The Irish Economic Update

Continuing Strong Performance

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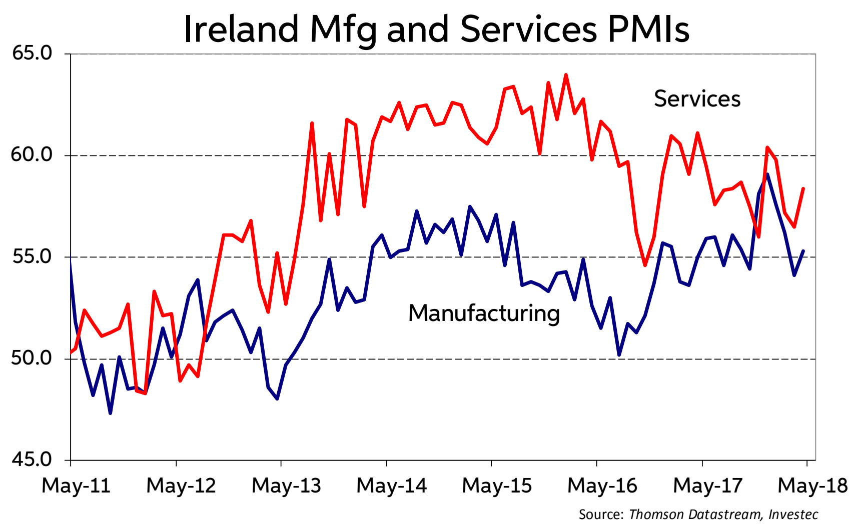
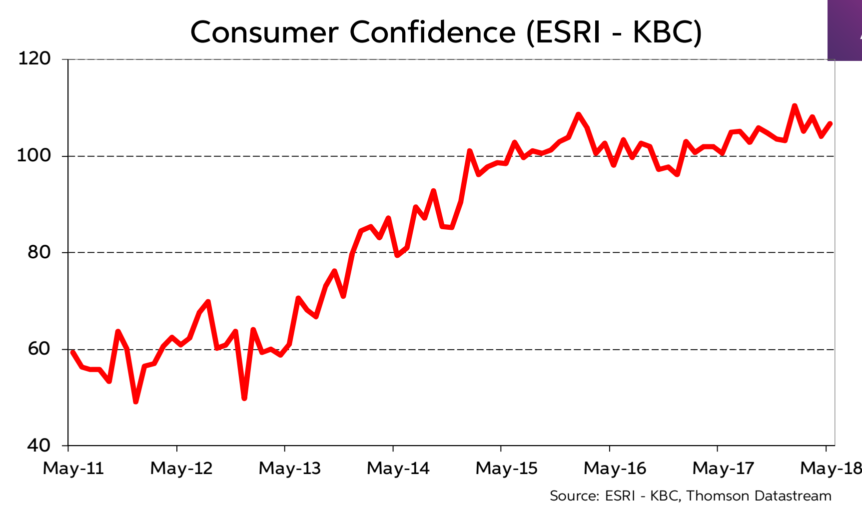
AIB

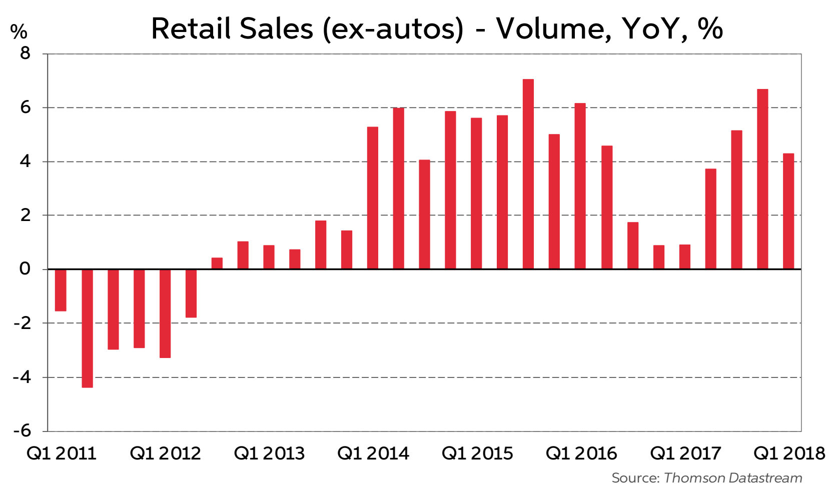
Strong recovery by Irish economy since 2013

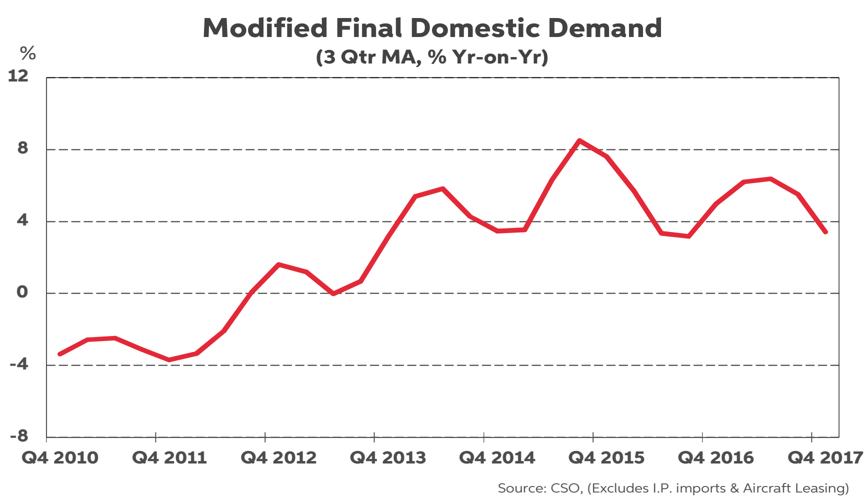
- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8.5% and GNP down 11%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance 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 rebounded strongly over 2013-17 – underlying growth averaged 4.4% for the period
- 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 5.3% by May 2018
- Budget deficit has declined at a quicker than expected pace. Down to 0.3% of GDP in 2017

