The Irish Economic Update

Signs of slower growth as Brexit looms

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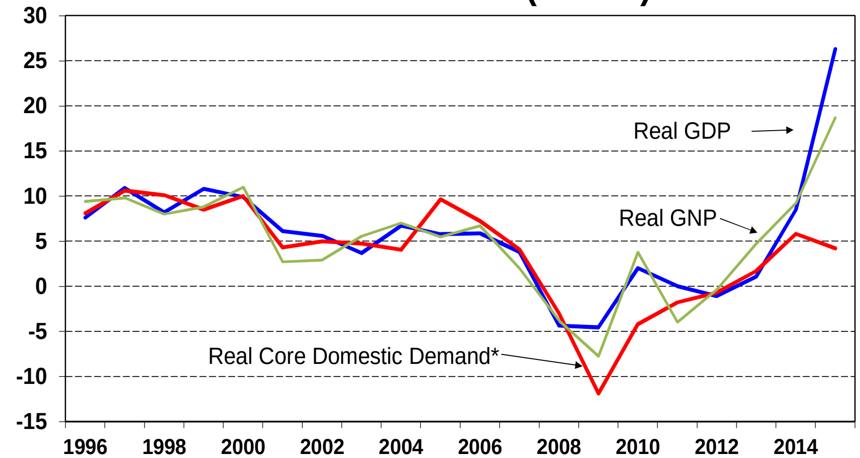
Strong recovery by Irish economy

- 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
- 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 8.3% by mid-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
- 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
- Tax receipts, Mfg PMI, retail sales, car sales softer recently – due to Brexit, weaker global growth?

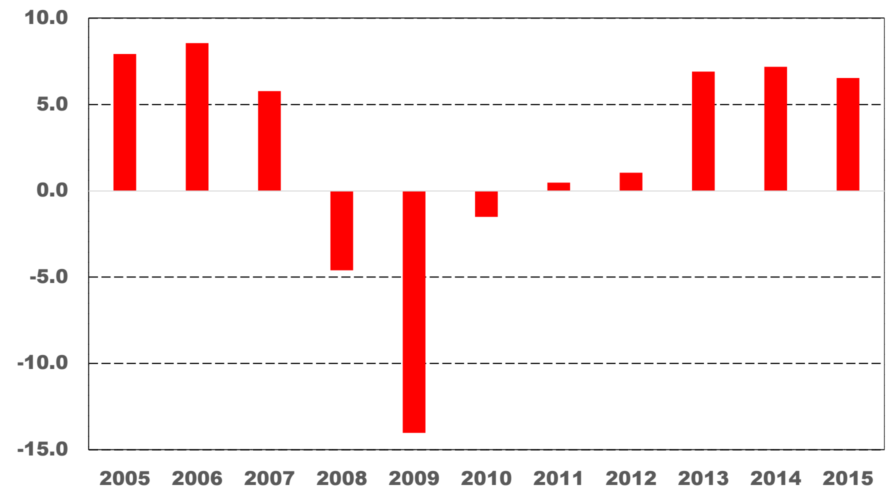
Economic Growth (% YoY)



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

Source: CSO and AIB ERU

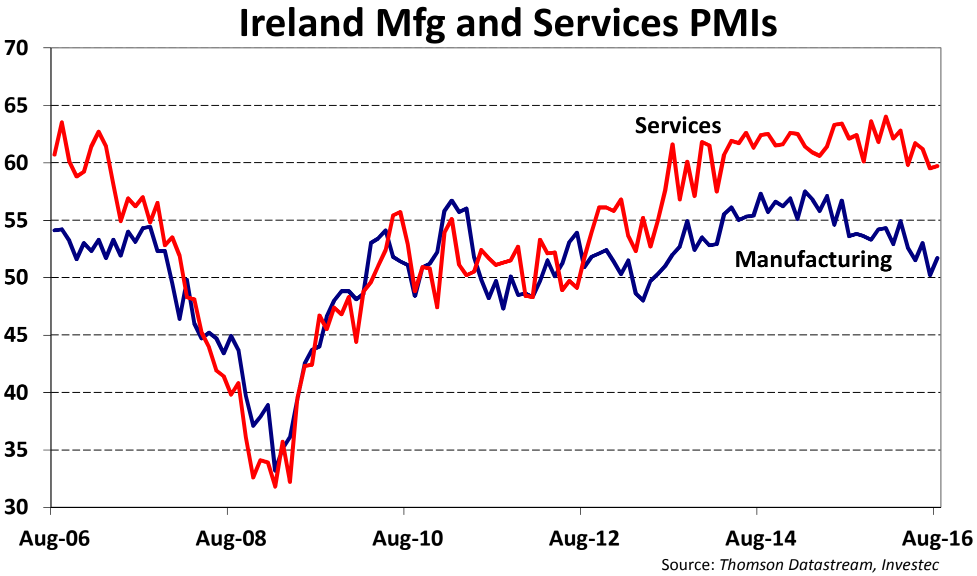
Net National Income* (Annual Nominal % Growth)

