The Irish Economic Update

Brexit Poses Challenge to Strong Recovery

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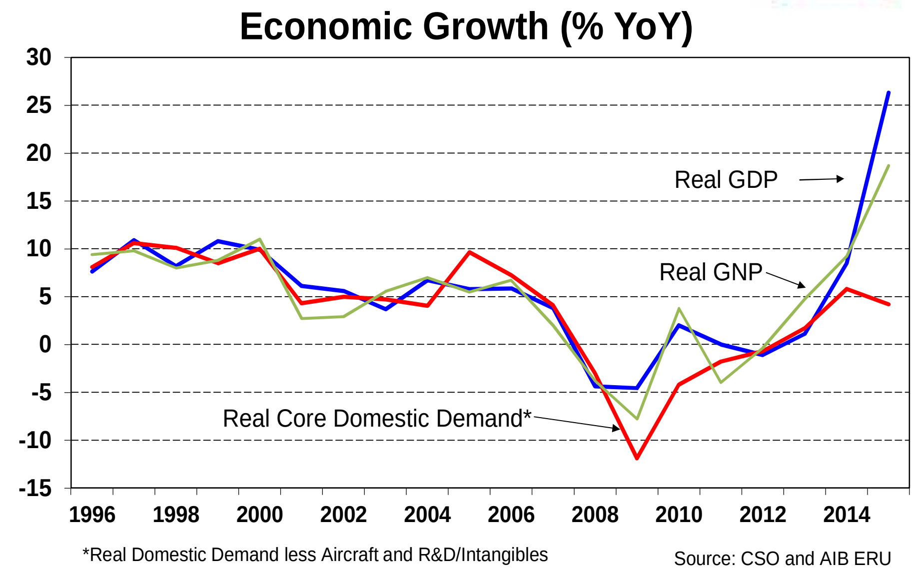
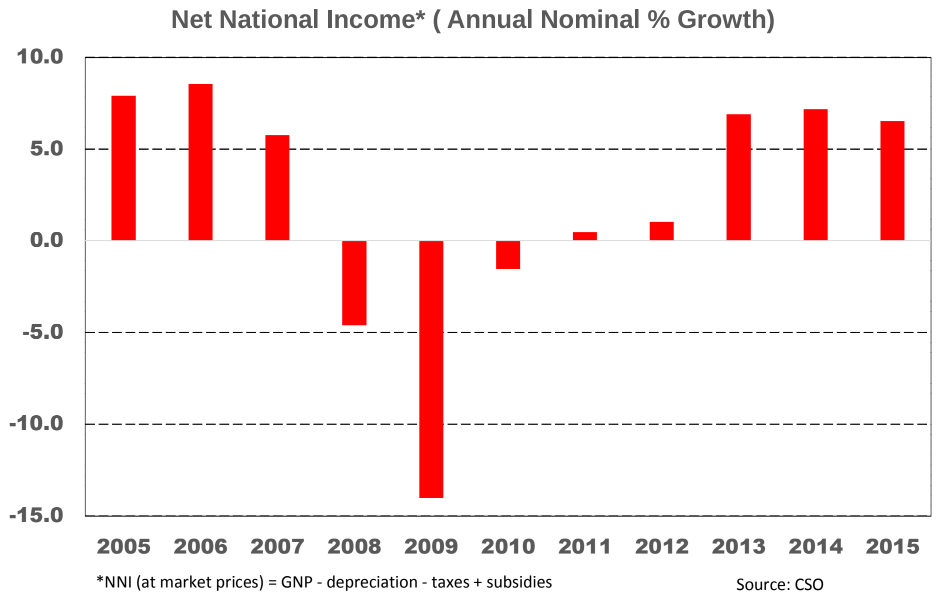
Strong recovery by Irish economy

- 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 very strong period of growth, unlike in other countries
- Ireland tackled its problems aggressively in the public finances, banking sector and property market. Imbalances in economy unwind – housing, debt levels, competitiveness, BoP
- Ireland focused on generating growth via its large export base as the route to recovery
- Recent GDP/GNP data distorted by corporate restructuring and trade reclassifications
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Core domestic demand averaged growth of 4% in the period 2013-15
- Strong jobs growth. Unemployment rate fallen from 15% in 2012 to below 8% in H1 2016
- Budget deficit has declined at quicker than expected pace. Balanced budget now in sight.

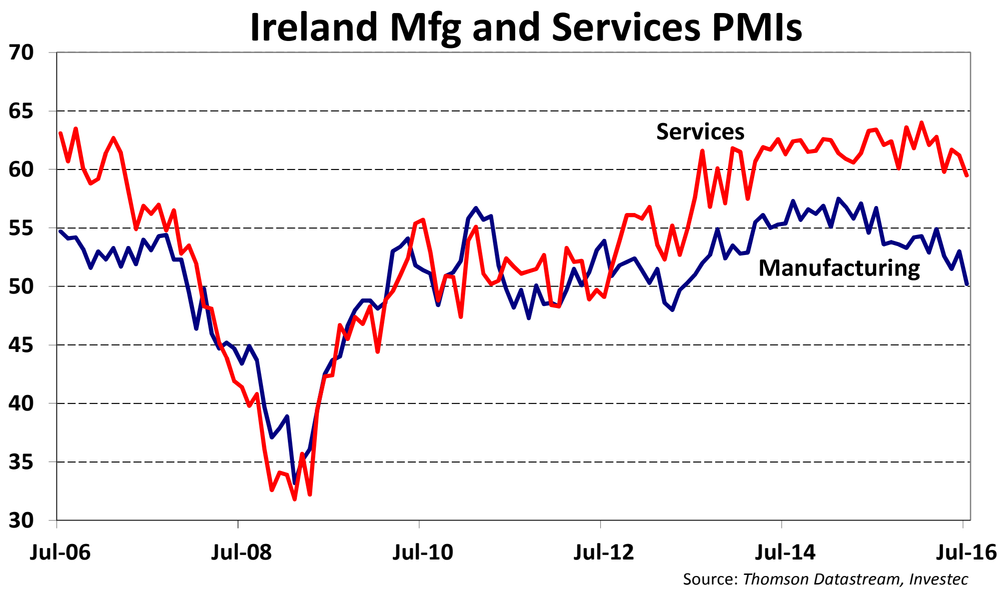
Huge distortions inflate Irish GDP/GNP figures

