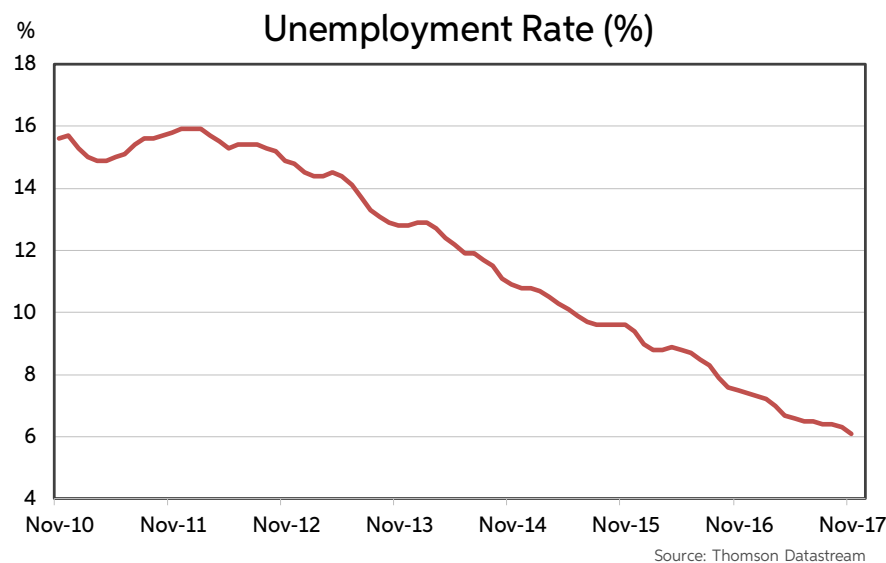
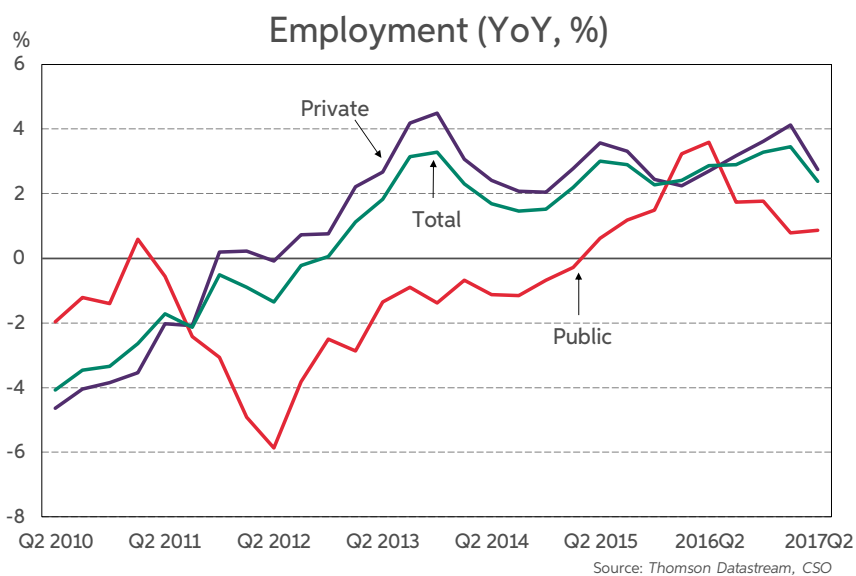
- Robust GDP growth of 5.1% in 2016. GDP forecast at 6.5% in 2017 but underlying rate put at 4-5%
- Mfg PMI hit record high of 59.1 in December - best level since series began in 1998
- Services PMI remained very strong in 2017, with index at 60.4 in December
- Continuing high construction PMI in 2017 – at 56.7 in November as sector grows strongly
- Consumer confidence at very robust levels – close to 15 year high in H2 2017
- Retail sales (ex-motor trade) rise strongly again last year, up 7.3% yoy in Q3 2017
- Total car regs (new + used imports) up 3.7% yoy in Jan-Nov 2017 – surged in 2014-16 period
- Housing completions up 28% yoy to October 2017, after 18% increase in 2016
- Mortgage lending rising strongly – mortgage drawdowns up 31.5% yoy to end September 2017
- Strong job growth continuing – employment rose by 3% year-on-year in H1 2017
- Live Register continues its sharp decline in 2017. Jobless rate down to 6.1% by Nov 2017
- Budget deficit fell to 0.3% of GDP in 2017. Tax receipts up 6% in the year.

Robust jobs growth; unemployment falls sharply



Year Average	2014	2015	2016	2017(f)	2018(f)	2019(f)
Unemployment Rate %	11.3	9.5	7.9	6.2	5.2	4.7
Labour Force Growth %	-0.3	0.5	1.2	0.7	1.0	1.2
Employment Growth %	1.7	2.6	2.9	2.6	2.0	1.8
Net Migration : Year to April ('000)	-8.5	5.9	16.2	19.8	25.0	30.0