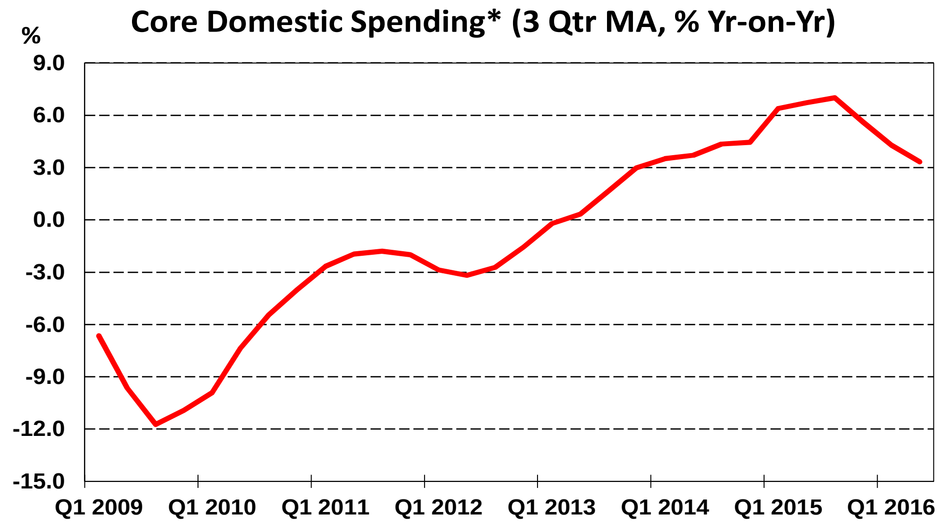


*NNI (at market prices) = GNP - depreciation - taxes + subsidies

Source: CSO

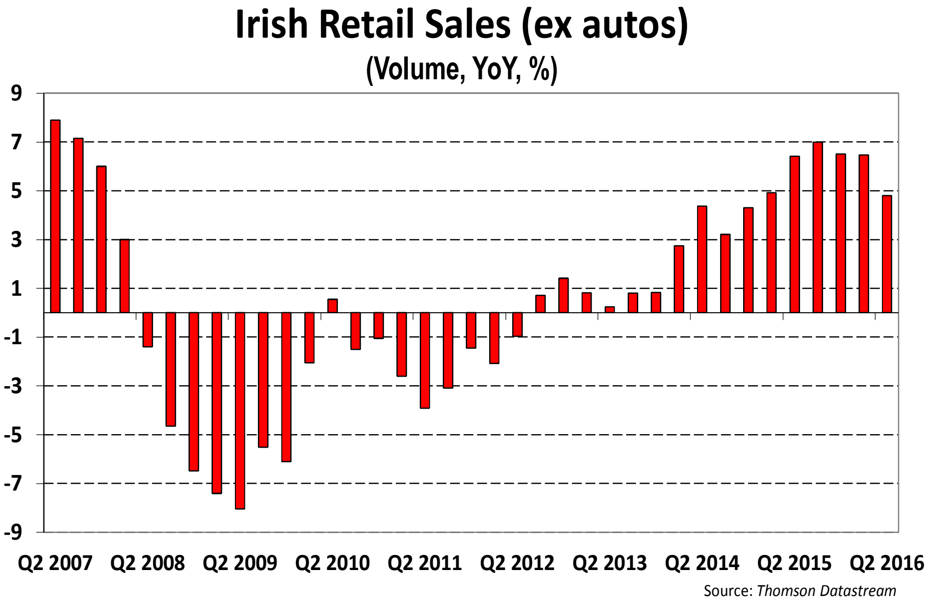
Signs that strong Irish growth rate is slowing