Economic indicators remain upbeat in early 2018









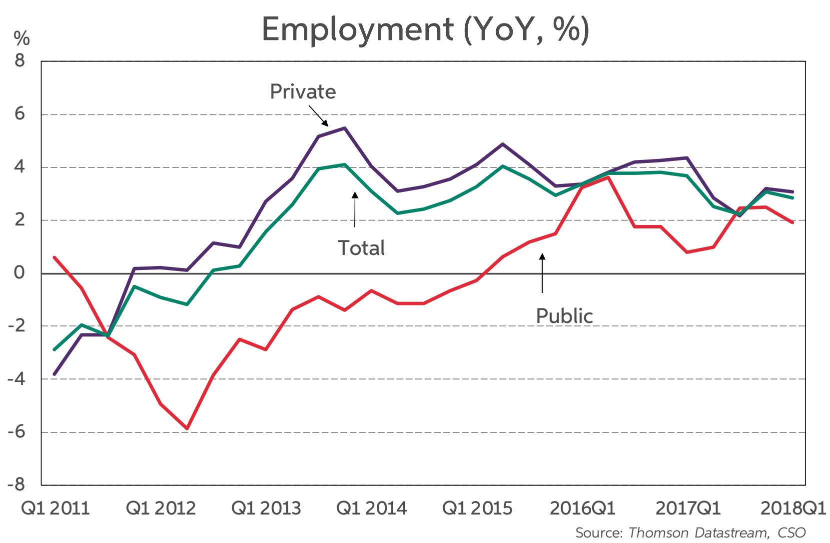
Economy continues to perform strongly in 2018

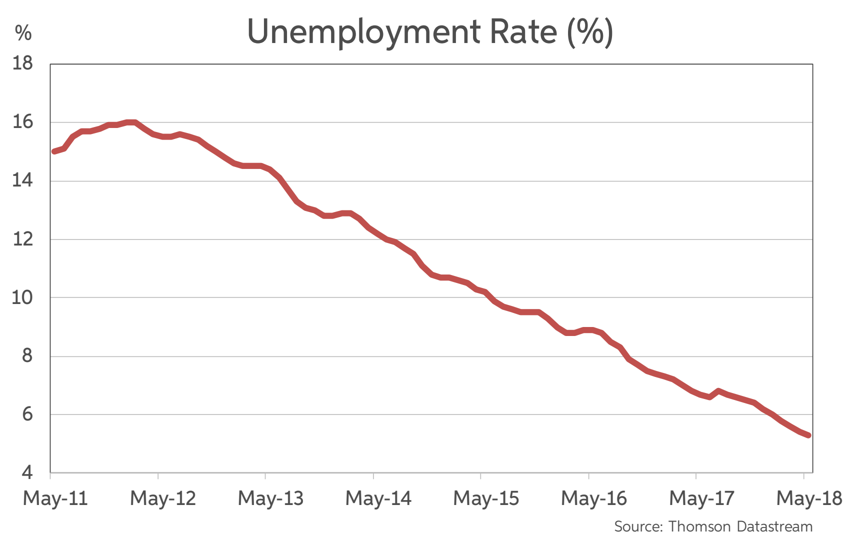
- Modified final domestic demand grew by 4.1% in 2017 after 4.6% growth in 2016
- Mfg PMI remains high in 2018 – at 55.4 in May and 55.3 in April
- Services PMI also very strong to date in 2018 – at 59.3 in May and 58.4 in April
- Continuing very high construction PMI – at 61.8 in May and 60.7 in April
- Consumer confidence at very robust levels in H1 2018 – highest in 17 years
- Retail sales (ex-motor trade) rise 4.5% yoy in Jan-May 2018 – stronger rate than in 2016 & 2017
- Total car regs (new + used imports) steady at high level in H1 2018 – surged over 2014-17
- Further strong rise in housing completions in Q1 2018 – up 27% yoy
- Mortgage lending rose by 22% yoy in value terms in Q1 2018, after rising by 29% in 2017
- Continuing strong job growth – employment rose by 2.9% yoy in Q1 2018
- Live Register continues its sharp decline in 2018. Jobless rate down to 5.3% by May.
- Budget deficit fell to 0.3% of GDP in 2017. Solid H1 2018 figures - taxes up 5% yoy to May

Robust jobs growth; unemployment falls sharply

Year Average	2015	2016	2017	2018(f)	2019(f)	2020(f)
Unemployment Rate %	10.0	8.4	6.8	5.4	4.8	4.4
Labour Force Growth %	1.2	1.9	1.1	1.4	1.6	1.6
Employment Growth %	3.5	3.7	2.9	2.8	2.3	2.0
Net Migration : Year to April ('000)	5.9	16.2	19.8	25.0	30.0	35.0