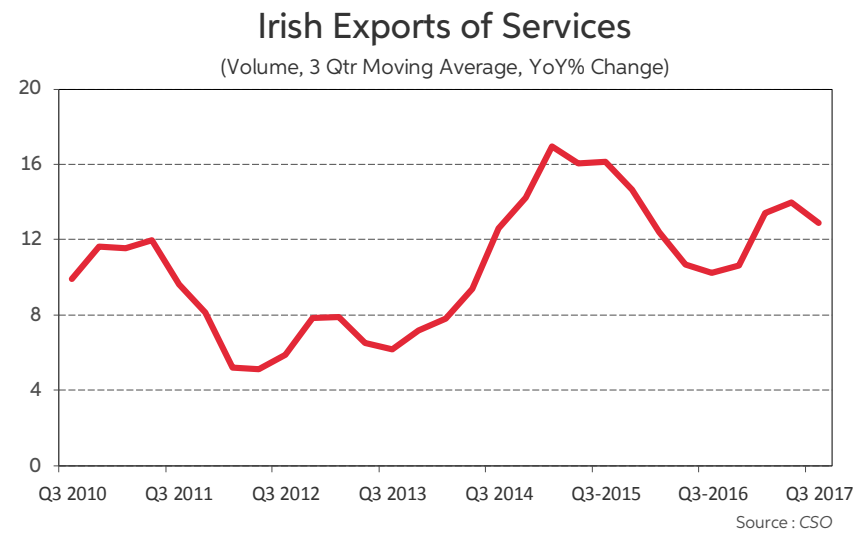
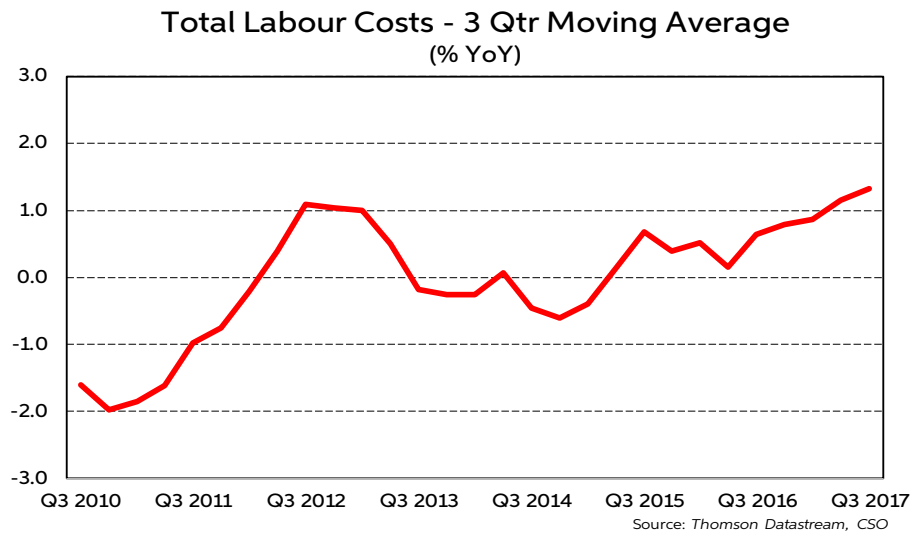
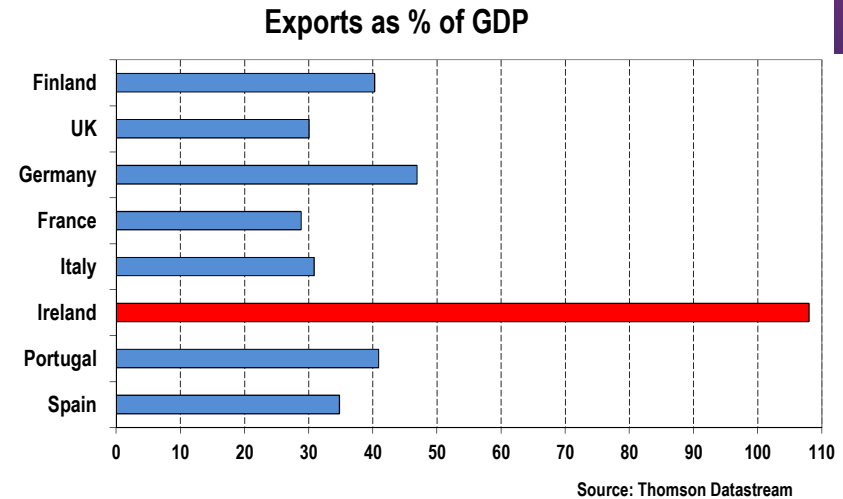
Source: CSO and AIB ERU forecasts



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 this decade, 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 but service exports up 13% yoy in Q1-Q3 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



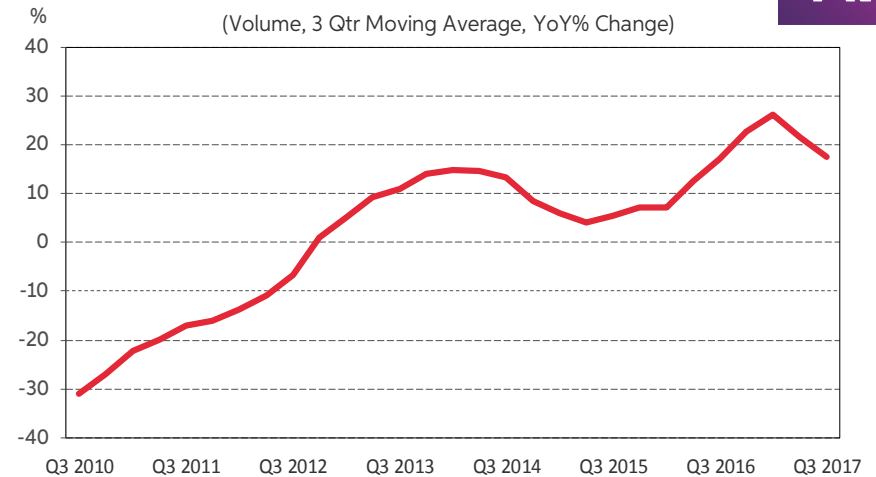
Strong recovery by domestic economy in place since 2013