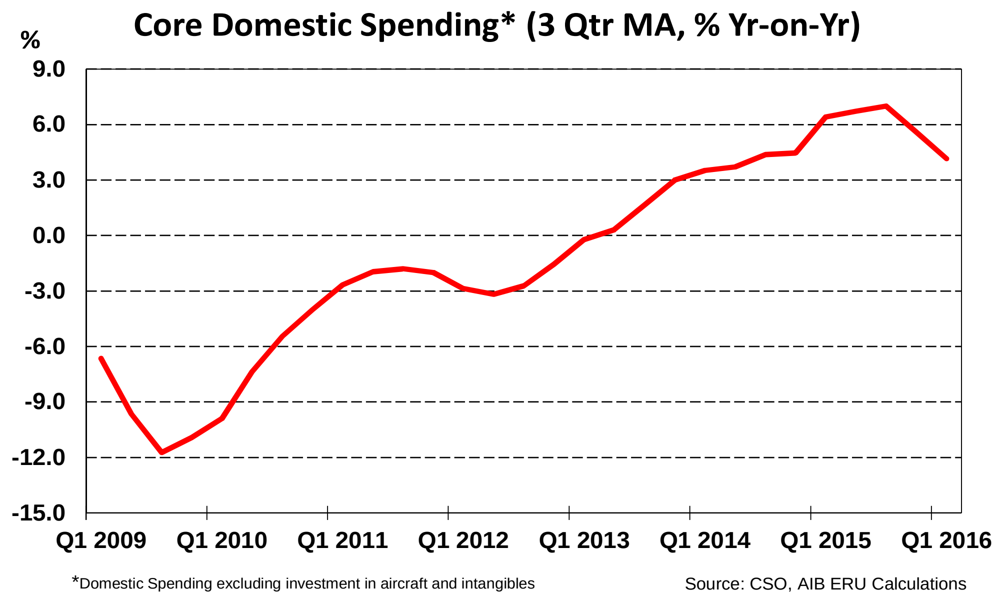
- GDP/GNP no longer reliable measures of output and income in Ireland. Review underway of National A\Cs
- Exports, imports, industrial production, investment and BoP all distorted by activities of some multi-nationals
- Capital stock ballooned by 40% in 2015 as a result of re-domiciling/inversions by some large corporates
- Contract manufacturing also distorting data in last two years – goods manufactured abroad for some Irish MNC included in Irish output and exports
- Aircraft leasing, R&D and intangibles such as patents, distorting investment figures
- Better measures of economic activity required that strip out distorting effects of multi-nationals
- We focus on core domestic demand/spending. Net national income/product also useful
- Also need to watch high frequency indicators like PMIs, retail sales, tax revenues, labour markets stats

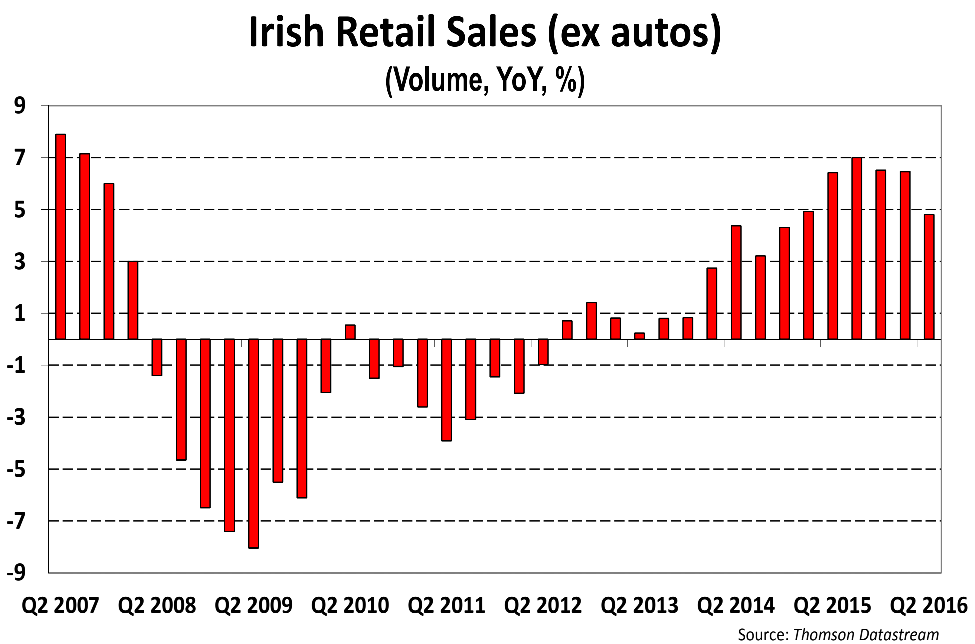


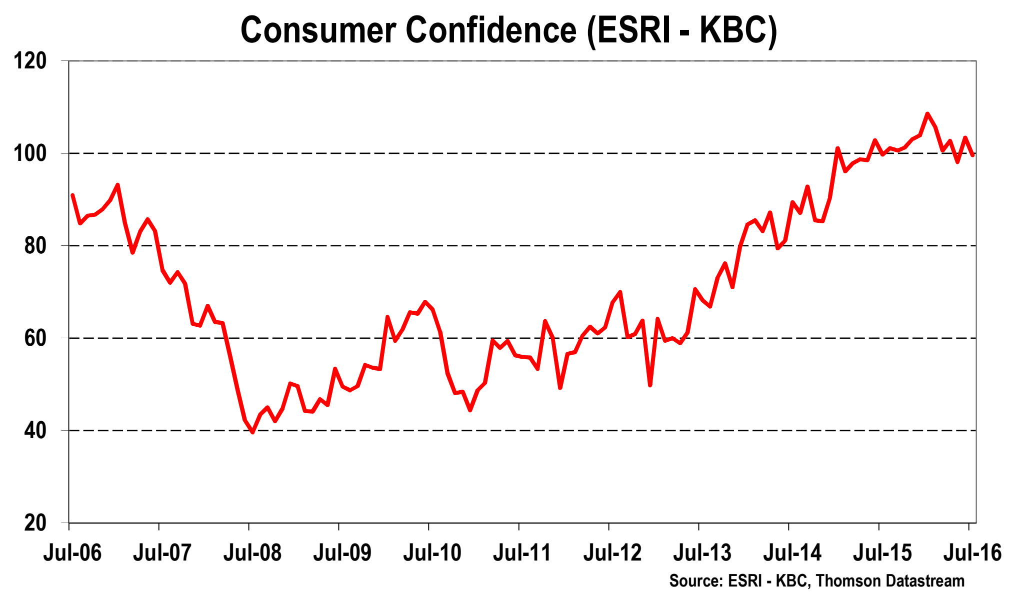


Many indicators point to robust Irish growth









Continuing good data in 2016

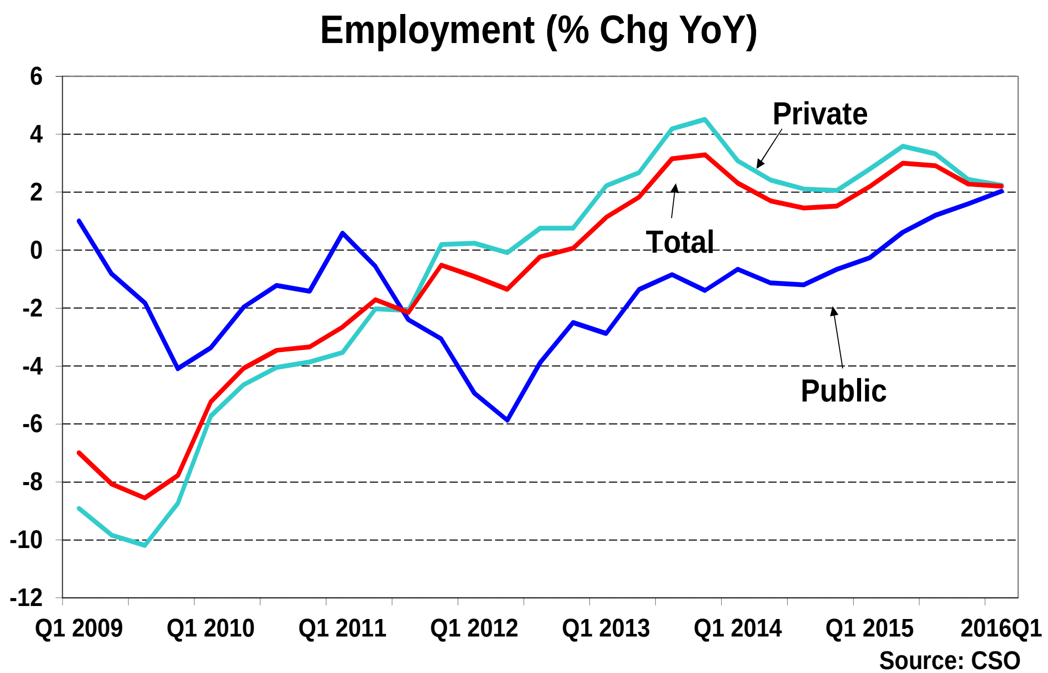
- Continuing good manufacturing PMI data – averaged 52.4 in H1 2016 but fell in July to 50.2
- Very robust services PMI to date in 2016 – averages 61.7, near 10 year highs. July at 59.5
- Construction PMI performing strongly – averaged 61.1 in H1 2016. At 61 in July
- Consumer confidence remained strong to date in 2016, near 15 year highs. July strong
- Core retail sales (ex motor trade) up by 5.6% yoy in H1 after 6.1% rise in 2015
- Car sales up by 19% yoy to July 2016 after 30% jump in both 2014 and 2015
- Housing completions up by 18% yoy in first six months of 2016
- Mortgage lending picks up in 2016 after slowing in 2015 on new CB lending rules
- Employment up for 14 consecutive quarters. Rose by 0.8% in Q1 2016 for gain of 2.4% yoy
- Live Register continues to fall. Jobless rate down to 7.8% by mid-2016 – peaked at 15.1%
- Continuing strong growth in tax receipts in 2016 – up 8.5% yoy to end July. Ahead of target
- Government budget deficit expected to fall to under 1% of GDP this year

