The Irish Economic Update

Growth Slowing as Brexit Looms

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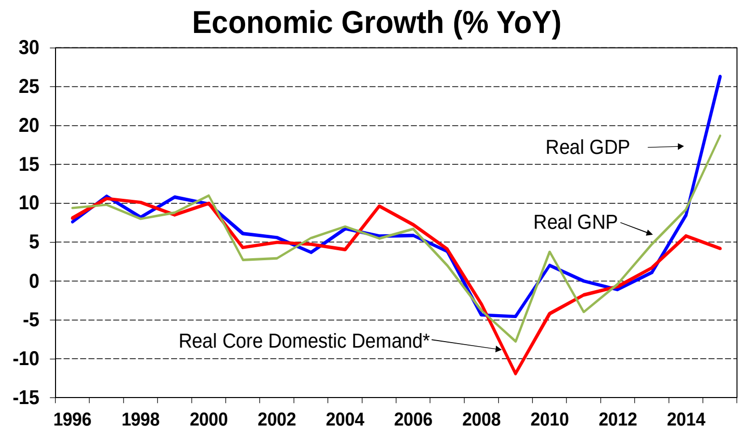
Strong recovery by Irish economy

- 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
- GDP/GNP 2015 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% by Q3 2016
- Budget deficit has declined at quicker than expected pace. Now below 1% of GDP

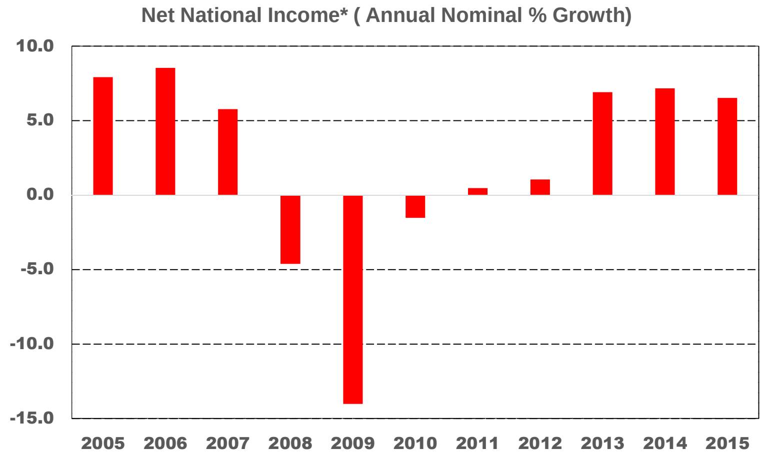
Huge distortions inflate Irish GDP/GNP figures

- GDP/GNP no longer reliable measures of output in Ireland. Review underway of National A\Cs
- Exports, imports, industrial production, investment, BoP distorted by activities of some multi-nationals
- Contract manufacturing also distorting trade data
- 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
- Growth in core domestic spending averaged around 5% in 2014-15
- Signs of a slowdown in growth this year, notably consumer spending and business investment



