



The Irish Economic Update

Economy Continues To Perform Well Despite Concerns Over Brexit

July 2017

Oliver Mangan
Chief Economist
AIB

Strong recovery by Irish economy since 2013

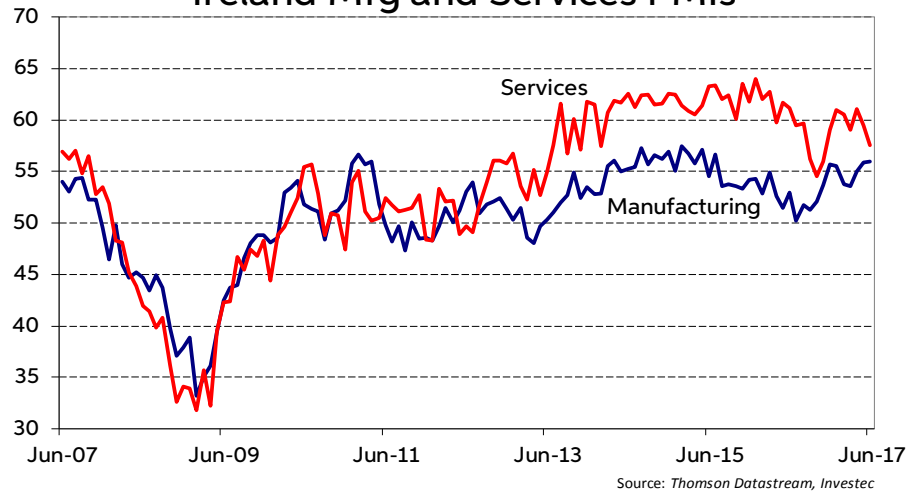


- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8% and GNP down 10%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance programme from 2010-2013
- GDP at end of 2008-09 recession 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 in 2013-16 period. Strong uptrend continues in 2017
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Strong jobs growth. Unemployment rate fell from 15% in 2012 to 6.3% by mid-2017
- Budget deficit has declined at quicker than expected pace. At just 0.5% of GDP in 2016

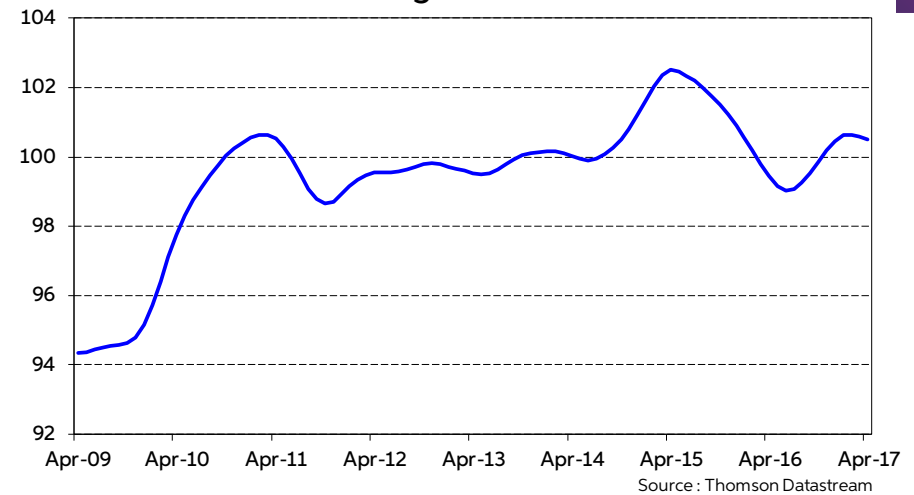
Indicators remain upbeat despite concerns over Brexit



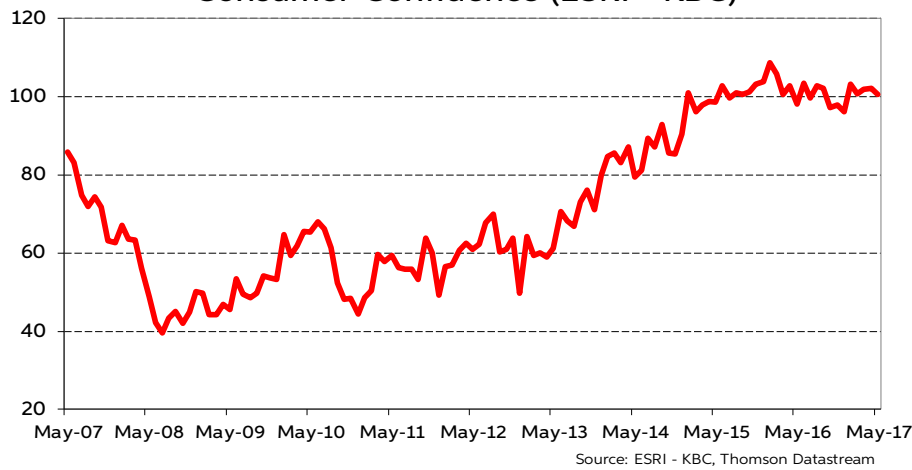
Ireland Mfg and Services PMIs



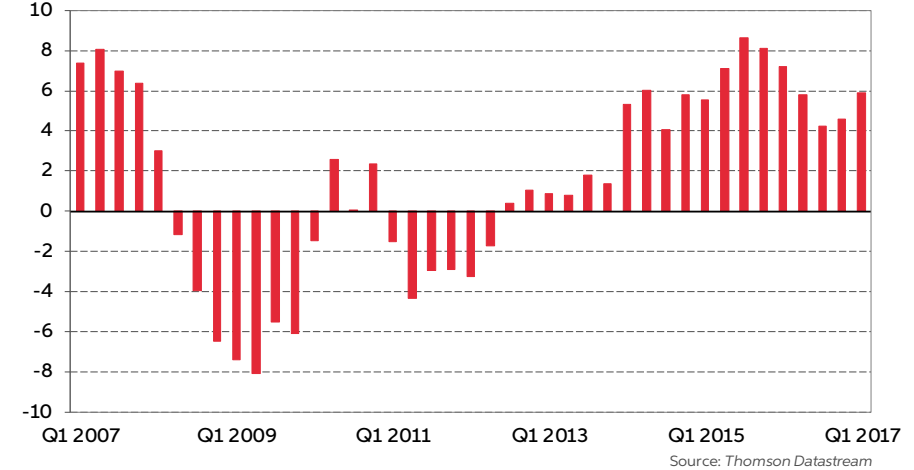
OECD Leading Indicator - Ireland



Consumer Confidence (ESRI - KBC)