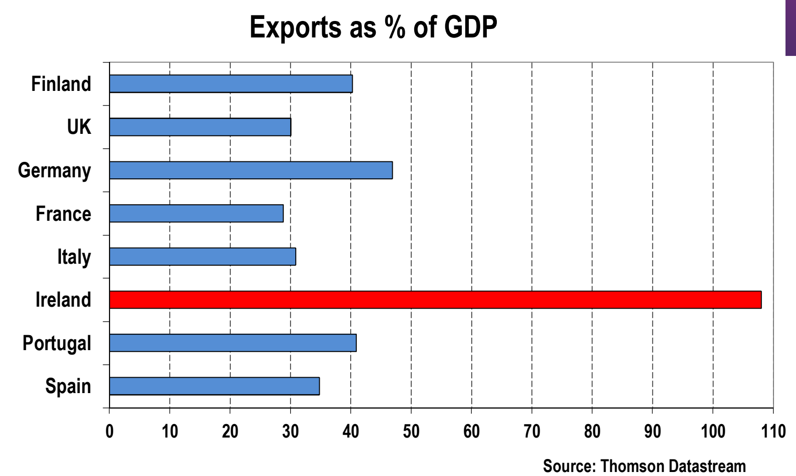
Source: CSO and AIB ERU forecasts

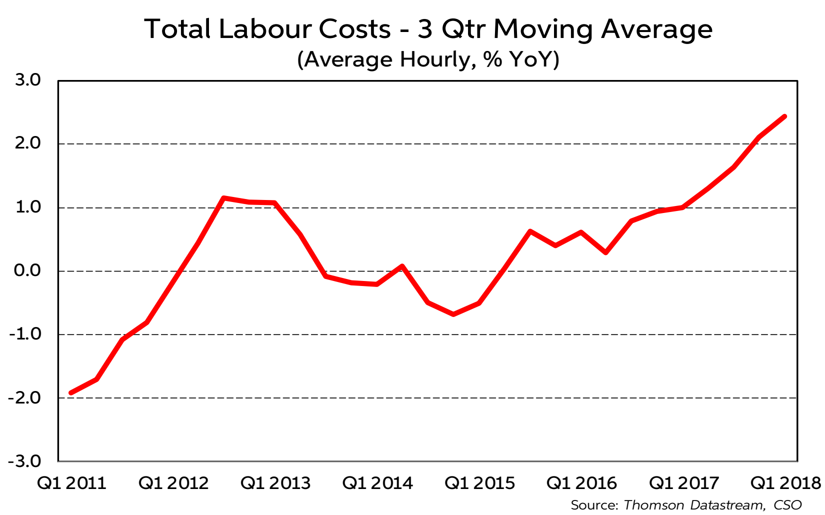


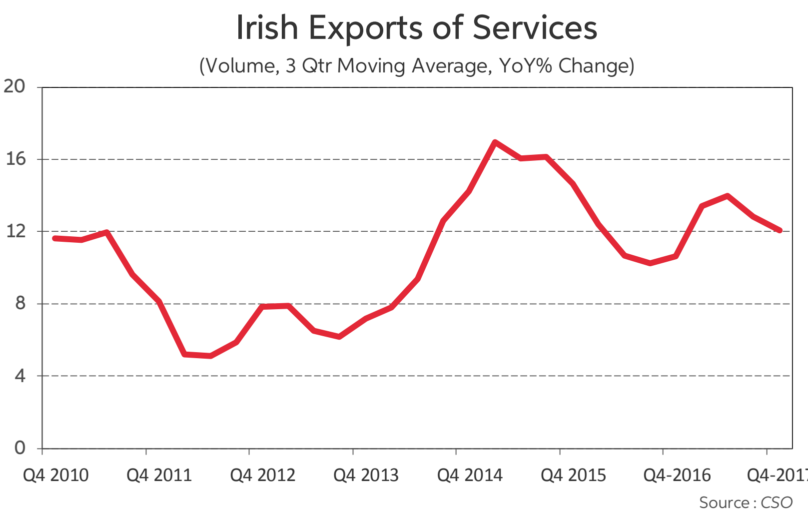


Large Irish export base performing very well

- Ireland a very open economy – exports, driven by huge FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness in 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 total exports still up by circa 7% in 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

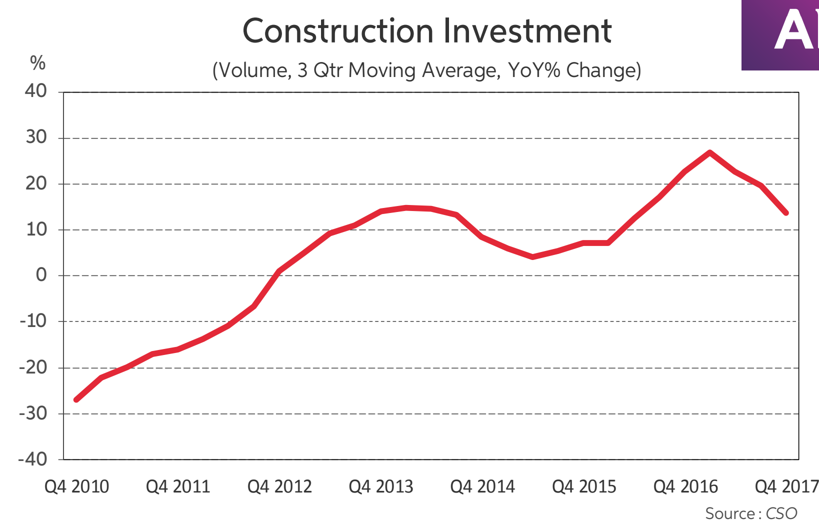
- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates

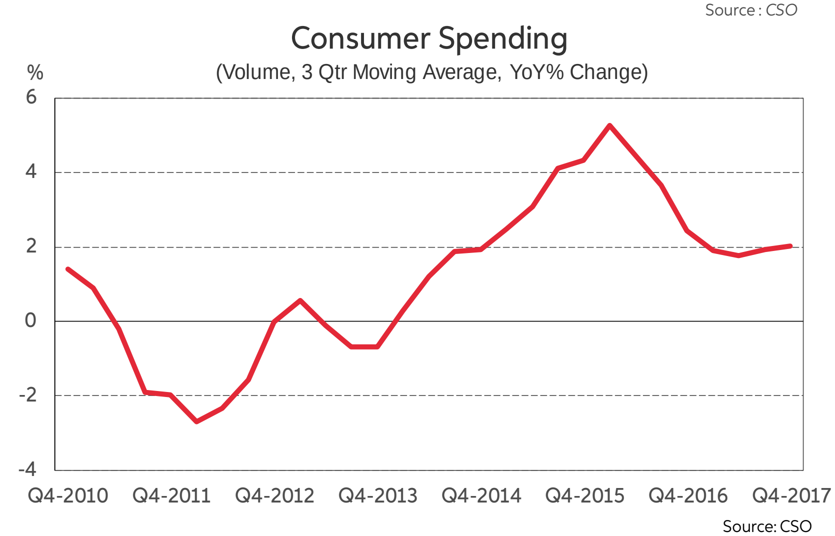
Many top global companies have big operations in Ireland

ebay
Abbott
Pfizer
Boston Scientific
Google
gsk GlaxoSmithKline
citi
ZURICH
BNY MELLON
DELL EMC
f
IBM
intel
ANALOG DEVICES
SAP
NOVARTIS
Microsoft
SIEMENS
accenture
Johnson & Johnson
STATE STREET

