The Irish Economic Update

Continuing Robust Growth

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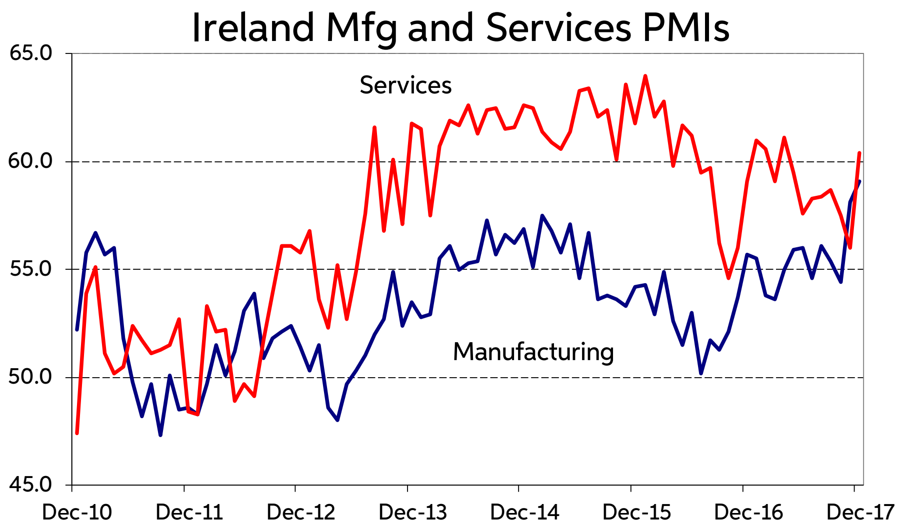
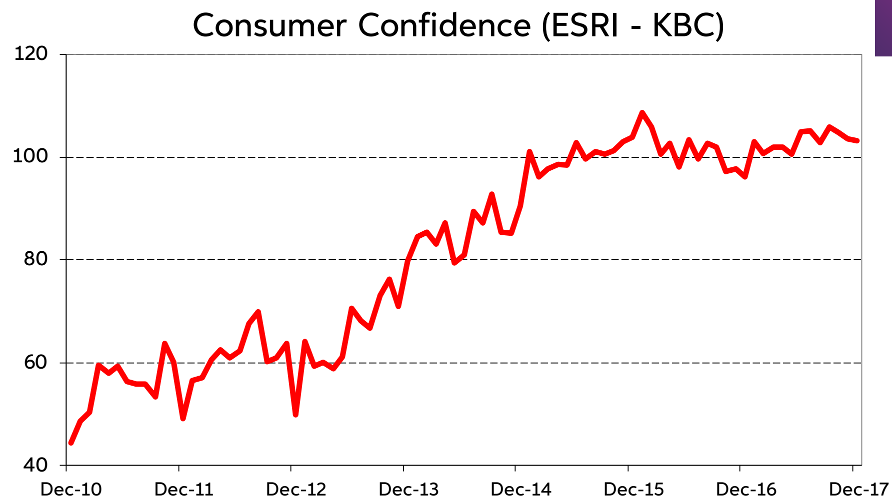
Strong recovery by Irish economy since 2013

- 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 near 6% by end 2017
- Budget deficit has declined at a quicker than expected pace. Down to 0.3% of GDP in 2017

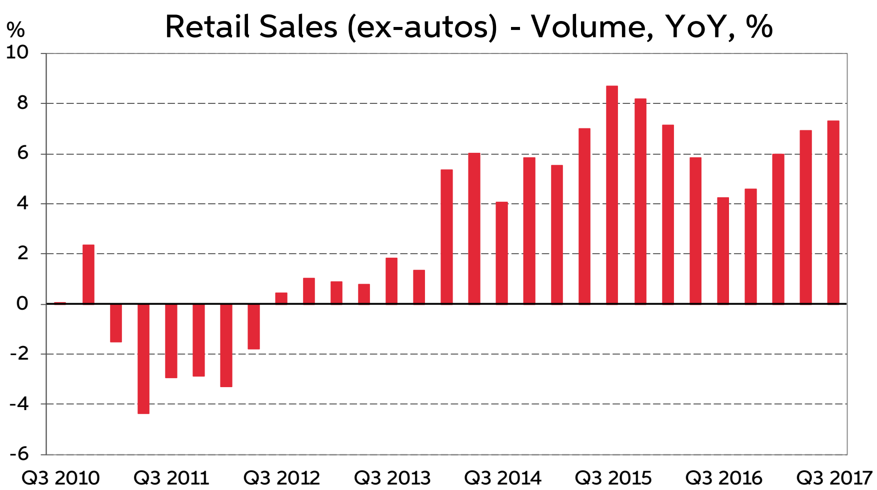
Indicators remain upbeat despite concerns over Brexit



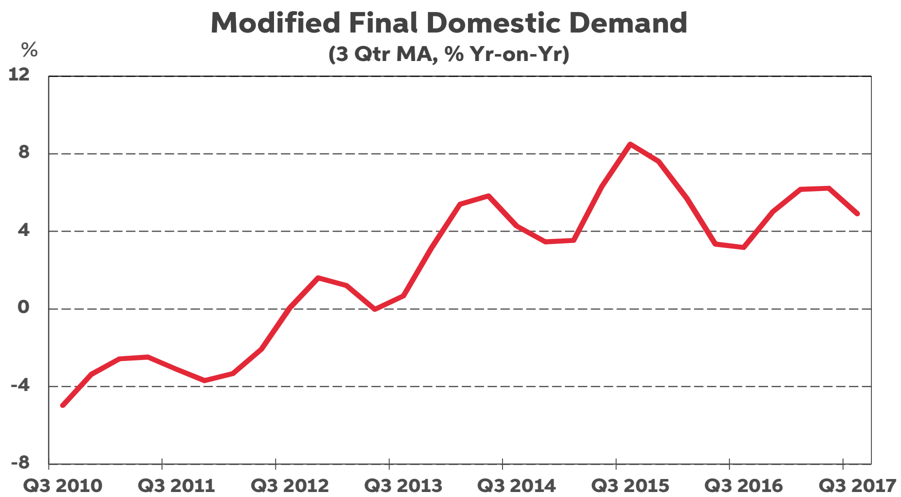
Source: *Thomson Datastream, Investec*



Source: ESRI - KBC, Thomson Datastream



Source: *Thomson Datastream*



Source: CSO, (Excludes I.P. imports & Aircraft Leasing)

