The Irish Economic Update

Brexit Poses Challenge to Strong Recovery

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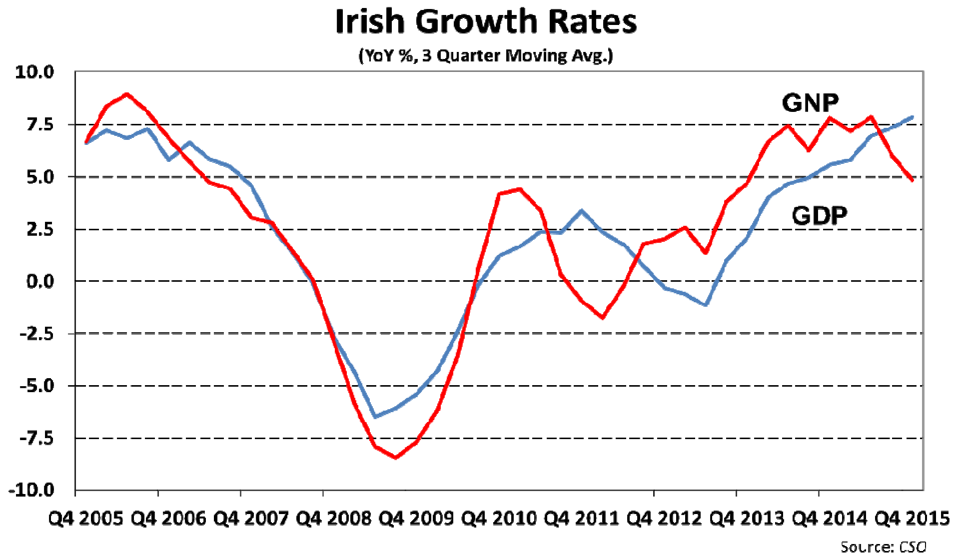
Irish recovery gains very strong momentum

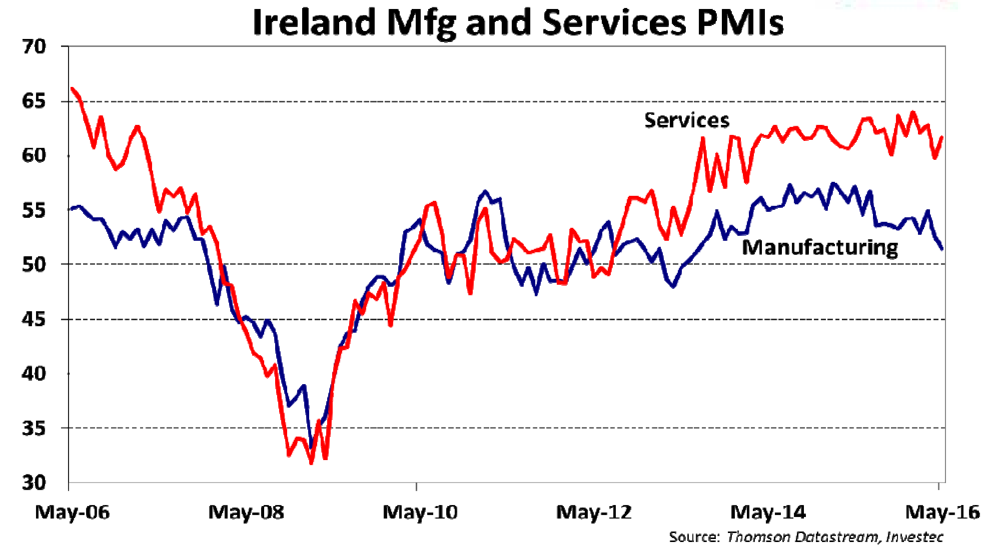
- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8% and GNP down 10%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance 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
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Domestic spending averages growth of 3.75% in past three years
- GNP growth averages 5.7% and GDP 4.8% in the three year period 2013-15
- Strong jobs growth. Unemployment rate falls from 15% in 2012 to below 8% by spring 2016
- Budget deficit has declined at quicker than expected pace. Balanced budget now in sight.
- Economy now on strong growth path. Brexit, though, will likely soften growth outlook