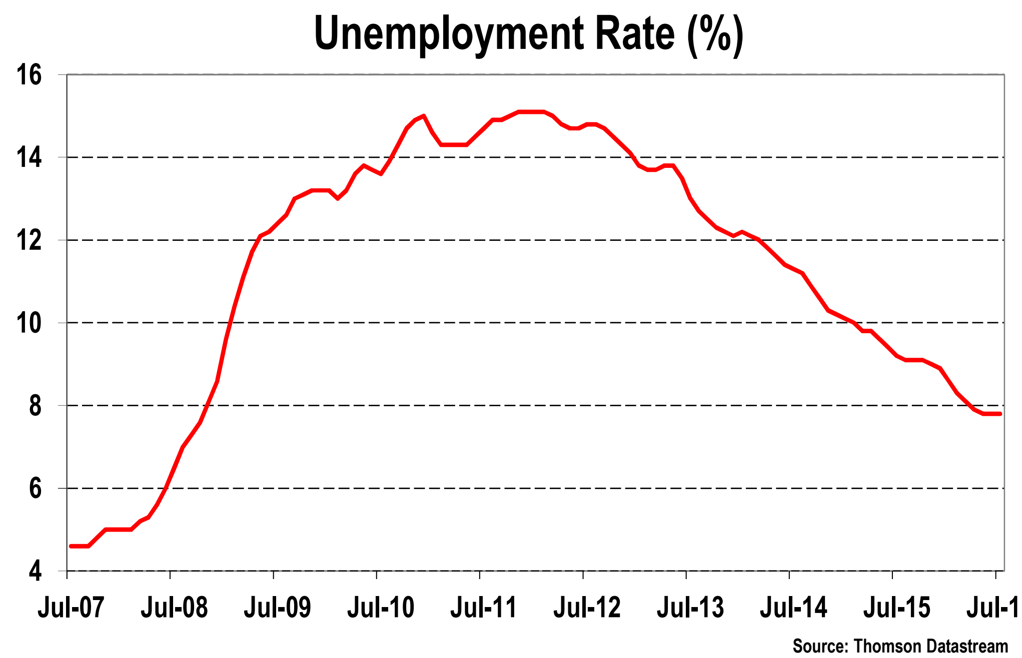
Strong jobs growth & falling unemployment

Year Average	2013	2014	2015	2016(f)	2017(f)	2018(f)
Unemployment Rate %	13.1	11.3	9.5	7.9	7.2	6.7
Labour Force Growth %	0.4	-0.3	0.5	0.4	0.9	1.0
Employment Growth %	2.4*	1.7	2.6	2.1	1.7	1.5
Net Emigration : Year to April ('000)	33.1	21.4	11.6	6.0	3.0	0.0

