Ireland: Steady progress amid external risks

Employment growth driving economy as Government is nearing EU fiscal target

October 2017

Gníomhaireacht Bainistíochta an Chisteáin Náisiúnta
National Treasury Management Agency

Index

Summary

Growth is strong and Ireland is living within its means

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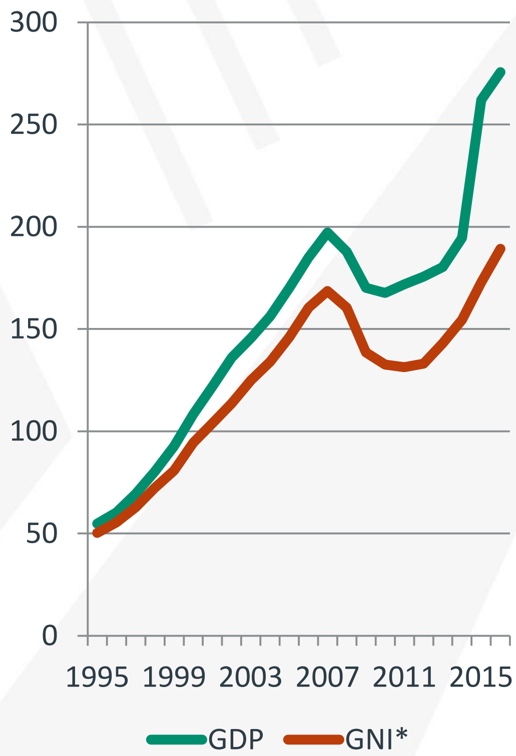
Macro picture is positive even if some metrics are skewed

Cleaner GNI* highlights rapid recovery (€bn)



Appropriate debt analysis is needed…

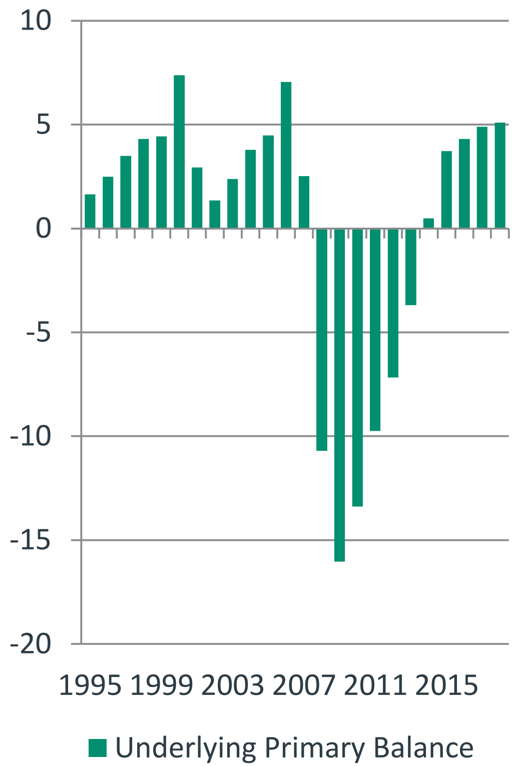
Debt-to-GDP
(72.8%, from 120%)

Debt-to-GNI*
(106%, from 158%)

Debt-to-GG Revenue
(274%, from 353%)

Average interest rate
(3.1%, from 5.1%)

…but Ireland running a primary surplus (€bn)



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More than €15bn in funding in 2017 as potential IMF early repayment deal sees NTMA exceed original funding plan

€15bn

>€15bn of funding completed YTD

Average maturity of issuance 12.2 years

Interest rate of 0.85%

A

All major credit rating agencies have Ireland firmly in "A" grade following Moody's upgrade in Sept 2017

37%

of buyers in the last five syndications were from Continental Europe

Challenges remain for Ireland

Debt

Ireland has used the QE period to deleverage ; healthiest demographics in Europe means that the country can cope with higher debt

US

Ireland is still a “high beta” bet on the US economy, in particular its ICT sector

US Corporate Tax reform

Brexit

For every 1% drop in UK GDP, Ireland’s output may fall by anywhere between 0.3-0.8%.

Section 1: Macro

GDP/GNP mislead; GNI*, employment and consumption best reflect reality

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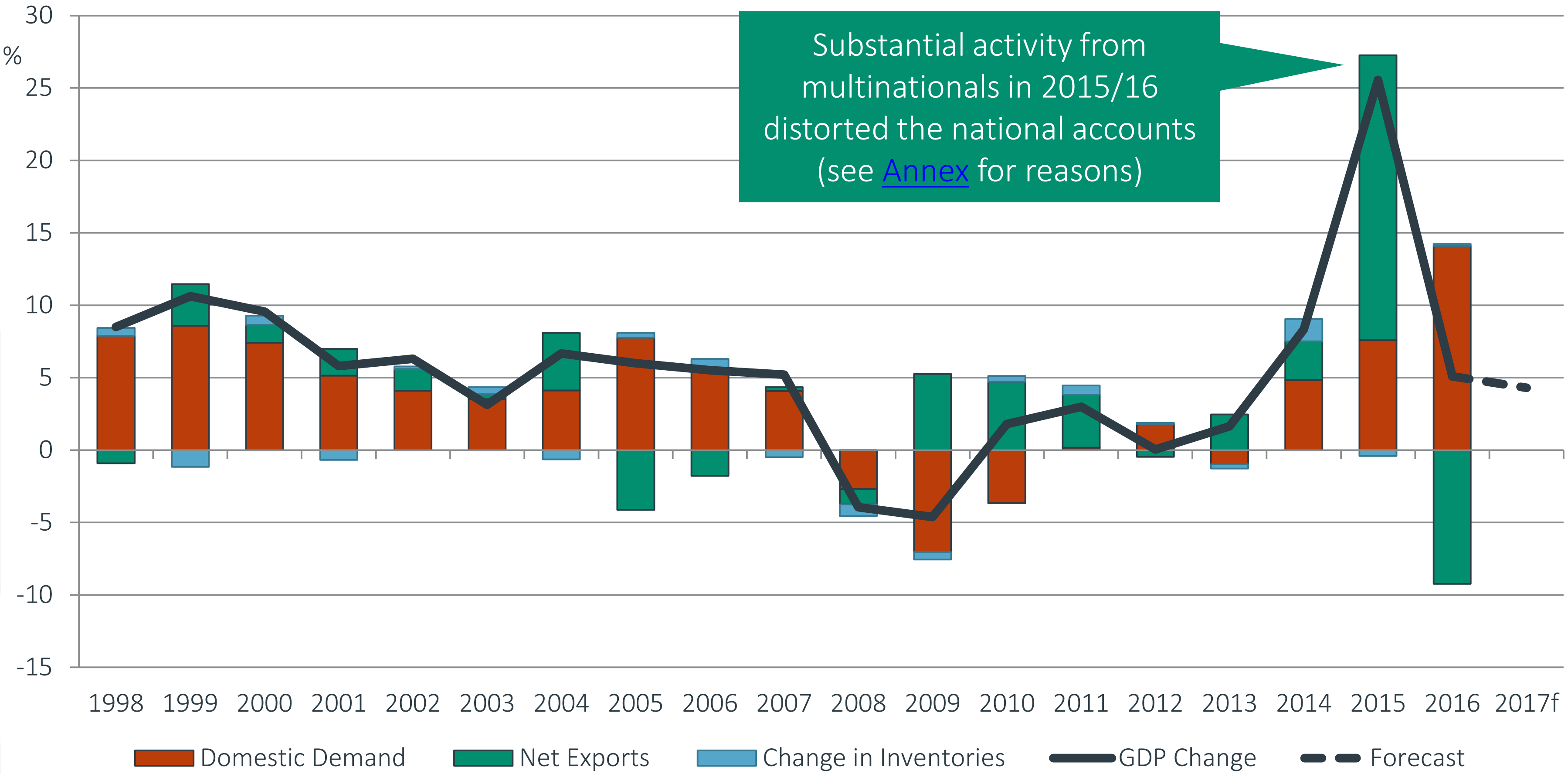
Distortions to GDP/GNP make them sub-optimal indicators of economic performance