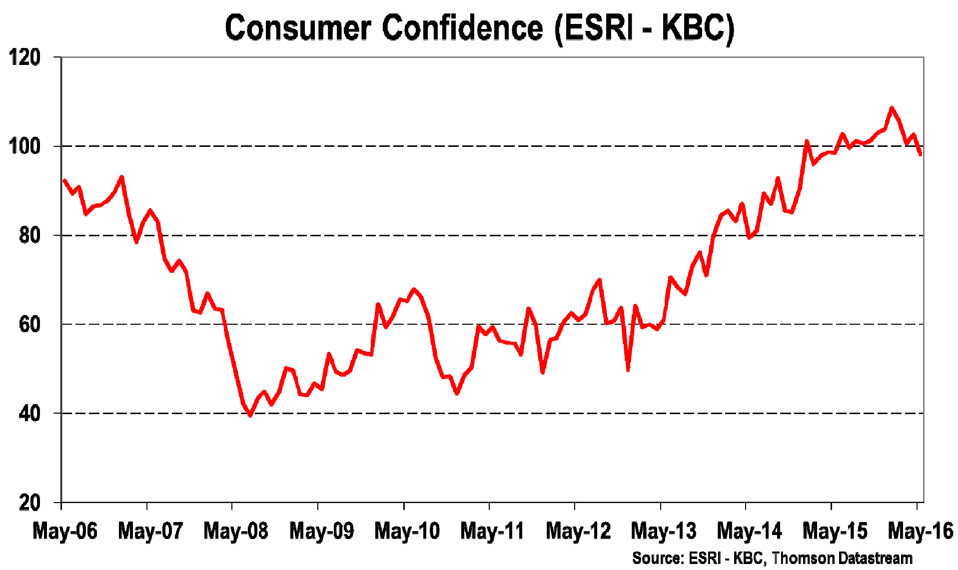
Continuing upbeat data in H1 2016

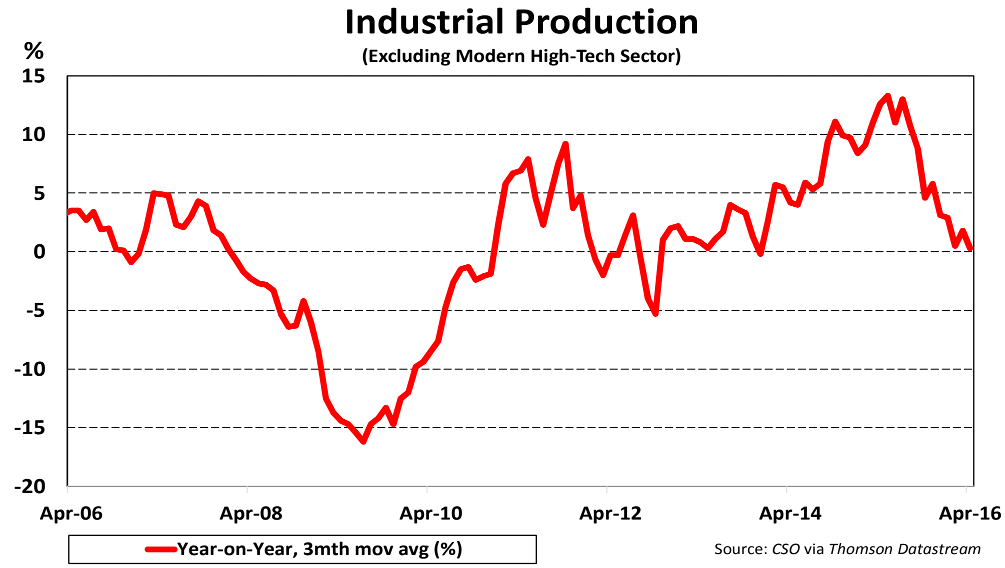
- GDP growth of 7.8% and GNP growth of 5.7% in 2015
- BoP surplus of 4.4% of GDP in 2015, up from 3.6% in 2014
- Strong export growth has continued in early months of 2016, after rise of 13.8% in 2015
- Continuing good manufacturing PMI data – averages 52.4 in H2 2016
- Very robust services PMI data in H1 2016 – averages 62.1 in Jan-May, near ten year highs
- Construction PMI performing more strongly – averages 61.4 in year to May
- Consumer confidence remained strong in 2016, but did see some impact ahead of Brexit vote
- Core retail sales (ex motor trade) up by 5.8% YTD in May after 6.1% rise in 2015
- Car sales rose by 23% yoy to end May after 30% jump in both 2014 and 2015
- 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 May 2016 – peaked at 15.1%
- Continuing strong growth in tax receipts in 2016 – up 9% yoy to end May
- Government budget deficit expected to fall to under 1% of GDP this year

Many indicators point to very robust growth







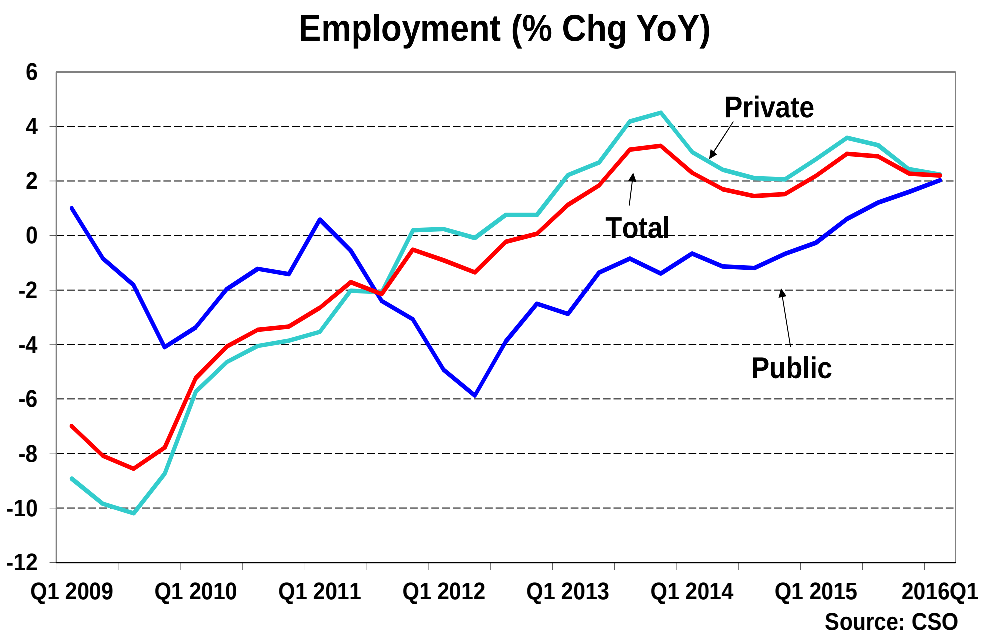


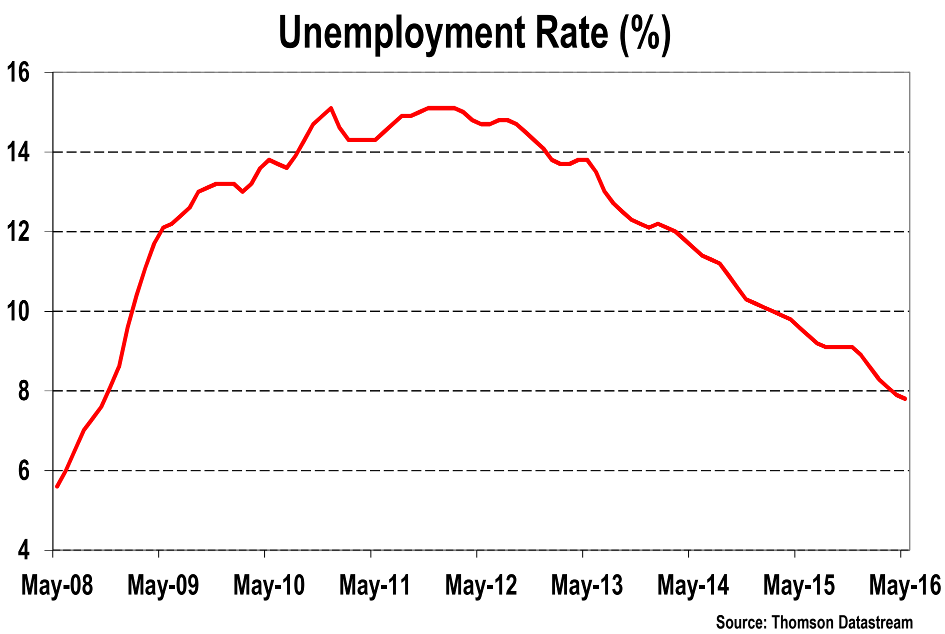
Strong jobs growth & falling unemployment