Employment ex Agriculture +1.3% in 2013

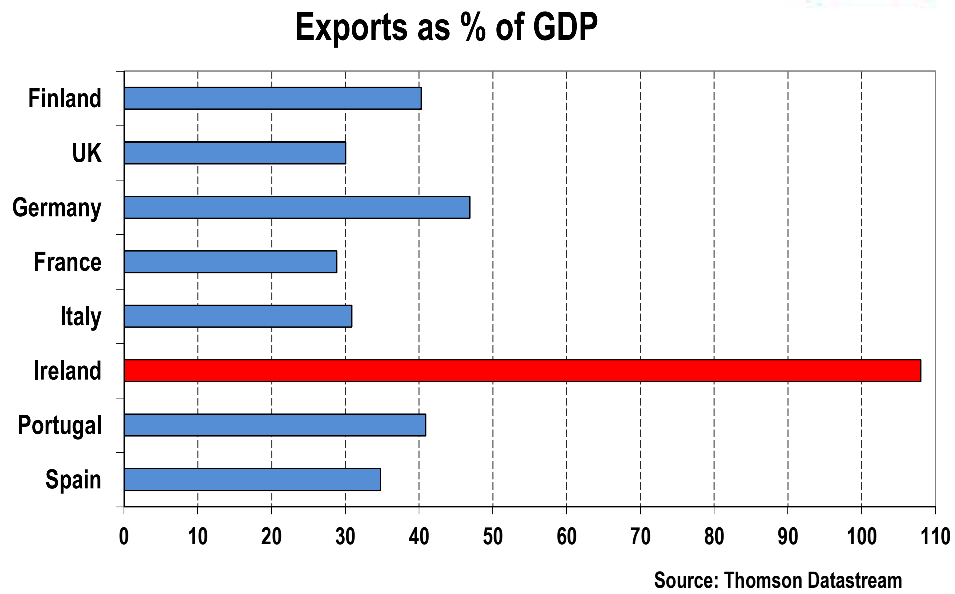
Source: CSO and AIB ERU forecasts

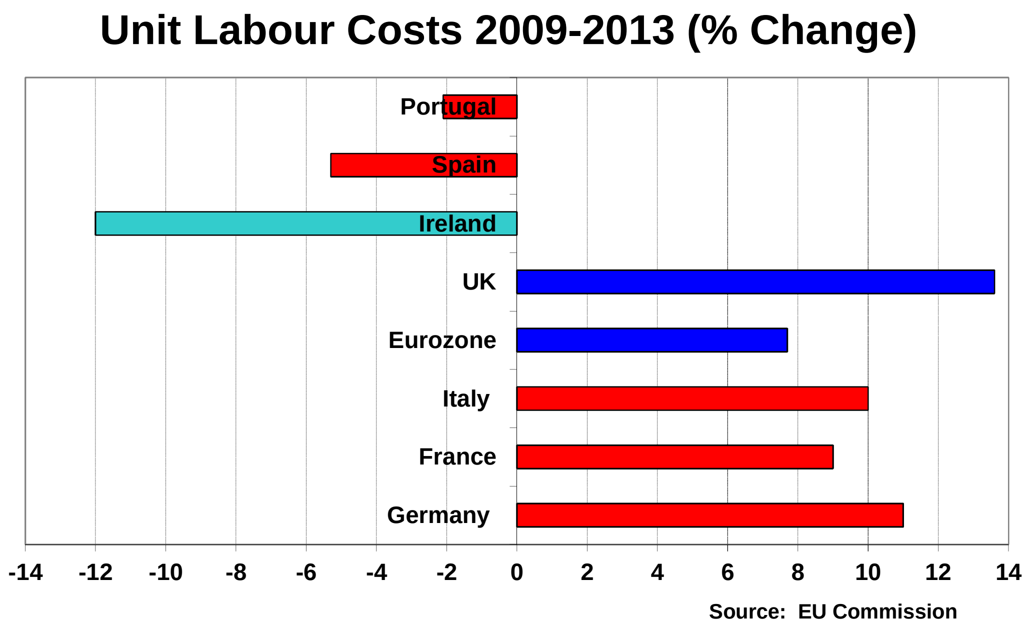


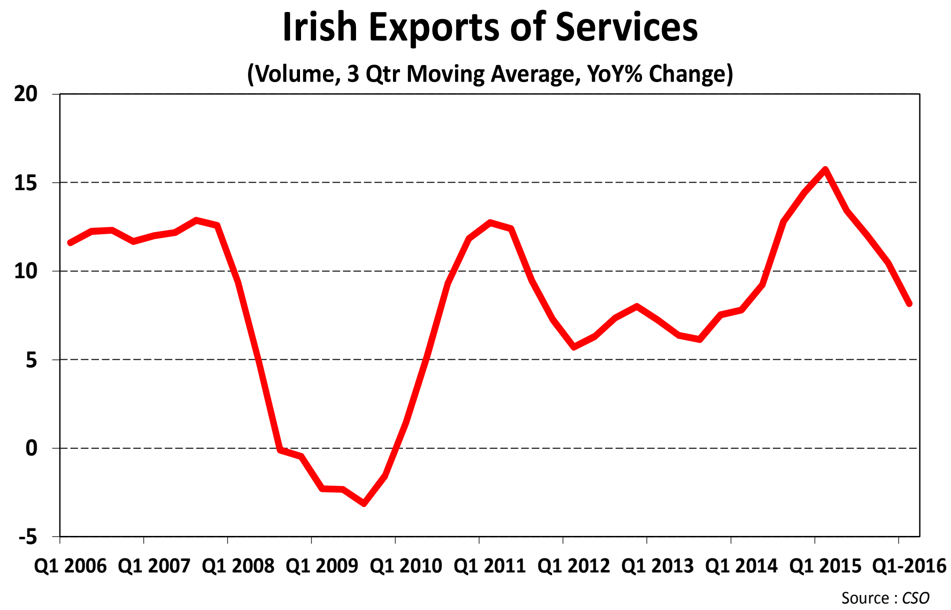


Ireland has very large export base

- Ireland a very open economy – exports, driven by huge FDI, equated to 108% of GDP in 2013
- 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
- Trade data distorted in 2014-15, especially goods







Impact of FDI on economy (Source IDA)

KEY FDI IMPACTS ON THE IRISH ECONOMY

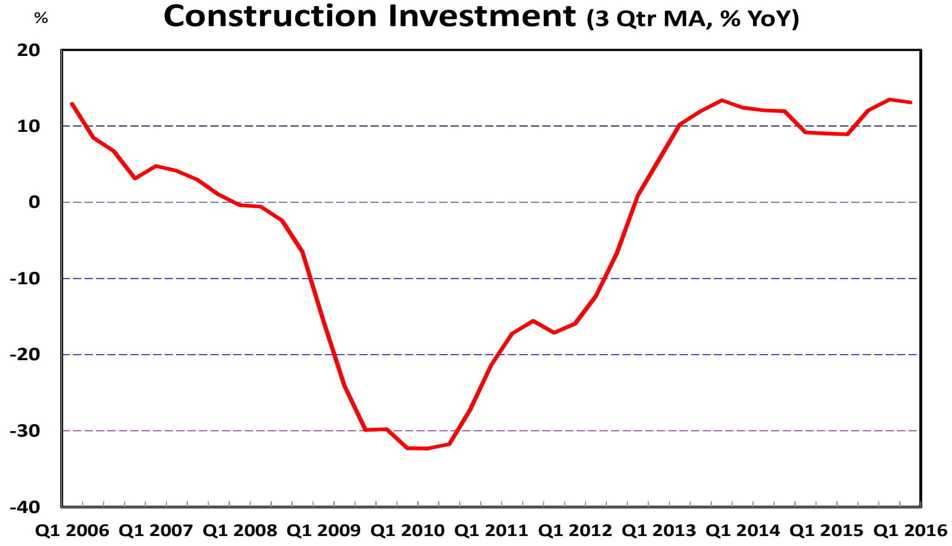
- 1,200 multinational companies
- €125bn Exports (70% of Irish exports)
- 175,000 Jobs in FDI, 290,000 in total
- 70% of Corporation Tax
- €13.5bn Spending on services/materials
- €8.5bn in Payroll
- 67% of Business R&D expenditure

WORLD LEADERS CHOOSE IRELAND

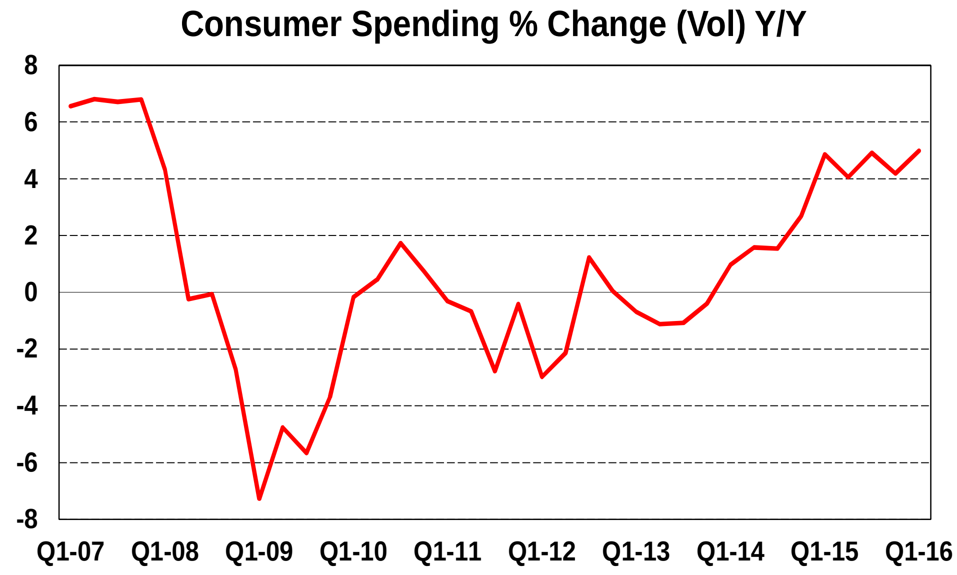
- 8 of the top 10 in ICT
- 9 of the top 10 in Pharmaceuticals
- 17 of the top 25 in Medical Devices
- 3 of the top 5 Games companies
- 10 of the 'top born on the Internet' firms
- More than 50% of the world's leading Financial Services firms

Strong rebound by domestic economy

- 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 – output rose by over 10% in each of last three years
- Business investment (ex planes/R&D) up by circa 25% in last couple of years
- Total core investment (ex aircraft, R&D/Intangibles) averages growth of 18% p.a. in last three years
- Consumer spending grew by 1.7% in 2014 and 4.5% in 2015 and 5% yoy in Q1 2016
- Core domestic spending (ex aircraft, R&D/Intangibles) rose by 2.3% in 2013, 4.2% in 2014 and 6.6% in 2015
- Core retail sales (ex motor trade) up by 5.6% yoy in H1 2016 after rise of 6.1% in 2015
- New car sales rose by 30% in both 2014 & 2015 and by a further 19% yoy in Jan-July 2016