*Real Domestic Demand less Aircraft and R&D/Intangibles

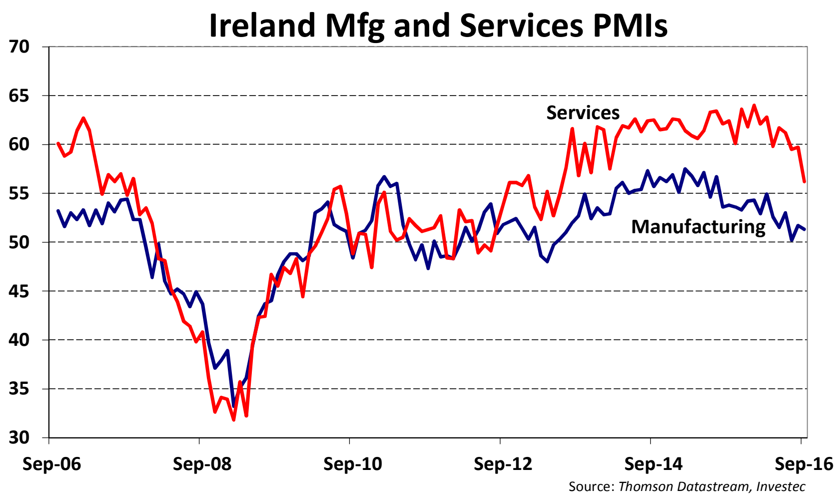
Source: CSO and AIB ERU

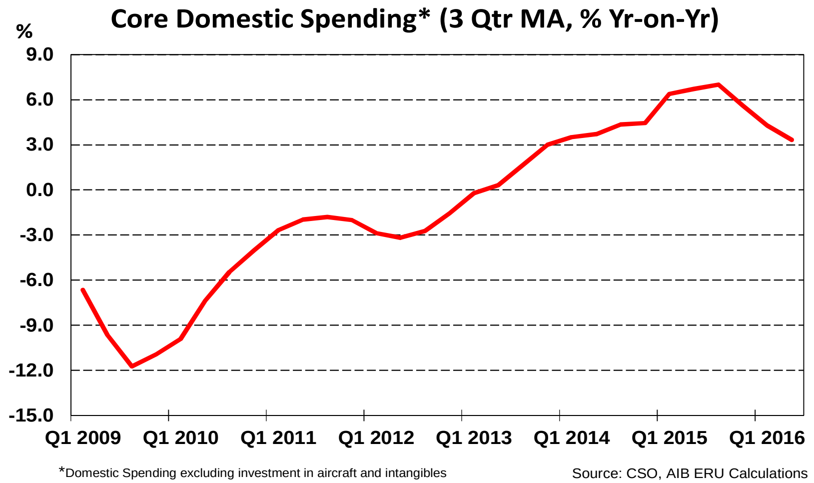


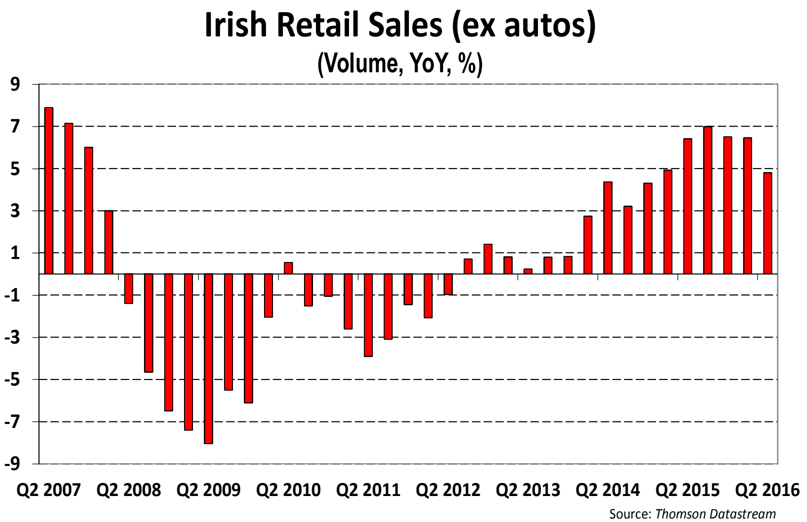
*NNI (at market prices) = GNP - depreciation - taxes + subsidies

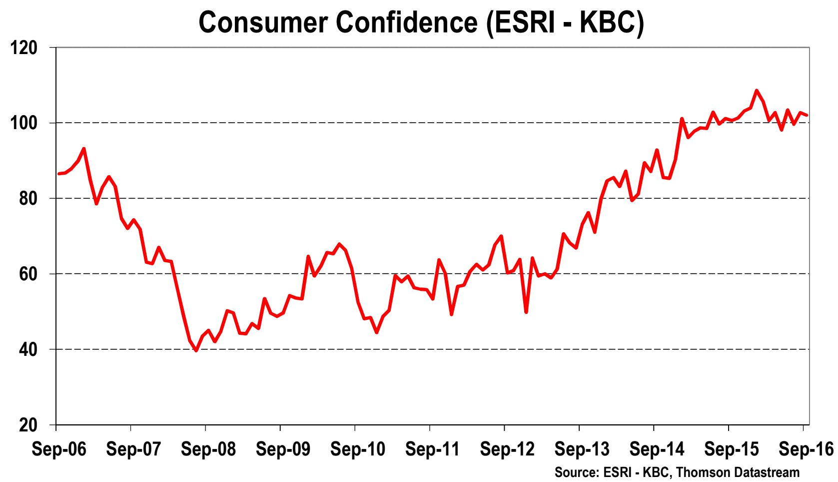
Source: CSO

Signs that strong Irish growth rate is slowing









More mixed tone to recent data

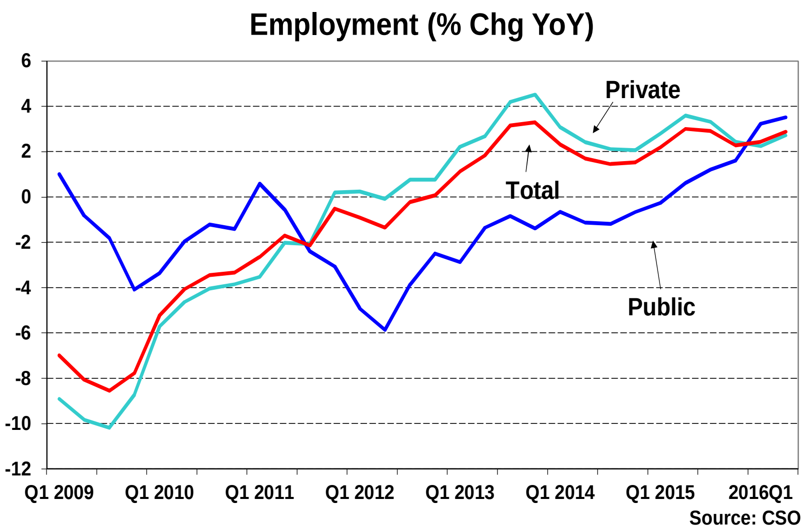
- GDP growth averaged 4% year-on-year in H1 2016
- Good manufacturing PMI data in H1 2016 but much lower in Q3, averaging 51
- Very robust services PMI in H1 2016 at near ten year highs, but hit 3-year low in Sept
- Slower growth in service exports of 5.8% yoy in H1 2016 after a big rise in 2015
- Construction PMI performing strongly – averaged over 60 in H1 2016. Close to 60 in Q3
- Consumer confidence remains very strong but below the 15 year highs hit in Q1
- Growth in core retail sales (ex motor trade) slows over summer – up 5.5% yoy in H1
- Growth in car sales slows since the spring after 30% jump in both 2014 and 2015
- Housing completions up by 19% yoy in first eight months of 2016
- Mortgage lending picks up strongly in 2016 after slowing in 2015 on new CB lending rules
- Employment rose by 0.8% in Q1 and 1.0% in Q2 2016 – up 2.9% yoy in Q2
- Live Register continues to fall. Jobless rate down below 8% – peaked at 15.1% in 201
- Slower growth in tax receipts since early summer but still ahead of target in 2016