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**

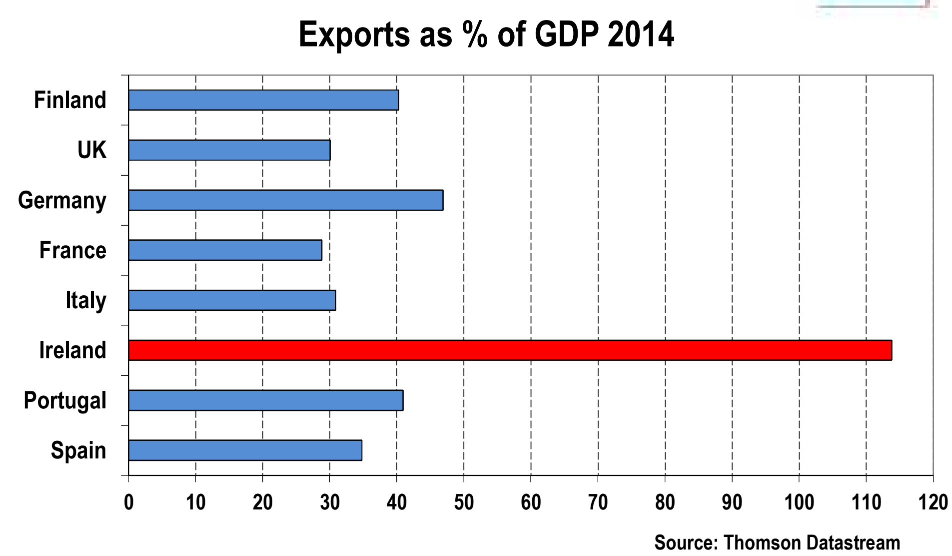
Source: CSO and AIB ERU forecasts

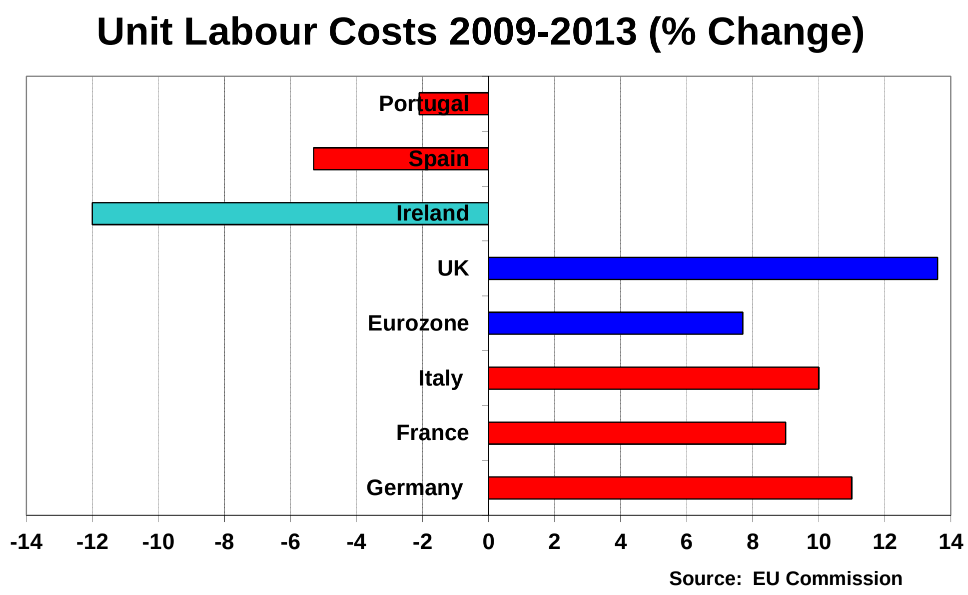


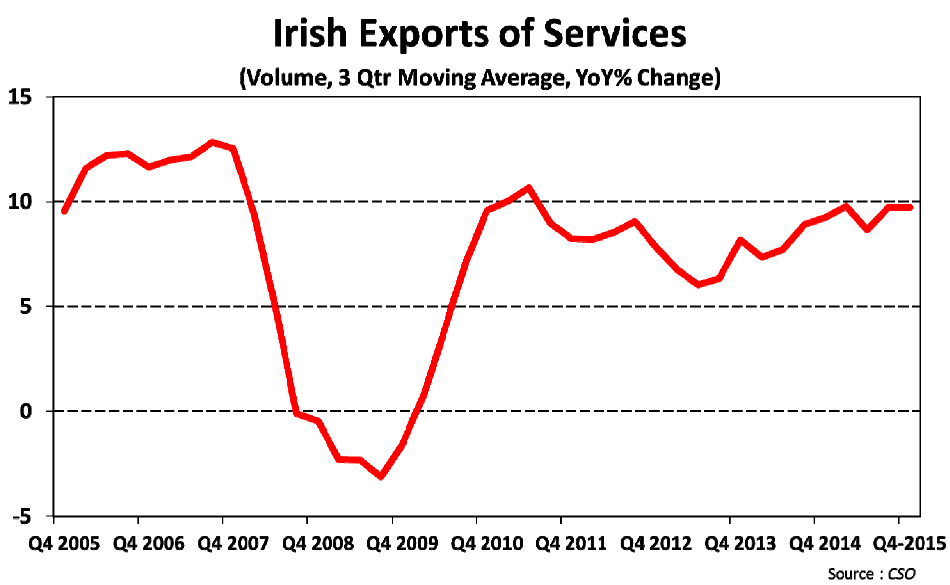


Impressive performance by exports

- Ireland a very open economy – exports, driven by huge FDI, equated 121.5% of GDP in 2015
- Major gains in Irish competitiveness since 2009
- Exports rise strongly helped by large FDI inflows and recovery in global economy
- Euro weakness gives additional boost to exports. Up by some 21% in value (14% in vol) in 2015