Irish Retail Sales (ex-autos) - Volume, YoY, %



Strong growth continues in H1 2017



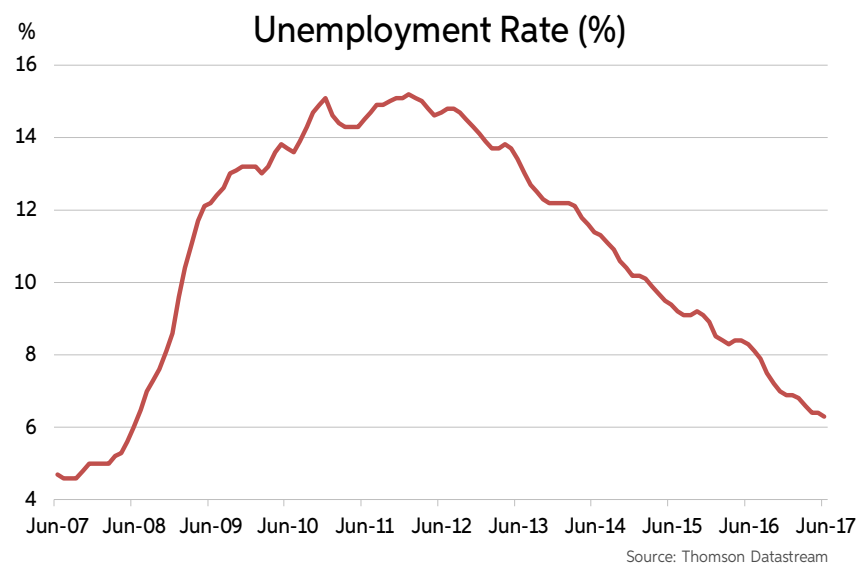
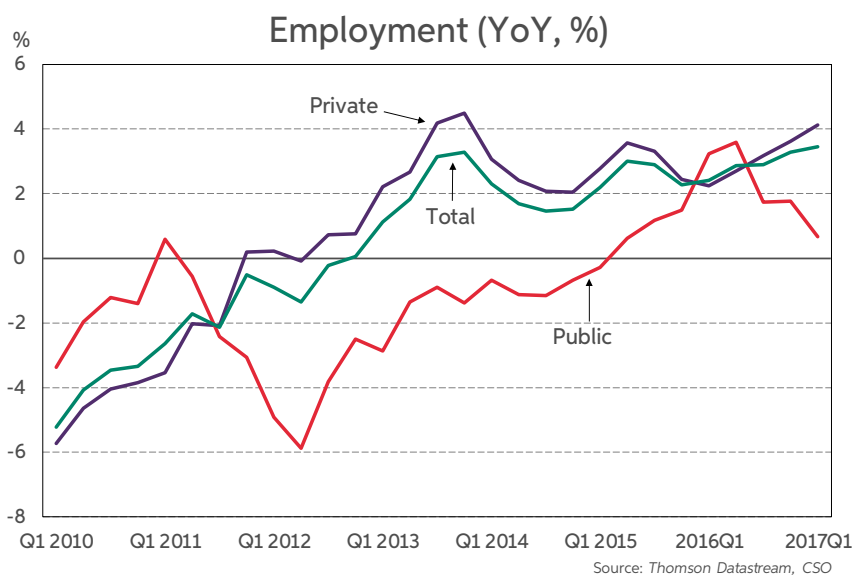
- Robust GDP growth of 5.2% in 2016. Growth looks to have remained strong in H1 2017
- Mfg PMI weakened after Brexit vote before rebounding strongly. At 56 in June, a 23-month high
- Strong rebound by services PMI after marked decline on Brexit vote. Averaged 59.4 in Q2
- Construction PMI averaged 58.1 in Q1 2017. Jumped to 63.6 in May
- OECD leading indicator index for Ireland hits 16-month highs in spring 2017
- Consumer confidence at very strong levels – close to 15 year high in H1 2017
- Retail sales (ex-motor trade) up by 1.7% in April/May versus Q1. Up 6.4% yoy in Jan-May 2017
- Total car regs (new + used imports) up 2% yoy in Jan-May 2017 – surged in 2014-16 period
- Housing completions rose 24% yoy in Q1 2017, after 18% increase in 2016
- Mortgage lending rising strongly – mortgage drawdowns up 26% yoy in Q1 2017
- Strong employment growth continuing – rose by 3.5% year-on-year in Q1 2017
- Live Register continues its sharp decline in 2017. Jobless rate down to 6.3% in June
- Budget deficit on target at end June 2017 – down to €0.5bn in H1 2017 from €1.1bn a year earlier

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	6.3	5.3	4.8
Labour Force Growth %	-0.3	0.5	1.2	1.3	1.5	1.6
Employment Growth %	1.7	2.6	2.9	3.1	2.5	2.2
Net Migration : Year to April ('000)*	-5.0	5.0	10.0	15.0	20.0	25.0