Strong recovery by domestic economy in place since 2013

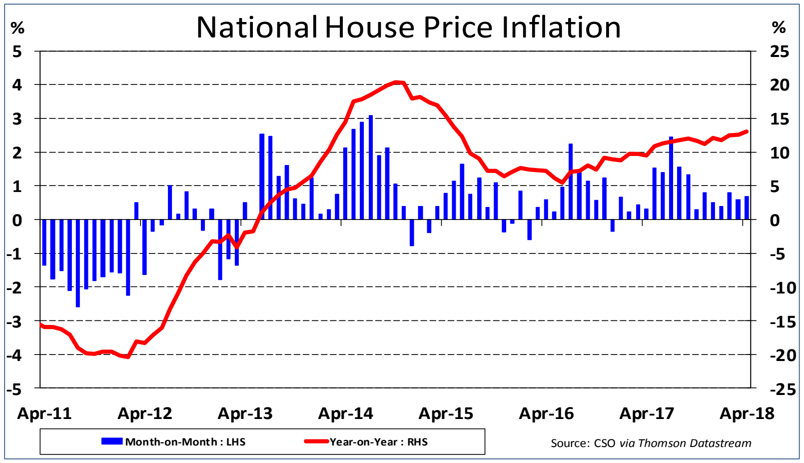
- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction has seen good recovery since 2013, with output up 15% in 2016 and 17% in 2017
- Core business investment (ex aircraft/intangibles) grew by average 22% in 2012-2016. Fell back in 2017
- Consumer spending grew by 3.2% on average over 2014-2016 period and up by 1.9% in 2017
- Core retail sales (i.e. ex-autos) rose by 4.1% in 2017 after 3.3% growth in 2016.
- Core retail sales up by strong 4.5% yoy in Jan-May 2018
- Total car regs (new + used imports) steady at high level in H1 2018, having surged over 2014-17 period
- Modified final domestic demand (excludes IP imports and aircraft leasing) up 4.1% in 2017 & 4.6% in 2016

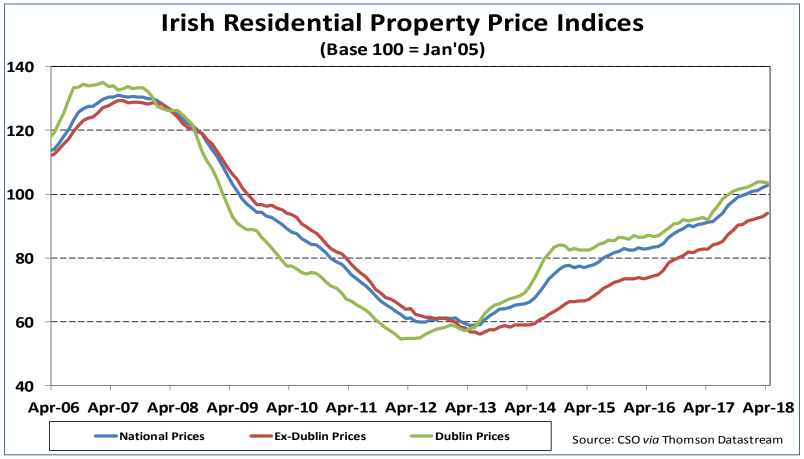




House prices rising strongly as big supply shortage persists

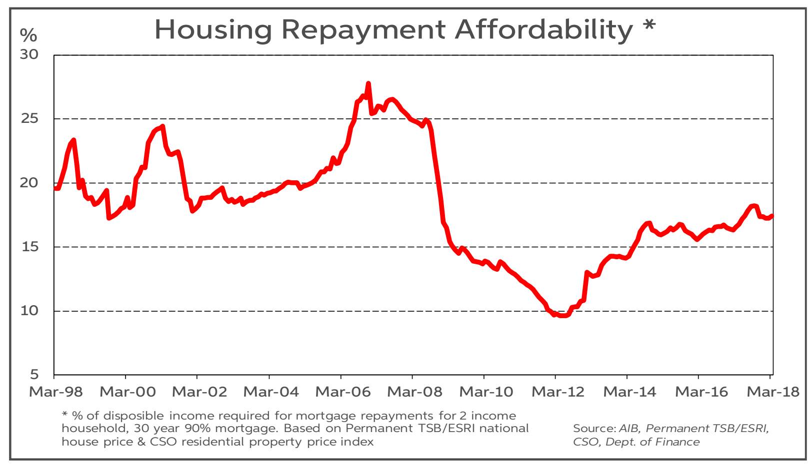
- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building
- Supply overhang eliminated with little stock for sale
- Prices up 76% by April 2018 from low in March 2013
- Dublin prices up by 90% from their trough in Feb 2012, while non-Dublin prices have risen by 70%
- House prices nationally are still 21% below their peak levels hit in 2007
- Prices up 13% yoy nationally in April 2018. Dublin up 12.5%, with non-Dublin rising 13.5% yoy
- Rents have also rebounded strongly – now 22 % above previous peak reached in 2008 per CSO data
- Supply shortage and pent-up demand to maintain upward pressure on house prices and rents





House building rising slowly from very low levels

- New CSO data show housing completions increased by 45% to 14,500 in 2017
- Housing commencements rose by 33% in 2017 to 17,500, pointing to continuing rising supply
- Completions rose by 27% yoy in Q1 2018
- Output still running well below annual new housing demand estimated at circa 33,000 units
- Measures put in place to boost new house building. More Local Authority and NAMA building
- Mortgage lending growing strongly: up by 22% yoy in Q1 2018 after rising by 29% in 2017
- Housing affordability hit by rising house prices but helped by low mortgage rates. Still at good levels
- Likely to be 2021 before housing output rises above 30,000 units – or close to estimated annual demand