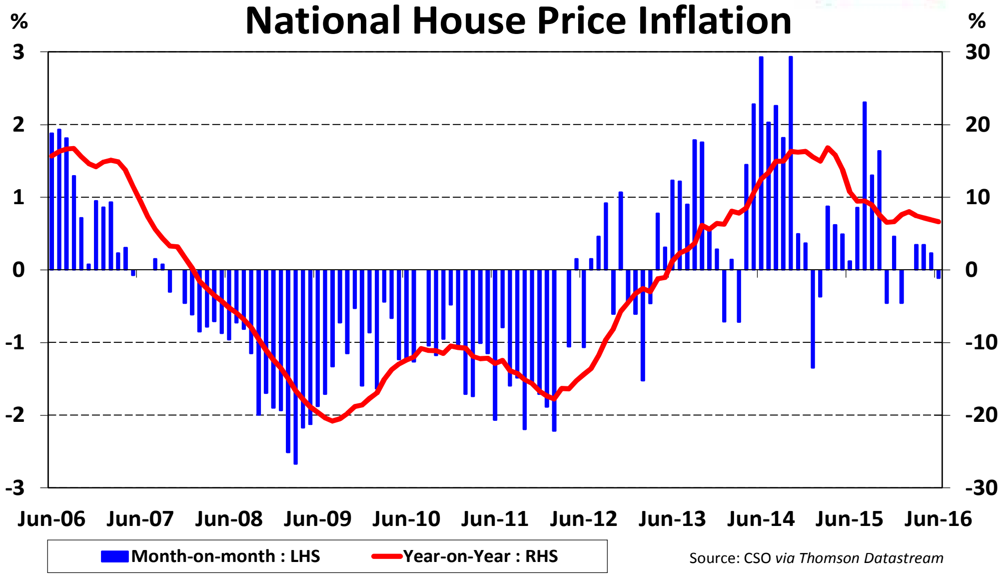
Source : CSO

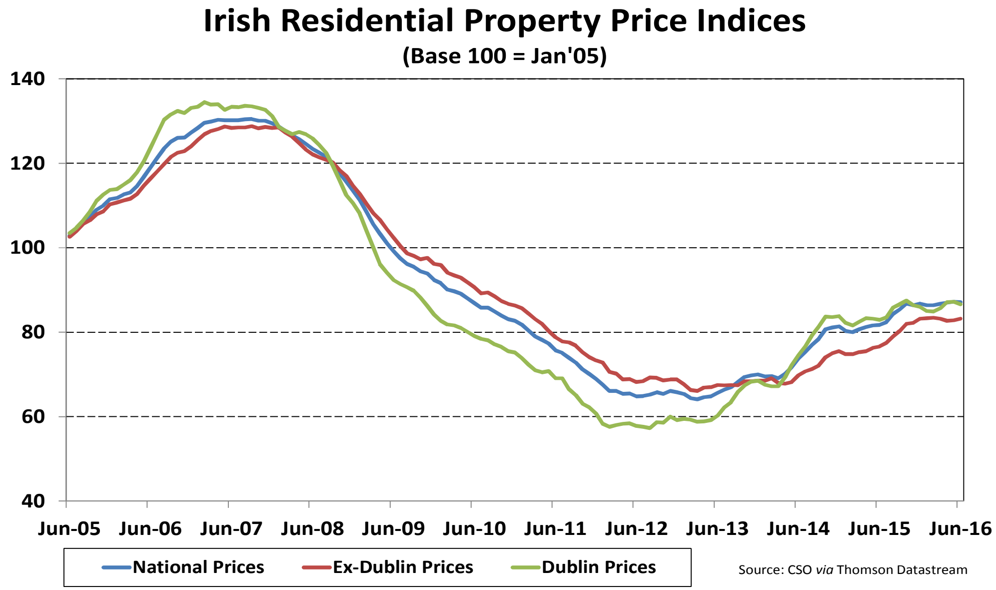


Source: CSO

House prices rise as shortages emerge in market

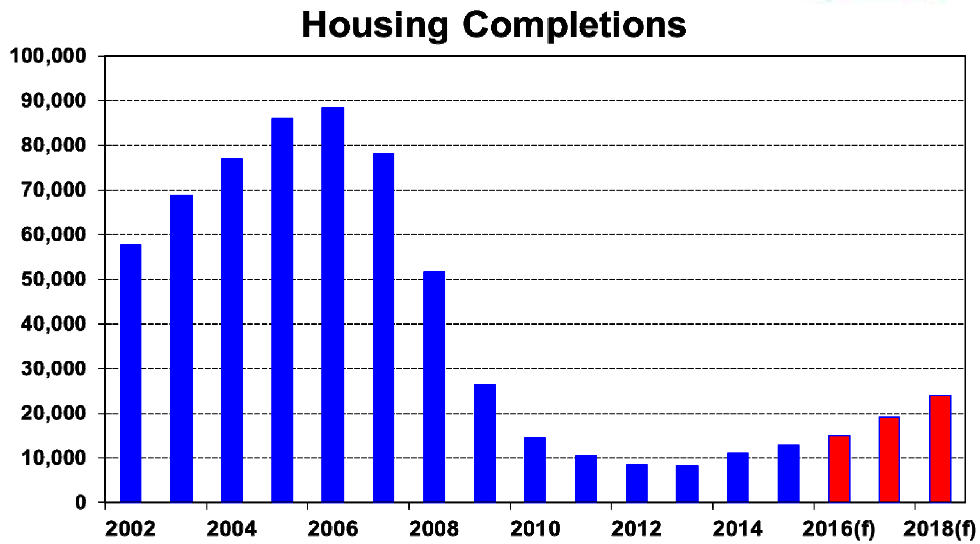
- Housing output fell by 90% but now past the bottom of cycle
- Bulk of the new housing stock overhang eliminated
- House prices declined sharply – fell by over 50% between their peak in late 2007 and early 2013
- House prices have recovered: up 36% in June 2016 from low in early 2013 as housing shortage emerges
- By June 2016, Dublin prices up by 51% and non-Dublin prices up by 26%, from their troughs
- House prices, though, including in Dublin, are still some 35% below peak levels hit in 2007
- New Central Bank mortgage rules cool Dublin house price inflation – falls from 25% to 4.5% yoy
- Nationally, prices up 6.6% yoy in June 2016, with higher rises outside Dublin – up 8.6% yoy
- Rents have rebounded – up over 40% from lows and now 6% above previous peak reached in 2008