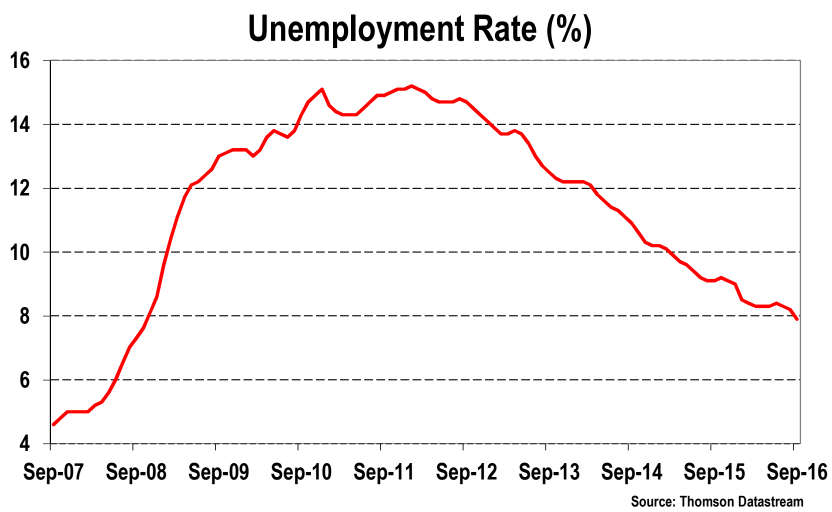
Strong jobs growth & marked fall in unemployment

Year Average	2013	2014	2015	2016(f)	2017(f)	2018(f)
Unemployment Rate %	13.1	11.3	9.5	8.1	7.2	6.7
Labour Force Growth %	0.4	-0.3	0.5	1.1	1.1	1.1
Employment Growth %	2.4*	1.7	2.6	2.6	2.0	1.7
Net Migration : Year to April ('000)	-33.1	-21.4	-11.6	3.0	10.0	15.0