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Source: CSO; Department of Finance

New GNI* metric is a better measure of underlying economic activity; grew by 9.4% nominally in 2016

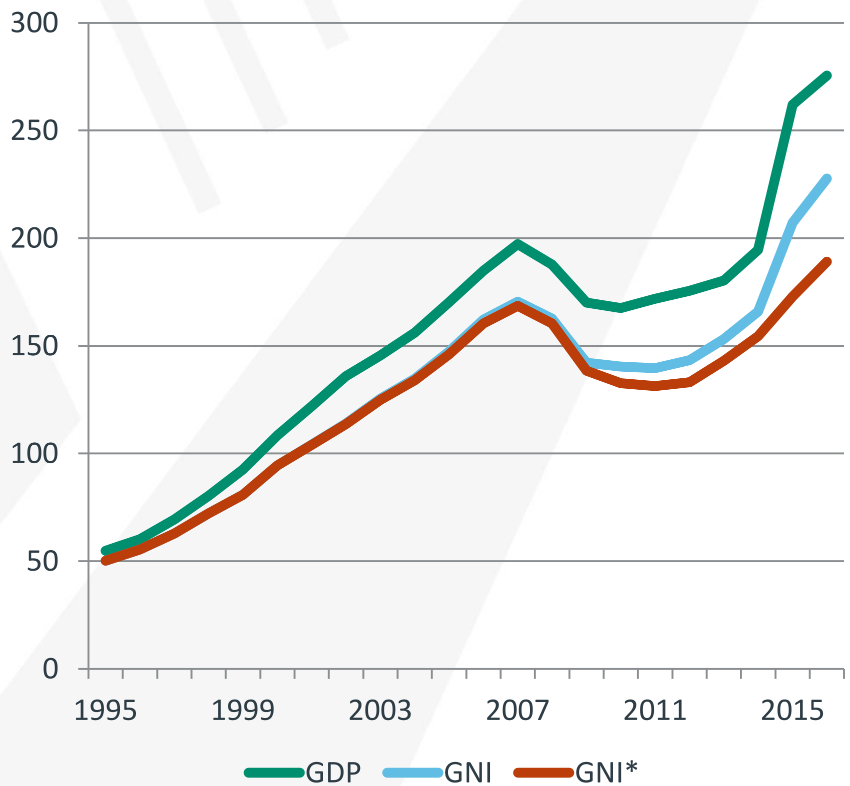
- GDP headline numbers do not reflect the "true" growth of Ireland's incomes due to MNCs.
- Reasons for 2015/16 MNC distortions:
  - Re-domiciling/inversions of several multinational companies
  - The "onshoring" of IP assets into Ireland by multinationals
  - The movement of aircraft leasing assets in Ireland.
- By modifying GNI to take account of these factors, GNI* gives us a better understanding of the underlying economy.
- GNI* only available in nominal terms at present.
- In time, GNI* will be published on a constant price basis as well as at a quarterly frequency.

National Account – Current Prices (€ Billions, y-o-y growth rates)	2015	2016
Gross Domestic Product (GDP)	262bn (34.7%)	275.6bn (5.2%)
minus Net Factor Income from rest of the world		
= Gross National Product (GNP)	206bn (25.0%)	226.7bn (10.1%)
add EU subsidies minus EU taxes	1.2bn	1.0bn
= Gross National Income (GNI)	207.2bn (24.9%)	227.7bn (9.9%)
minus retained earnings of re-domiciled firms	-4.6bn	-5.8bn
minus depreciation on foreign owned IP assets	-25.0bn	-27.8bn
minus depreciation on aircraft leasing	-4.6bn	-5.0bn
= GNI*	172.9bn (11.9%)	189.2bn (9.4%)

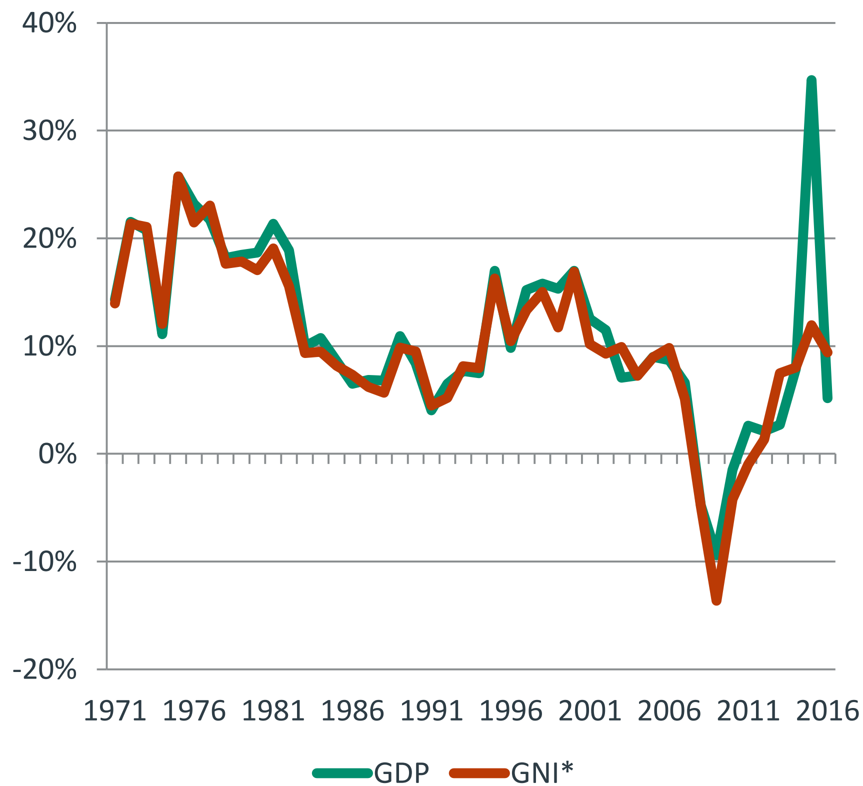
Source: CSO

Irish recovery more realistic when looking at GNI*

GNI* was €189bn in 2016; 12% higher than in 2007 (current prices)



GNI* growth rate averaged 7.6% since 2011 (current prices)