- 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 15% in 2016 and 17% yoy to Q3 2017
- Core business investment (ex aircraft/intangibles) grew by average 22% in 2012-2016. Fell back in 2017
- Consumer spending grew by 2.0% in 2014, 4.2% in 2015 and 3.3% in 2016. Rose by 2% yoy to Q3 2017
- Core domestic spending (ex aircraft/intangibles) grew by average 4.8% in 2014-2016. Up 2% yoy to Q3 2017
- Core retail sales rose strongly in 2014-16 period. Trend continues in 2017 – sales (ex-autos) up 6.6% yoy to Oct
- Total car regs (new + used imports) continue to rise, up by 3.7% to November 2017 after surging in 2014-16

Construction Investment

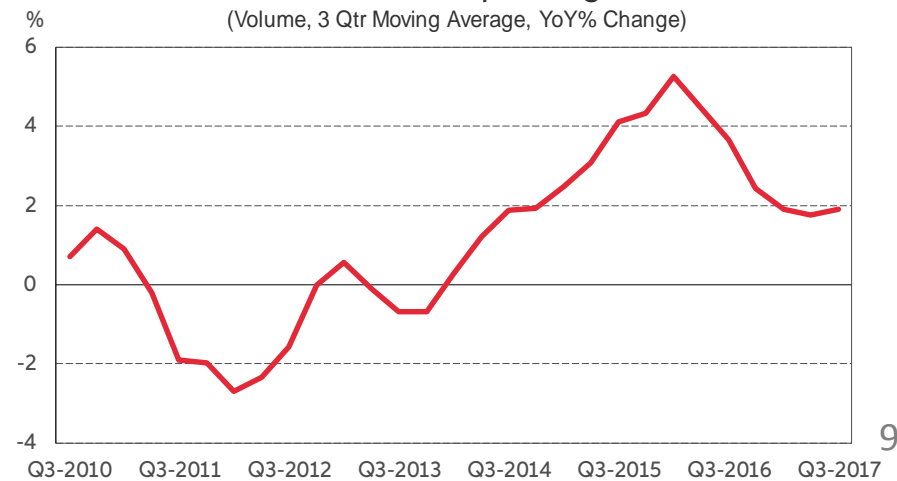
(Volume, 3 Qtr Moving Average, YoY% Change)



Source: CSO

Consumer Spending

(Volume, 3 Qtr Moving Average, YoY% Change)

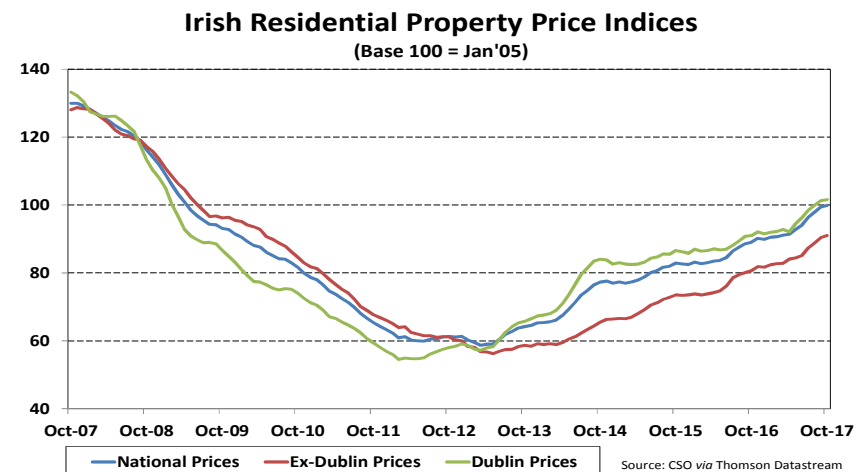
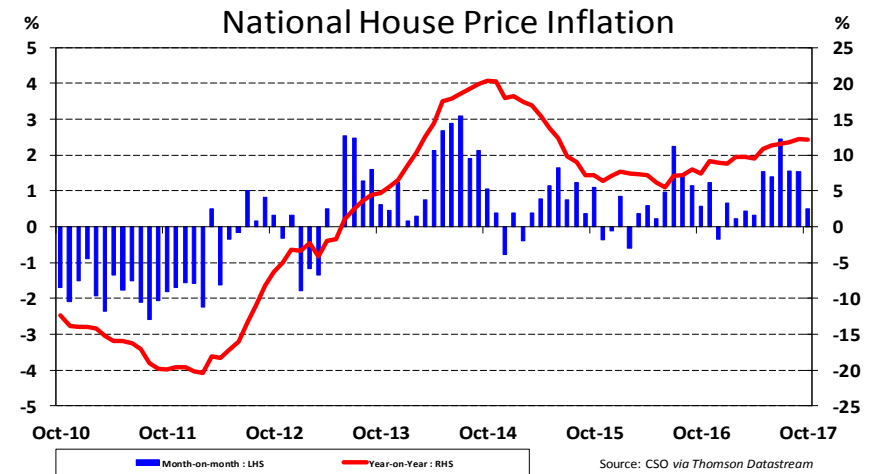