AIB Model of Estimated Housing Demand

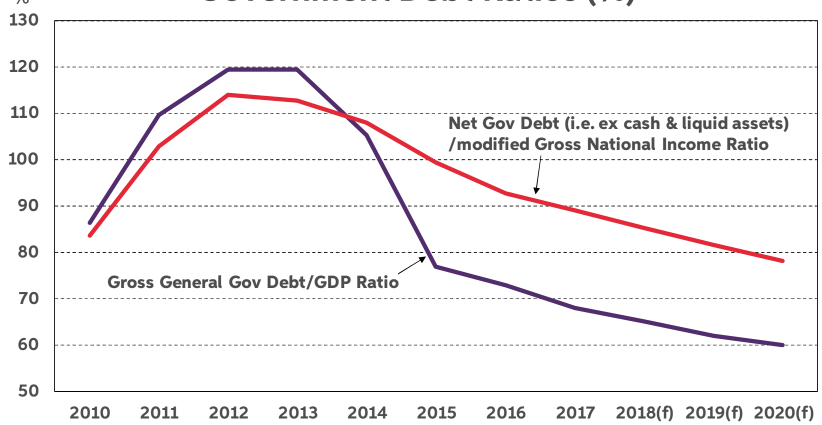
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – 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	**9,900**	**14,500**	**18,500**	**23,000**	**27,000**
Shortfall in Supply	*-22,100*	*-17,500*	*-13,500*	*-10,000*	*-6,000*

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

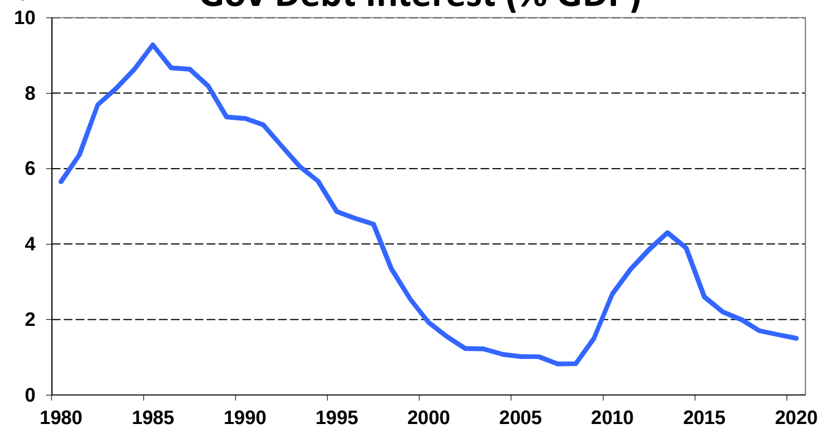
Govt debt ratios fall, private sector deleverages

Government Debt Ratios (%)



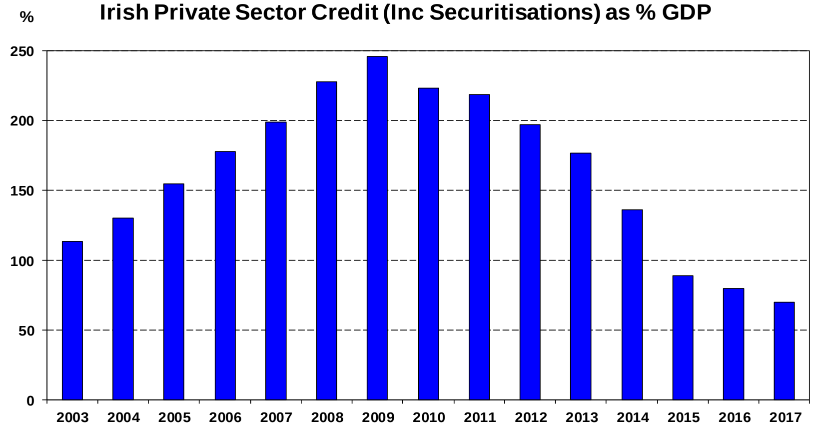
Sources: Dept of Finance, Irish Fiscal Council, AIB ERU (Note Inflated/Distorted GDP figues from 2015)

Gov Debt Interest (% GDP)



Source: NTMA; Dept of Finance

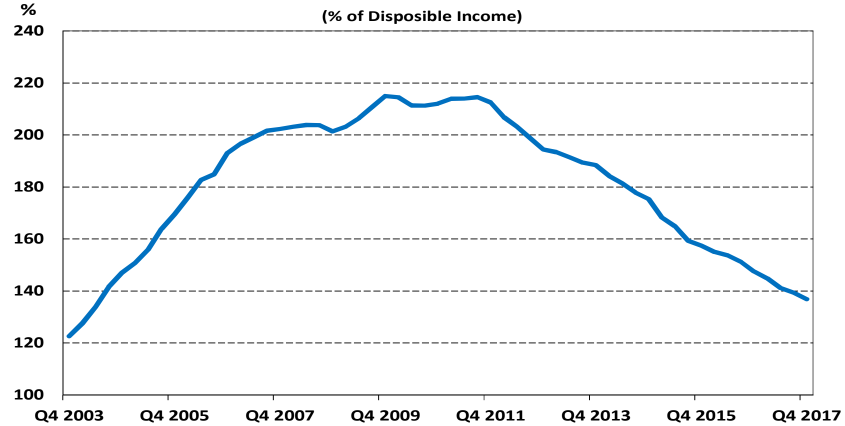
Irish Private Sector Credit (Inc Securitisations) as % GDP



Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figs for 2015-17)

Irish Household Debt Ratio

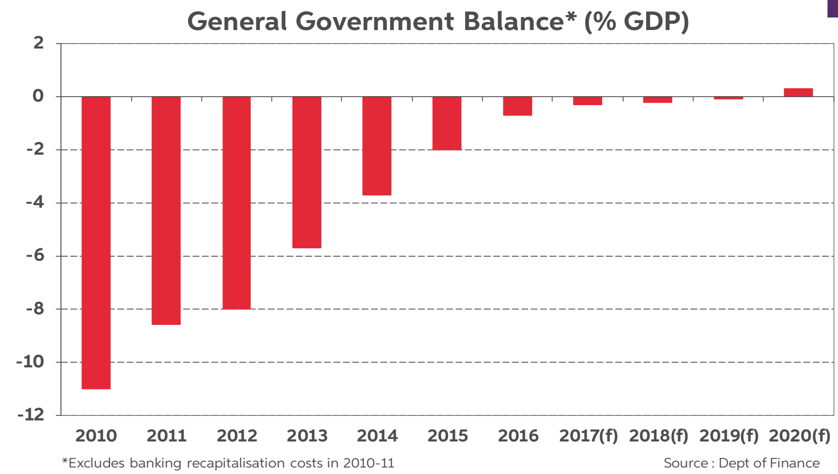
(% of Disposible Income)