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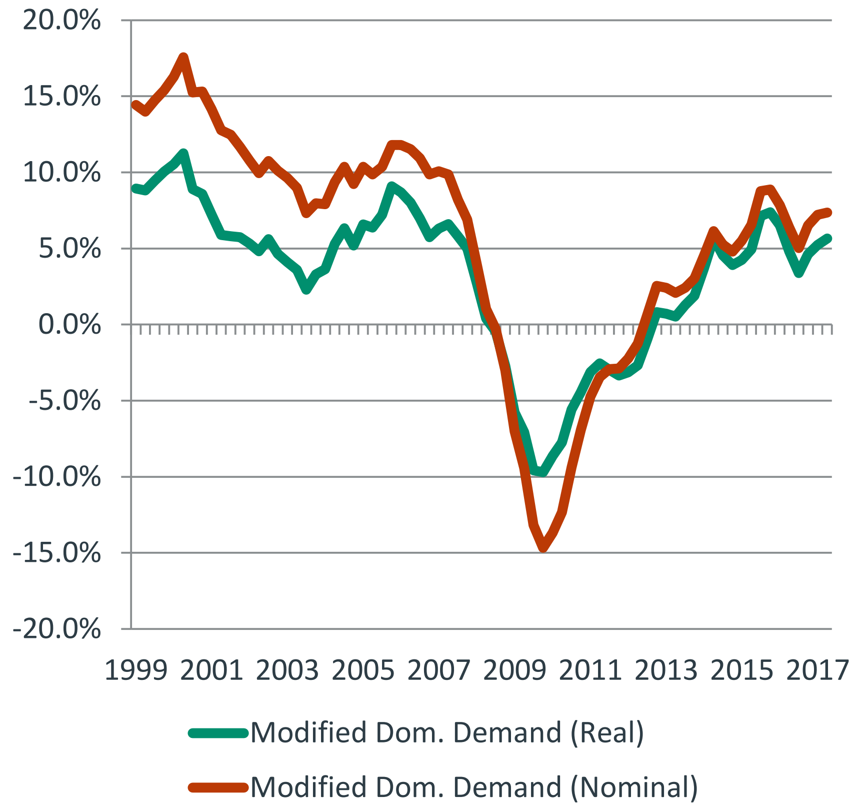
Source: [CSO]
Note: GNI series pre 1995 = GNI given minimal distortions in pre-1995 era.*

Modified Final Domestic Demand (MFDD) is a useful cyclical indicator

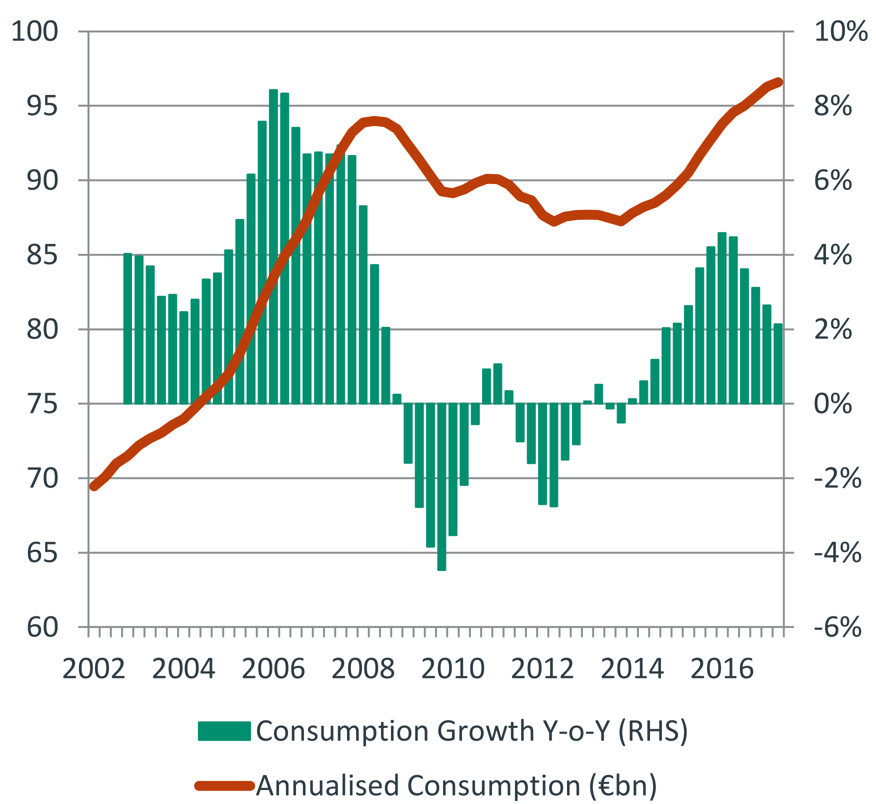
- MFDD also seeks to strip out the impacts of the MNC distortions.
- The measures omits parts of aircraft leasing and IP imports from investment to give a modified measure of domestic demand.
- The measures includes:
  - private consumption
  - government consumption
  - building investment
  - elements of machinery & equipment investment
  - elements of intangible asset investment
- This measure pegs nominal growth closer to 7.4% at Q2 2017 (annualised y-o-y). In real terms, growth y-o-y in Q2 was 5.6%.



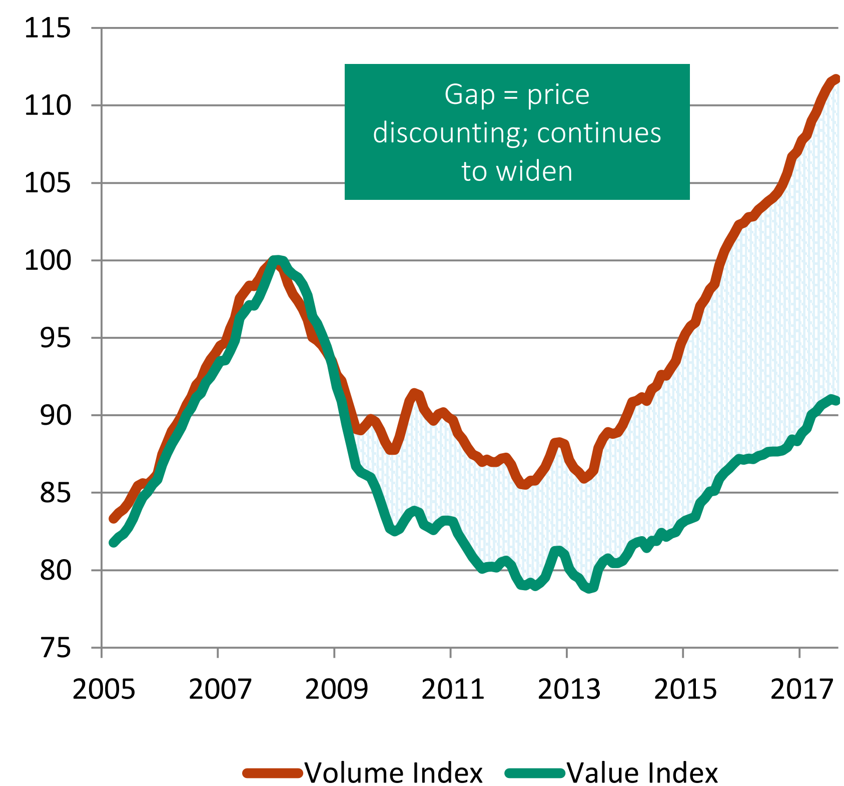
Source: CSO

Consumption is a large contributor to economic growth; unaffected by MNC distortions

Private consumption grew at 2.1% y-o-y in Q2 2017



“Core”* retail sales up 3.9% y-o-y in value terms August 2017 (peak=100)