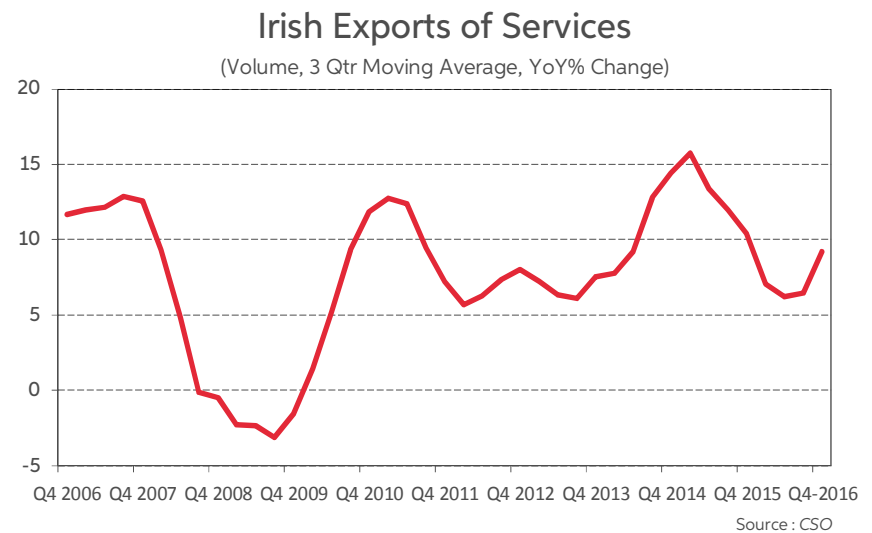
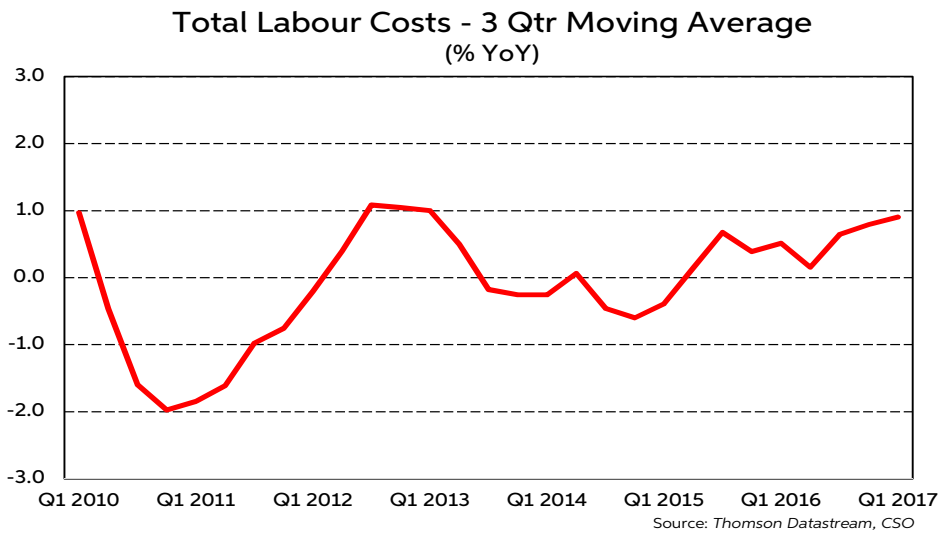
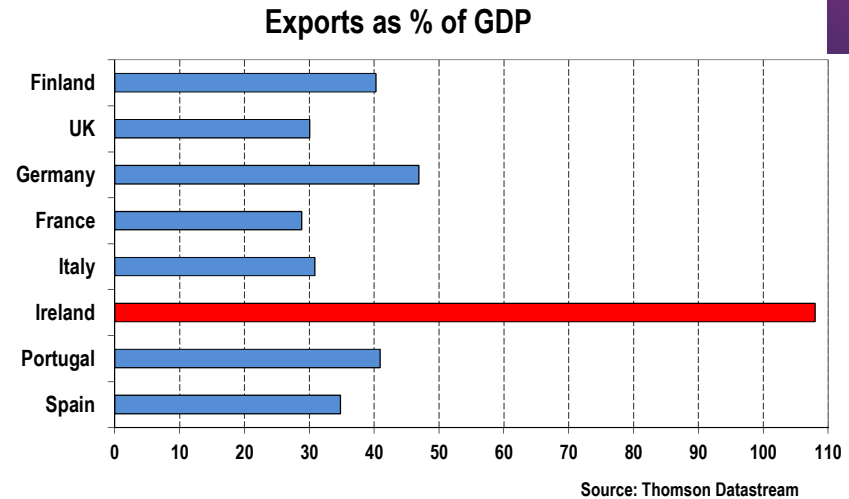
Source: CSO and AIB ERU forecasts *AIB estimates for migration. CSO will publish updated annual migration figures later this year based on Census 2016



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 but service exports rose 11.5% yoy in H2 2016



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

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
- Risk of protectionism means need bases abroad
- No certainty about future US tax policy
- But Republicans border tax plan could hit FDI

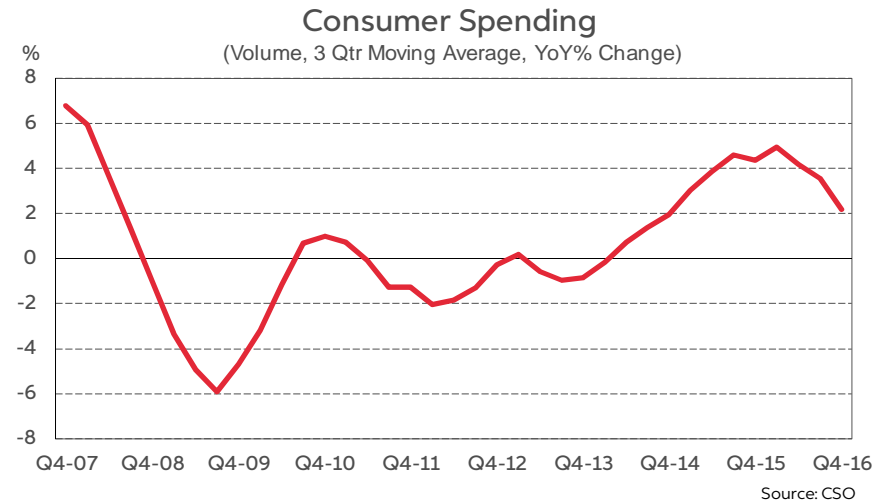
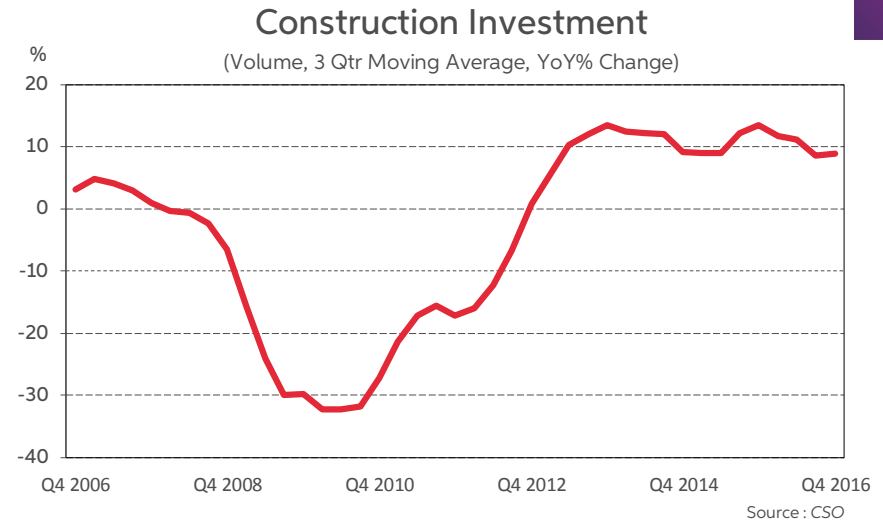
Many top global companies have big operations in Ireland