* *Employment ex Agriculture +1.3% in 2013*

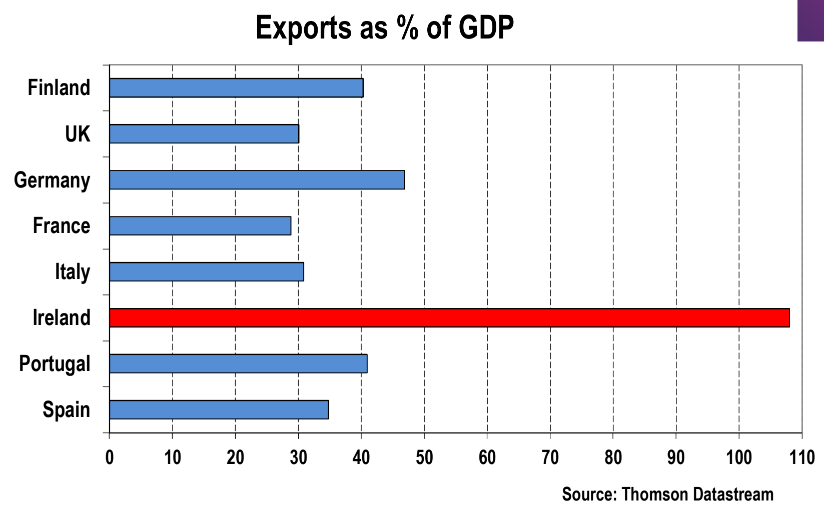
Source: CSO and AIB ERU forecasts

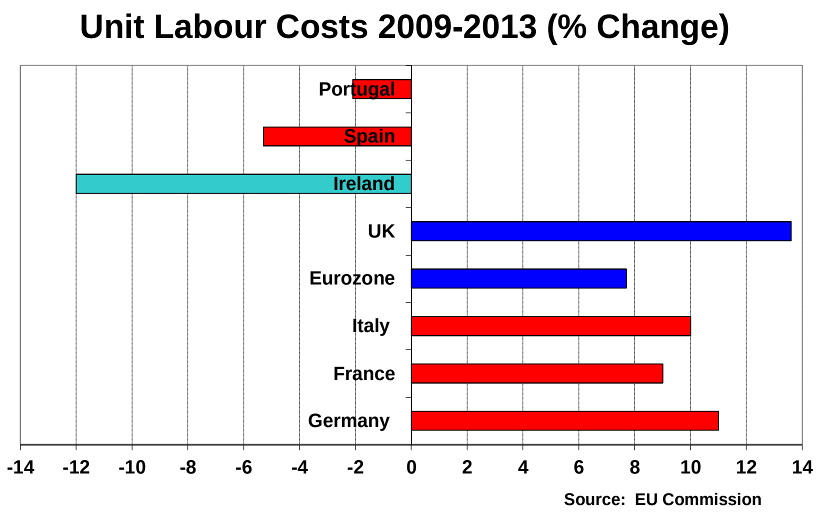


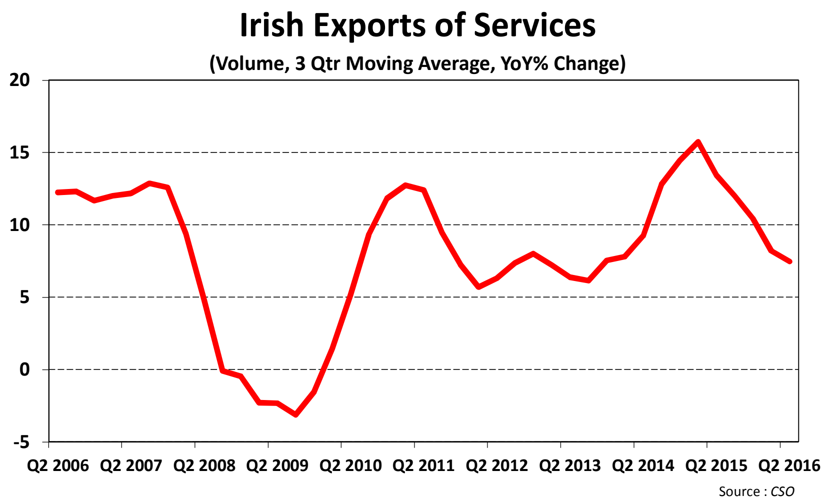


Large Irish export base performing strongly

- 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

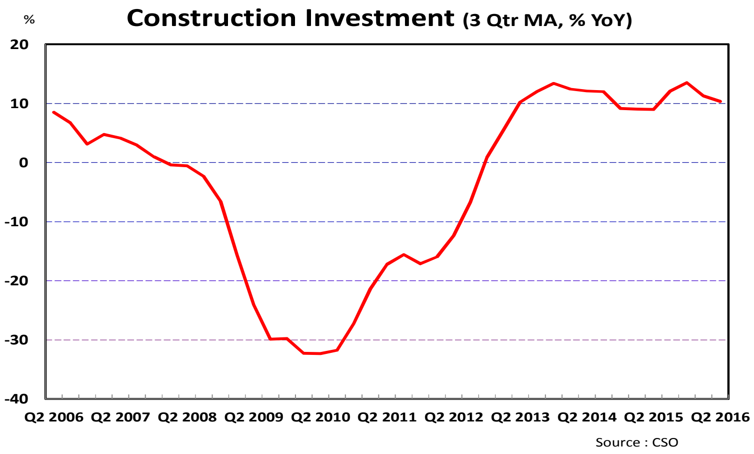
- 1,200 multinational companies
- €125bn Exports (70% of Irish exports)
- 175,000 Jobs in FDI, 290,000 in total
- 70% of Corporation Tax
- €13.5bn Spending on services/materials
- €8.5bn in Payroll
- 67% of Business R&D expenditure

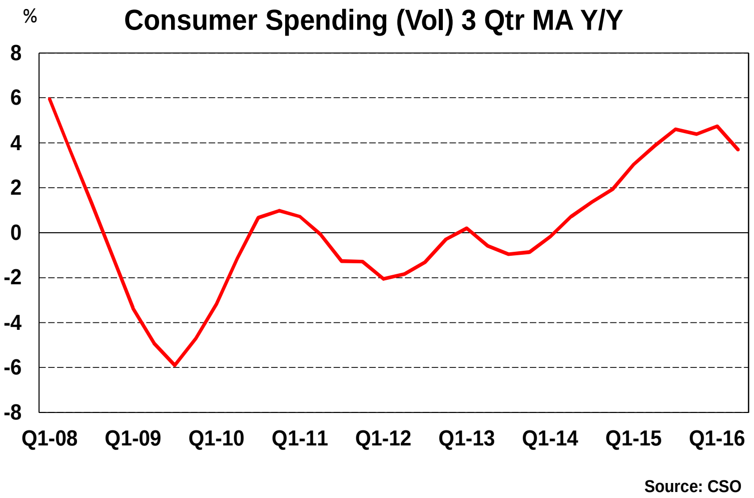
WORLD LEADERS CHOOSE IRELAND

- 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

Slower growth in domestic economy this year

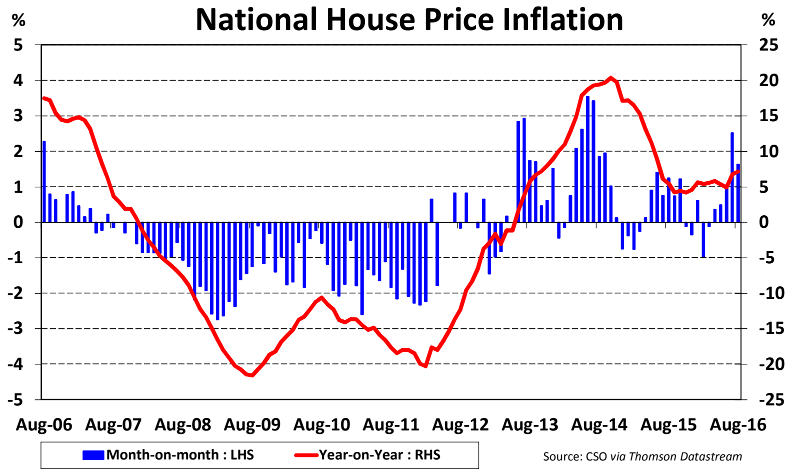
- Domestic economy contracted by 20% from 2008-12
- Collapse in construction was big drag on GDP - fell from 13.5% of GDP in 2005-07 to 5.3% by 2012
- Construction has seen steady growth since 2013 – output rose by over 10% in each of last three years
- Business investment (ex planes/R&D) more than doubled in 2013-2015 but falls back in H1 2016
- Consumer spending grew by 1.7% in 2014, 4.5% in 2015 and 3.5% yoy in H1 2016
- Core domestic spending (ex aircraft, R&D, Intangibles) averaged growth of 4.4% in 2013-2015
- Slower growth of 2.4% yoy in core domestic spending in H1 2016 as business investment falls
- Slowdown in retail sales over summer with new car sales also losing some momentum since the spring