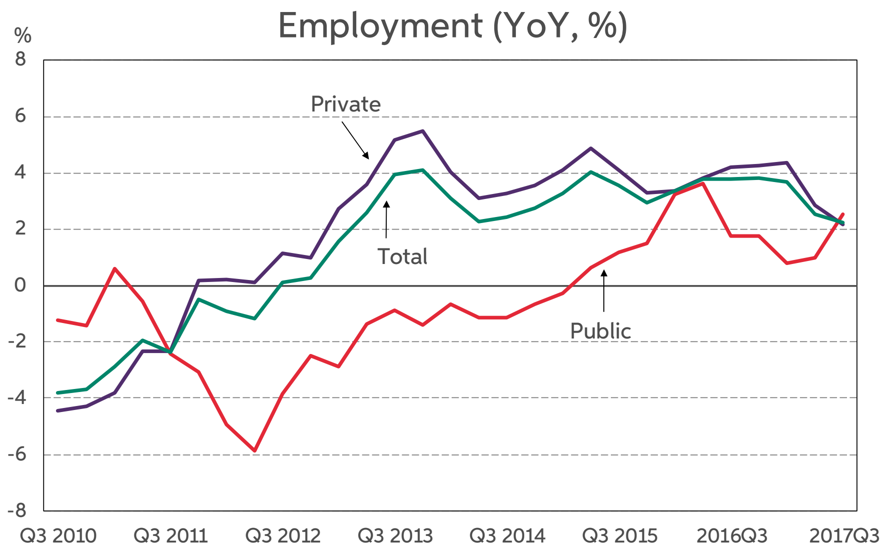
Strong growth again in 2017

- 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 58.0 in December as sector grows strongly
- Consumer confidence at very robust levels – close to 15 year high in H2 2017
- Retail sales (ex-motor trade) rose by 7% in 2017 – fourth year in a row of strong growth
- Total car regs (new + used imports) rose further 3.5% in 2017 – surged in 2014-16 period
- Housing completions (ESB connections) rose by 29% to 19,300 in 2017 after 18% increase in 2016
- Mortgage lending rising strongly – mortgage drawdowns rose by 29% in value terms in 2017
- Strong job growth continuing – employment rose by 2.8% year-on-year during Q1-Q3 2017
- Live Register continued its sharp decline in 2017. Jobless rate down to 6.2% by December 2017
- Budget deficit fell to 0.3% of GDP in 2017. Tax receipts up 6% in the year.

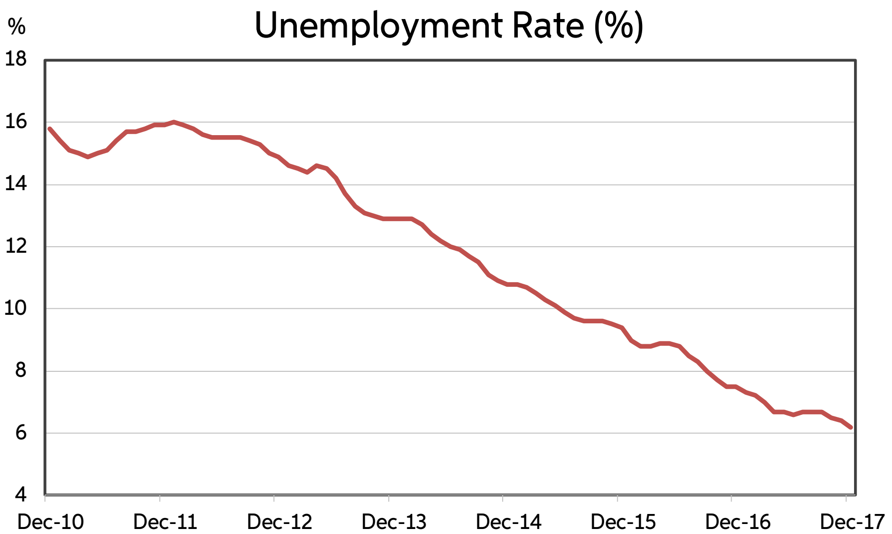
Robust jobs growth; unemployment falls sharply

Year Average	2014	2015	2016	2017(e)	2018(f)	2019(f)
Unemployment Rate %	11.9	10.0	8.4	6.7	5.8	5.2
Labour Force Growth %	0.4	1.2	1.9	0.8	1.2	1.3
Employment Growth %	2.6	3.5	3.7	2.7	2.2	1.9
Net Migration : Year to April ('000)	-8.5	5.9	16.2	19.8	25.0	30.0