Strong recovery by domestic economy in place since 2013

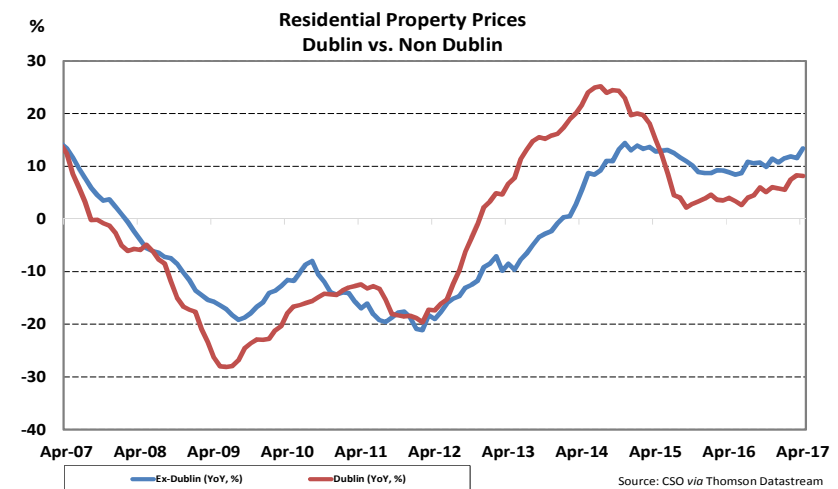
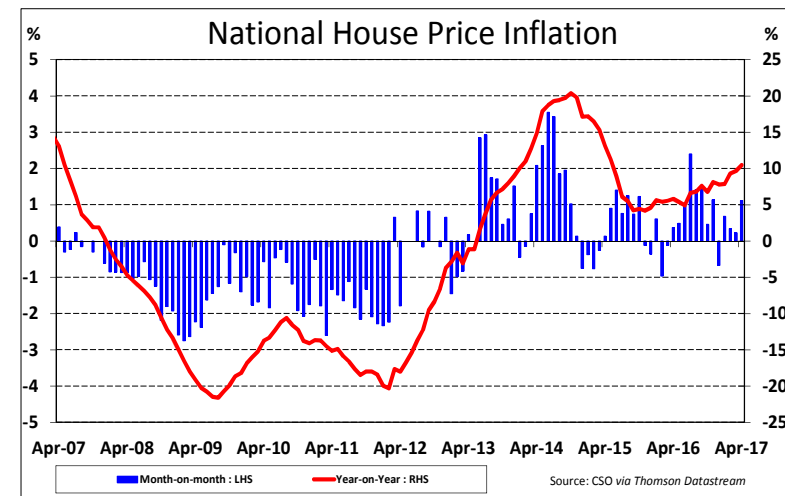


- Domestic economy contracted by 20% in period from 2008-2012 with particularly big fall in construction
- Construction has seen steady growth since 2013 of circa 10% per annum
- Business investment (ex aircraft/intangibles) more than doubled in 2013-2015 but fell back in 2016
- Consumer spending grew by 1.7% in 2014, 4.5% in 2015 and 3.0% in 2016
- Core domestic spending (ex aircraft/intangibles) averaged growth of 4.4% in 2013-2015
- Slower growth in core domestic spending in 2016
- Core retail sales rose strongly in 2014-16 period. Trend continuing – up 6.4% yoy in Jan-May 2017
- Total car regs continue uptrend in 2017 (+2% yoy)



House prices rebound as big housing shortage emerges

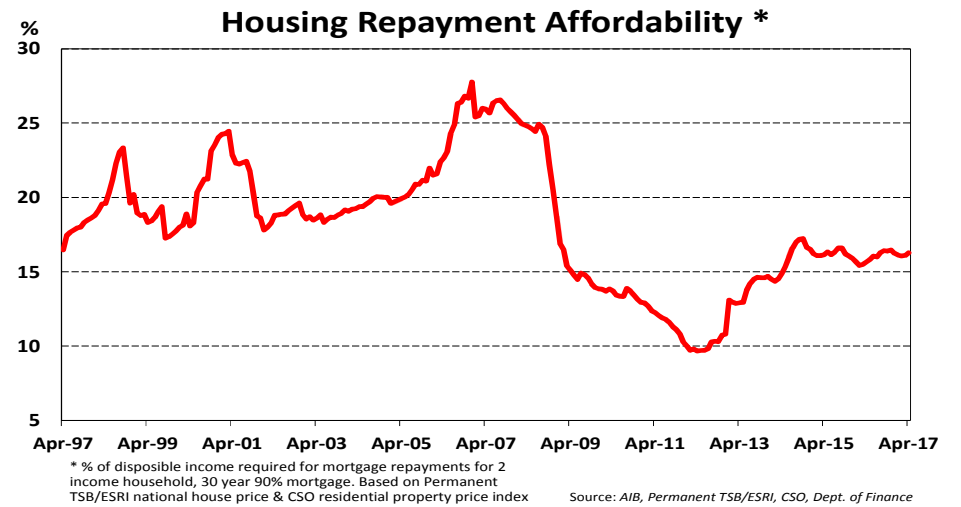
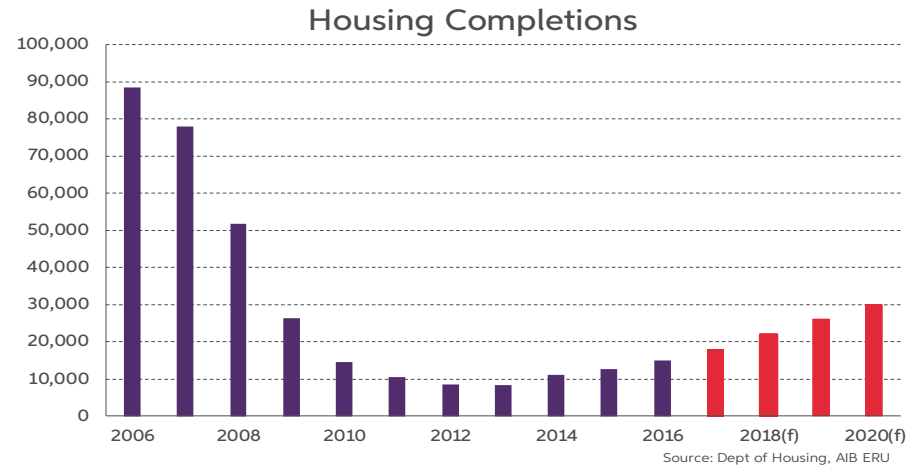
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices then rebounded as big housing shortage emerged after 90% fall in house building
- Supply overhang eliminated with little stock for sale
- Prices up 52% by April 2017 from low in early 2013
- Dublin prices up by 68% from trough, while non-Dublin prices have risen by 49%
- House prices, though, including in Dublin, are still more than 30% below peak levels hit in 2007
- Central Bank mortgage rules cooled Dublin house price inflation – fell from 25% to below 3% in 2015
- House prices inflation has picked up again. Prices up 10.5% yoy nationally in April 2017. Dublin up 8.2%, with non-Dublin prices rising 13.4% yoy
- Rents have also rebounded strongly – now 14 % above previous peak reached in 2008