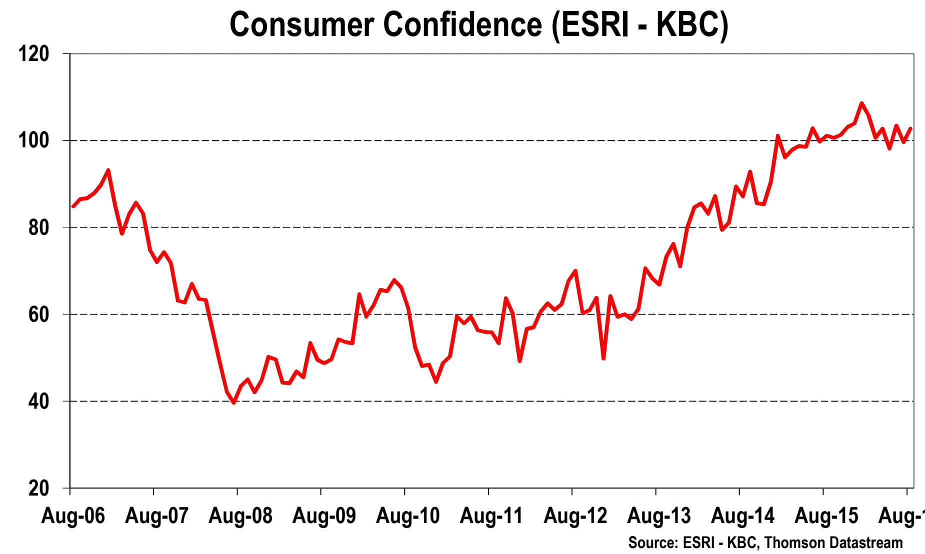




*Domestic Spending excluding investment in aircraft and intangibles

Source: CSO, AIB ERU Calculations





More mixed tone to recent data

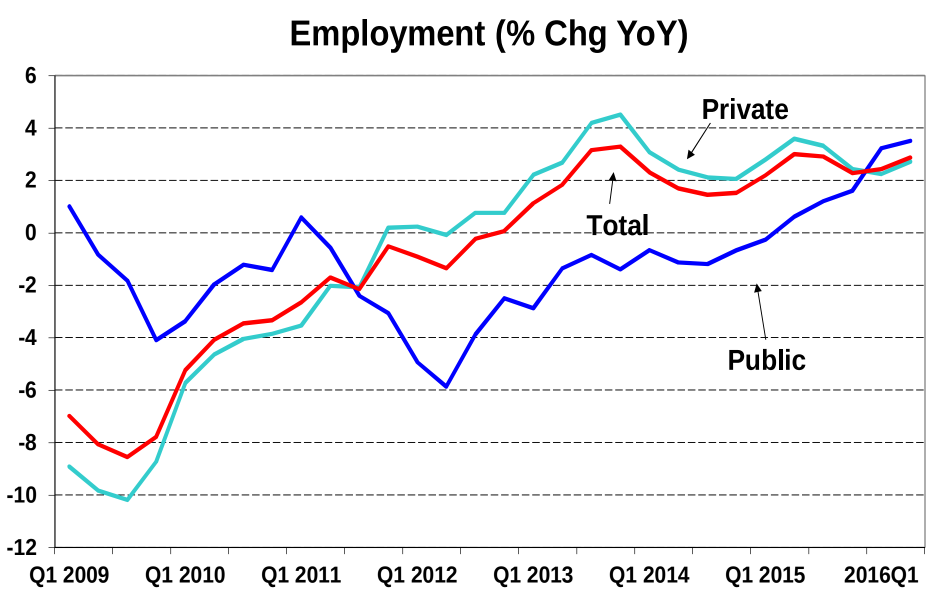
- GDP growth averaged 4% year-on-year in H1 2016
- Good manufacturing PMI data in H1 2016 but lower in July/Aug – 51.7 in August
- Very robust services PMI in 2016 but below its Q1 ten year highs. At 59.7 in August
- Slower growth in service exports of 5.8% yoy in H1 2016 after a big rise in 2015
- Construction PMI performing strongly – averaged 61 in H1 2016. Close to 60 in July/Aug
- 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 to 8.3% – peaked at 15.1% in 2012
- Migration flows turn slightly positive in 2016…. first net inward migration since 2009
- Slower growth in tax receipts over summer months but still ahead of target in 2016

Strong jobs growth & marked fall in unemployment

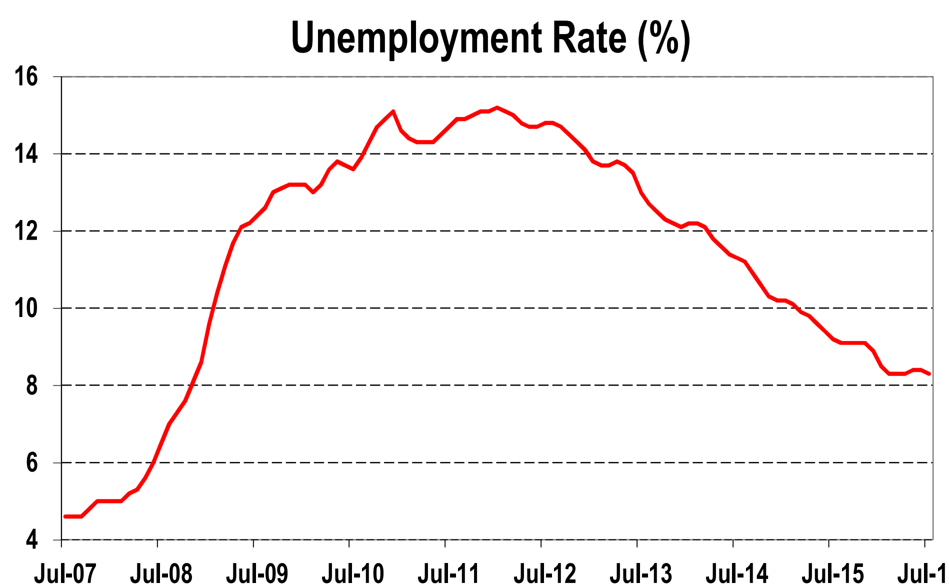
Year Average	2013	2014	2015	2016(f)	2017(f)	2018(f)
Unemployment Rate %	13.1	11.3	9.5	8.1	7.2	6.6
Labour Force Growth %	0.4	-0.3	0.5	1.2	1.3	1.3
Employment Growth %	2.4*	1.7	2.6	2.7	2.3	2.0
Net Migration : Year to April ('000)	-33.1	-21.4	-11.6	3.0	10.0	15.0