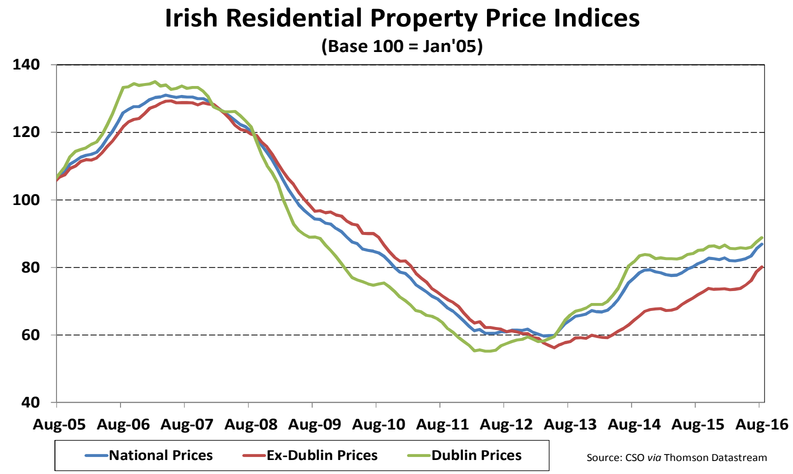




House prices rise as shortage emerges

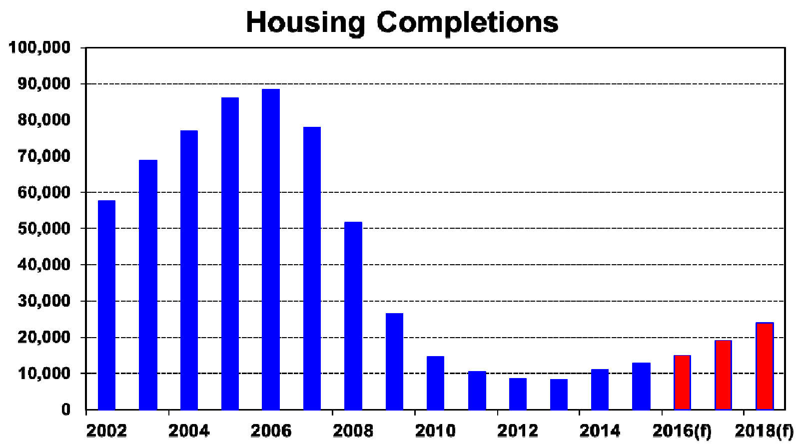
- Housing output fell by 90% but now past trough
- Bulk of the new housing stock overhang eliminated
- House prices declined sharply – fell by almost 55% between their peak in late 2007 and early 2013
- House prices rebound: up 45% by Aug 2016 from low in early 2013 as housing shortage emerges
- Dublin prices up by 61% from trough with non-Dublin prices up by 43%
- House prices, though, including in Dublin, are still some 34% below peak levels hit in 2007
- Central Bank mortgage rules cool Dublin house price inflation – falls from 25% to below 5% yoy
- Nationally, prices up 7.2% yoy in Aug 2016, with higher rises outside Dublin – up 11.4% yoy
- Rents have rebounded – up over 40% from lows and now 8% above previous peak reached in 2008



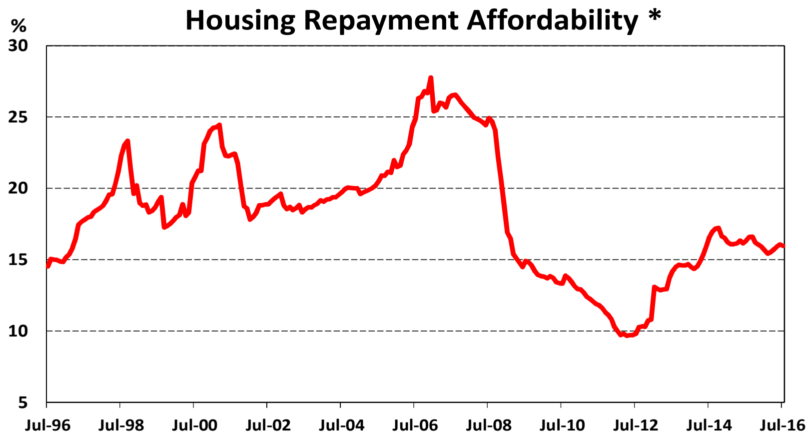


House building rising slowly from low level

- Housing completions at 12,700 in 2015, up from 11,000 in 2014 and 8,300 in 2013
- Completions up 19% to August 2016. Should reach 15,000 units this year but still at very low levels
- Annual demand estimated at 25,000-30,000 units
- Trend in new housing registrations and starts 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 CB lending rules
- Housing affordability helped by low mortgage rates but Central Bank mortgage rules an issue in Dublin