House building rising only 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 24% yoy in Q1 in Q1 2017.
- Completion should reach 18,000-19,00 in 2017 but annual demand estimated at circa 30,000 units
- Measures being put in place to boost new house building. More Local Authority and NAMA building
- Central bank lending rules relaxed while tax rebate introduced in budget to help fund deposits for FTB
- Mortgage lending has picked up again after slowing on introduction of CB rules in 2015
- Housing affordability helped by low mortgage rates
- However, could be 2020 before housing output rises to 30,000 units – 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 on demand of circa 10,000 p.a.
- Assume no change in headship in 2016-2020 – note long-term trend is upwards, adding to demand
- Pent-up demand also builds 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 or demand being reduced by fall in headship rate. Both factors very evident in 2011-16 period

Calendar Year	2016	2017	2018	2019	2020
Household Formation	24,000	24,000	24,500	25,500	26,000
<i>of which</i>					
Indigenous Population Growth	19,500	18,000	17,000	16,500	15,500
Migration Flows	4,500	6,000	7,500	9,000	10,500
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	29,500	29,500	30,000	31,000	31,500
Completions	15,000	18,500	22,000	26,000	30,000
Shortfall in Supply	-14,500	-11,000	-8,000	-5,000	-1,500

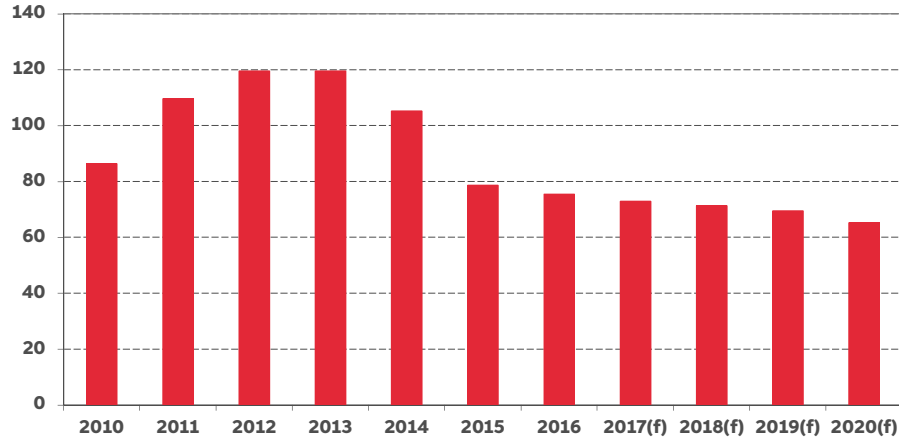
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU

Govt debt ratio falls, private sector deleverages

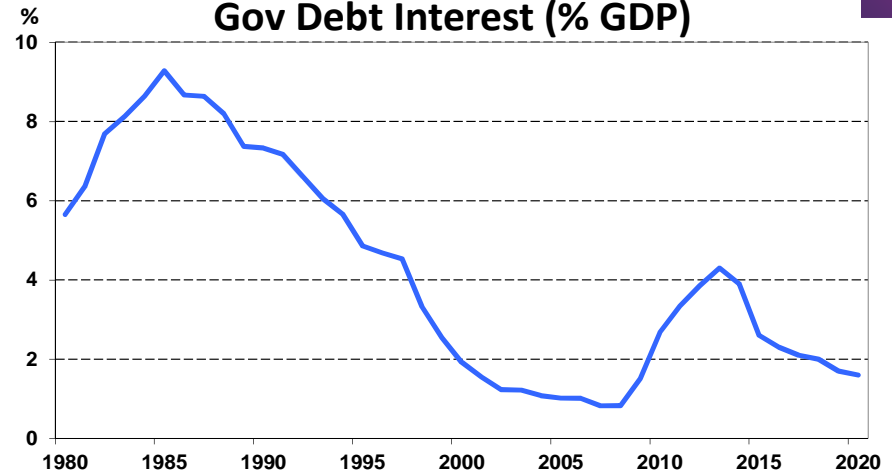


Gross Gen Gov Debt (% GDP)



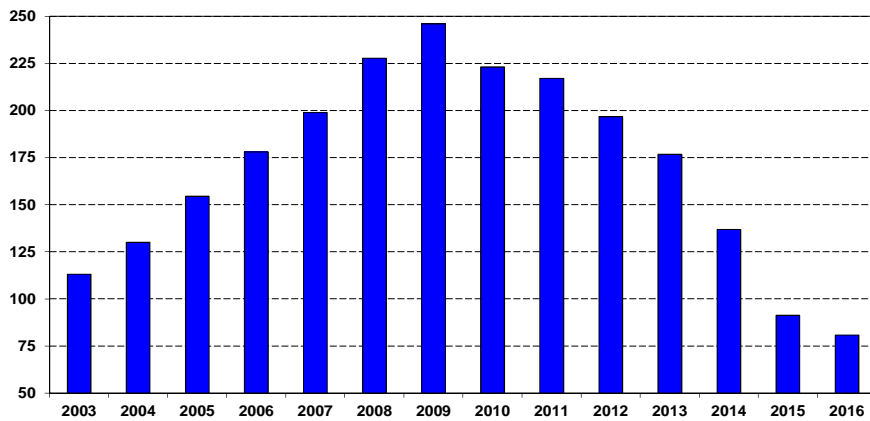
Source: Dept of Finance. (Note Inflated/Distorted GDP figures from 2015)