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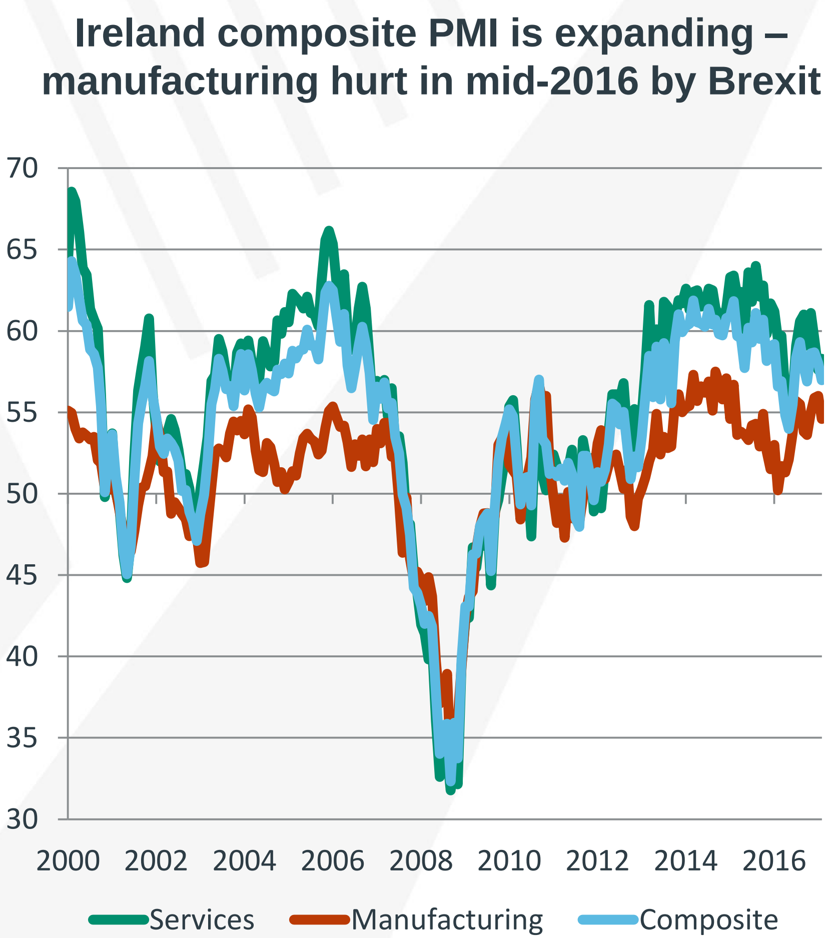
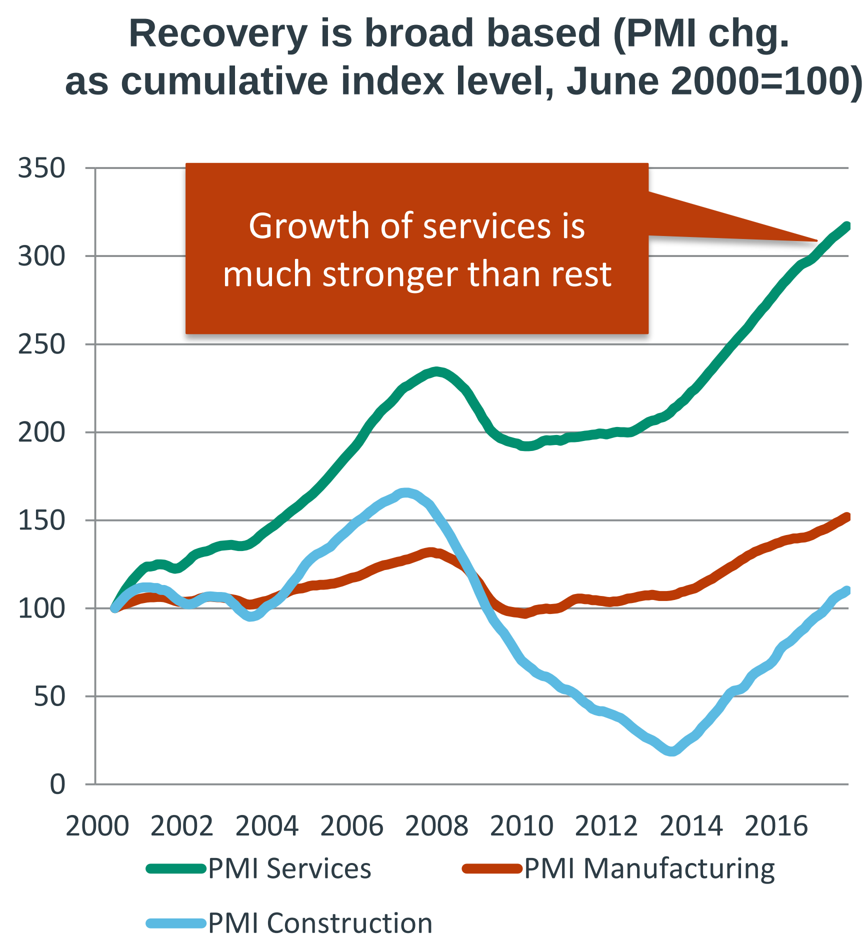
Source: CSO, CSO (retail sales)   ** excludes motor sales; 3m average*

PMI indicators show Ireland's broad based recovery





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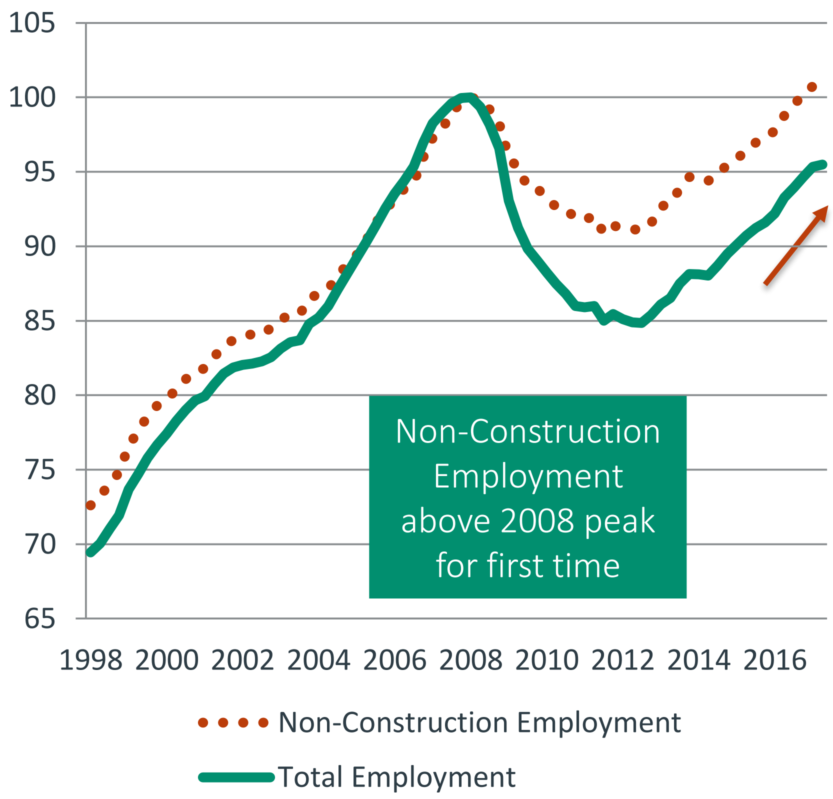
Source: Markit; Bloomberg; Investec ; NTMA workings