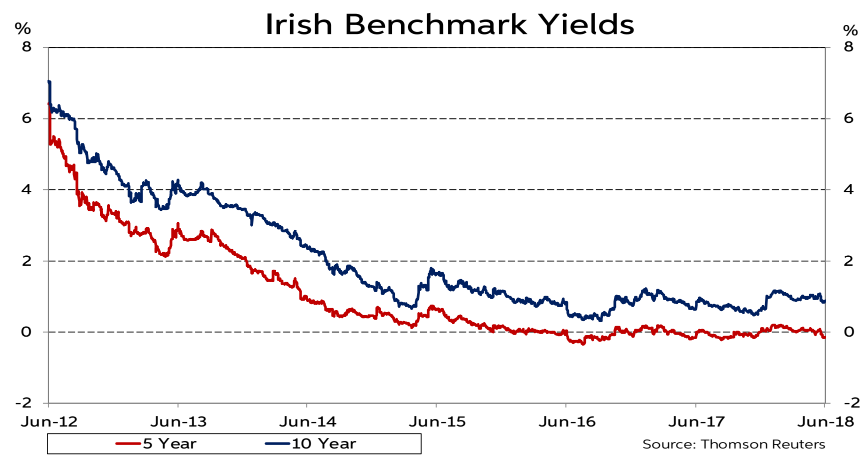


Source: *CSO, Central Bank, AIB ERU*

Budget deficit falls sharply – now close to balance

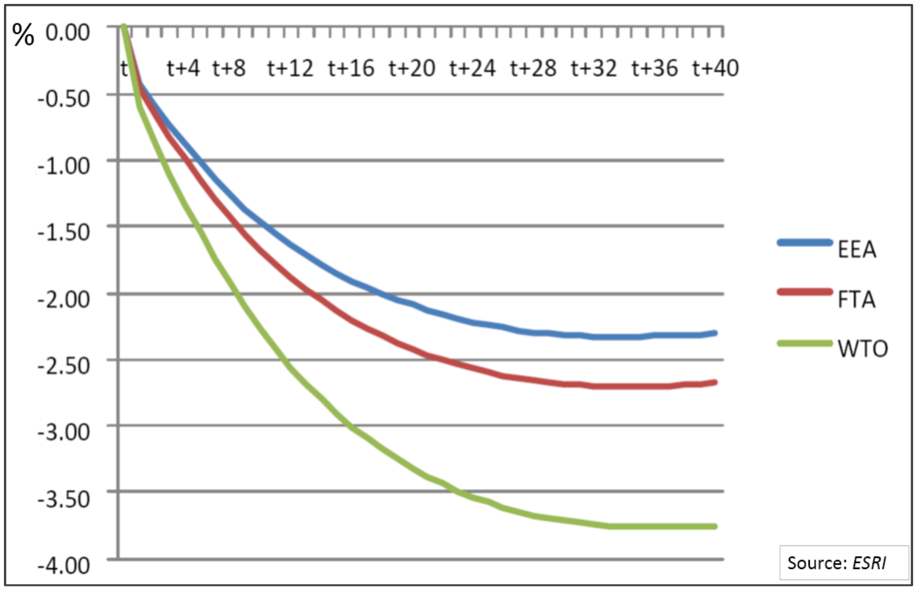
- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit has fallen sharply over the course of this decade
- The deficit fell to 0.3% of GDP in 2017 and is forecast at 0.2% of GDP for 2018
- Primary budget surplus (i.e. excluding debt interest) of 1.6% of GDP in 2017
- Debt interest costs low – at 2% of GDP in 2017
- Solid start to 2018, with Exchequer finances on target and tax receipts up by 5% to May
- 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 expected to lower growth rate of Irish economy

Impact of Brexit on Output *(% deviation from base)*



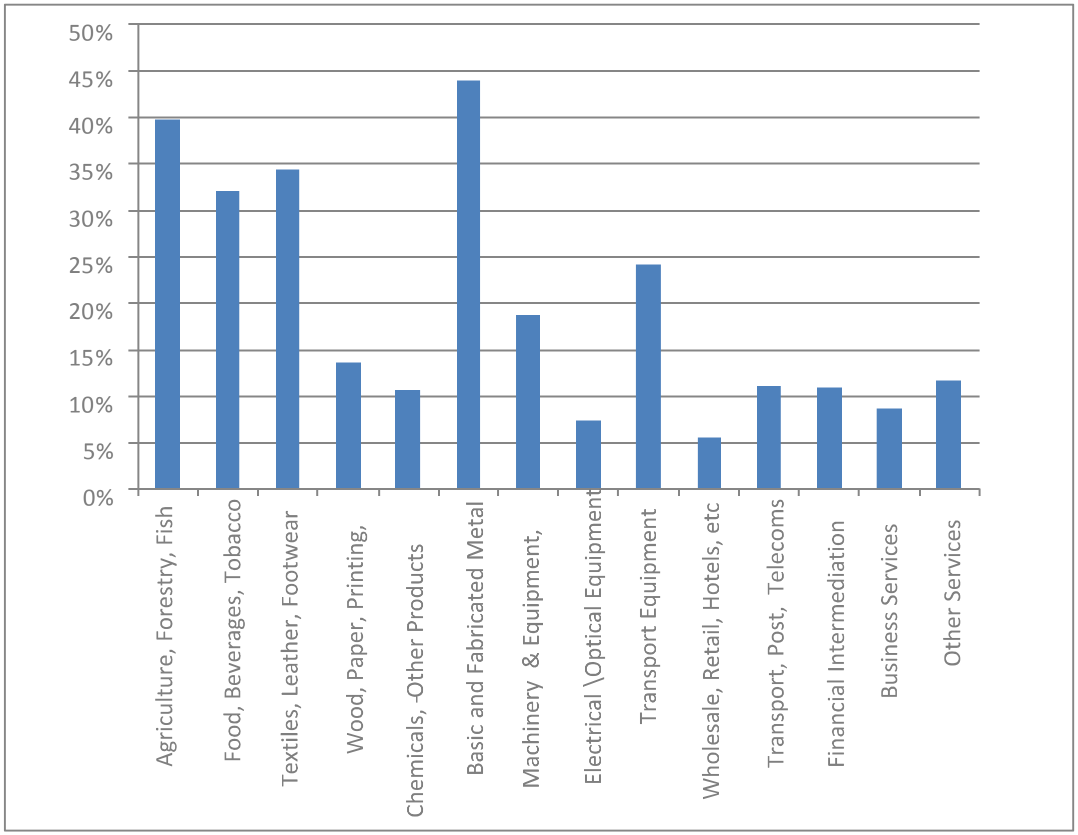
- ESRI estimate that Irish output would be reduced by 2-2.5% on a soft Brexit
- Sharp fall-off in trade with UK likely on a hard Brexit
- Output almost 4.0 % lower over time if there is hard Brexit and a fall back on WTO rules and tariffs
- Employment 2% lower and unemployment rate nearly 2% higher in hard Brexit