Gov Debt Interest (% GDP)



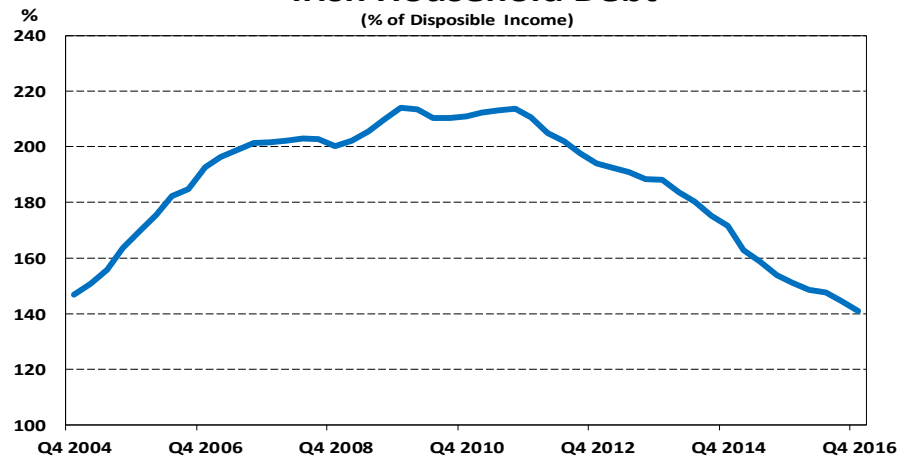
Source: NTMA; Dept of Finance

Irish Private Sector Credit (Inc Securitisations) as % GDP



Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figs in 2015/16)

Irish Household Debt (% of Disposable Income)

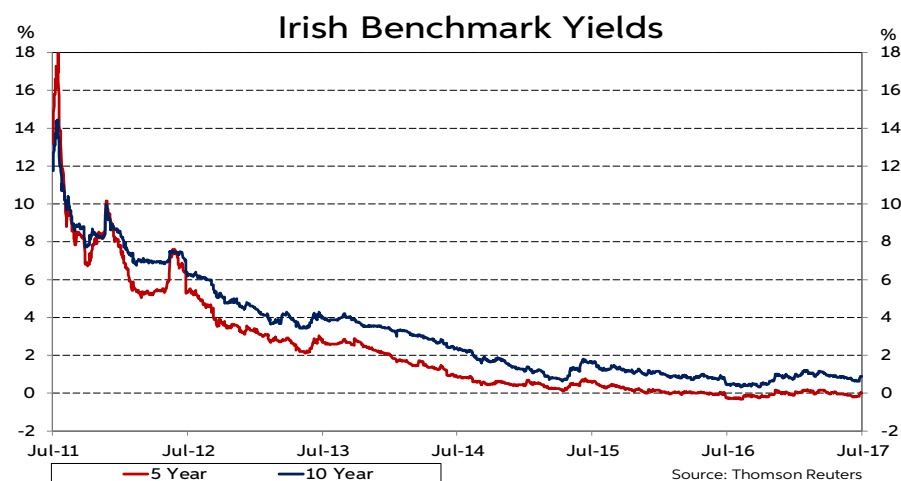
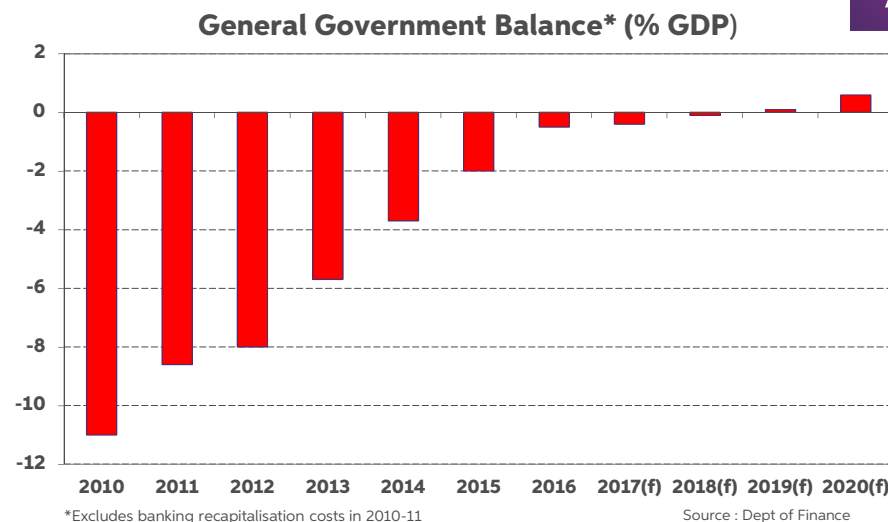


Source: CSO, Central Bank, AIB ERU

Budget deficit falls sharply – now close to balance



- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit falls sharply to very low levels - down to 0.5% of GDP in 2016.
- Public finances close to target to date in 2017 – taxes and spending close to schedule at end June, with deficit €0.6bn lower than last year
- Budget deficit forecast at 0.1% of GDP for 2018
- Primary budget (i.e. excluding debt interest) surplus of 1.8% of GDP in 2016
- 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 A3



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 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 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 would be impacted by a hard Brexit