**** Employment ex Agriculture +1.3% in 2013***

Source: CSO and AIB ERU forecasts



Source: CSO

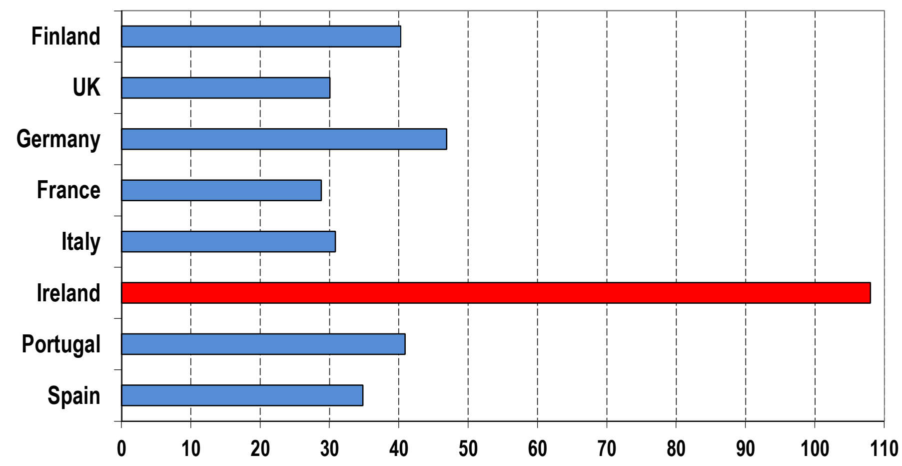


Source: Thomson Datastream

Very large Irish export base performing strongly

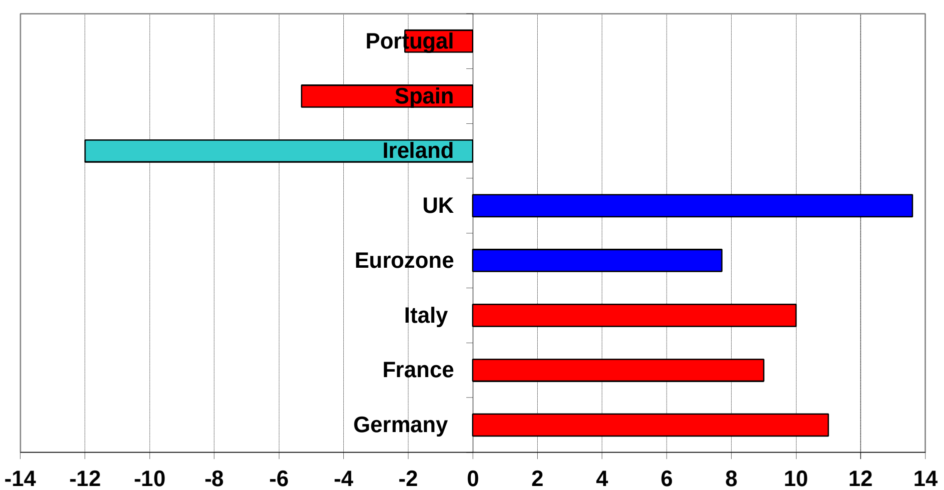
- Ireland a very open economy – exports, driven by huge FDI, equated to 108% of GDP in 2013
- Major gains in Irish competitiveness since 2009, with weakening of euro also helpful
- Exports have risen strongly helped by large FDI inflows and recovery in global economy
- Trade data distorted in 2014-15, especially goods

Exports as % of GDP



Source: Thomson Datastream

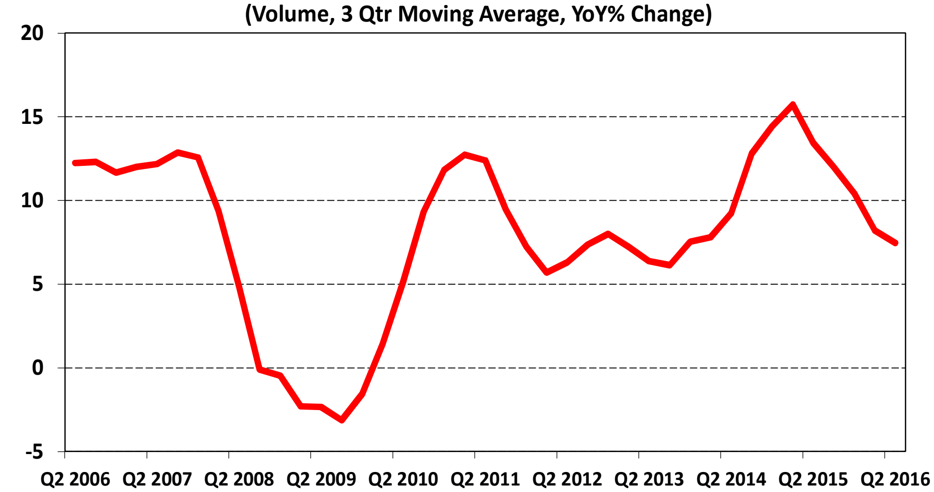
Unit Labour Costs 2009-2013 (% Change)



Source: EU Commission

Irish Exports of Services

(Volume, 3 Qtr Moving Average, YoY% Change)



Source : *CSO*

Impact of FDI on economy (Source IDA)

KEY FDI IMPACTS ON THE IRISH ECONOMY

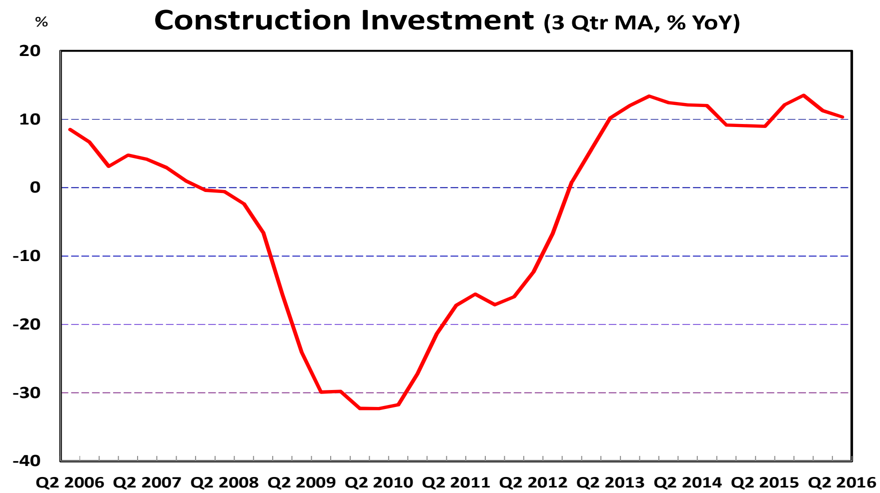
- 1,200 multinational companies
- €125bn Exports (70% of Irish exports)
- 175,000 Jobs in FDI, 290,000 in total
- 70% of Corporation Tax
- €13.5bn Spending on services/materials
- €8.5bn in Payroll
- 67% of Business R&D expenditure