Source: CSO; DoEHLG and AIB ERU



* % of disposible 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

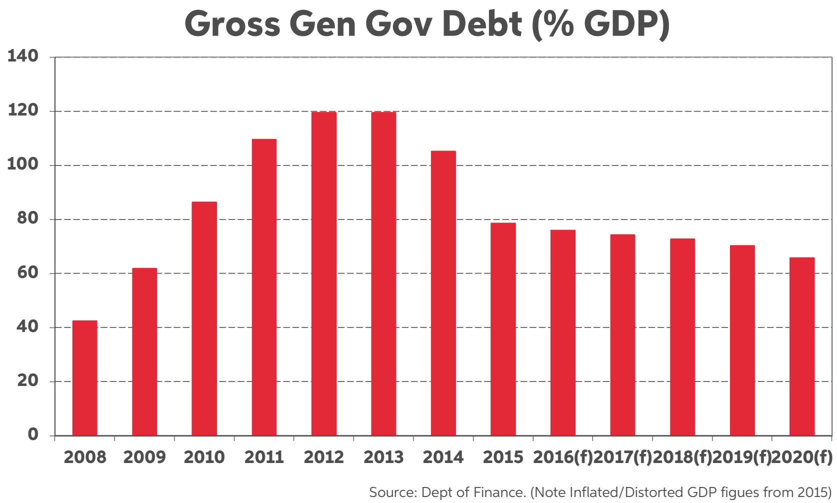
Source: *AIB, Permanent TSB/ESRI, CSO, Dept. of Finance*

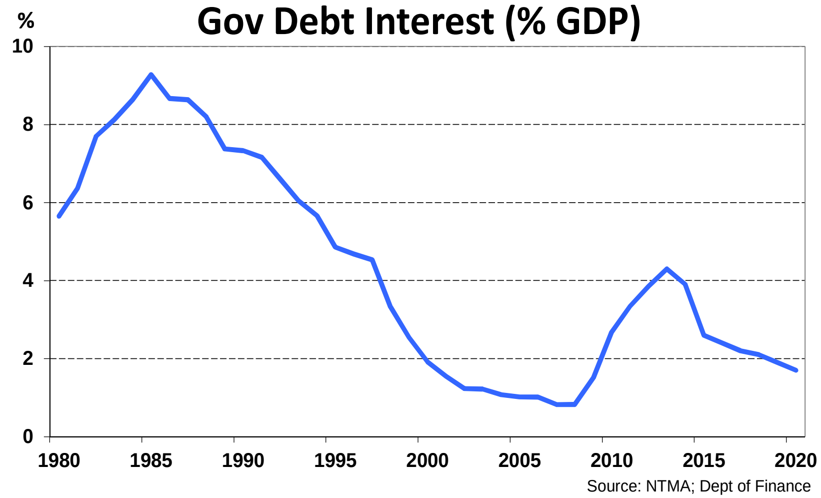
AIB Model of Potential Housing Demand

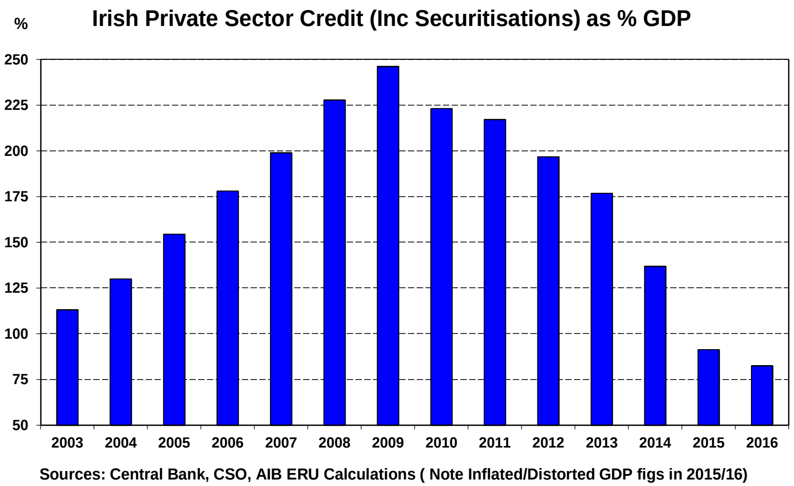
Calendar Year	2012	2013	2014	2015	2016	2017	2018
Household Formation	14,000	15,000	16,500	19,500	21,500	22,000	23,000
of which							
Indigenous Population Growth	*20,000*	*17,500*	*17,000*	*17,500*	*17,000*	*16,000*	*15,500*
Migration Flows	*-9,000*	*-5,500*	*-3,500*	*-1,500*	*1,000*	*2,500*	*3,500*
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*