Source: CSO and AIB ERU forecasts



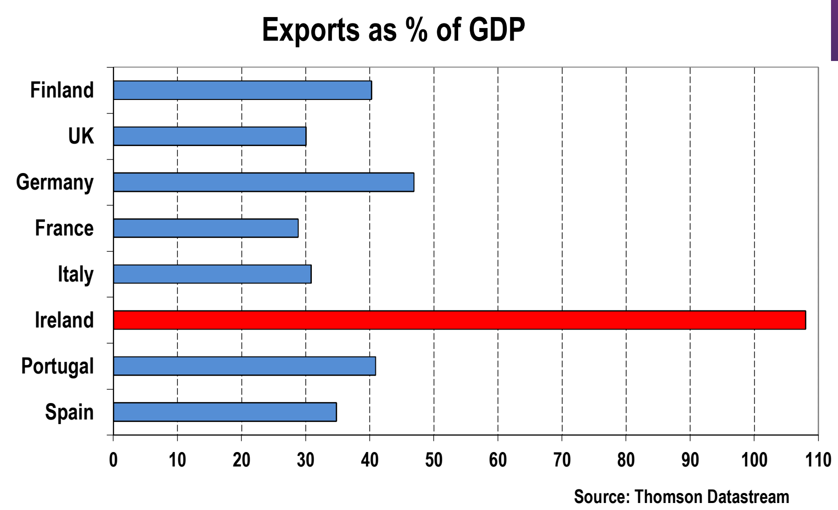
Source: *Thomson Datastream, CSO*

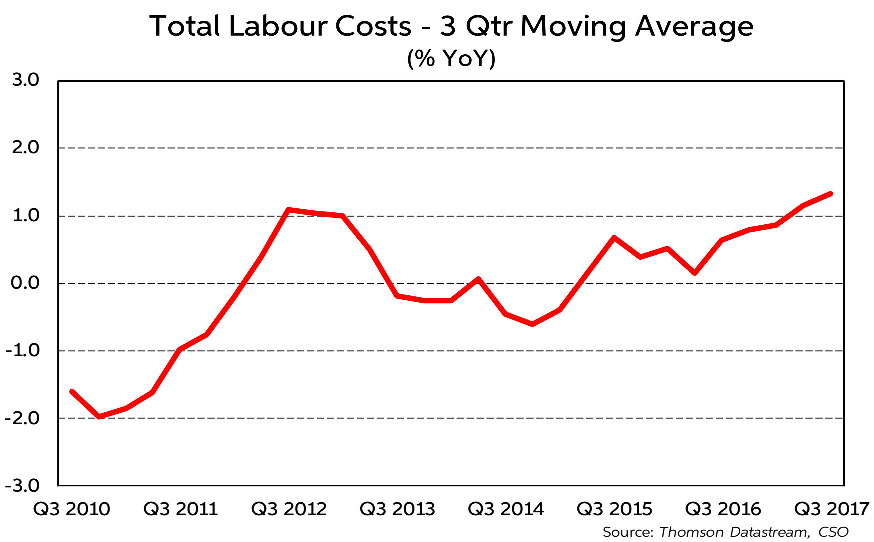


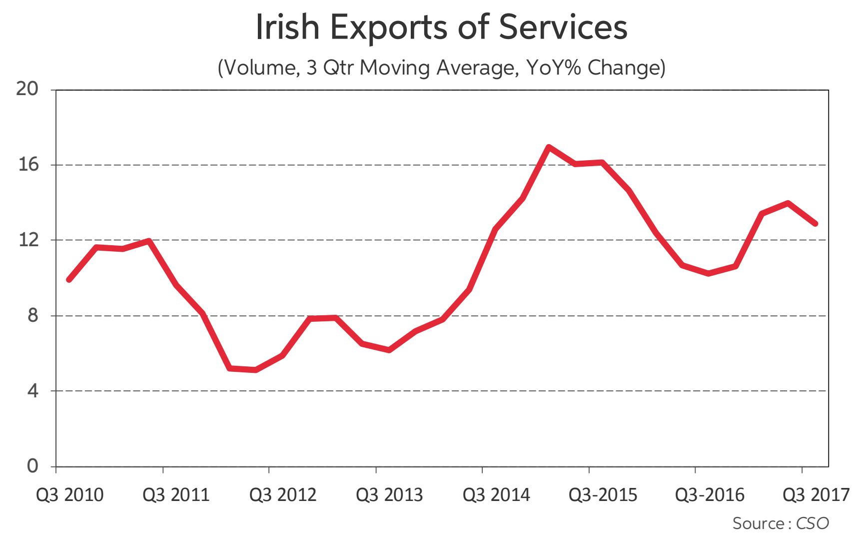
Source: Thomson Datastream

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 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