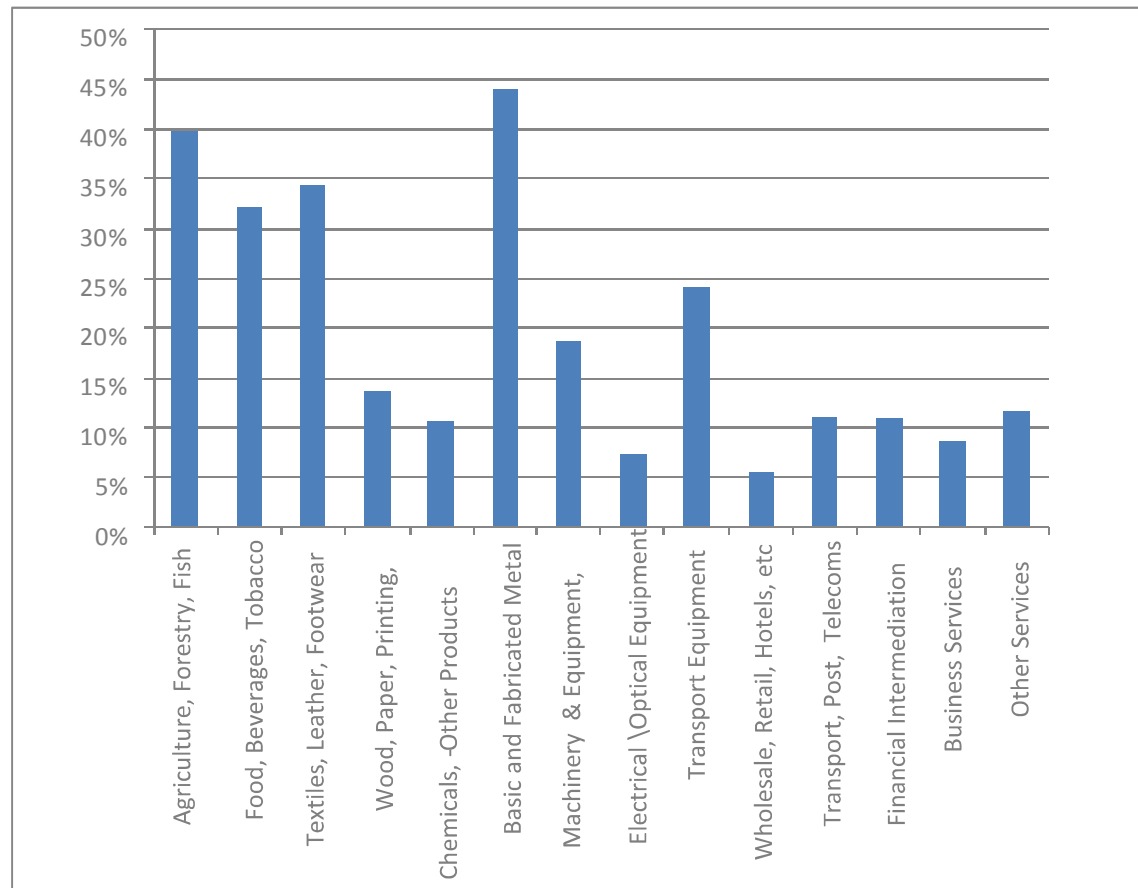
- Unclear what trade arrangements will be put in place between EU and UK post Brexit
- UK to leave Single Market and possibly Customs Union – does not want common external tariffs
- Ireland and UK want to preserve common travel area but need will EU agreement on this
- Very unlikely to see a full EU-UK trade deal concluded before Brexit
- Exit deal will need to contain transition arrangements on trade to avoid economic disruption
- Leaving the Customs Union and Single Market makes this more difficult to achieve
- Worst outcome is if UK has 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 and increased costs from non-tariff barriers like rules of origin, production standards, licenses etc
- Both UK and EU say they want to avoid this and reach an agreement of future trade relationship
- Brexit likely to have impact on the border with Northern Ireland. Gov does not want hard border
- Main upside is that Brexit would make Ireland more attractive for FDI vis-à-vis the UK
- Hard Brexit in 2019, with no deal on trade, would depress Irish growth

Agri-sector would be severely impacted by hard Brexit



- Main EU tariffs relate to food products. 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

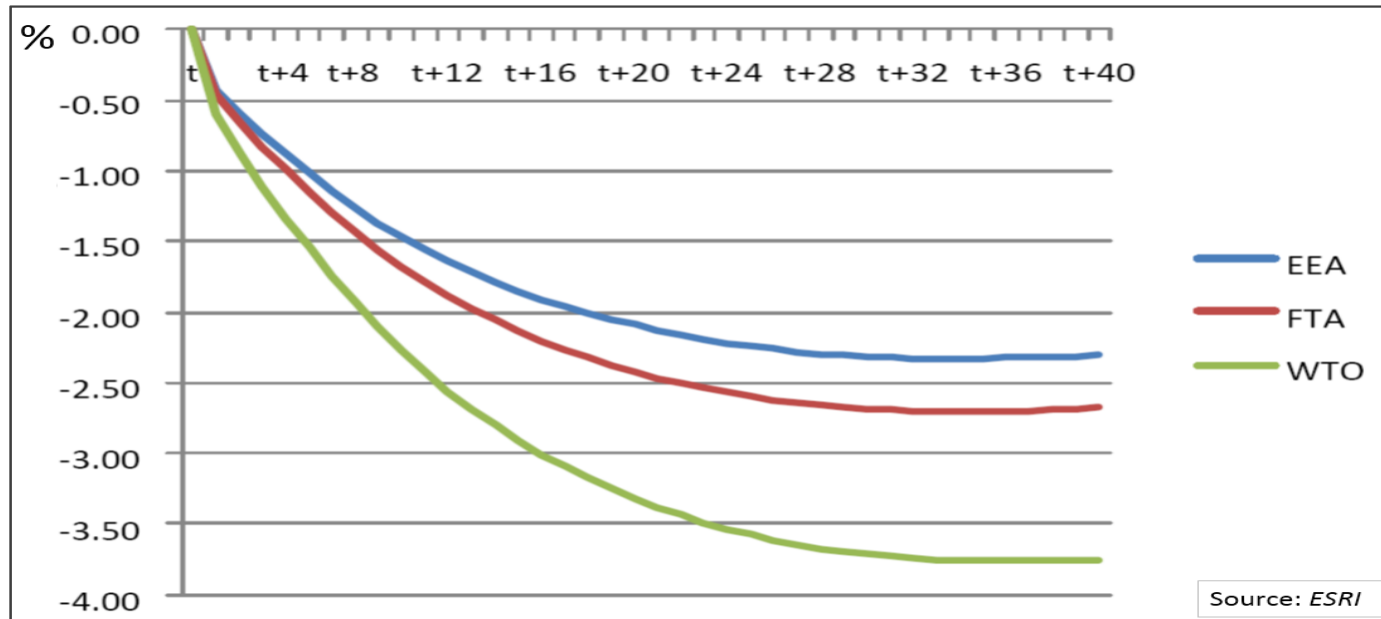
Share of Exports by Industry Destined for the UK (ESRI)