Labour market has rebounded since 2012; unemployment continues to fall and Ireland employs two million again

Unemployment rate: 6.1% in September 2017

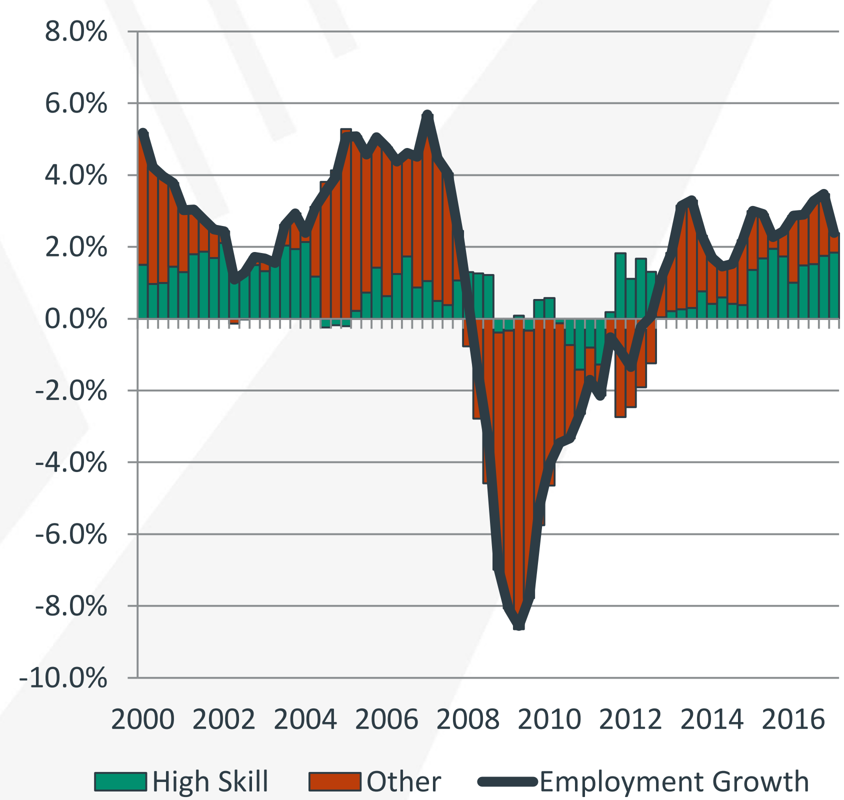
Employment up 12.6% from cyclical low (2008 peak = 100)



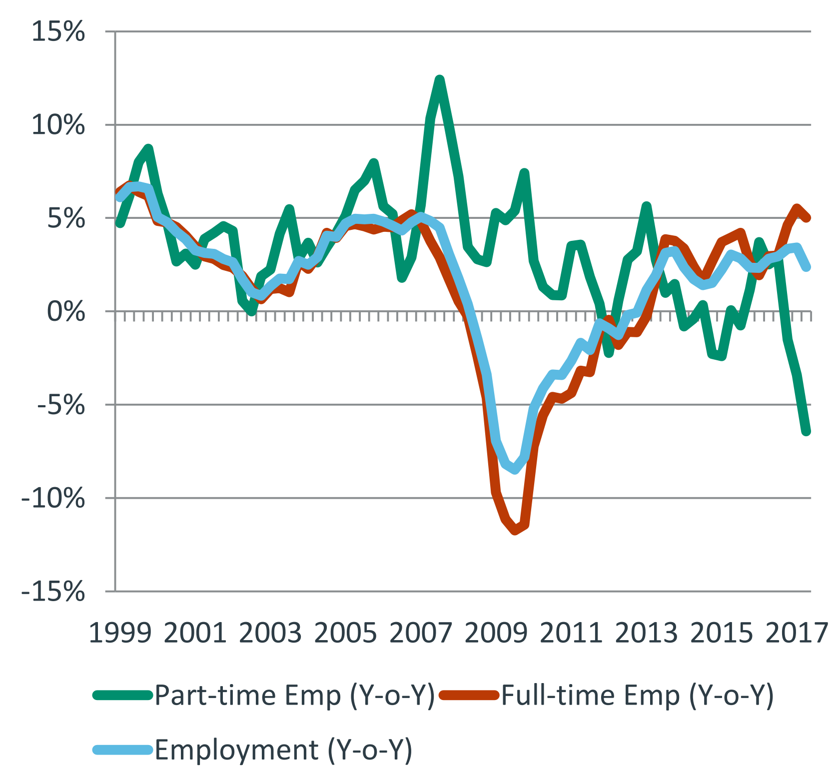
Source: CSO

Employment growth driven by high skill job creation; Full-time employment growing at 5% in Q2 2017

Over 55% of all employment growth has been high skilled since start of 2014



Substantial shift from part-time employment to full-time employment in recent quarters