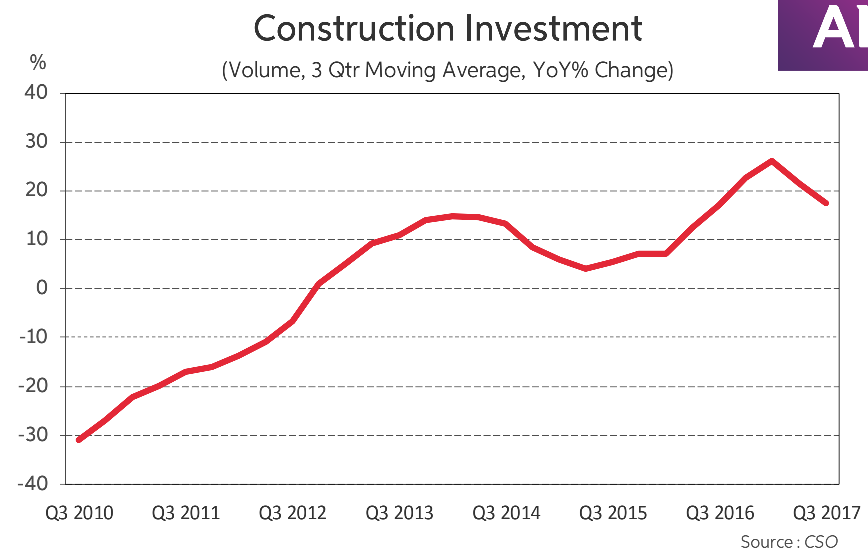
US TAX CHANGES SHOULD NOT HIT FDI

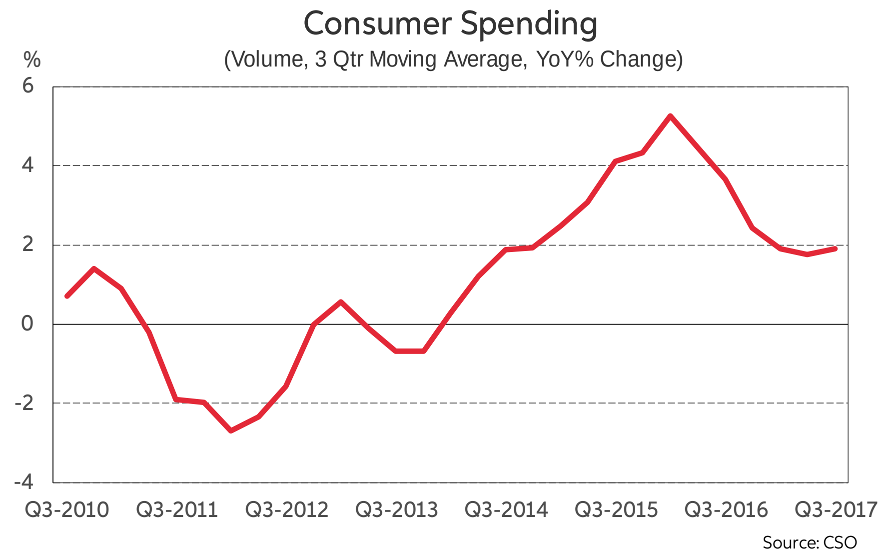
- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates

Many top global companies have big operations in Ireland

Strong recovery by domestic economy in place since 2013

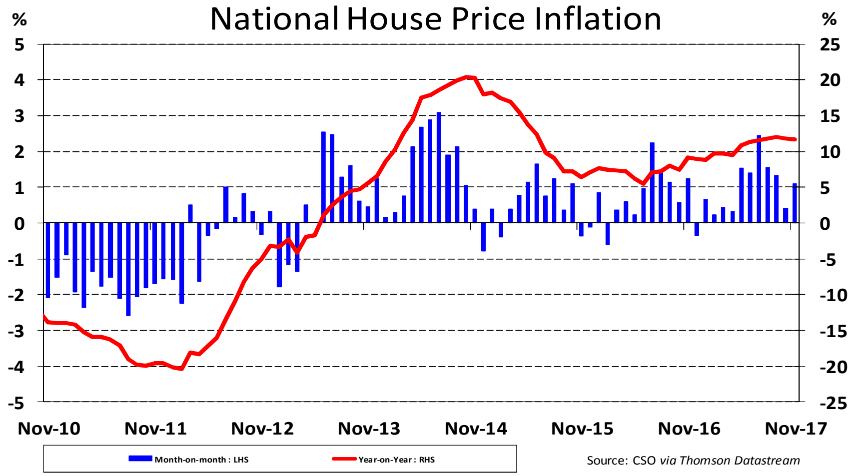
- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction has seen good recovery since 2013, with output up 15% in 2016 and 17% yoy to Q3 2017
- Core business investment (ex aircraft/intangibles) grew by average 22% in 2012-2016. Fell back 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, so growth in domestic economy slowed in 2017
- Core retail sales (i.e. ex-autos) rose strongly in 2014-16 period. Trend continued in 2017, up 7% in the year
- Total car regs (new + used imports) continue to rise, up by 3.5% in 2017 after surging in 2014-16 period

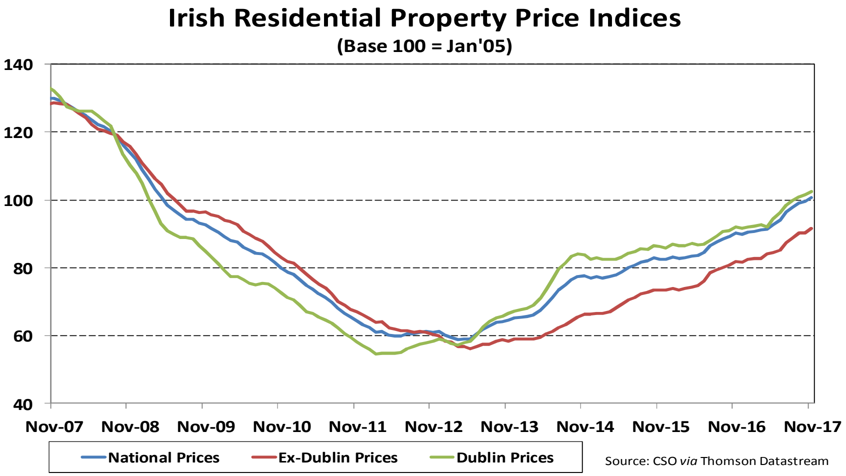




House prices rebound as big housing shortage emerges

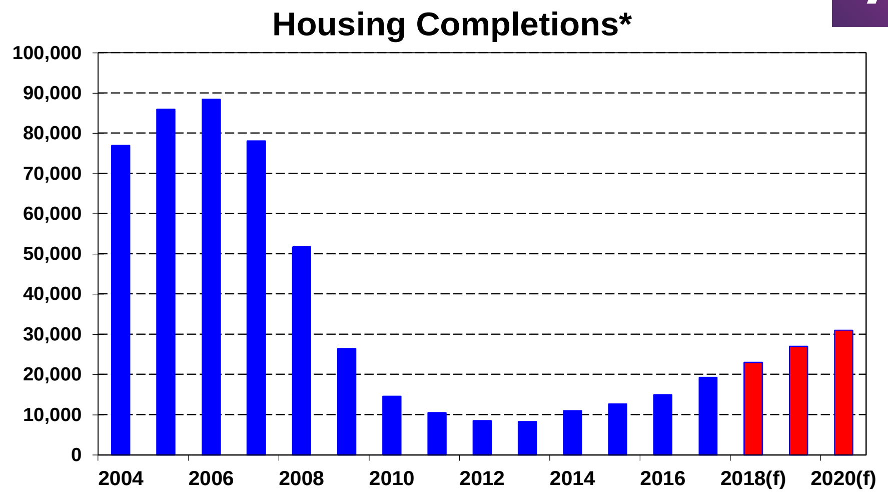
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building
- Supply overhang eliminated with little stock for sale
- Prices up 72% by Nov 2017 from low in Mar 2013
- Dublin prices up by 88% from their trough in Feb 2012, while non-Dublin prices have risen by 63%
- House prices, though, including in Dublin, are still some 23% below peak levels hit in 2007
- House price inflation picked up in 2017
- Prices up 11.6% yoy nationally in Nov 2017. Dublin up 11.3%, with non-Dublin rising 11.7% yoy
- Rents have also rebounded strongly – now 18.5 % above previous peak reached in 2008 per CSO data