Source: CSO

House prices rebound as big housing shortage emerges



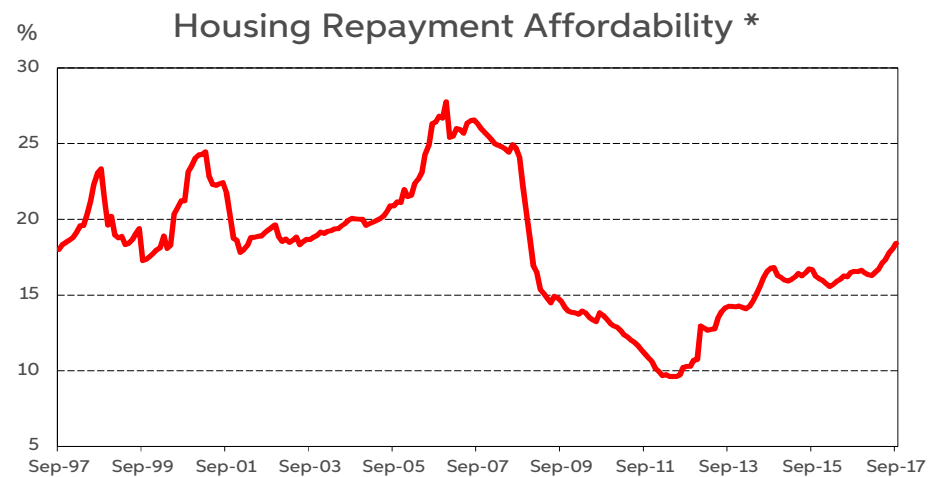
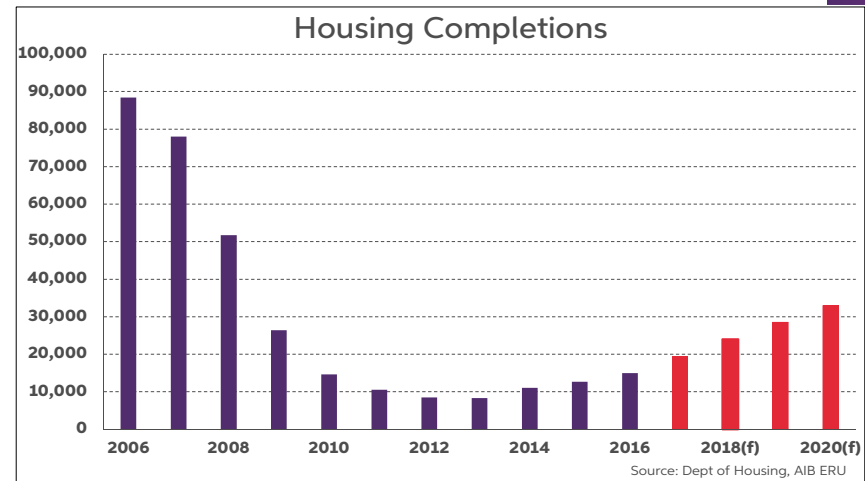
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building
- Supply overhang eliminated with little stock for sale
- Prices up 70% by Oct 2017 from low in Mar 2013
- Dublin prices up by 86.5% from their trough in Feb 2012, while non-Dublin prices have risen by 62%
- House prices, though, including in Dublin, are still some 24% below peak levels hit in 2007
- House price inflation picked up in 2017.
- Prices up 12% yoy nationally in October 2017. Dublin up 11.6%, with non-Dublin prices rising 12.8% yoy
- Rents have also rebounded strongly – now 17.7 % above previous peak reached in 2008 per CSO data



House building rising slowly from very low levels



- Housing completions at 12,700 in 2015, up from 11,000 in 2014 and 8,300 in 2013
- Completions rose by 18% to 15,000 in 2016 and up by 28% yoy to October 2017
- Completions likely to rise around 19,000 in 2017, but annual demand estimated at above 30,000 units
- Measures being put in place to boost new house building. More Local Authority and NAMA building
- Central bank lending rules relaxed in 2016 while tax rebate introduced to help fund deposits for FTB
- Mortgage lending picks up again after slowing on new CB rules in 2015 - up 31.5% yoy to Sept 2017
- Housing affordability hit by rising house prices but helped by low mortgage rates. Still at good levels
- Likely to be 2020 before housing output rises above 30,000 units – or close to estimated annual demand



* % of disposable income required for mortgage repayments for 2 income household, 30 year 90% mortgage. Based on Permanent TSB/ESRI national house price & CSO residential property price index