Impact of FDI on economy (Source IDA)

KEY FDI IMPACTS ON THE IRISH ECONOMY

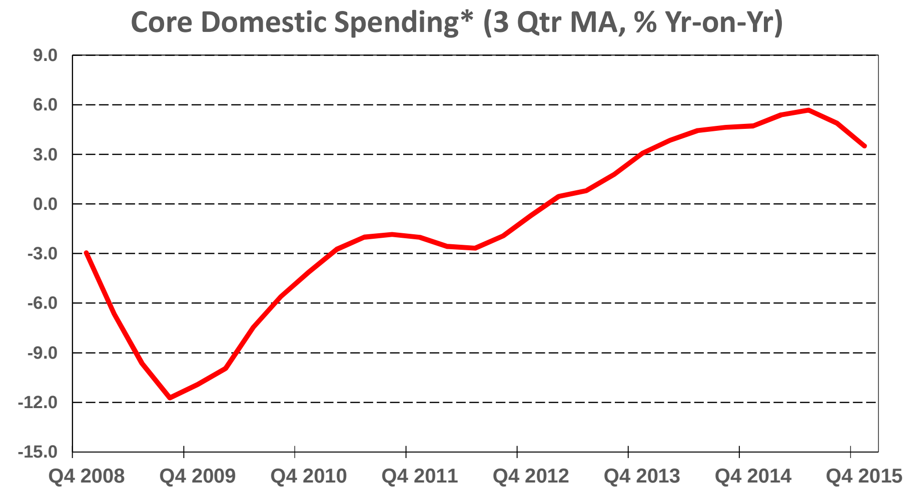
- 1,200 multinational companies
- €125bn Exports (70% of Irish exports)
- 175,000 Jobs in FDI, 290,000 in total
- 70% of Corporation Tax
- €13.5bn Spending on services/materials
- €8.5bn in Payroll
- 67% of Business R&D expenditure

WORLD LEADERS CHOOSE IRELAND

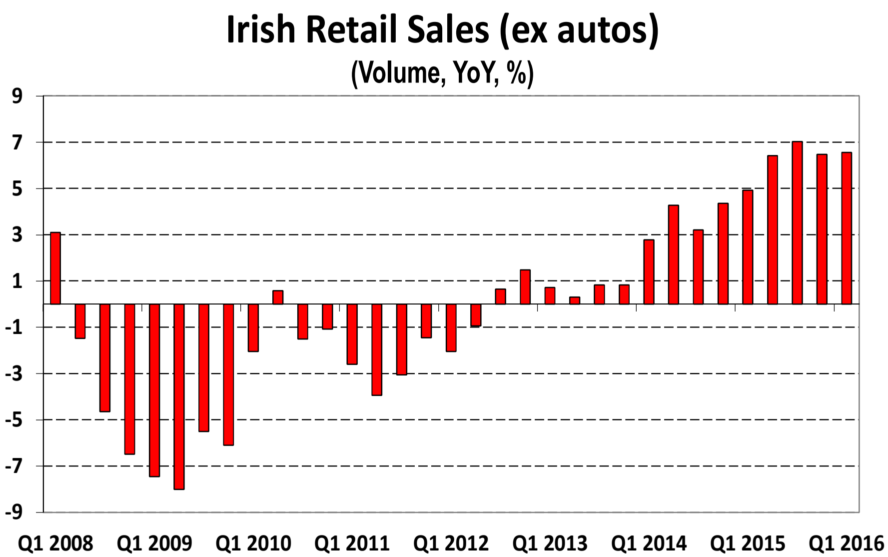
- 8 of the top 10 in ICT
- 9 of the top 10 in Pharmaceuticals
- 17 of the top 25 in Medical Devices
- 3 of the top 5 Games companies
- 10 of the 'top born on the Internet' firms
- More than 50% of the world's leading Financial Services firms

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 modest pick up since then – output rose by 8-10% in each of last three years
- Business investment (ex planes/R&D) up by 23% in 2015 after growth of 33% in 2014
- Total investment (ex planes, R&D) up 15% in 2015 after rise of 18% in 2014
- Core domestic spending (ex planes, R&D) rose by 2.3% in 2013, 4.7% in 2014 and 4.3% in 2015
- Consumer spending grew by 2% in 2014 and 3.5% in 2015 – but spending on services still very weak
- Core retail sales (ex motor trade) up by 5.8% yoy in Jan-May 2016 after rise of 6.1% in 2015
- New car sales rose by 30% in both 2014 & 2015 and by a further 23% yoy in Jan-May 2016



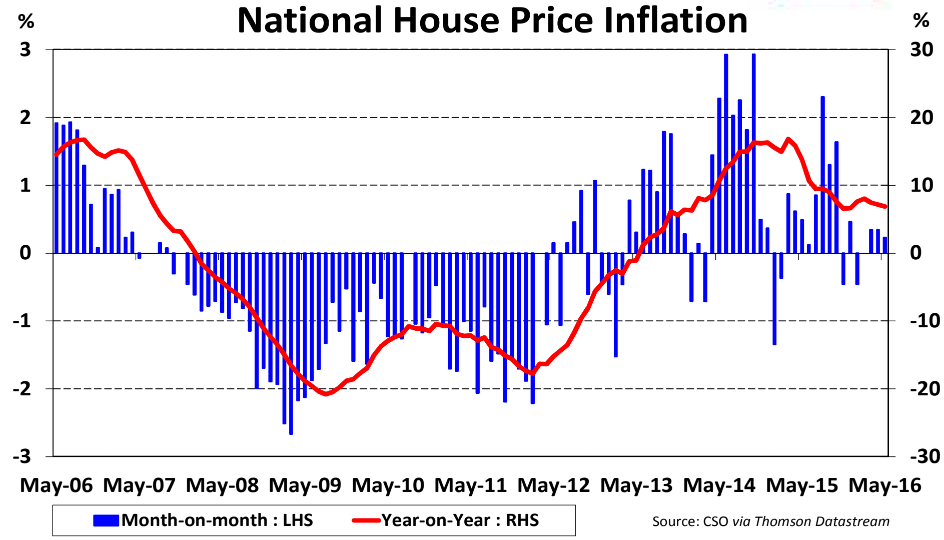
*Domestic Spending excluding investment in R&D and planes Source: CSO, AIB ERU Calculations