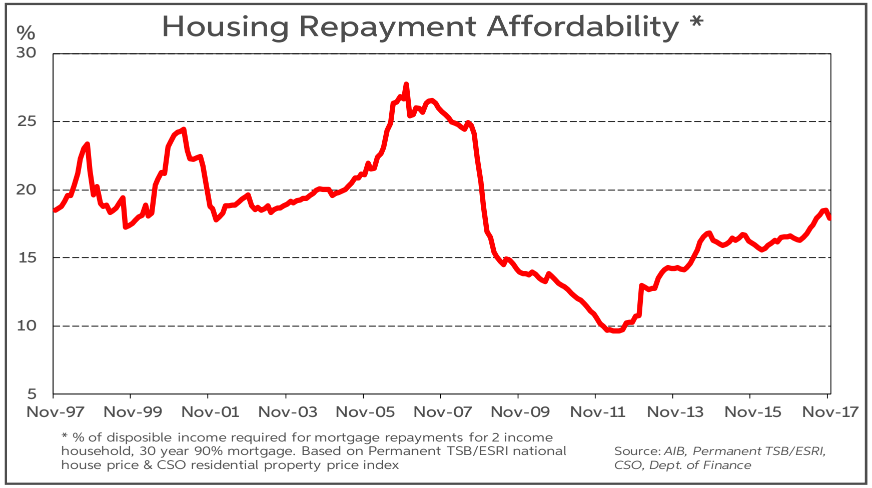


House building rising slowly from very low levels

- Housing completions (new electricity connections) at 12,700 in 2015, 11,000 in 2014 and 8,300 in 2013
- Completions rose to 15,000 units in 2016 and then increased by 29% to 19,300 in 2017
- Output still running well below annual new housing 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 somewhat, while tax rebate introduced to help fund deposits for FTB
- Mortgage lending picks up again after slowing on new CB rules in 2015 – rose by 29% in 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



*Source: CSO; DoEHLG and AIB ERU. *(Based on new connections to electricity network)*



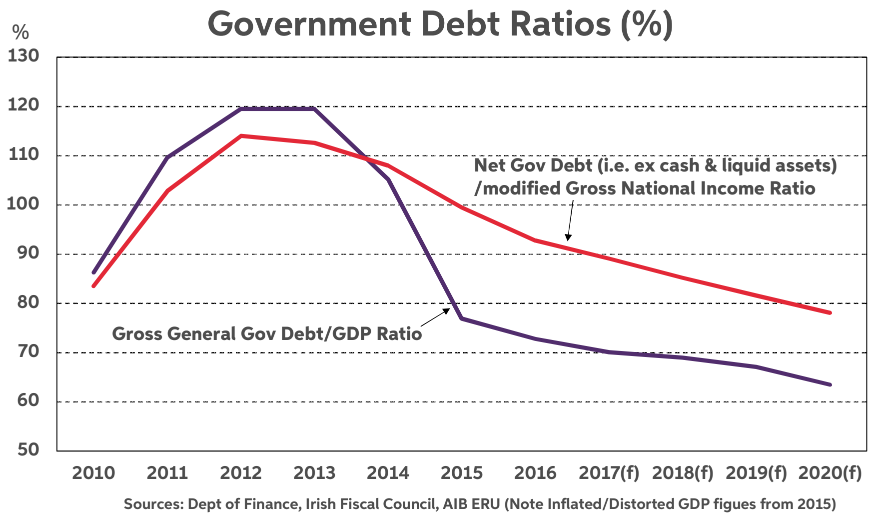
AIB Model of Estimated Housing Demand

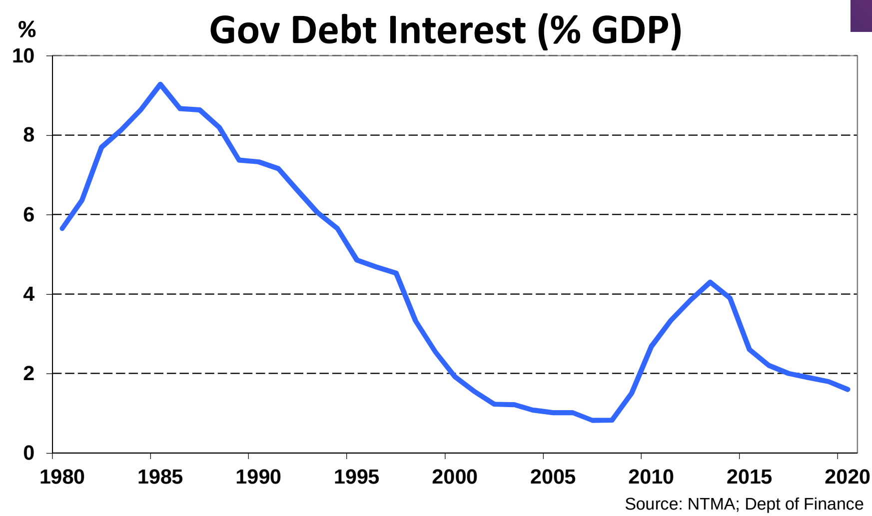
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – 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