Source: AIB, Permanent TSB/ESRI, CSO, Dept. of Finance

AIB Model of Estimated Housing Demand



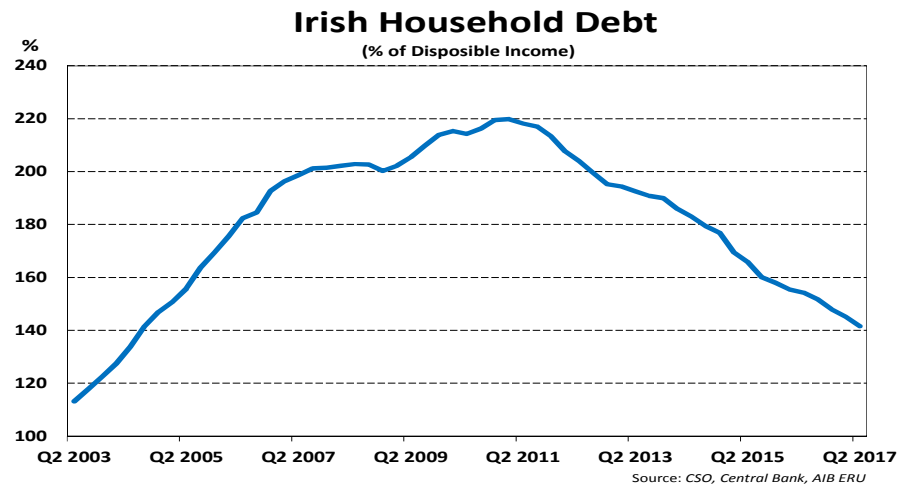
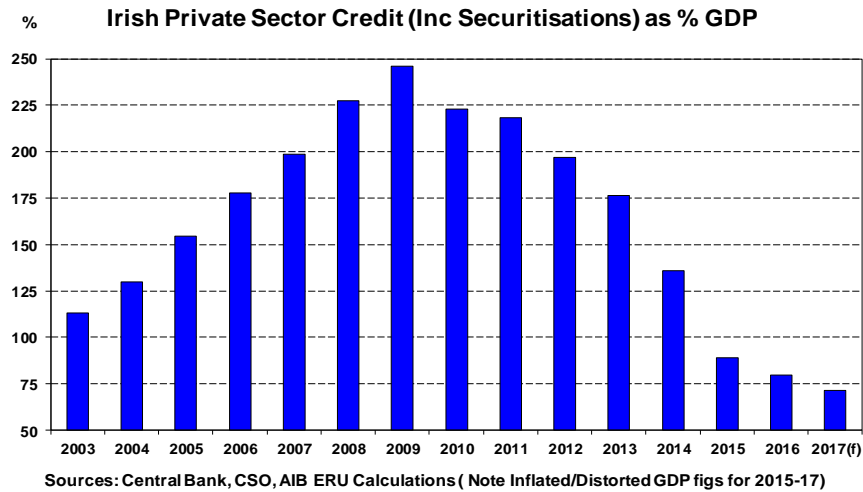
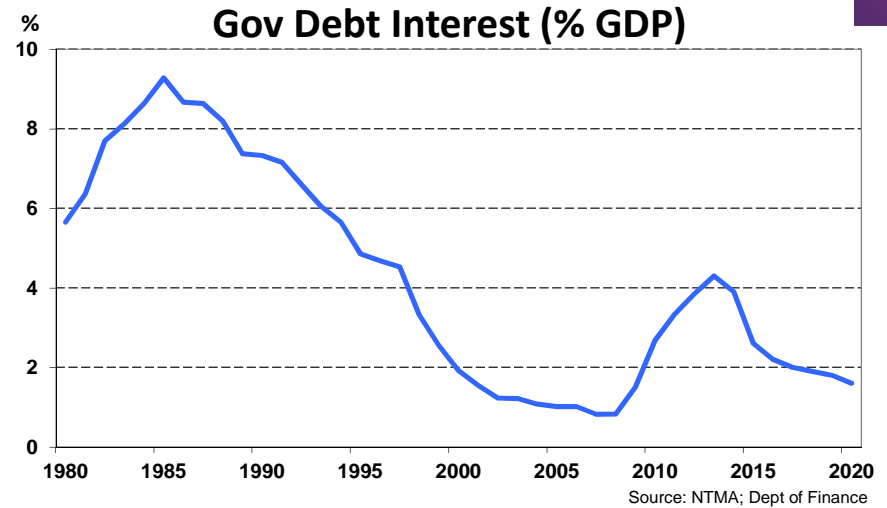
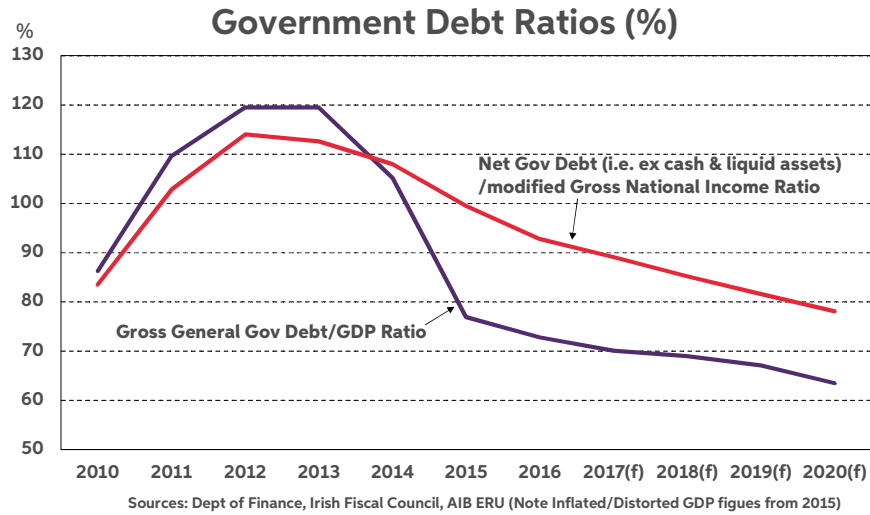
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – 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
Household Formation	26,500	26,500	26,500	27,500	27,500
<i>of which</i>					
Indigenous Population Growth	18,000	18,000	17,000	16,500	14,500
Migration Flows	8,500	8,500	9,500	11,000	13,000
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	32,000	32,000	32,000	33,000	33,000
Completions	15,000	19,000	23,000	27,000	31,000
Shortfall in Supply	-17,000	-13,000	-9,000	-6,000	-2,000