WORLD LEADERS CHOOSE IRELAND

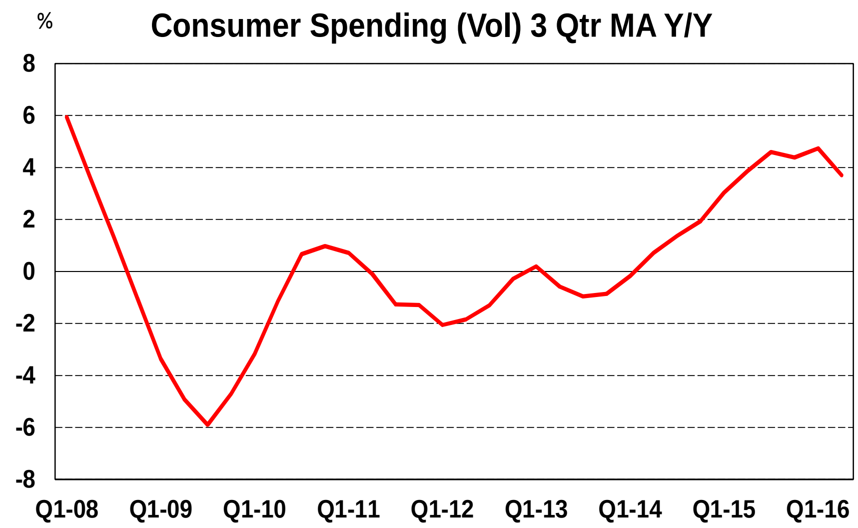
- 8 of the top 10 in ICT
- 9 of the top 10 in Pharmaceuticals
- 17 of the top 25 in Medical Devices
- 3 of the top 5 Games companies
- 10 of the 'top born on the Internet' firms
- More than 50% of the world's leading Financial Services firms

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
- Core retail sales (ex motor trade) up by 5.5% yoy in H1 2016 after rise of 6.1% in 2015
- Slowdown in retail sales over summer with new car sales also losing some momentum since the spring