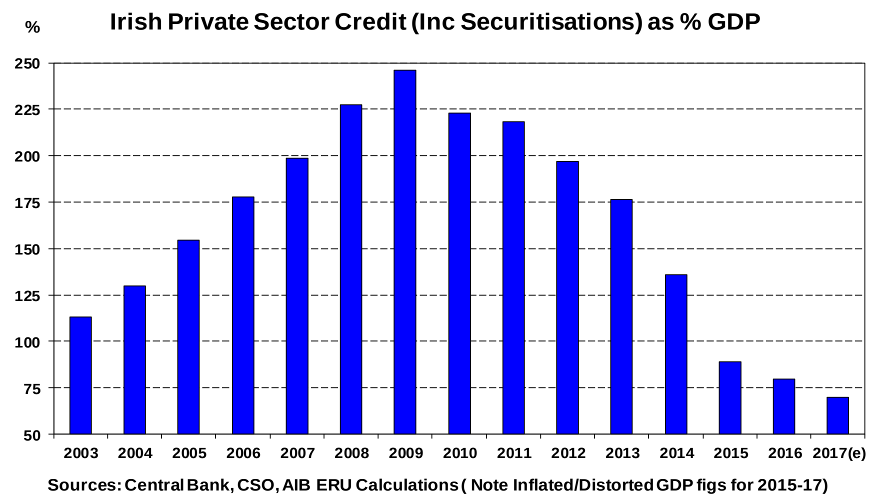
Calendar Year	2016	2017	2018	2019	2020
Household Formation	26,500	26,500	26,500	27,500	27,500
of which					
Indigenous Population Growth	*18,000*	*18,000*	*17,000*	*16,500*	*14,500*
Migration Flows	*8,500*	*8,500*	*9,500*	*11,000*	*13,000*
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	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 (ESB)	**15,000**	**19,300**	**23,000**	**27,000**	**31,000**
Shortfall in Supply	***-17,000***	***-12,700***	***-9,000***	***-6,000***	***-2,000***

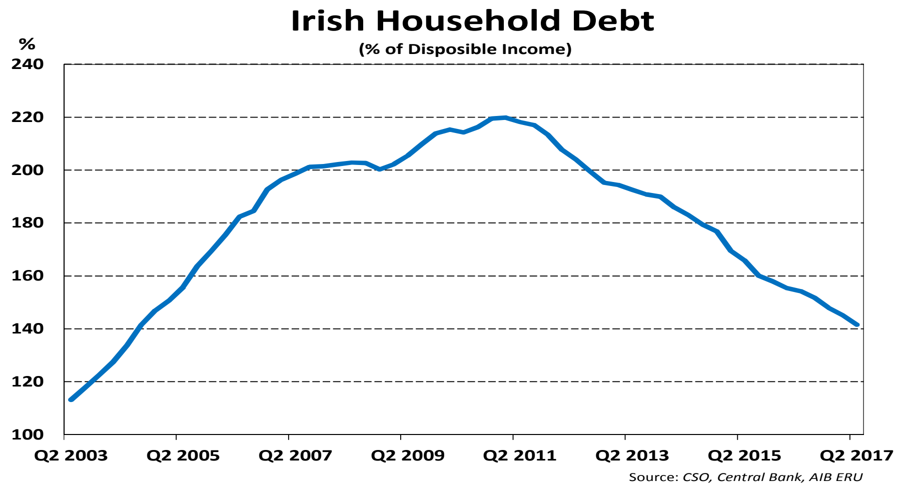
**Headship is % of population that are heads of households.* *Sources: CSO, DoECLG, AIB ERU*

Govt debt ratios fall, private sector deleverages



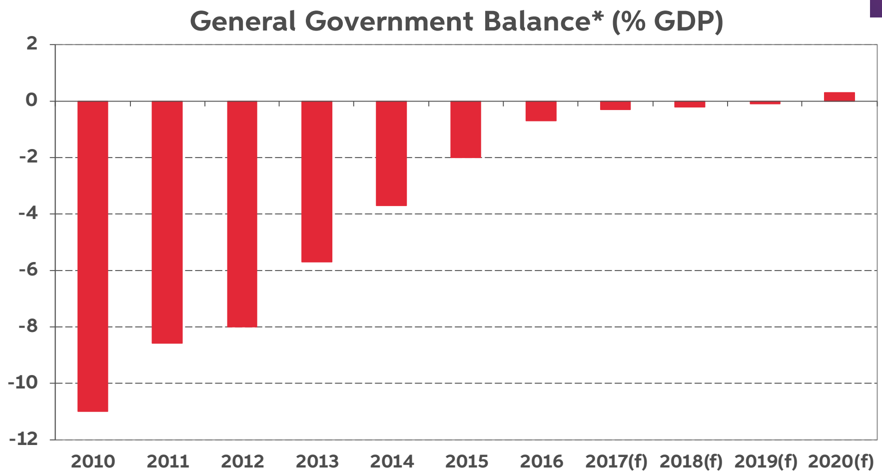






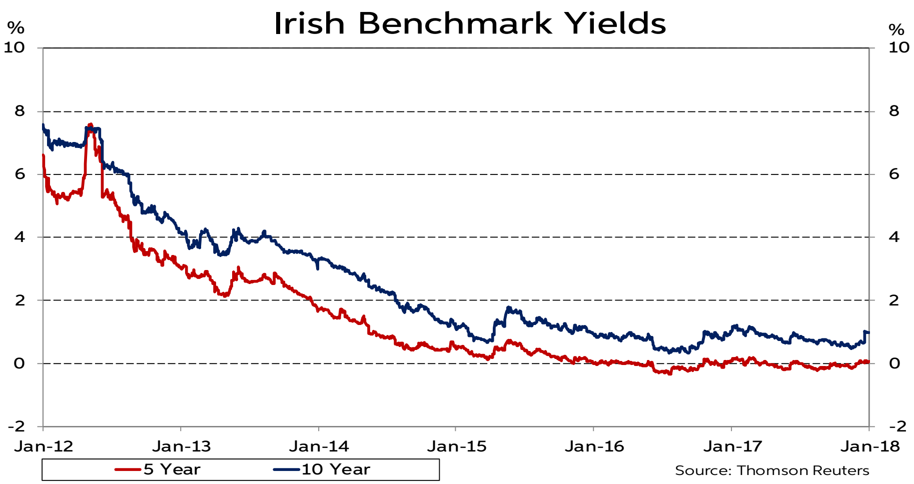
Budget deficit falls sharply – now close to balance