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

Sources: CSO, DoECLG, AIB ERU

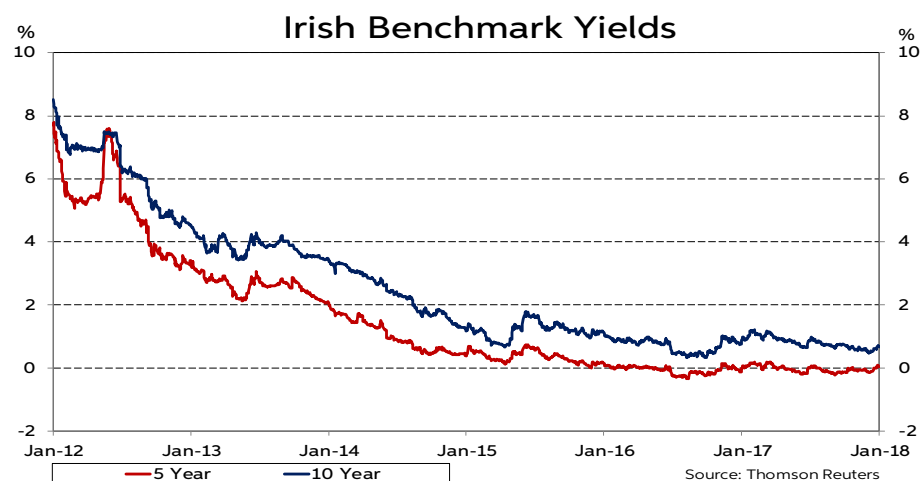
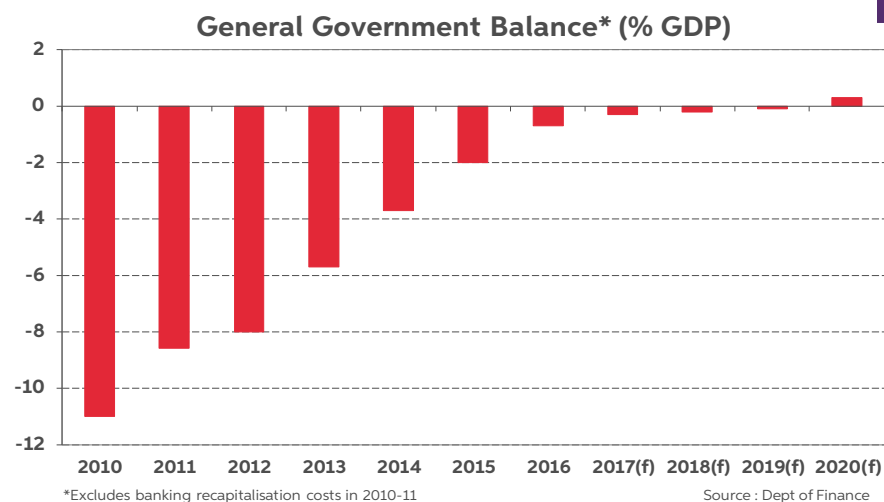
Govt debt ratios fall, private sector deleverages



Budget deficit falls sharply – now close to balance



- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit fell sharply over the course of this decade
- Public finances were very close to target in 2017, with deficit falling to 0.3% of GDP
- Budget deficit forecast at 0.2% of GDP for 2018
- Primary budget (i.e. excluding debt interest) surplus of 1.7% of GDP in 2017
- Debt interest costs low – at 2% of GDP in 2017
- 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 is a major challenge 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 some **40% of Irish indigenous firms 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 services, the sectors likely to be most impacted by Brexit

- Sterling has fallen sharply on Brexit concerns, which hits **exports to UK**
- Impacts Irish firms **competing with UK exports** to Ireland and elsewhere
- 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. Also big rise in on-line sales going to the UK
- **Sterling weakness** also has a significant impact on cross-border businesses like hotels, restaurants

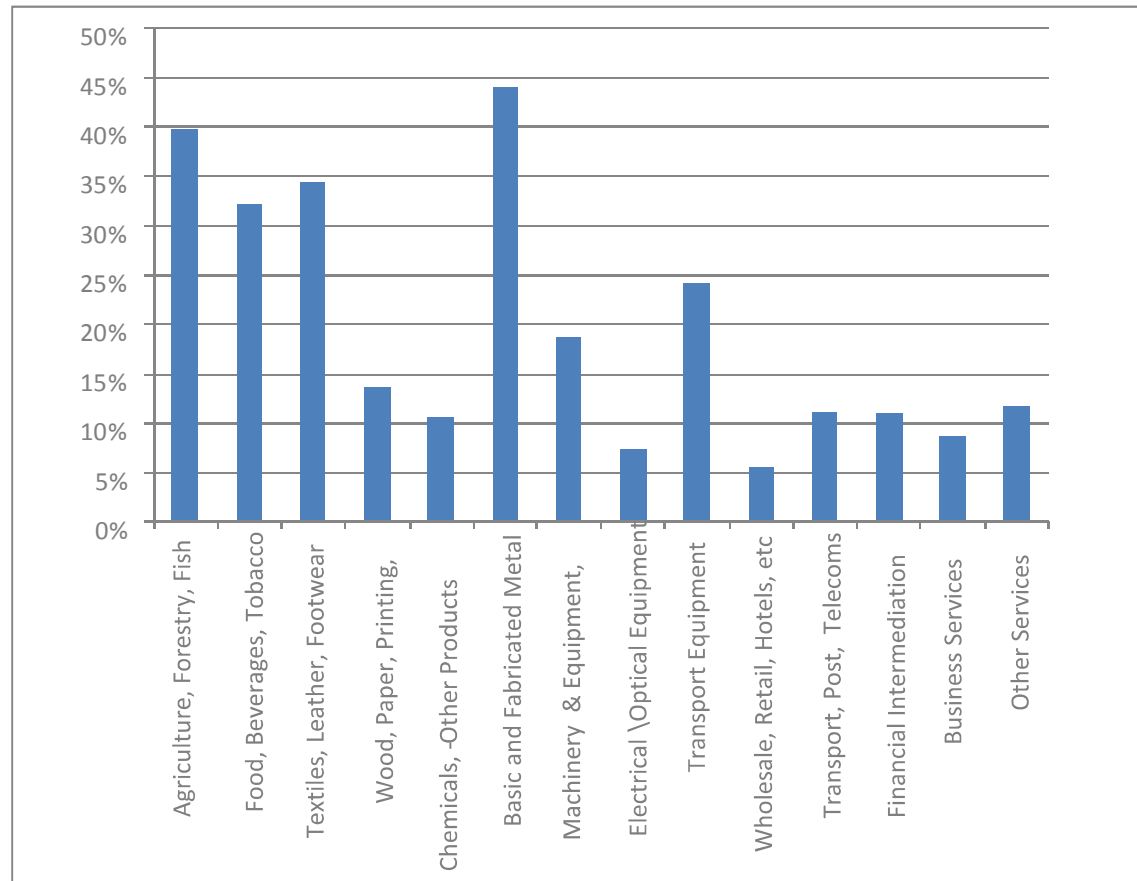
- **Higher trading costs** from more administration, differing rules and regulations, compliance costs, possible customs duties/tariffs when UK leaves EU
- Brexit could impact considerable **cross-country investment** between UK and Ireland.
- **Border** with Northern Ireland will become an external 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.