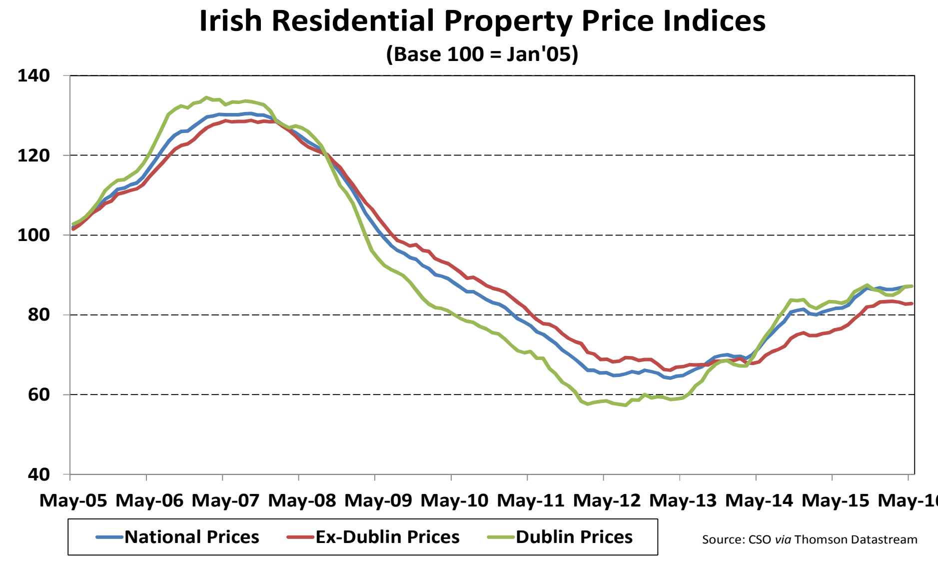


Source: Thomson Datastream

House prices rise as shortages emerge in market

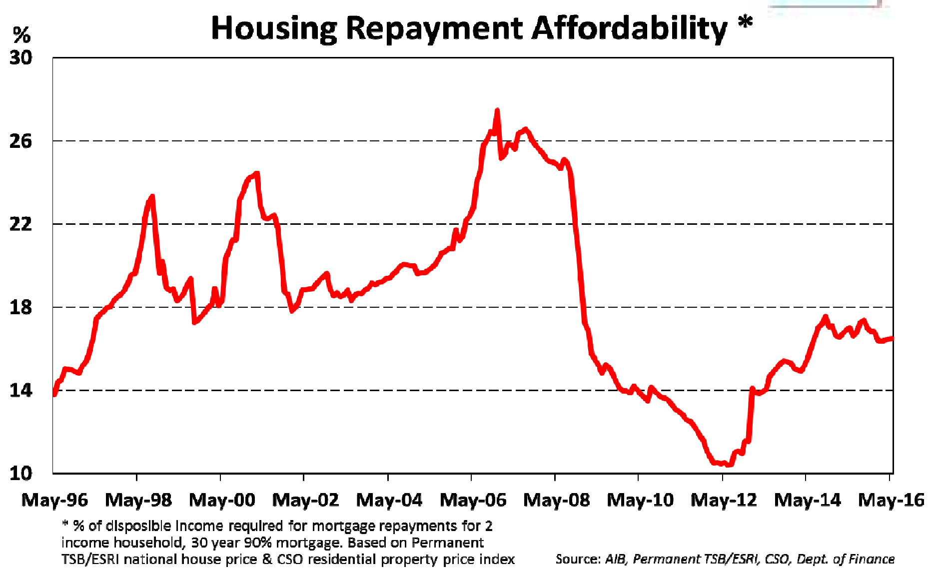
- Housing output fell by 90% but now past the bottom of cycle
- Bulk of the new housing stock overhang eliminated
- House prices declined sharply – fell by over 50% between their peak in late 2007 and early 2013
- House prices have recovered: up 36% in May 2016 from low in early 2013 as housing shortage emerges
- By May 2016, Dublin prices up by 52% and non-Dublin prices up by 25% from their troughs
- House prices, though, including in Dublin, are still around 33-35% below peak levels hit in 2007
- New Central Bank mortgage rules cool Dublin house price inflation – falls from 25% to around 4.5% yoy
- Nationally, prices up 7% yoy in May 2016, with higher rises outside Dublin – up 8.5% yoy
- Rents have rebounded – up over 40% from lows and now 6.1% above previous peak reached in 2008