- Copenhagen Economics Report considers costs of regulatory divergence for goods and services and of border checks, as well as tariffs in assessing impact of Brexit
- Estimates impact by 2030 is to reduce Irish GDP by 2.8% under a soft Brexit (EEA), 4.3% in a FTA and 7% in a hard Brexit WTO scenario

Agri. sector would be severely impacted by hard Brexit

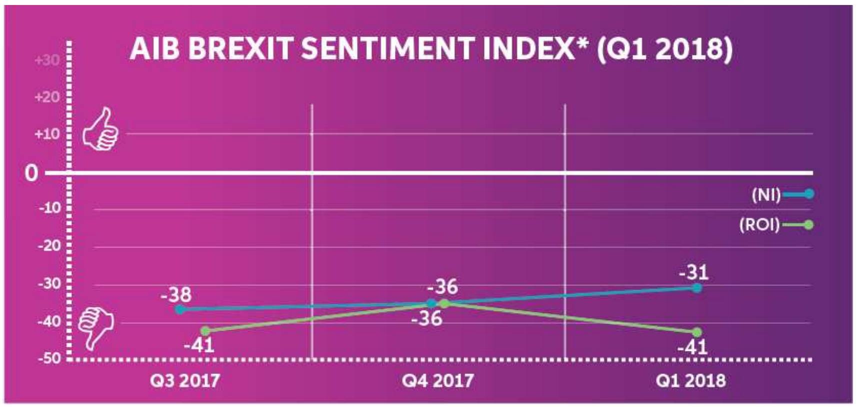
- Main EU tariffs relate to food products, keeping prices up. UK may not maintain these post-Brexit
- Food and Beverages account for 25% of total Irish exports to UK
- Around 40% of Irish food exports go to the UK
- Other sectors very dependent on UK market include machinery and transport, metal products, textiles
- Some 40% of indigenous Irish exports go to UK compared to 10% for foreign owned companies

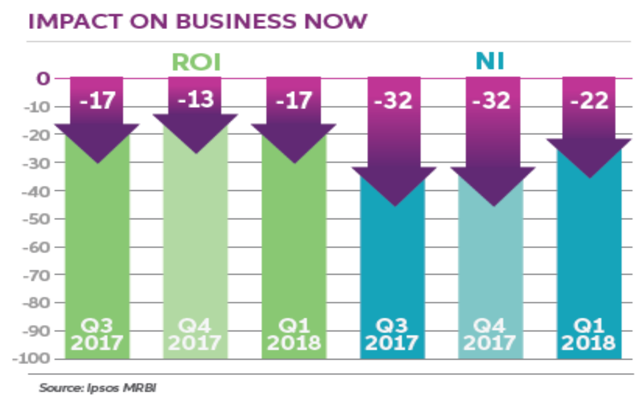
Share of Exports by Industry Destined for the UK (ESRI)

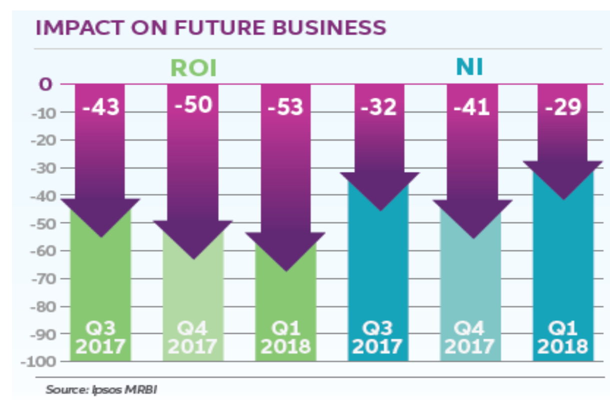


AIB Brexit Sentiment Index – Q1 2018

- A total of ***700 SME's (with up to 250 employees)*** across the island of Ireland
- Fieldwork (W3) took place between ***6th-26th March 2018.***







- **Brexit is having little impact on businesses now**
- **SMEs surveyed more concerned about its impact on the future, both on their own business and wider economy**
- **SMEs operating in the Food & Drink, Manufacturing and Retail sectors most concerned about impact of Brexit**