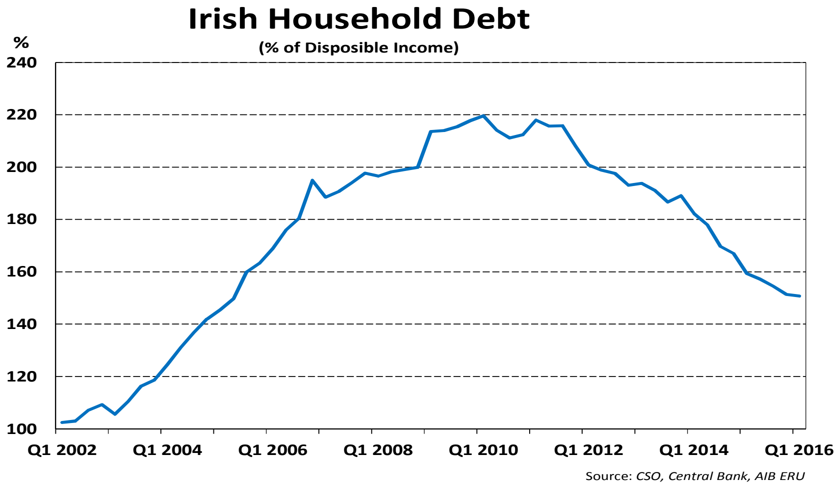
Sources: CSO, DoECLG, AIB ERU

Gov debt ratio falling, private sector deleveraging



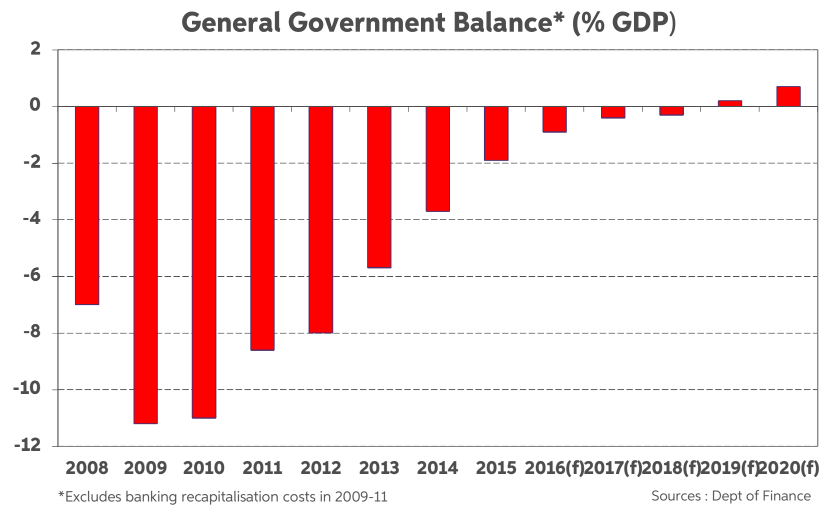


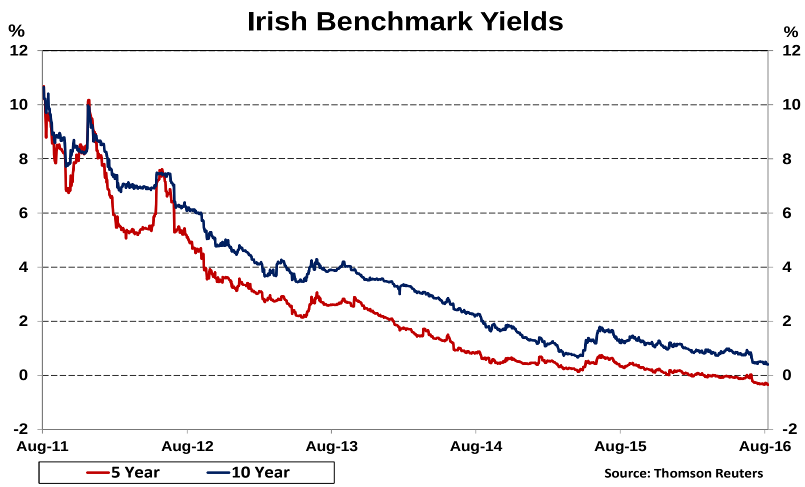




Budget deficit falls to very low level

- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Fiscal policy now mildly expansionary
- Budget deficit falls sharply in recent years
- Deficit of under 1% of GDP likely in 2016
- Budget deficit forecast at below 0.5% of GDP for 2017 and 2018
- Primary budget (i.e. excluding debt interest) surplus of circa 1.5% of GDP likely in 2016
- Debt interest costs low – circa 2.5% of GDP
- Gross Gov Debt/GDP ratio in marked decline
- Irish bonds yields have fallen sharply, with negative five year yields, ten year circa 0.5%
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A, Moody's A3





Brexit is a major headache for Ireland

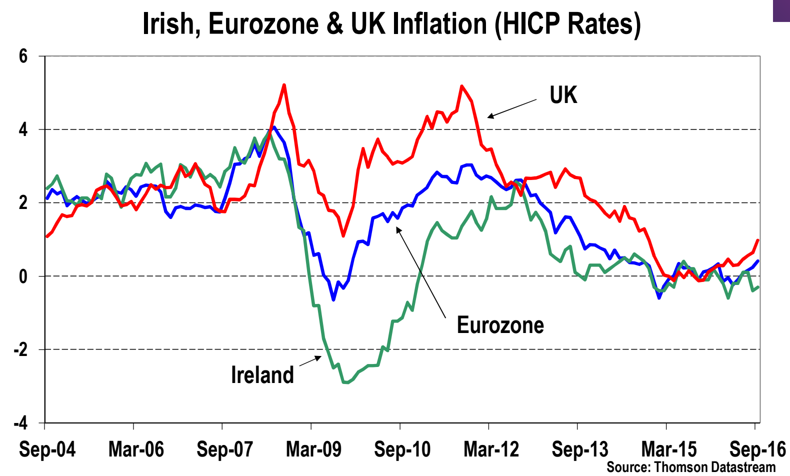
- Brexit has serious implications for Ireland given close economic/trade links with UK
- Trade with UK equates to 35% of Irish GDP. Thus, it is a key trading partner
- UK takes 43% of Irish indigenous firms exports, so very important trading partner for them
- Hence, negative impact of Brexit on UK economy will have knock-on effects in Ireland
- Sterling has also weakened sharply on Brexit concerns, which will hit exports to UK
- Also impacts Irish firms competing with UK exports to both Ireland and third country markets
- Cross-border trade likely to pick up as shoppers head north following sterling's big fall, while there will be a significant impact on cross-border businesses like hotels and restaurants
- Higher trading costs from more administration, differing trade rules and regulations, compliance costs, possible customs duties and tariffs when UK leaves the EU
- 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
- Border with Northern Ireland would become an external EU land border
- Ireland will lose a key ally within EU when UK leaves as share similar views on taxation, regulation, state involvement in economy etc.