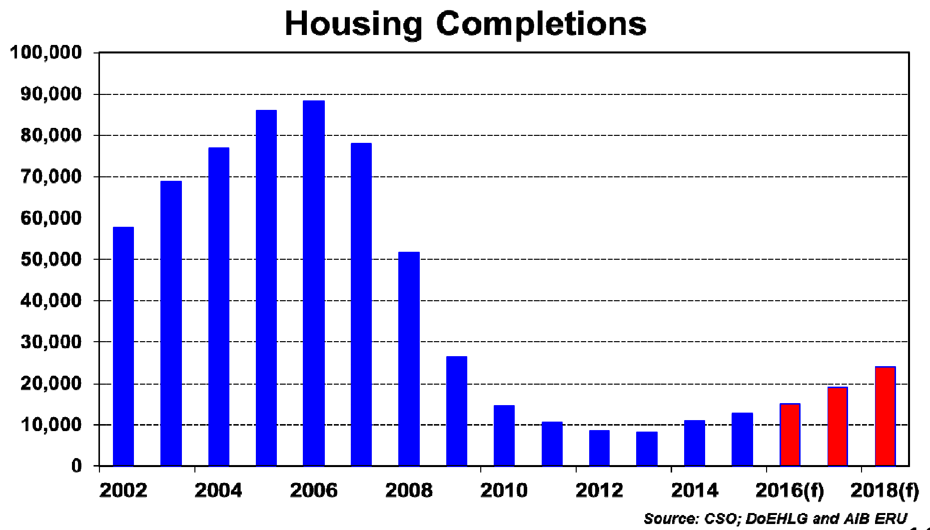




House building rising slowly from very depressed levels

- Housing completions at 12,700 in 2015, up from 11,000 in 2014 and 8,300 in 2013
- House building still at very low levels. Way below previous peak of near 90,000 completions
- Annual demand estimated at over 25,000 new units
- Trend in new housing registrations/commencements points to continuing slow recovery in house building
- Housing affordability not as issue - still below levels pertaining before boom started in 1998
- Growth in mortgage lending slows sharply during 2015/early 2016 on new tighter CB lending rules
- Number of measures put in place to help boost new house building. NAMA will have role to play
- Rise in house prices should help building activity
- Housing PMI has been strong so far in 2016
- However, likely to be 2018 at the earliest before housing output rises to around 25,000 units





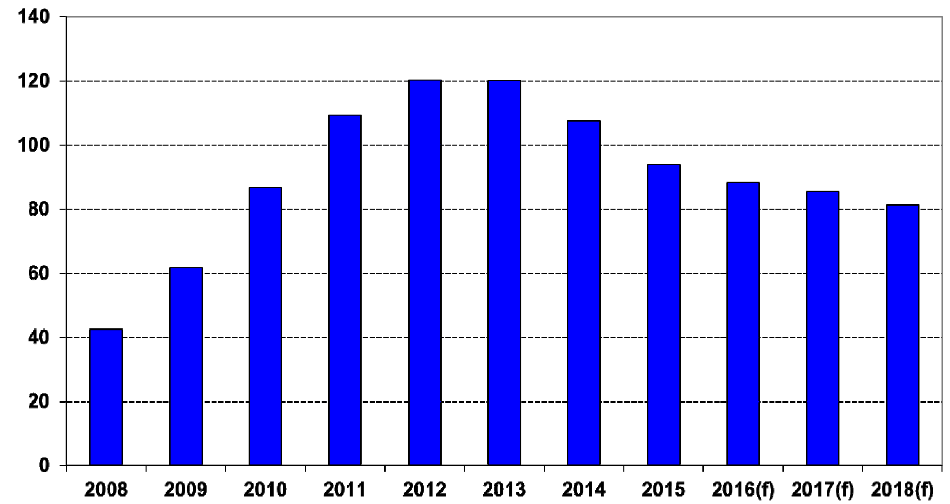
AIB Model of Estimated Potential Housing Demand

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

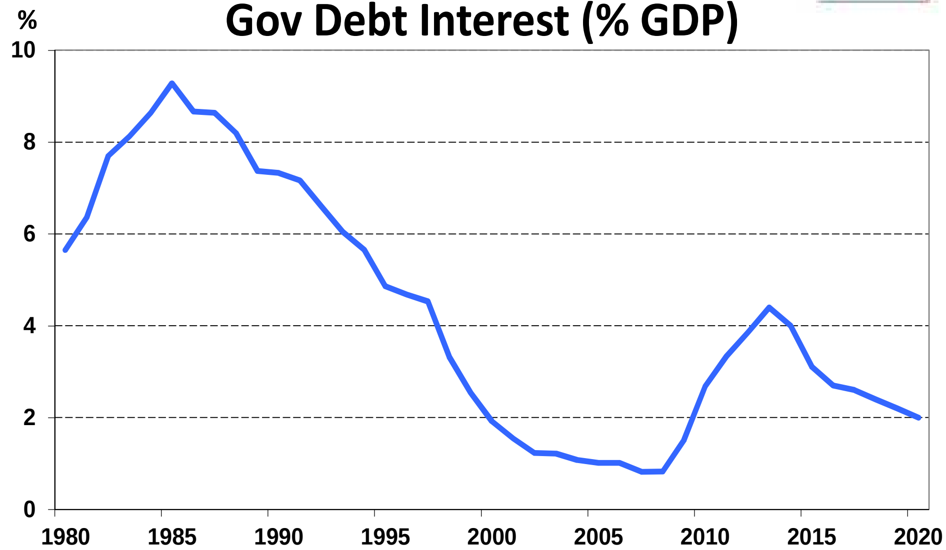
Gov debt ratio falling, private sector deleveraging

Gross Gen Gov Debt (% GDP)



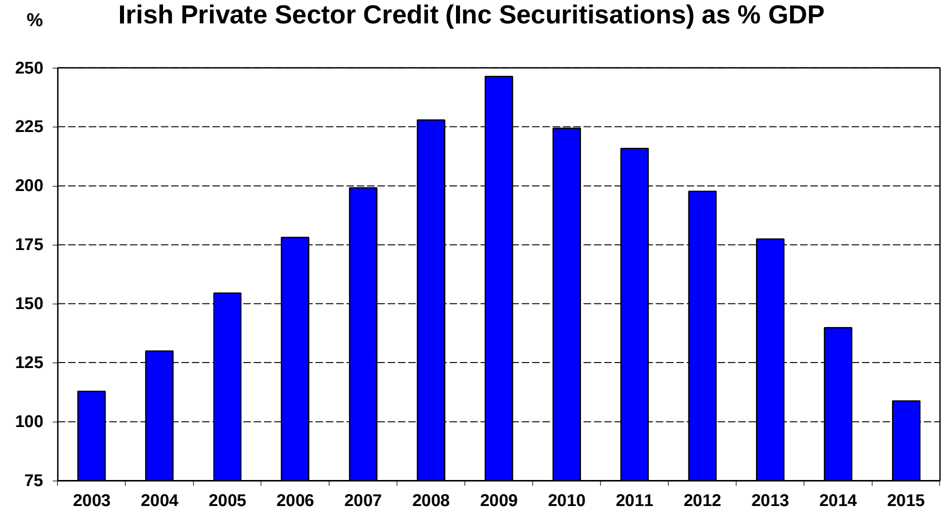
Source: Dept of Finance

Gov Debt Interest (% GDP)