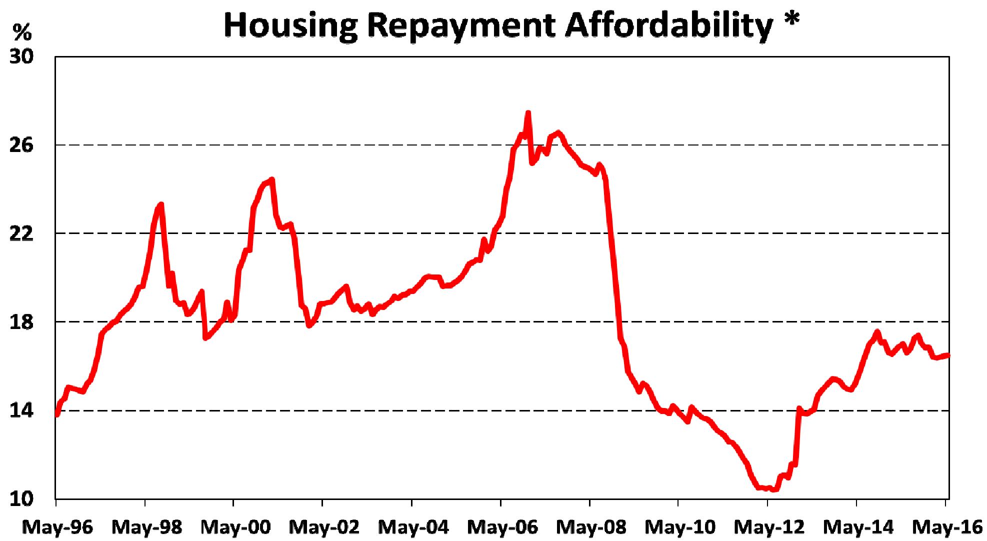


House building rising slowly from very depressed levels

- Housing completions at 12,700 in 2015, up from 11,000 in 2014 and 8,300 in 2013
- Completions up 18% in H1 2016. May reach 15,000 units this year but still at very low levels
- Annual demand estimated at over 25,000 new units
- Trend in new housing registrations/commencements points to continuing slow recovery in house building
- Measures being put in place to boost new house building. More Local Authority and NAMA building
- Housing PMI has been very strong so far in 2016
- However, likely to be 2018/19 at the earliest before housing output rises to around 25,000 units
- Mortgage lending picking up again after slowing in 2015/early 2016 on new tight CB lending rules
- Housing affordability helped by low mortgage rates but Central Bank mortgage rules an issue in Dublin
- Dublin house prices well above LTV mortgage limit



Source: CSO; DoEHLG and AIB ERU



* % 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

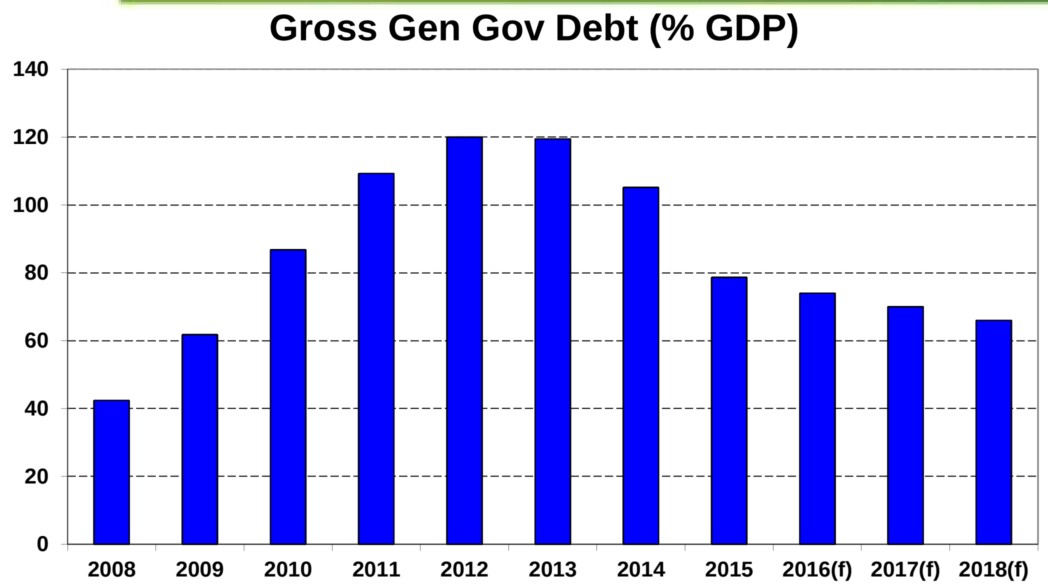
Source: *AIB, Permanent TSB/ESRI, CSO, Dept. of Finance*

AIB Model of Estimated Potential Housing Demand

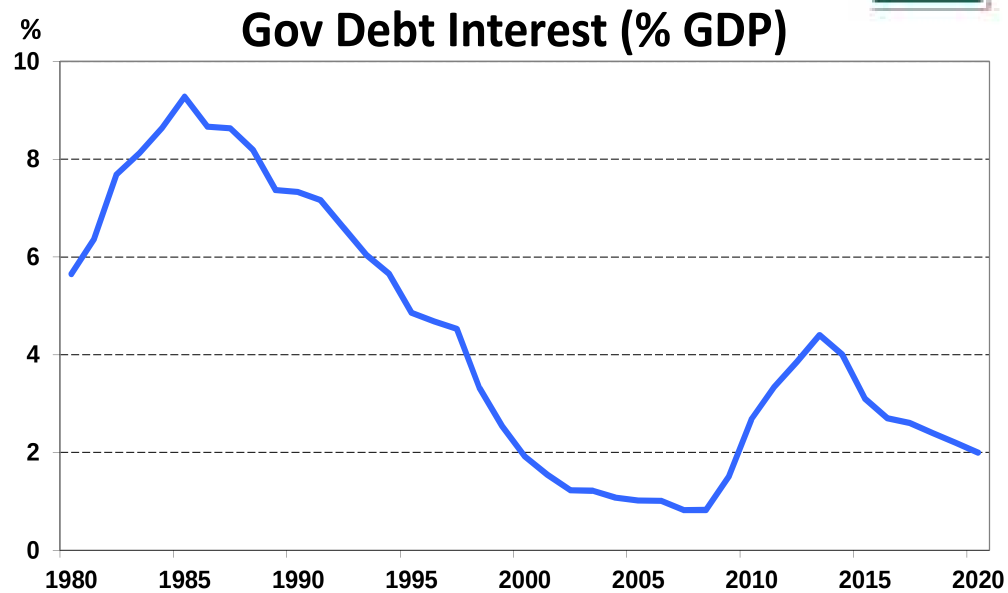
Calendar Year	2012	2013	2014	2015	2016	2017	2018
Household Formation	14,000	15,000	16,500	19,500	21,500	22,000	23,000
of which							
Indigenous Population Growth	*20,000*	*17,500*	*17,000*	*17,500*	*17,000*	*16,000*	*15,500*
Migration Flows	*-9,000*	*-5,500*	*-3,500*	*-1,500*	*1,000*	*2,500*	*3,500*
Increased Headship	*3,000*	*3,000*	*3,000*	*3,500*	*3,500*	*3,500*	*4,000*
Second Homes	1,000	1,000	1,000	1,000	1,000	1,500	1,500
Replacement of Obsolete Units	4,000	4,000	4,500	4,500	4,500	5,000	5,500
Total POTENTIAL Demand	19,000	20,000	22,000	25,000	27,000	28,500	30,000
Completions	8,500	8,300	11,000	12,700	15,000	19,000	24,000
POTENTIAL Impact on Vacant Stock	*-10,500*	*-11,700*	*-11,000*	*-12,300*	*-12,000*	*-9,500*	*-6,000*

Sources: CSO, DoECLG, AIB ERU

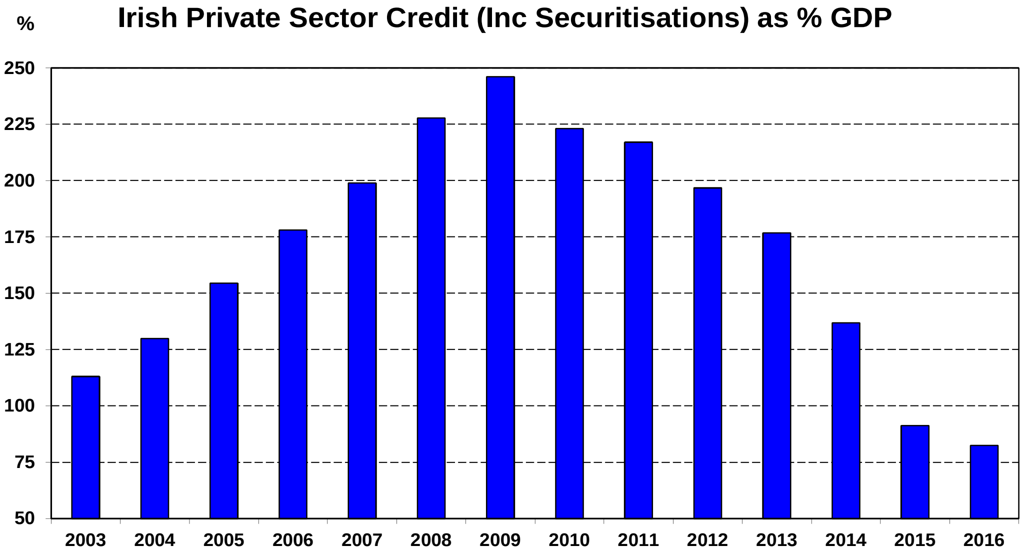
Gov debt ratio falling, private sector deleveraging