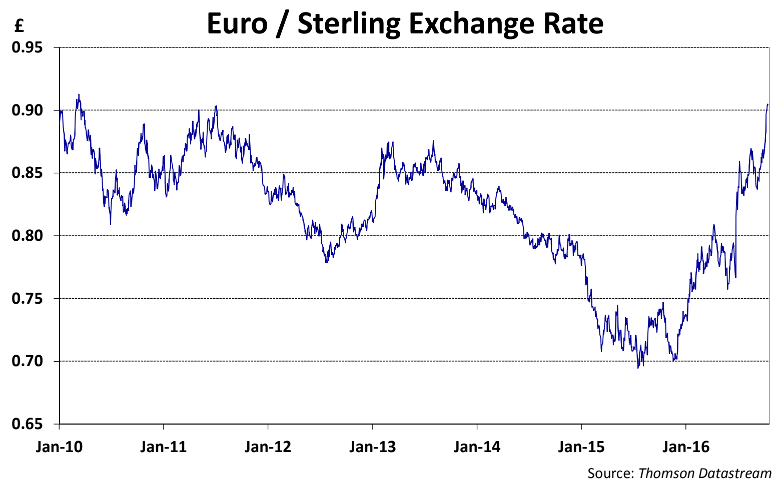
Hard Brexit would impact Irish/UK trade

- Key will be the trade arrangements put in place between EU and UK post Brexit
- Ideally, UK would retain access to Single Market and UK/Irish common travel area remains
- Indications from EU that talks on new trade deal can only begin after UK leaves
- Thus, exit deal likely to contain only transition or interim arrangements on trade
- UK Government putting the emphasis on regaining control over immigration and return of full sovereignty and thus could lose access to Single Market – hard Brexit
- An interim/transitional trade deal will be difficult to conclude if UK continues to insist on regaining control over immigration and full independence
- Hard Brexit would see UK leaving the EU Customs Union and Single Market
- UK would have to fall back on WTO rules in a hard Brexit, which require a common set of tariff rates to be applied to all countries where no free trade deals exits
- This would be bad news for Irish/UK trade as could see imposition of tariffs, customs duties
- Main upside is that Brexit would make Ireland more attractive for FDI vis-à-vis the UK
- Lower Irish growth during 2016-19 in run-up to Brexit on weak sterling and UK slowdown
- Long term impact will depend on the trade arrangements put in place post-Brexit

Brexit to curtail rebound of Irish economy

- Strong rebound by Irish economy and labour market
- Wage growth and very low inflation boosting spending
- Construction should continue its recovery from its still depressed activity levels
- Fiscal tightening over, with budgetary policy now mildly expansionary
- Ireland benefits 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
- No sign of impact on FDI from corporate tax changes
- Brexit uncertainty, though, will hamper activity
- Weaker UK economy and slide in sterling negatives
- Slower global growth also a headwind for exports
- Irish growth slows in 2016, weak business investment
- GDP growth could slow to 3.0-3.5% in 2016-19





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**	**3.5**	**3.5**	**3.0**
GNP	4.7	9.2	18.7	5.5	3.0	2.5
Personal Consumption	-0.8	1.7	4.5	3.0	3.0	2.5
Government Spending	0.1	5.4	1.1	3.0	1.0	1.0
Fixed Investment	-5.4	18.2	32.7	9.5	6.0	5.0
Core Fixed Investment*	22.6	14.4	18.3	3.0	6.0	5.0
Core Domestic Spending*	**2.3**	**4.2**	**6.6**	**3.0**	**3.7**	**3.1**
Exports	3.1	14.4	34.4	4.5	4.5	4.5
Imports	1.1	15.3	21.7	6.2	4.8	4.8
HICP Inflation (%)	0.5	0.3	0.0	-0.1	0.5	0.5
Unemployment Rate (%)	13.1	11.3	9.5	8.1	7.2	6.7
Budget Balance (% GDP)	-5.5	-3.7	-1.8	-0.8	-0.5	-0.3
Gross General Gov Debt (% GDP)	119.5	105.2	78.7	76	73	70

*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 impact on sterling
- Recovery in the global economy still quite fragile, with on-going risks and headwinds, including weakness of emerging economies. Ireland vulnerable to any shocks that impacts its exports
- Questions around corporation tax regime could impact FDI, though no sign of this to date
- 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
- Continuing credit contraction – fewer banks, tighter credit conditions, on-going deleveraging, household debt levels remain high