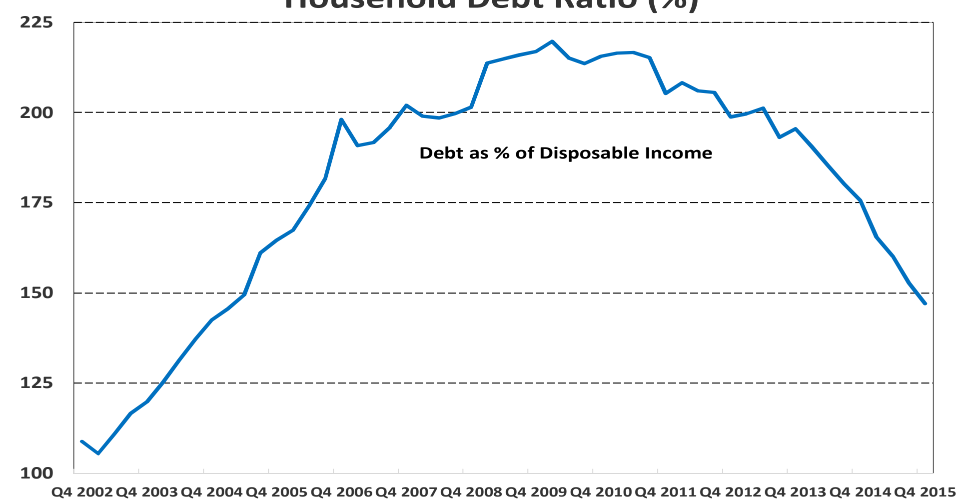
Source: NTMA; Dept of Finance

Irish Private Sector Credit (Inc Securitisations) as % GDP



Sources: Central Bank, CSO, AIB ERU Calculations

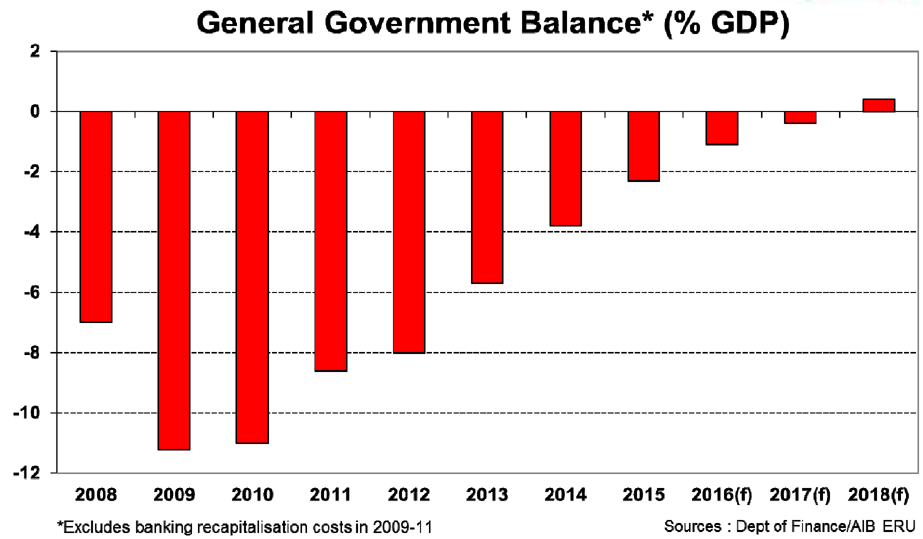
Household Debt Ratio (%)