- 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 surplus (i.e. excluding debt interest) 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



*Excludes banking recapitalisation costs in 2010-11

Source : Dept of Finance



Source: Thomson Reuters

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

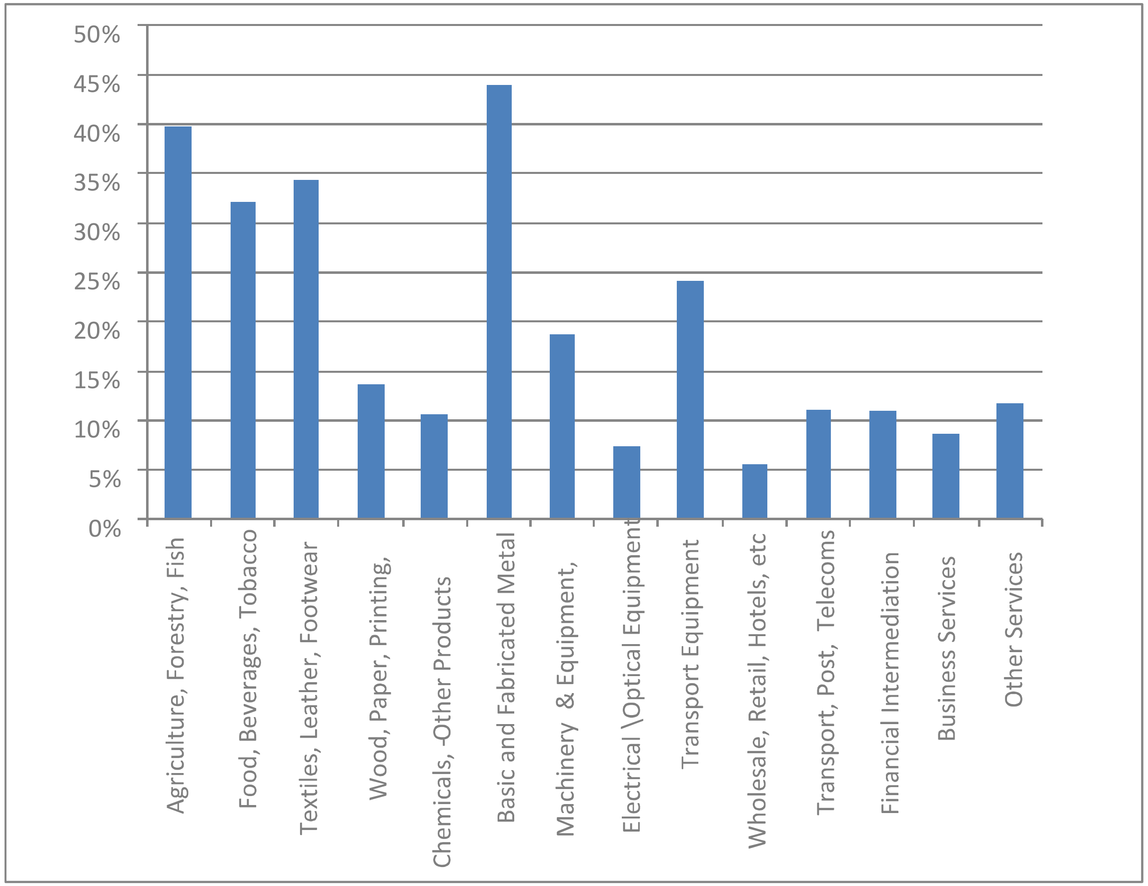
- Sterling has fallen sharply on Brexit concerns, which hits **exports to UK**
- Impacts Irish firms **competing with UK exports** to Ireland and elsewhere
- Many Irish exporters are small firms with no Treasury function so don't hedge currency exposure
- **Cross border trade** picks up as shoppers head 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

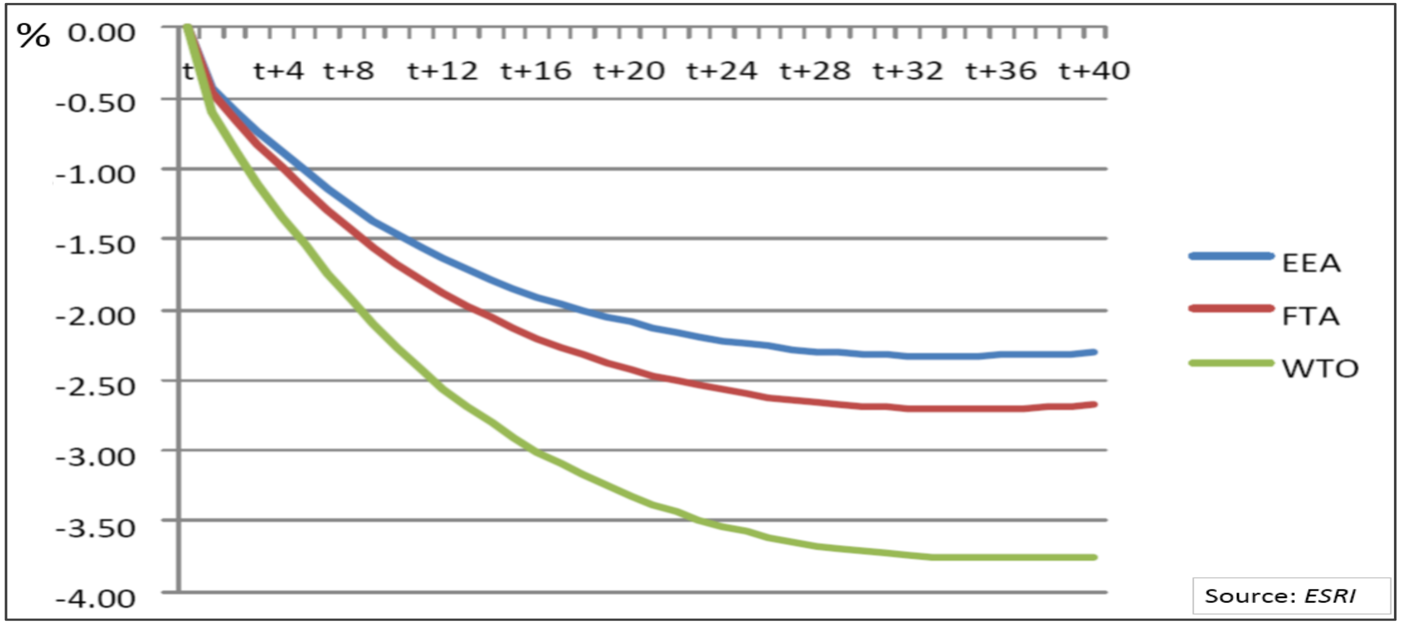
- Main EU tariffs relate to food products, keeping prices up. UK may not maintain these post-Brexit
- Food and Beverages account for 25% of total Irish exports to UK
- Around 40% of Irish food exports go to the UK
- Other sectors very dependent on UK market include machinery and transport, metal products, 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 citizenship 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 Brexit issue