Customs proving difficult Brexit issue

- **UK leaving EU**, Single Market and Customs Union in March 2019
- **Transition Period** to end 2020 likely that will avoid disruption after UK leaves while a new free trade deal is being negotiated. No change in current trading arrangements during this period.
- **Withdrawal Agreement** to be completed by autumn to allow for orderly UK departure from EU. Expected to sketch out future trade/customs arrangements and provide for the transition period
- **Arrangements for customs** after transition period ends proving problematic
- **UK Customs suggestions:** 'a new customs partnership' (UK acts as EU agent) or else 'highly streamlined customs arrangements' (max-fac)
- **Border with Northern Ireland;** all sides say want to avoid hard border but will prove difficult to avoid without similar EU\UK customs arrangements and continuing regulatory alignment
- **Period of uncertainty**, including on NI border, could last until end 2020 when transition period finishes and it is hoped to have concluded an EU/UK free trade deal

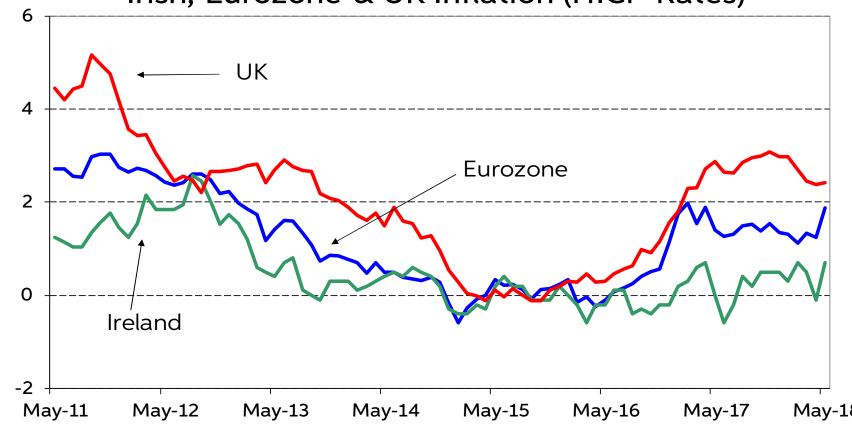
Soft Brexit looks increasingly likely

- **Brexit a process;** Brexiteers main objective is to ensure UK leaves the EU next March. See Brexit as a process not a one-day event. Can disentangle UK further from EU over time after Brexit
- **Brexiteers** will not want to bring down government over a soft Brexit and risk UK not leaving EU in March or Labour taking power and delivering a very soft Brexit
- **UK Parliament;** large majority favour a soft Brexit. 'No deal' outcome could well be blocked
- **Policy preferences point to Soft Brexit:** UK wants to stay part of EU regulatory agencies and EU standards systems – would help maintain regulatory alignment
- **NI backstop:** PM looked to extend NI backstop to whole of UK – stay in a customs union?
- **No Planning for Hard Brexit:** UK has not moved to prepare for a hard Brexit – no move to set up its own regulatory agencies, customs arrangements etc
- **But hard Brexit cannot be ruled out**, given uncertain political backdrop in the UK and delays in the negotiations in recent months

Irish growth expected to remain strong

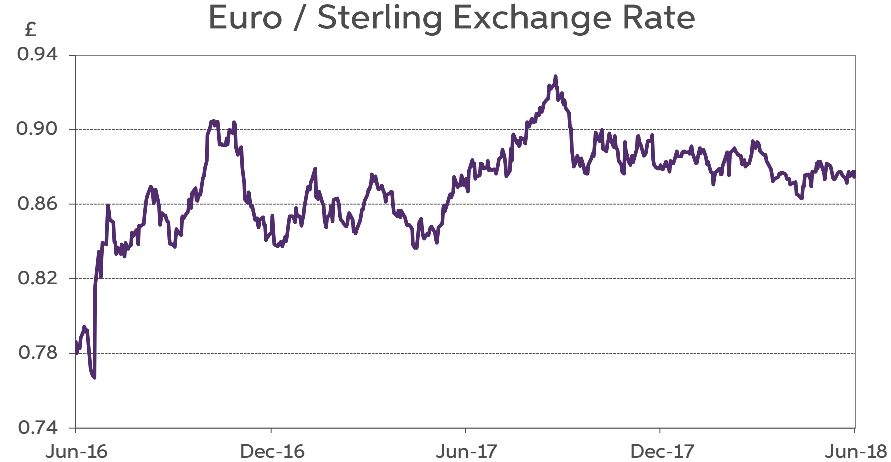
- Strong growth by Irish economy continuing in 2018
- Construction picking up from still low output levels
- Budgetary policy turns mildly expansionary
- Activity supported by low interest rate environment
- FDI strong despite concerns on corporate tax
- Very low Irish inflation, well below that of the Eurozone and especially the UK
- Global economy, including the Eurozone, has picked up momentum, helping Irish exports
- However, Brexit is a challenge for the economy
- Sharp fall in sterling impacts exports to UK, tourism from UK, Irish firms competing with UK exports
- GDP growth forecast at 4-4.5% for 2018-19
- ESRI estimates long-term growth rate of economy at around 3.25% in the period 2020-2025

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	2016	2017	2018 (f)	2019 (f)	2020 (f)
GDP	**5.1**	**7.8**	**4.5**	**4.0**	**3.5**
GNP	9.6	6.6	4.2	3.7	3.2
Personal Consumption	3.3	1.9	2.7	2.5	2.5
Government Spending	5.3	1.8	2.0	2.0	2.0
Fixed Investment	61.2	-22.3	8.0	7.0	6.0
Core Fixed Investment*	13.6	5.7	8.0	7.0	6.0
Exports	4.6	6.9	5.0	4.5	4.3
Imports	16.4	-6.2	5.0	4.5	4.5
HICP Inflation (%)	-0.2	0.2	0.8	1.2	1.5
Unemployment Rate (%)	8.4	6.8	5.8	5.3	4.8
Budget Balance (% GDP)	-0.5	-0.3	-0.2	-0.1	0.2
Gross General Gov Debt (% GDP)	72.8	68.0	65.0	62.0	60.0

*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
- Uncertain external environment with growing downside risks to global growth from increasing protectionism/tariffs, tightening monetary conditions, problems in some emerging economies
- Questions around Irish corporation tax regime (Apple ruling, moves on tax harmonisation in EU, cuts in US/UK rates) could impact FDI. Note that 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 – tighter lending rules, on-going deleveraging