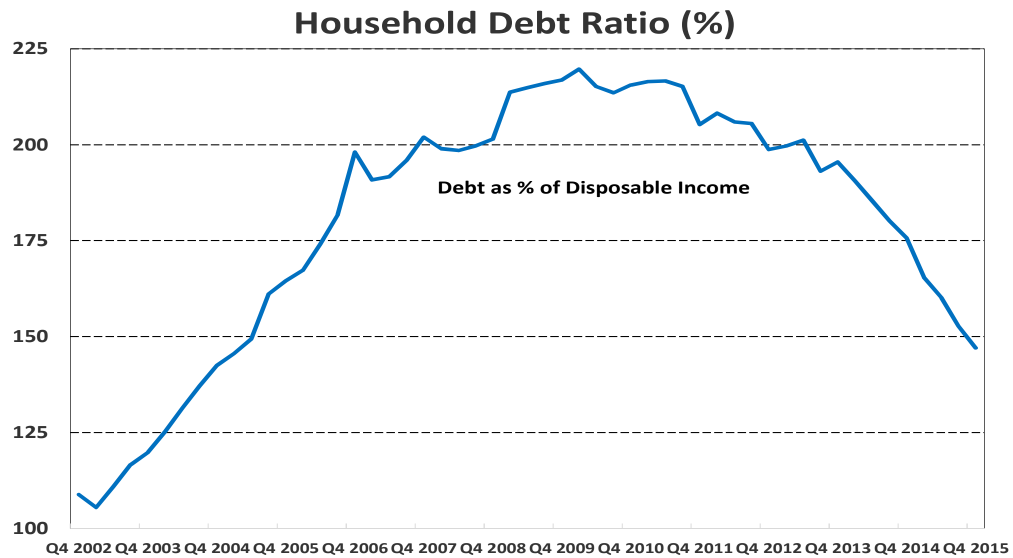
Source: Dept of Finance/AIB ERU. Note Inflated/Distorted GDP figues from 2015)



Source: NTMA; Dept of Finance



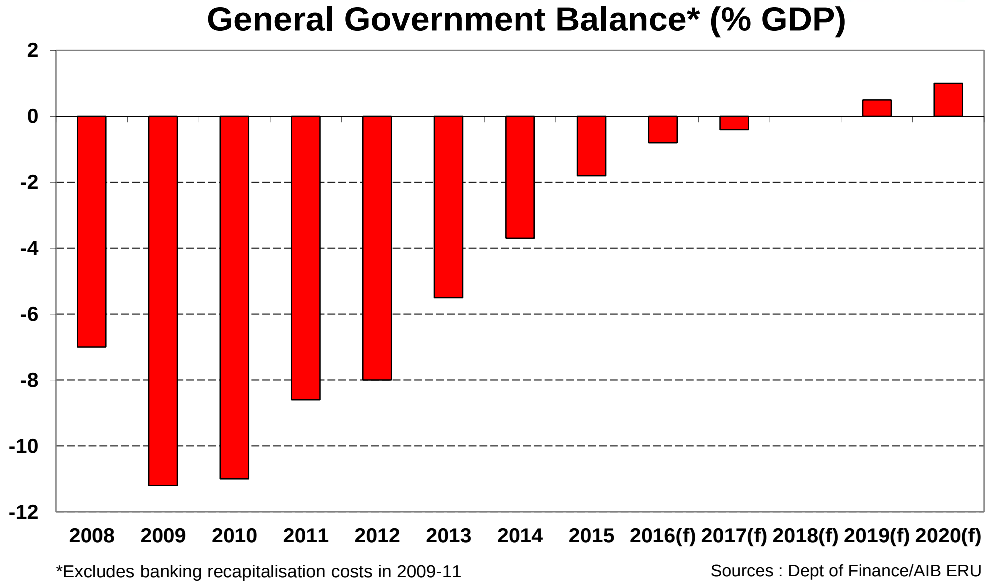
Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figs in 2015/16)