- 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 exits
- 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 don't want hard border - agreed on this in Phase 1 of Brexit negotiations, but would prove difficult to avoid if UK has its own tariffs
- Period of uncertainty could last until end 2020/early 2021 when it is hoped to conclude an EU/UK free trade deal that will determine future trade relationship

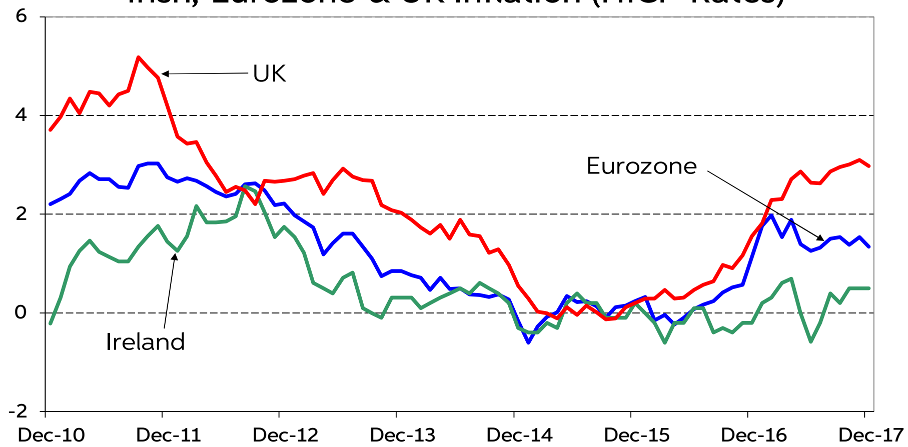
Talks on trade to determine shape of Brexit

- Aim is to agree arrangements by this March for a circa two-year transition period post Brexit. UK will have to continue to abide by EU rules during this period
- Talks on a post-transition period trade deal to prove difficult as UK wants separate customs arrangements, negotiate trade deals and have its own rules and regulations
- Different to usual trade talks as no trade barriers at present. Thus, EU points out that any free trade deal for UK will be inferior to the Single Market
- EU insistent on a level playing field in any trade deal to prevent "Regulatory Dumping" e.g. similar 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 Single Market
- The more UK moves away from EU rules, the less access it will have to Single Market

Strong Irish growth to continue ahead of Brexit

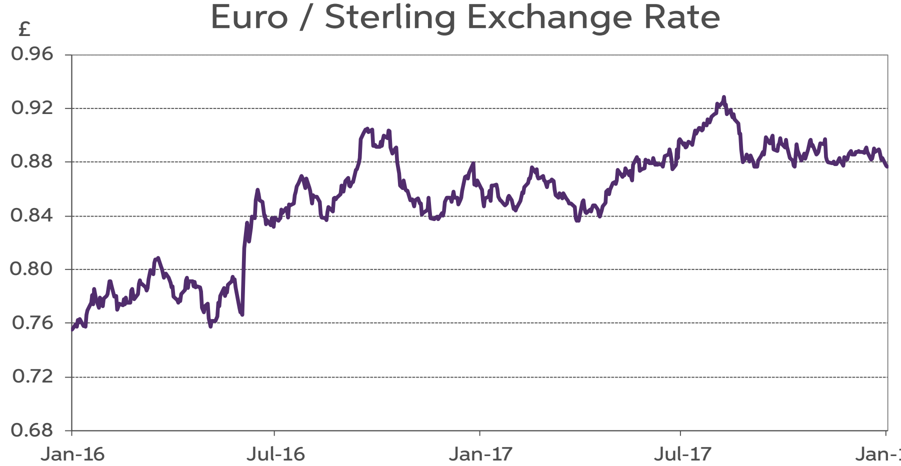
- Strong growth by Irish economy is continuing
- Construction picking up from still low output levels
- Budgetary policy turns mildly expansionary
- Activity supported by low interest rate environment
- FDI strong despite concerns on corporate tax
- Very low Irish inflation, well below that of the Eurozone 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 underling 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

Irish, Eurozone & UK Inflation (HICP Rates)



Source: Thomson Datastream

Euro / Sterling Exchange Rate



Source: Thomson Datastream

AIB Irish Economic Forecasts

% change in real terms unless stated	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	0.2	0.8	1.2
Unemployment Rate (%)	11.9	10.0	8.4	6.7	5.8	5.2
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