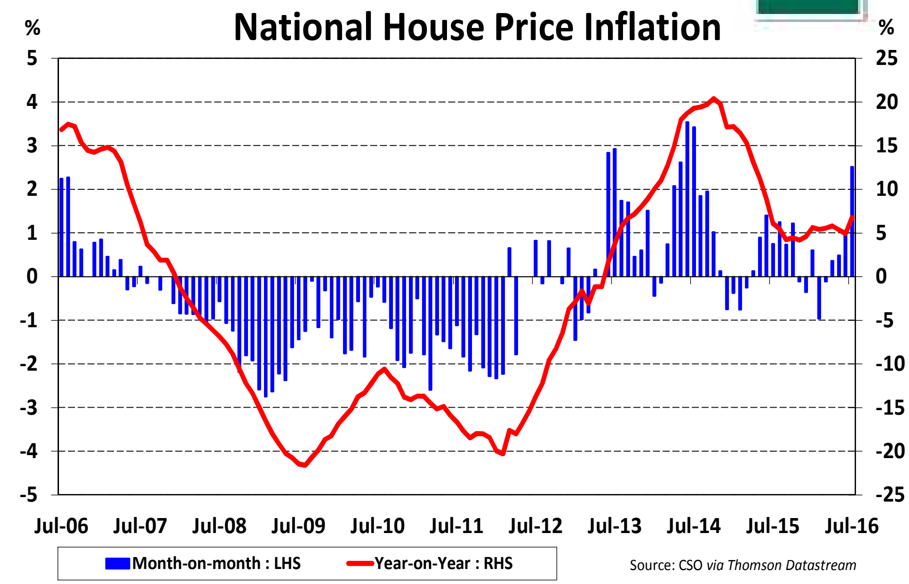
Source : CSO

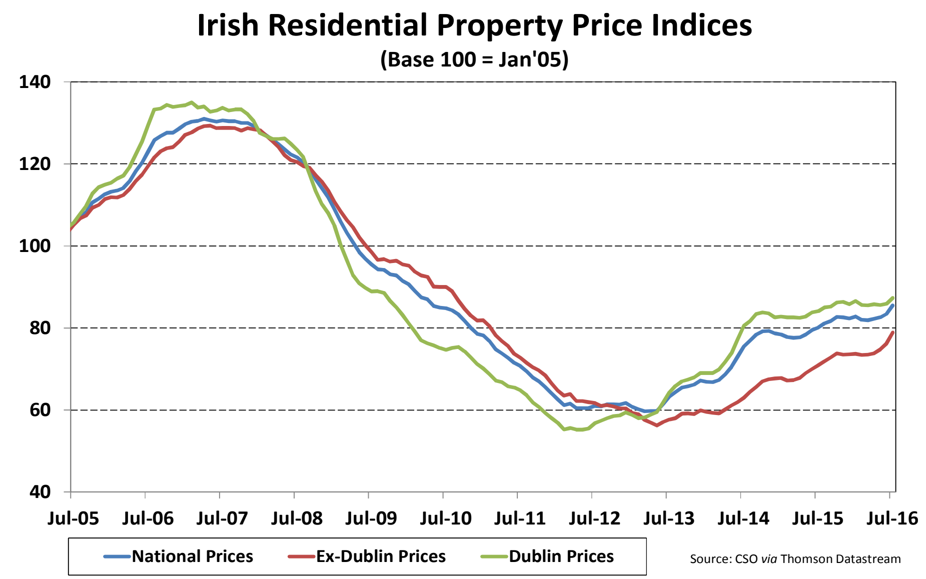


Source: CSO

House prices rise as shortages emerge in market

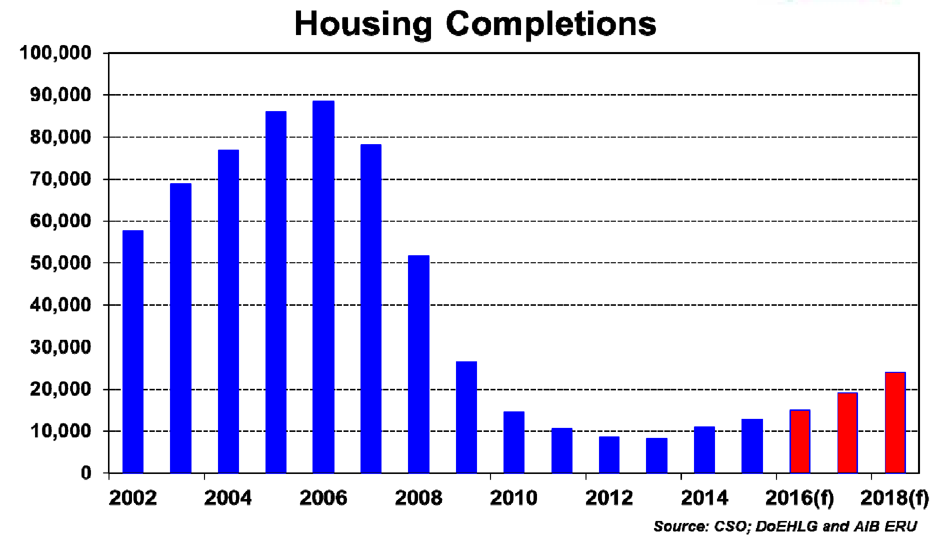
- Housing output fell by 90% but now past the bottom of cycle
- Bulk of the new housing stock overhang eliminated
- House prices declined sharply – fell by almost 55% between their peak in late 2007 and early 2013
- House prices have recovered: up 43% by July 2016 from low in early 2013 as housing shortage emerges
- Dublin prices up by 58% from trough with non-Dublin prices up by 40%
- 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 below 4% yoy
- Nationally, prices up 6.7% yoy in July 2016, with higher rises outside Dublin – up 11.3% yoy
- Rents have rebounded – up over 40% from lows and now 8% above previous peak reached in 2008

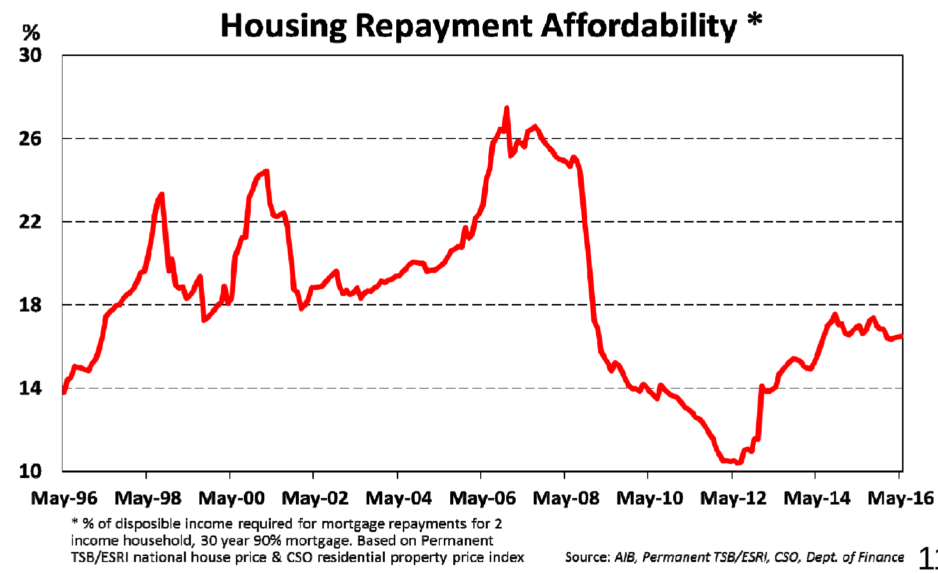




House building rising slowly from very depressed levels

- Housing completions at 12,700 in 2015, up from 11,000 in 2014 and 8,300 in 2013
- Completions up 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/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 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