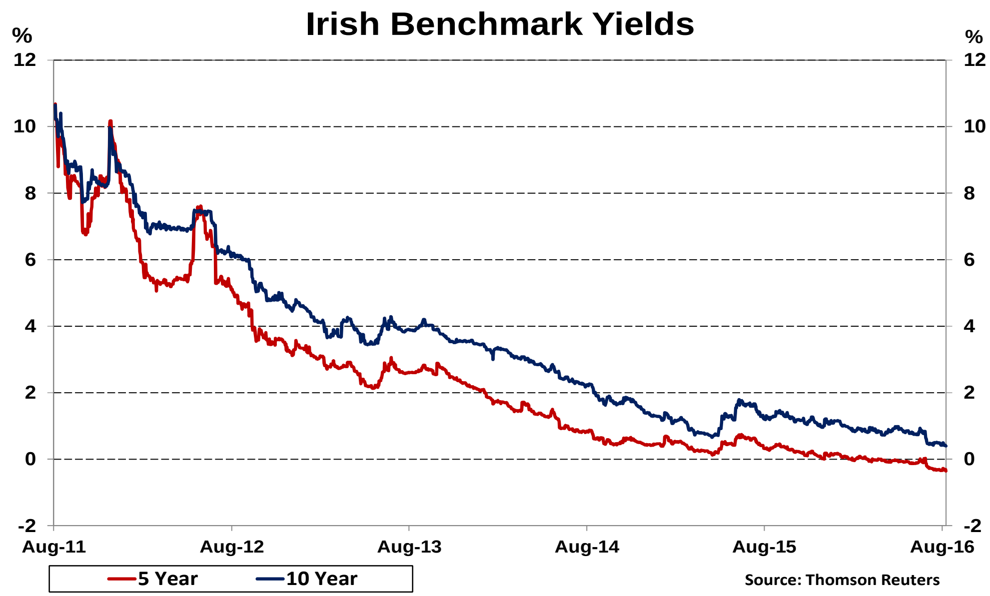


Source : Central Bank of Ireland & CSO Data ; AIB ERU Calculations

Budget deficit falls to very low level

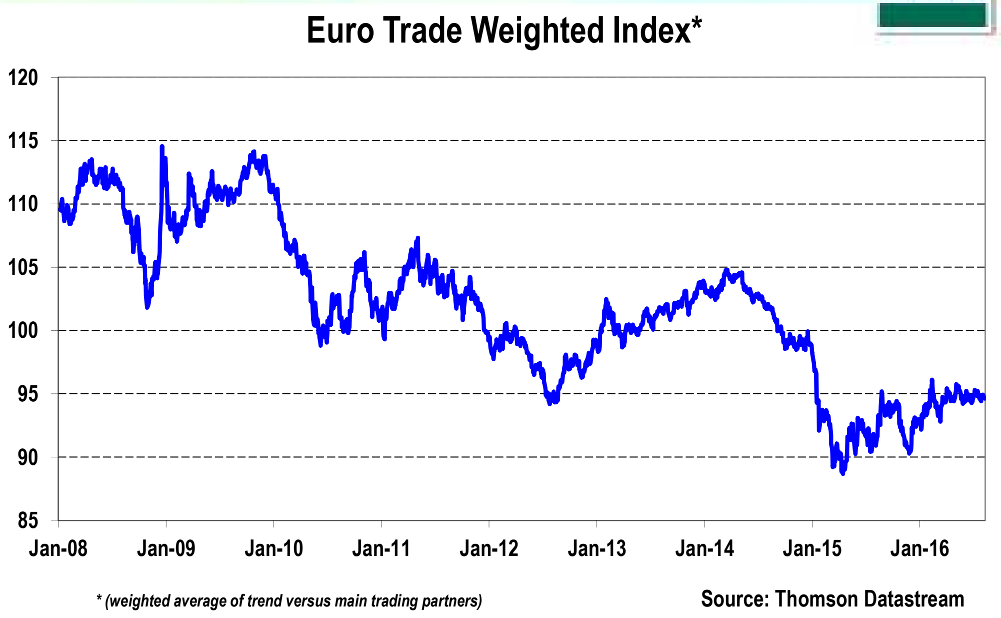
- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budgetary policy turns mildly expansionary in 2015 and 2016
- Budget deficit falls sharply in recent years
- Deficit of under 1% of GDP likely in 2016
- Balanced budget possible in 2017 or 2018
- Primary budget (i.e. excluding debt interest) surplus of 1.5% of GDP likely in 2016
- Debt interest costs low - below 3% of GDP
- Gross Gov Debt/GDP ratio falling sharply. Now well below its peak of 120% in 2013
- Irish bonds yields have fallen sharply, with negative five year yields, ten year at 0.4%
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A, Moody's A3

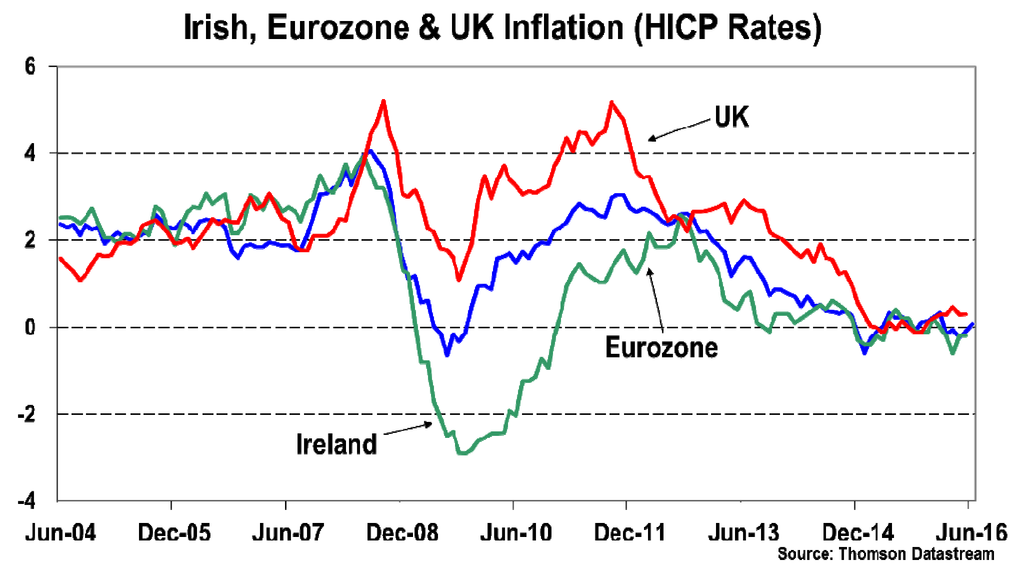




Economy has capacity to grow strongly but…

- The contraction on the domestic side of economy is well over and it is now recovering strongly
- Wage growth and very low inflation boosting real spending power
- Labour market on steadily improving path
- Construction should continue its recovery from its still very depressed activity levels
- Fiscal tightening over, with budgetary policy now mildly expansionary
- Ireland benefitting from weakness of euro and improvement in European growth in past two years
- Activity supported by low interest rate environment
- Large, diversified export base performing very well
- Economy has capacity to grow very strongly
- But Brexit uncertainty will hamper activity
- Weaker UK economy and slide in sterling negatives
- Growth could slow to 3.0-3.5% in 2017-18





…Brexit is a major headache for Ireland

- Brexit has serious implications for Ireland given close economic/trade links with UK
- Trade with UK equates to 35% of Irish GDP. Thus, it is a key trading partner
- Hence negative impact of Brexit on UK growth will have knock-on effects in Ireland
- Sterling has also weakened sharply on Brexit concerns, which will hit exports to UK and Irish firms competing with UK imports on the Irish market
- Higher trading costs from more admin, differing trade rules, possible customs duties/tariffs
- Brexit could impact the considerable cross-country investment between UK and Ireland
- Agri sector, tourism, energy, retailing, financial sector likely to be most impacted by Brexit
- UK is a very important market for Irish food exports in particular
- Border with Northern Ireland would become an external EU land border
- Key is the trade arrangements put in place between EU and UK post Brexit. Ideally, UK would retain access to the Single Market and UK/Irish common travel area remains
- Ireland will lose a key ally within the EU when UK leaves
- Main upside is that Brexit would make Ireland more attractive for FDI vis-à-vis the UK
- Irish growth to be lower is 2017-18 in run-up to Brexit on weak sterling and UK slowdown
- Impact post 2018 will depend on the Brexit deal negotiated between the EU and UK

AIB Irish Economic Forecasts

% change in real terms unless stated	2013	2014	2015	2016 (f)	2017 (f)	2018 (f)
GDP	**1.1**	**8.5**	**26.3**	**4.7**	**3.5**	**3.0**
GNP	4.7	9.2	18.7	4.2	3.0	2.5
Personal Consumption	-0.8	1.7	4.5	3.5	3.0	2.5
Government Spending	0.1	5.4	1.1	1.0	1.0	1.0
Fixed Investment	-5.4	18.2	32.7	7.0	6.0	5.0
Core Fixed Investment*	22.6	14.4	18.3	7.0	6.0	5.0
Core Domestic Spending*	**2.3**	**4.2**	**6.6**	**4.2**	**3.6**	**3.1**
Exports	3.1	14.4	34.4	6.0	5.0	4.5
Imports	1.1	15.3	21.7	5.8	5.5	4.8
HICP Inflation (%)	0.5	0.3	0.0	0.1	0.5	0.5
Unemployment Rate (%)	13.1	11.3	9.5	7.9	7.2	6.7
Budget Balance (% GDP)	-5.5	-3.7	-1.8	-0.8	-0.4	0.0
Gross General Gov Debt (% GDP)	119.5	105.2	78.7	74	70	66

***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
- Recovery in the global economy still quite fragile, with on-going risks and headwinds especially from weak emerging economies. Ireland vulnerable to any shocks that would hit exports
- Supply constraints in the construction sector, especially new house building, which is recovering at a very slow pace and remains at depressed levels
- Very low level of public capital spending putting pressure on infrastructure
- Competitiveness issues - high house prices, high rents, high personal taxes
- High indebtedness of households. Major deleveraging has already taken place. Difficult to estimate its duration but likely to have further to run as debt ratios still high
- Continuing credit contraction – fewer banks, tighter credit conditions, on-going deleveraging