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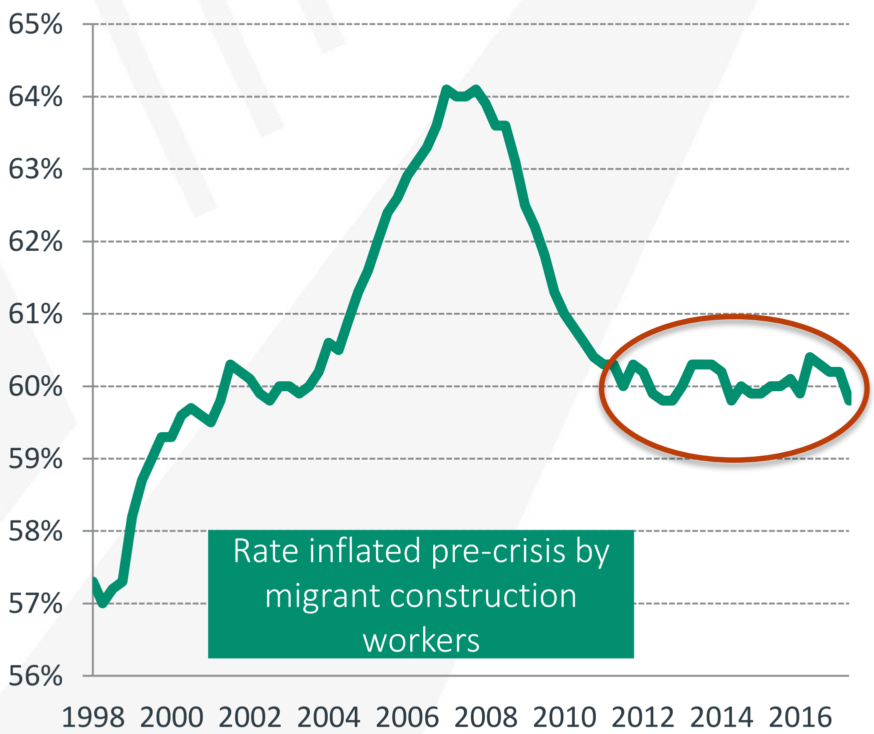
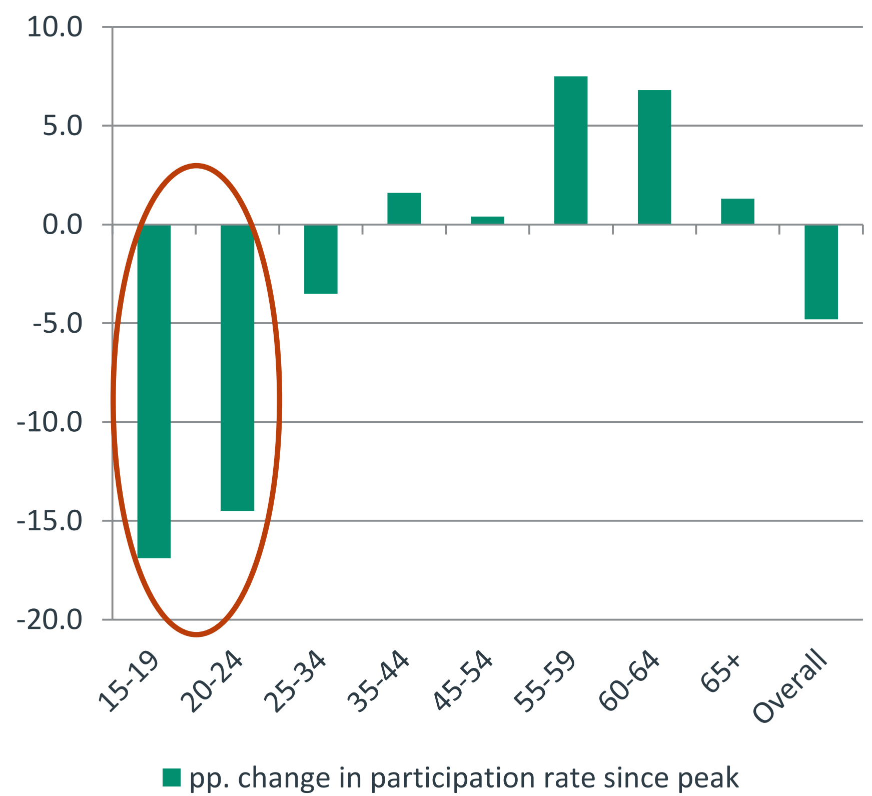
Source: Eurostat; CSO
High Skill jobs include the ISCO08 defined groupings Managers, Professionals, Technicians and associate professionals

Labour participation has not yet recovered – young age groups the driver

Participation rate hovering around 60%



Part. rate down as construction jobs lost and younger people stay in education longer



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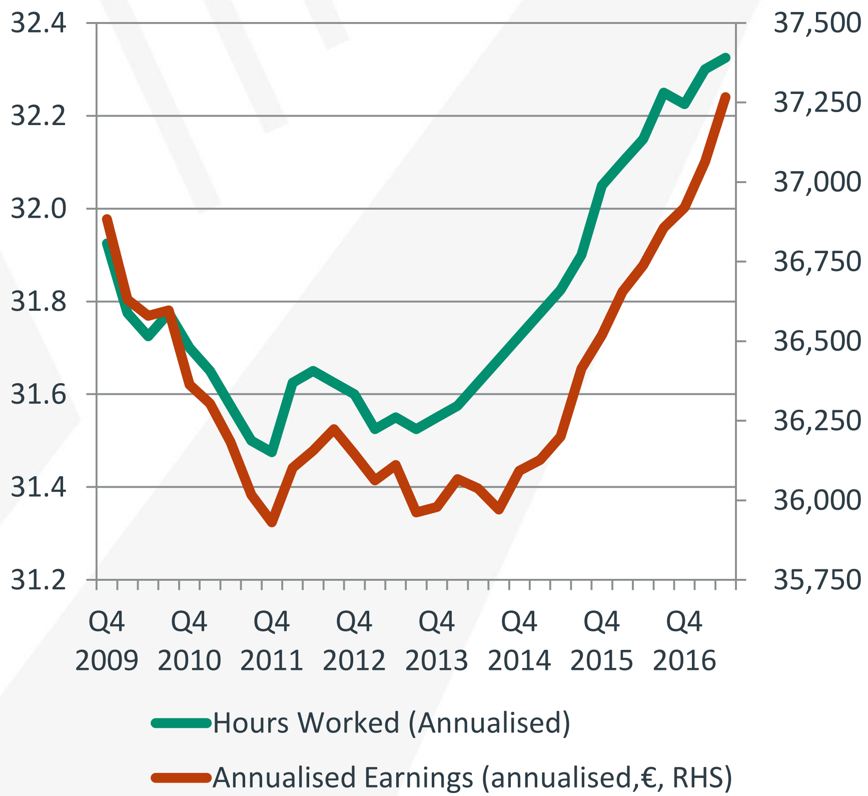
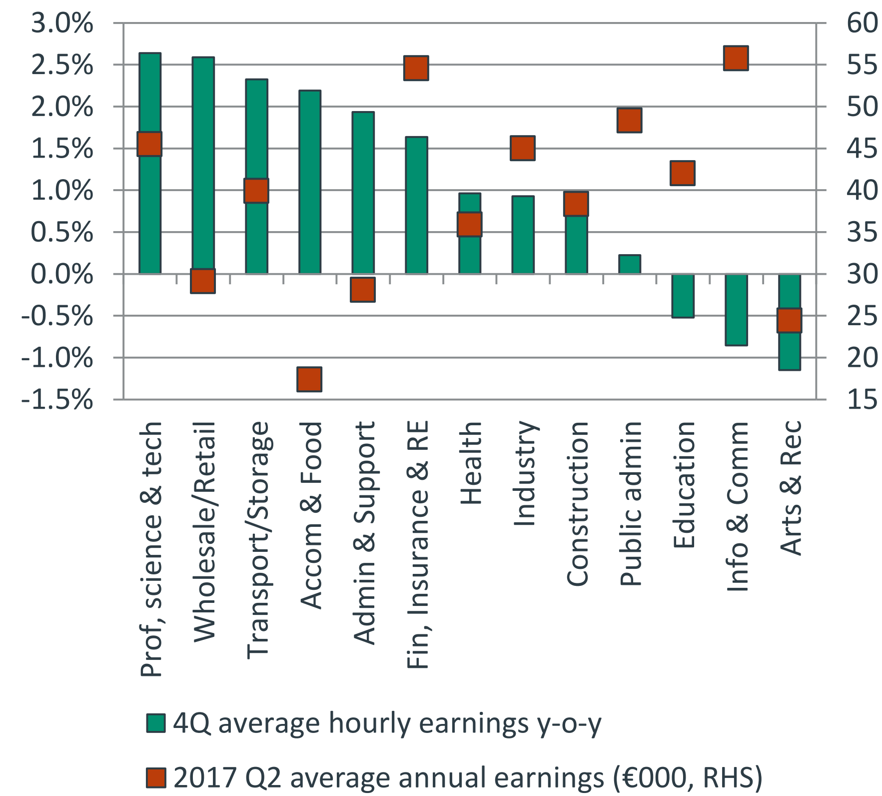
Source: CSO,

Wages only now rising, pointing to slack in the market

Wages and hours worked beginning to recover, although pockets of excess capacity remain