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

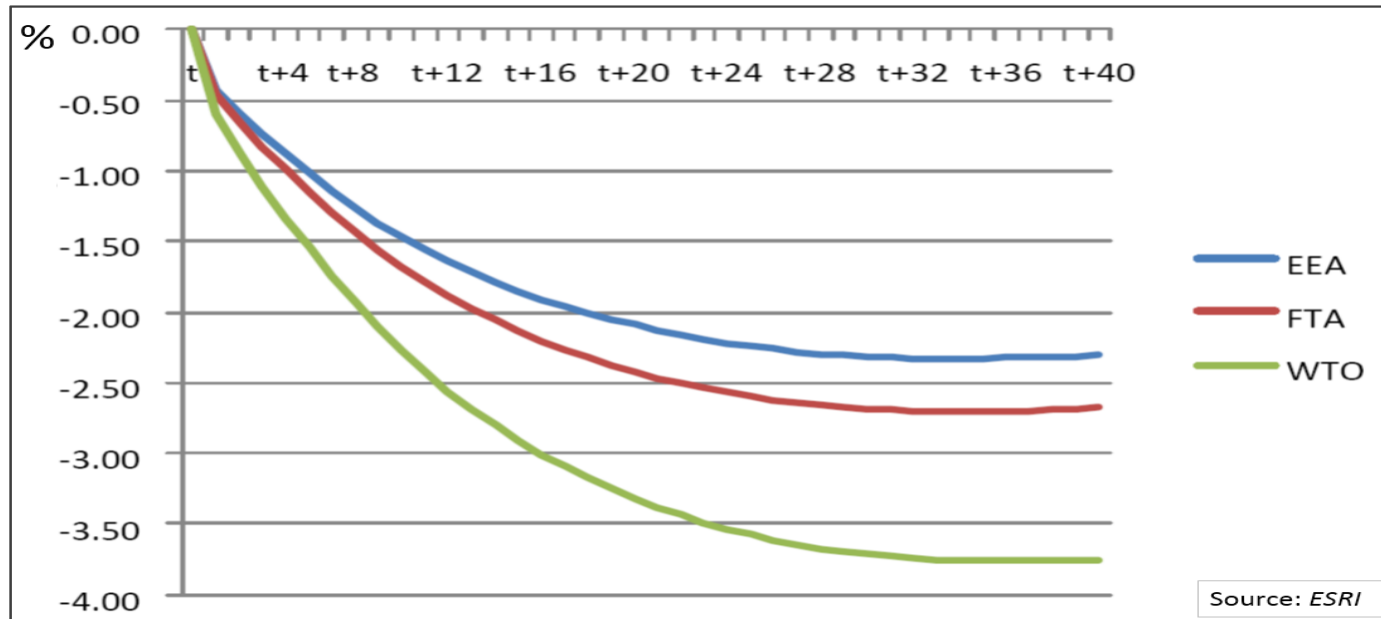
Share of Exports by Industry Destined for the UK (ESRI)



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 by 2-2.5% 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 rate nearly 2% higher in hard Brexit

Irish Government's Priorities in Brexit Talks



Border

- Avoid a hard border on the island of Ireland
- Cater for Good Friday Agreement and allow Northern Ireland to automatically join EU if it ever opts for United Ireland
- Irish citizens in Northern Ireland to retain EU citizens rights post Brexit
- Retain the Common Travel Area between Ireland and the UK
- UK and EU to agree on reciprocal protection of citizens rights for those residing in each others territory

Trade

- Orderly withdrawal of UK from the EU that avoids a hard Brexit or cliff-edge
- Agree transitional arrangements to bridge the gap between UK's exit from EU and a future EU-UK free trade agreement (FTA)
- Future FTA needs top be broad and ambitious
- Integrity of single market needs to be protected in FTA
- FTA to promote regulatory conformity and avoid regulatory dumping
- Disputes resolution mechanism needs to be part of a FTA

Customs arrangements key issue in Brexit



- UK to leave EU, Single Market and Customs Union – does not want common external tariffs
- Exit deal will need to contain transition arrangements to avoid disruption to trade until EU/UK free trade deal is done. UK suggests common UK-EU Customs Unions during transition period
- UK wants to conclude full free trade deal with EU within 2 years of its 2019 departure
- Worst outcome is if UK has to fall back on WTO rules post Brexit. These 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 and increased costs from non-tariff barriers like rules of origin, production standards, licenses
- Unclear what the arrangements on customs will be after transition period ends. UK suggests 'a new customs partnership' or else 'highly streamlined customs arrangements' as part of FTA
- Brexit impacts the border with Northern Ireland. All sides want to avoid a hard border and this was agreed in Phase 1 of Brexit negotiations, but may prove difficult if UK has own tariffs
- Period of uncertainty could last until 2021 when UK hopes to conclude free trade deal with EU
- Main upside for Ireland is that Brexit makes it more attractive for FDI to locate here than in UK