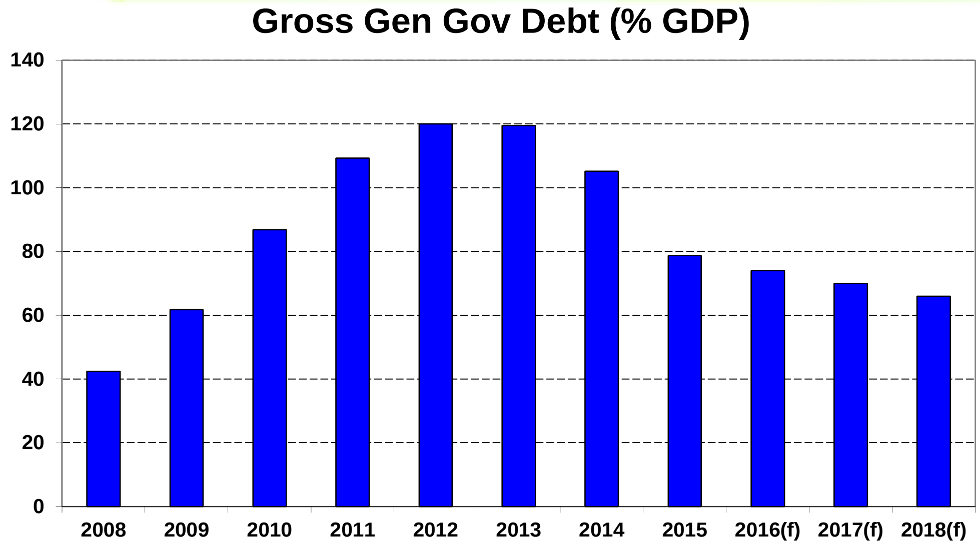


AIB Model of Estimated Potential Housing Demand

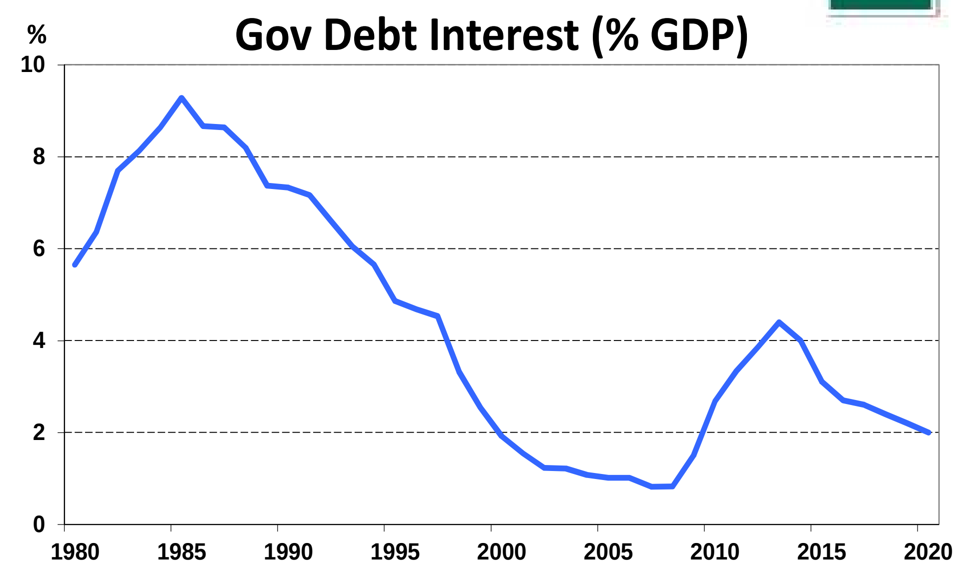
Calendar Year	2012	2013	2014	2015	2016	2017	2018
Household Formation	**14,000**	**15,000**	**16,500**	**19,500**	**21,500**	**22,000**	**23,000**
of which							
Indigenous Population Growth	***20,000***	***17,500***	***17,000***	***17,500***	***17,000***	***16,000***	***15,500***
Migration Flows	***-9,000***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

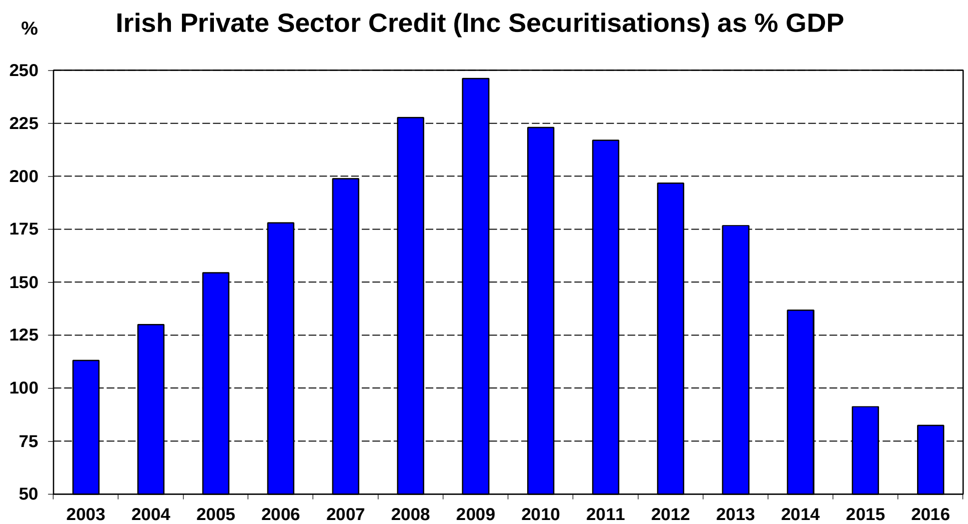
Gov debt ratio falling, private sector deleveraging



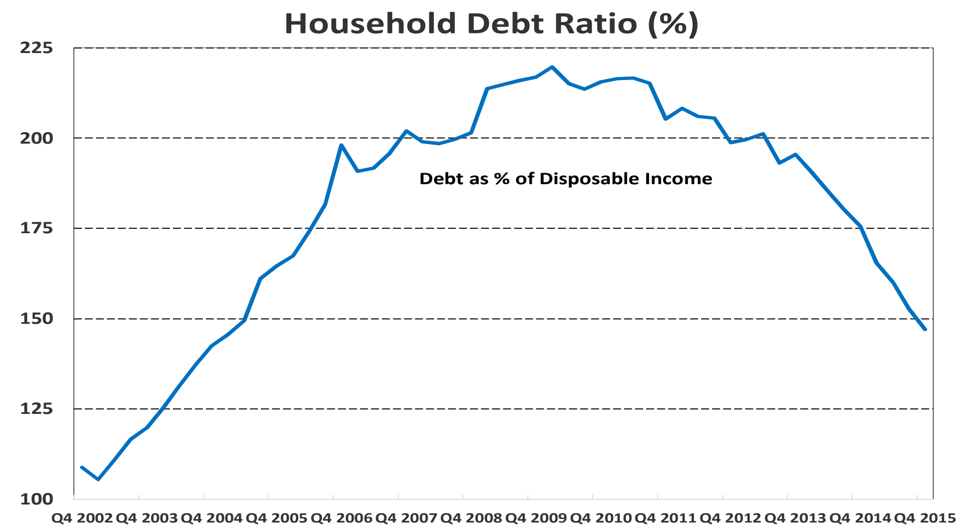
Source: Dept of Finance/AIB ERU. Note Inflated/Distorted GDP figues from 2015)