Wide disparity in wage growth across sectors



Source: CSO (Earnings), NTMA Analysis

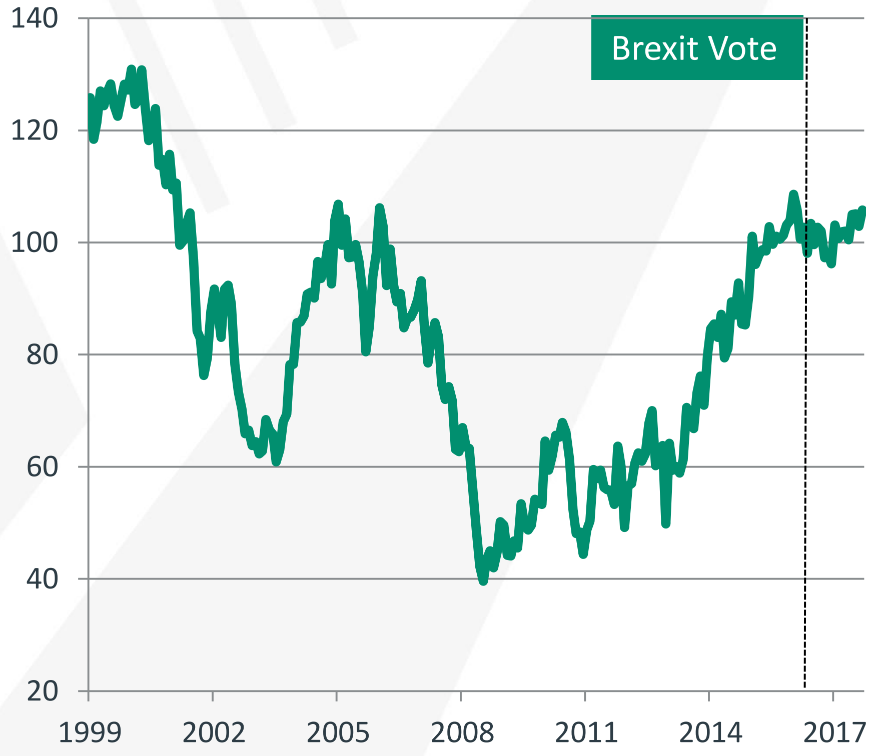
Unemployment falling across Europe; falling faster here

	Q4 2013 %	Q4 2014 %	Q4 2015 %	Q4 2016 %	Q2 2017 %
Germany	5.1	4.9	4.5	4.0	**3.9**
Netherlands	7.6	7.1	6.7	5.5	**5.0**
Ireland	12.2	10.4	9.0	7.0	6.2
Sweden	8.0	7.8	7.1	6.9	**6.6**
Belgium	8.5	8.6	8.7	7.2	**7.6**
EU 28	10.7	9.9	9.0	8.3	**7.7**
Euro area	11.9	11.4	10.5	9.7	**9.2**
Portugal	15.4	13.5	12.3	10.4	**9.2**
France	10.1	10.4	10.2	10.0	**9.6**
Italy	12.3	12.7	11.6	11.8	**11.2**
Spain	25.8	23.8	21.0	18.7	**17.3**
Greece	27.6	25.9	24.3	23.3	**22.6**

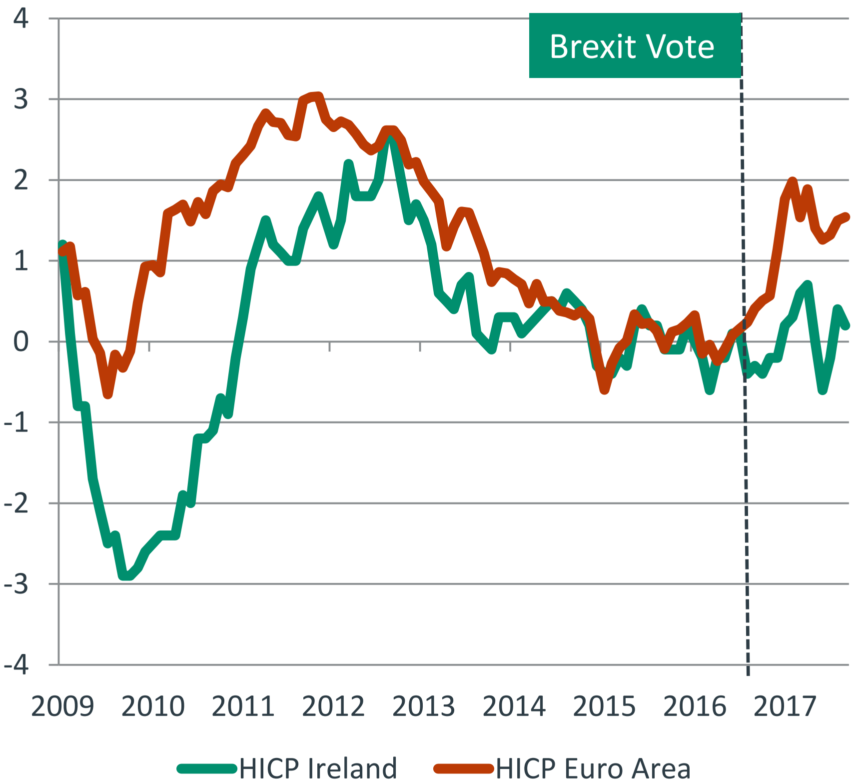
Source: Eurostat, 15-74 age basis

Rising employment and house price rises lift confidence; stagnating consumer prices underpin real income…

Consumer confidence had recovered, though Brexit may have impacted



Inflation in Ireland lower than EA due to sterling weakness



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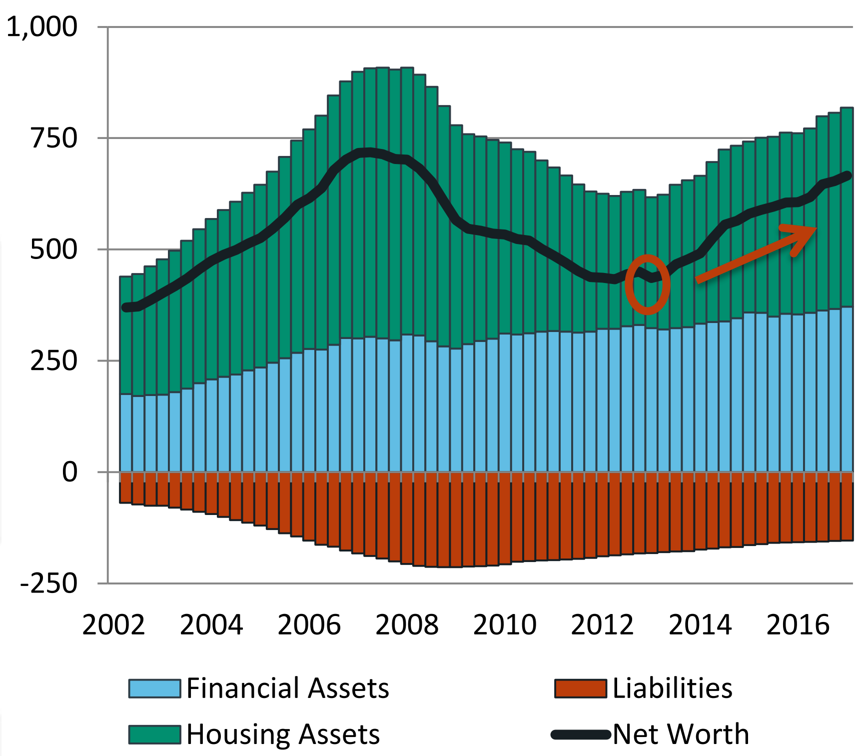
Source: KBC, ESRI, CSO; Eurostat