Talks on trade to determine shape of Brexit

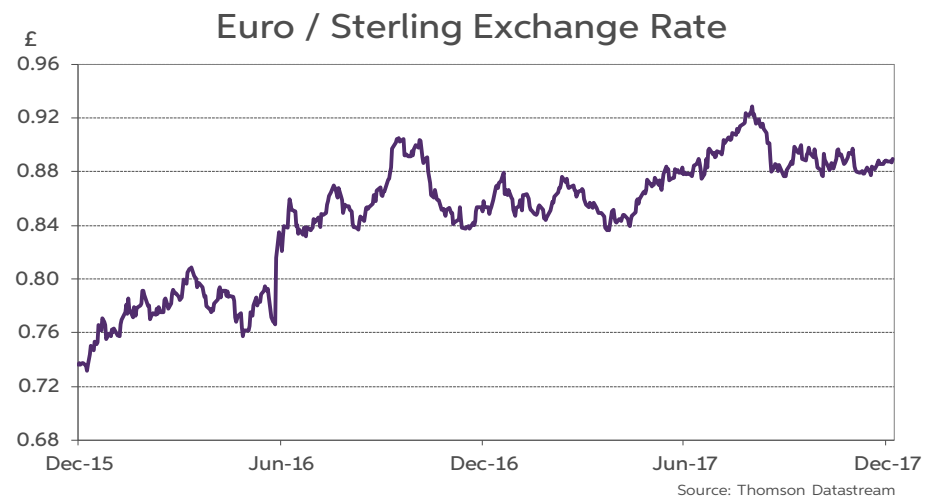
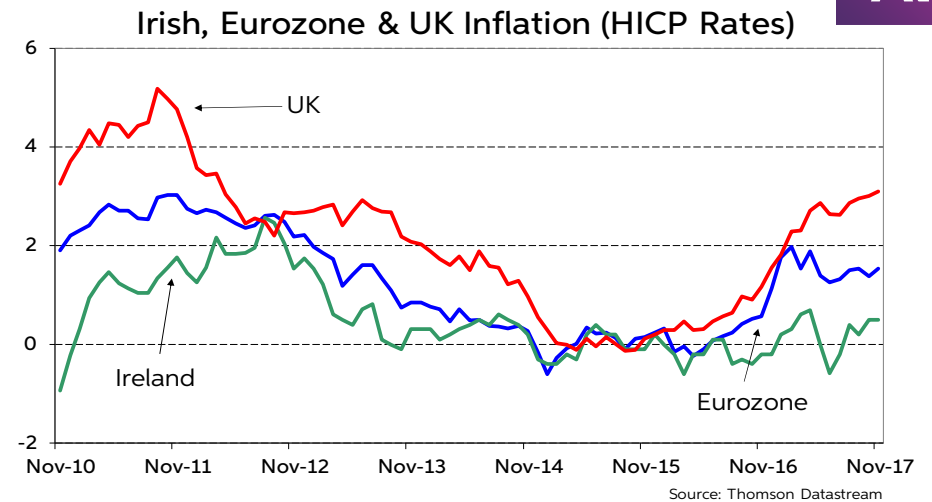


- Sufficient progress made on citizens rights, financial settlement and Irish border in Brexit negotiations in H2 2017 to move talks in 2018 on to transition arrangements and future trade
- Should be able to agree on arrangements for a circa two-year transition period post Brexit in March 2019, as UK willing to mirror EU Customs Union and abide by EU rules during this period
- Talks on a post-transition period trade deal to prove difficult as UK wants to have its own customs arrangements, do trade deals and be free to determine its own rules and regulations
- Different to normal trade deal as no trade barriers at present. Thus, EU points out that any free trade deal will be inferior to the Single Market
- EU insistent on a level playing field in any trade deal to prevent “Regulatory Dumping” e.g. workers rights, subsidy rules, production standards, environmental controls
- Disputes resolution mechanism will need to be agreed, but it will be inferior to the ECJ
- UK faces a trade-off in talks between regaining sovereignty and retaining access to EU markets
- UK appears to be moving slowly away from cliff-edge, hard Brexit, but such an event cannot be ruled out in next couple of years if UK & EU can’t agree on a broad trade deal

Strong Irish growth to continue ahead of Brexit



- Strong growth by Irish economy is continuing
- 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, including the Eurozone, is picking up momentum, helping Irish exports
- However, Brexit is a major challenge for economy
- Sharp fall in sterling impacts exports to UK, tourism from UK, Irish firms competing with UK exports
- Irish GDP growth forecast at around 6.5% for 2017 but real underlying rate put at 4% to 5%
- GDP growth generally forecast at circa 4% for 2018
- ESRI estimate long-term growth rate of economy at around 3.5% in 2016-2025 period



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2014	2015	2016	2017 (f)	2018 (f)	2019 (f)
GDP	8.3	25.6	5.1	6.5	4.0	3.5
GNP	9.0	16.3	9.6	5.0	3.5	3.0
Personal Consumption	2.0	4.2	3.3	2.2	2.7	2.5
Government Spending	4.8	1.8	5.3	2.0	2.0	2.0
Fixed Investment	18.1	27.9	61.2	-12.0	6.0	5.0
Core Fixed Investment*	13.5	10.8	13.6	-12.0	6.0	5.0
Exports	14.4	38.4	4.6	5.5	4.5	4.5
Imports	14.9	26.0	16.4	-3.2	4.0	4.0
HICP Inflation (%)	0.3	0.0	-0.2	0.3	1.0	1.3
Unemployment Rate (%)	11.3	9.5	7.9	6.2	5.2	4.7
Budget Balance (% GDP)	-3.7	-2.0	-0.7	-0.3	-0.2	-0.1
Gross General Gov Debt (% GDP)	105.3	76.9	72.8	70.0	69.0	67.0

*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
- Possibility of reduced FDI as US cuts its corporate tax rate from 35% to 21%
- Questions around Irish corporation tax regime (Apple ruling, moves on tax harmonisation in EU) could impact FDI, though Ireland retains 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 – 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.