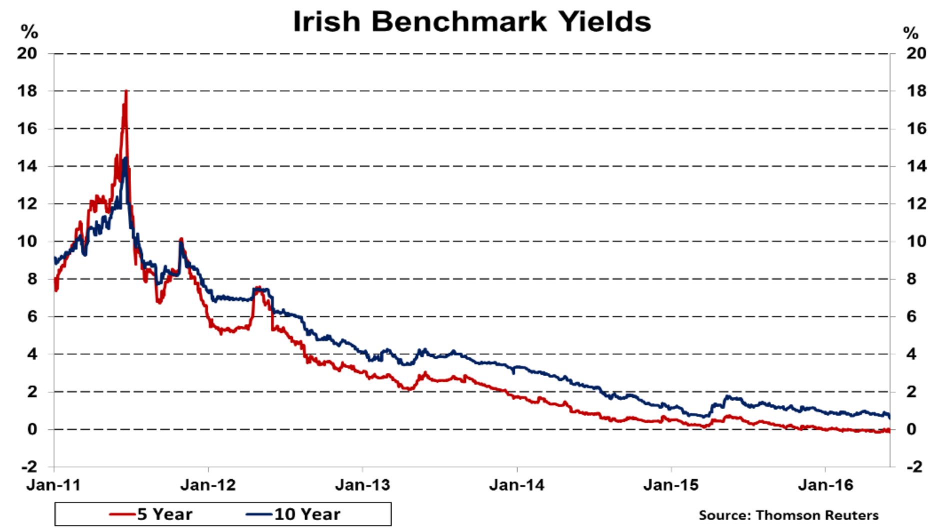


Source : Central Bank of Ireland & CSO Data ; AIB ERU Calculations

Budget deficit falls to very low level

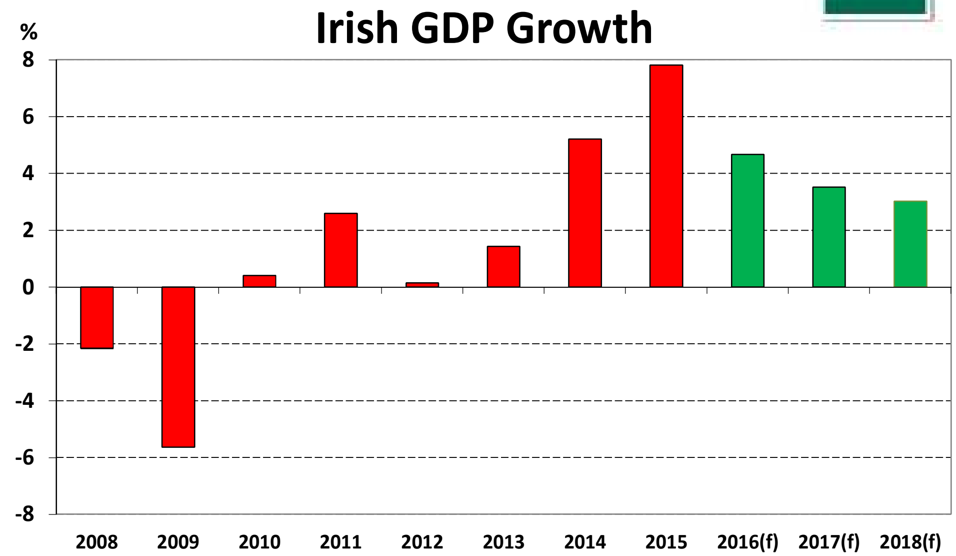
- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budgetary policy turns mildly expansionary in 2015 and 2016
- Budget deficit falls sharply in recent years
- Deficit of under 1% of GDP likely in 2016
- Balanced budget possible in 2017 or 2018
- Primary budget (i.e. excluding 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. Down from 120% in 2013 to 94% in 2015
- Irish bonds yields have fallen sharply, with five year yields below 0%, ten year at 0.6%
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A, Moody's A3



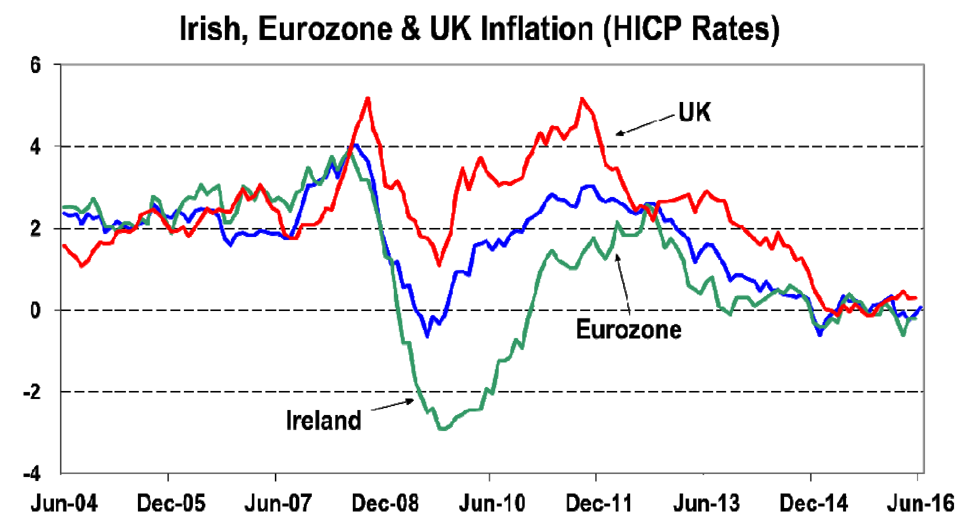


Brexit vote to impact growth but should remain strong

- 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 recover from its current, 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



Source: *Thomson Datastream, AIB ERU*



Source: Thomson Datastream

AIB Irish Economic Forecasts – Post Brexit Vote

% change in real terms unless stated	2013	2014	2015	2016 (f)	2017 (f)	2018 (f)
GDP	**1.4**	**5.2**	**7.8**	**4.7**	**3.5**	**3.0**
GNP	4.6	6.9	5.7	4.2	3.0	2.5
Personal Consumption	-0.3	2.0	3.5	3.3	2.5	2.5
Government Spending	1.4	4.6	-0.8	1.0	1.5	1.5
Fixed Investment	-6.6	14.3	28.2	9.5	6.5	6.0
Core Domestic Spending	**2.3**	**4.7**	**4.3**	**4.0**	**3.5**	**3.4**
Exports	2.5	12.1	13.8	9.5	7.0	5.0
Imports	0.0	14.7	16.4	9.5	7.2	5.3
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)	-5.7	-3.8	-2.3	-0.8	0.4	0.0
Gross General Gov Debt (% GDP)	120	107.5	94	89	85	81
BoP Current A\C (as % GDP)	3.1	3.6	4.4	4.3	3.7	3.0

Source: CSO, AIB ERU Forecasts

Brexit poses big risks for UK economy

- UK votes to leave EU in Referendum on June 23rd. Uncertainty prevails over the exit
- Very close links between the UK and rest of EU, which takes 44% of UK exports
- Over 50% of UK imports come from EU, about half of which are intermediates goods
- UK runs a large trade deficit with EU but only 10% of EU exports go to UK
- UK is the biggest recipient of FDI in the EU. Around half comes from EU, 30% from US
- Strong migrant inflows into UK labour market from rest of EU help to address skills shortages
- London is the centre of the financial services industry in Europe. Brexit will impact trading in euros and Eurozone wholesale banking in London. Will have to shift elsewhere
- Not surprising, then, most models show significant negative impact on UK economy of Brexit
- Key issue is trade. EU is a single market. UK is likely to have to adhere to nearly all EU rules and regulations and pay EU budget contribution to get full access to Single Market
- Uncertainty surrounding Brexit also a negative for economy. Expected to take at least two years to negotiate EU exit terms. UK will not have a veto over the terms
- GDP growth to be lower in next couple of years – possibly 3% weaker by end 2018
- Models which allow for significant trade and FDI effects, lower migration, impact on productivity suggest GDP could be 5-10% lower in total where UK exits EU without good trade deal

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, a key trading partner
- Negative Brexit impact on UK growth will have knock-on effects for activity here
- Key for Ireland is the trade arrangements put in place between EU and UK post Brexit. Ideally, UK would remain part of EEA, like Norway
- Higher trading costs from more admin, differing trade rules, possible customs posts/duties
- Would 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
- May be restrictions on freedom of movement, passport controls, customs posts, etc
- Sterling has already weakened on Brexit concerns, which will hit exports to UK
- 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

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 weakening 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 it has further to run as debt ratios still high
- Continuing credit contraction – fewer banks, tighter credit conditions, on-going deleveraging