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 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 rate nearly 2% higher

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 the exit deal 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

Possible Exit Negotiations Timeline



The Withdrawal Terms (June-December 2017)

Some key issues

- Disentangling past ties/commitments
- Budget discussions on the Exit Bill the UK faces
- Citizen Rights -4m EU/UK migrants, preserving their rights, how to enforce it
- Ireland/NI, type of border, Irish citizens in NI, provision to allow NI re-join EU if United Ireland

Future Relationship (January – June 2018)

Some key issues

- Scope of discussions on future relations – trade, security etc
- Sketch aims for post-Brexit FTA
- Different to normal trade deal as no trade barriers at present
- Level playing field- prevent “Regulatory Dumping” e.g. workers rights, subsidy rules
- Extent of market access to be maintained
- Disputes resolution mechanism

Transition Arrangements (July-November 2018)

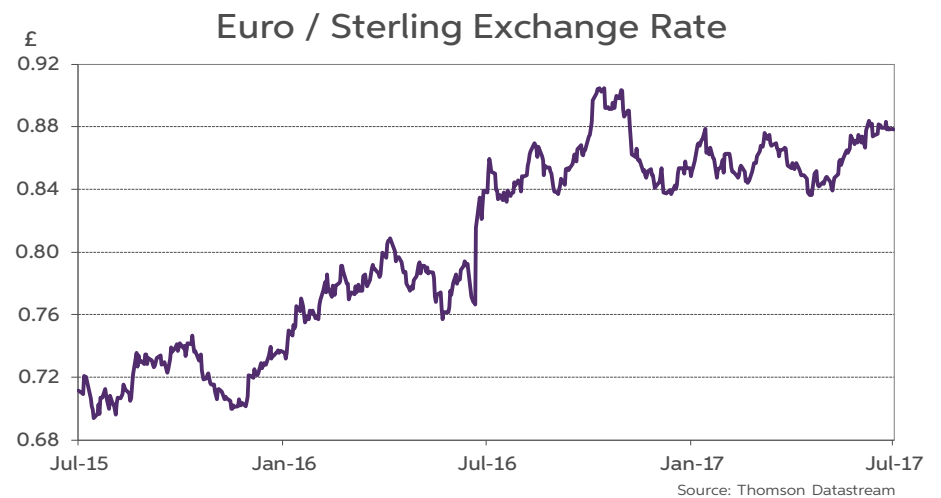
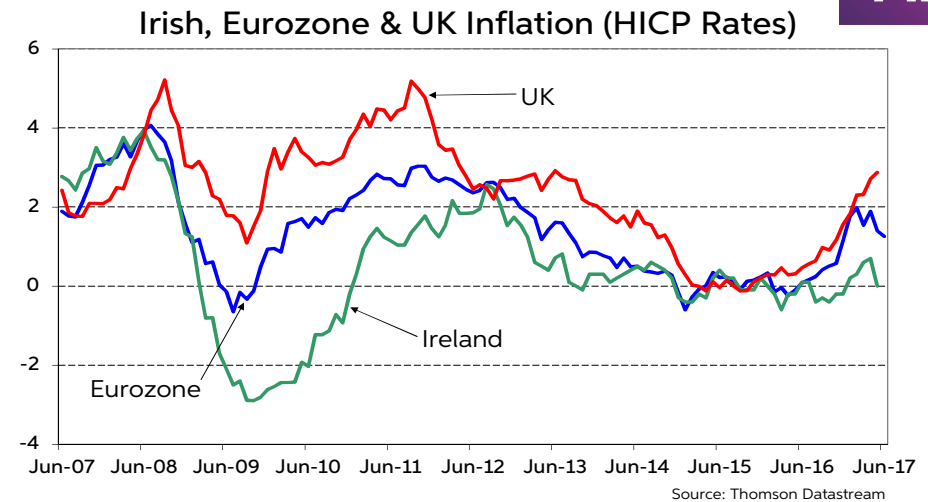
Some key issues

- Role of European Court of Justice in this period
- Benefitting from market access requires adhering to EU Rules
- Free movement of labour and immigration controls
- Cost to access markets/EU agencies
- Likely period of time transition arrangement will last

Solid Irish growth to continue ahead of Brexit



- Rebound 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
- Irish inflation remains very low at 0% in May, well below that of the Eurozone and especially UK
- Global economy, including the Eurozone, is picking up momentum, helping 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 grew by a strong 5.2% in 2016
- Irish GDP growth generally forecast at around 4% for 2017 and 3.5% in 2018
- Not many signs yet, though, that economy is slowing



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2014	2015	2016	2017 (f)	2018 (f)	2019 (f)
GDP	8.5	26.3	5.2	4.0	3.5	3.0
GNP	9.2	18.7	9.0	3.5	3.0	2.5
Personal Consumption	1.7	4.5	3.0	3.0	2.5	2.2
Government Spending	5.4	1.1	5.3	1.5	1.5	1.5
Fixed Investment	18.2	32.7	45.5	6.0	5.0	4.5
Core Fixed Investment*	14.4	18.3	N.A.	6.0	5.0	5.0
Core Domestic Spending*	4.2	6.6	N.A.	3.9	3.3	3.0
Exports	14.4	34.4	2.4	4.5	4.2	4.0
Imports	15.3	21.7	10.3	4.0	3.8	3.7
HICP Inflation (%)	0.3	0.0	-0.2	0.7	1.2	1.5
Unemployment Rate (%)	11.3	9.5	7.9	6.3	5.3	4.8
Budget Balance (% GDP)	-3.7	-2.0	-0.5	-0.4	-0.1	0.1
Gross General Gov Debt (% GDP)	105.3	78.7	75.4	73.0	71.0	69.0

*Excludes investment in aircraft and intangibles (data not available for 2016)

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 from US if Trump administration slashes corporate taxes and introduces border tax on imports. Any trade war would undermine fragile global recovery
- Questions around corporation tax regime (eg Apple ruling) could impact FDI but seems unlikely
- 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
- 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.