Source: NTMA; Dept of Finance



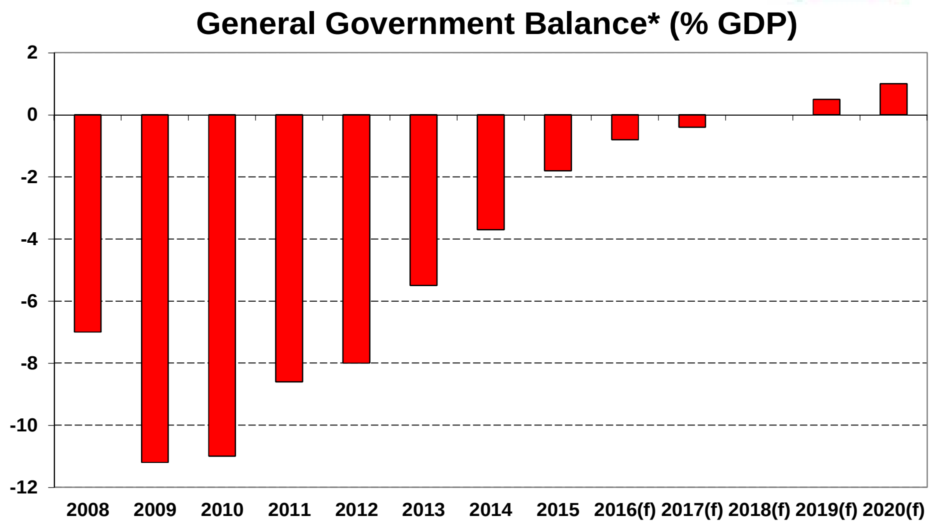
Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figs in 2015/16)



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

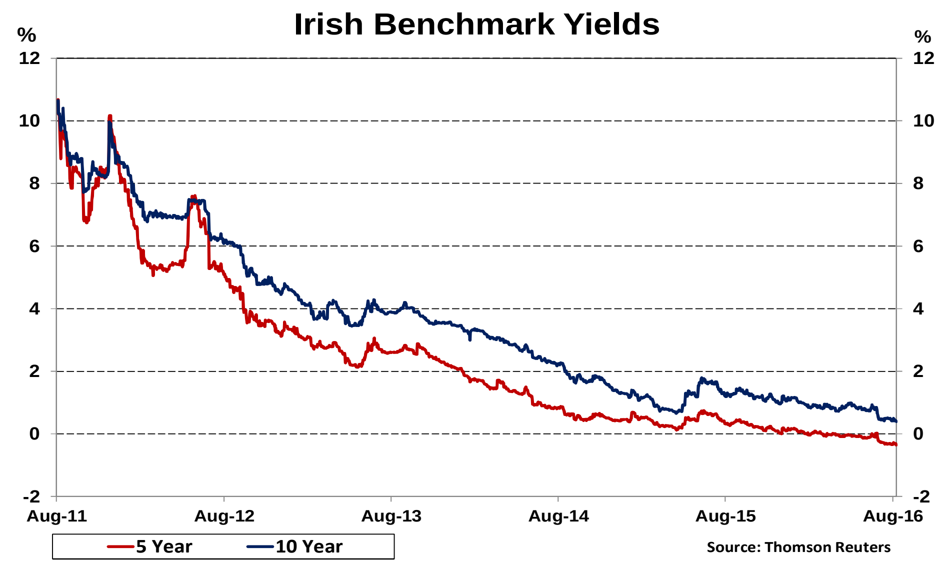
Budget deficit falls to very low level

- 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 in marked decline
- 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



*Excludes banking recapitalisation costs in 2009-11

Sources : Dept of Finance/AIB ERU



Source: Thomson Reuters

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 economy 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 and third country markets
- 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
- Lower Irish growth during 2016-19 in run-up to Brexit on weak sterling and UK slowdown
- Longer term, impact will depend on Brexit deal negotiated between the EU and UK

Brexit likely to curtail rebound of Irish economy

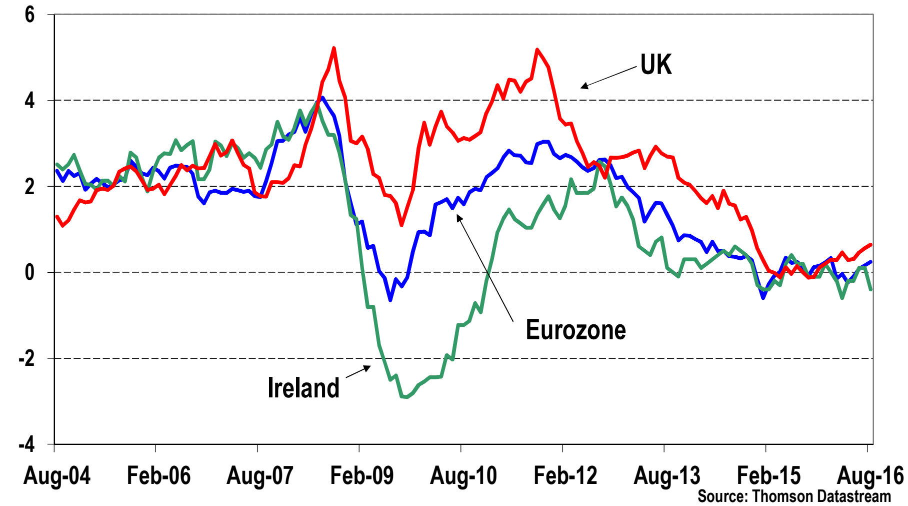
- Strong rebound by Irish economy
- Wage growth and very low inflation boosting spending
- Labour market on steadily improving path
- Construction should continue its recovery from its still very depressed activity levels
- Fiscal tightening over, with budgetary policy now mildly expansionary
- Ireland 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
- No sign of impact on FDI from corporate tax changes
- Brexit uncertainty, though, likely to 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 2016-18

Euro Trade Weighted Index*

* (weighted average of trend versus main trading partners)

Source: Thomson Datastream

Irish, Eurozone & UK Inflation (HICP Rates)



Source: Thomson Datastream

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	0.0	0.5	0.5
Unemployment Rate (%)	13.1	11.3	9.5	8.1	7.2	6.6
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, impact on sterling
- 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
- Questions around corporation tax regime could impact FDI, though no sign of this
- 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