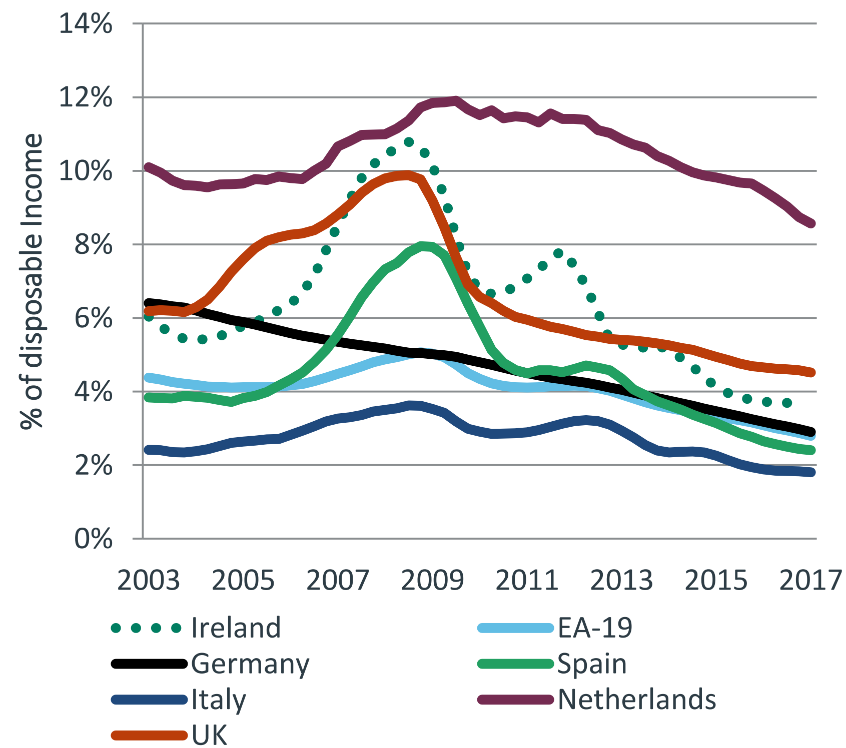
… while household deleveraging continues; rising house prices bolster household balance sheets

Household net worth (€bn) improved since 2012 underpinning consumer spending



Source: [CBI](), NTMA Calculations

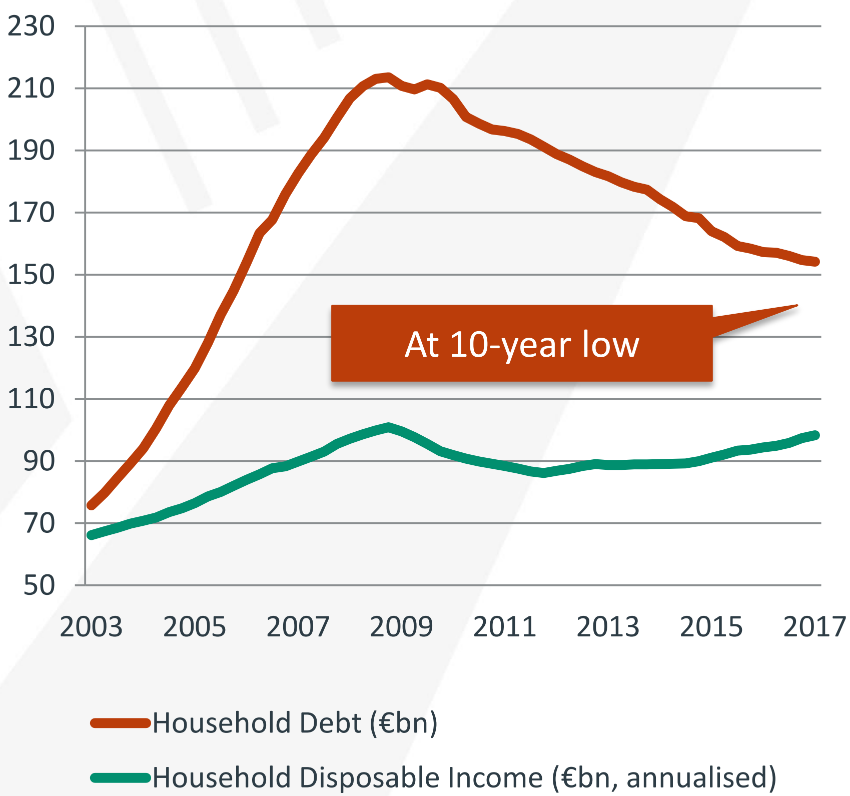
Interest burden down to only 4% of disposable income from peak of 11%



Source: CBI, Eurostat NTMA calculations
Note: Non-trackers bare c.90% of the interest burden

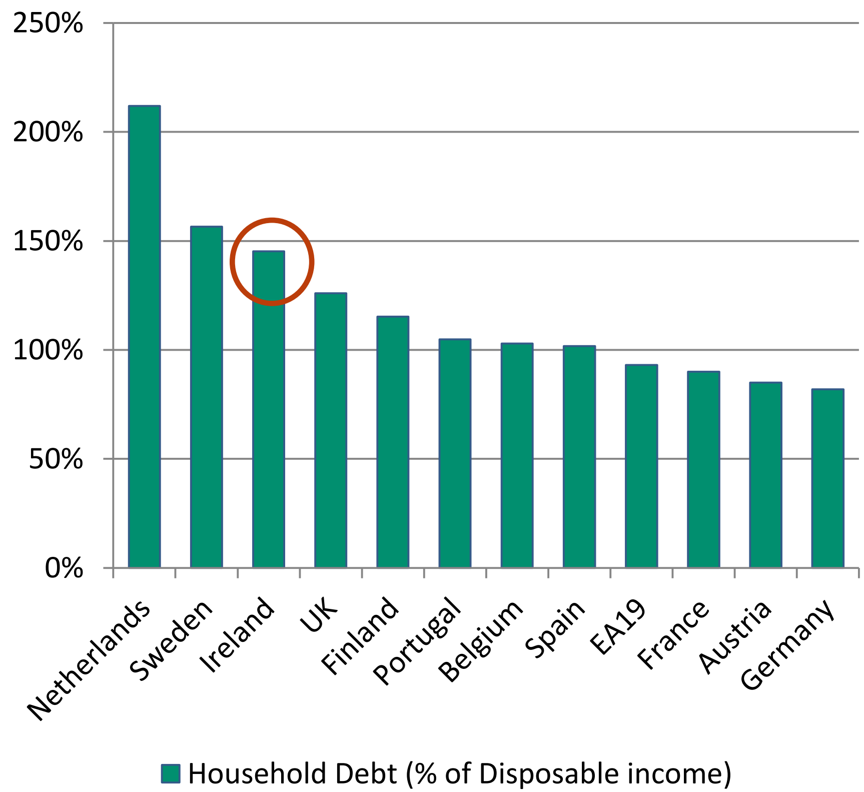
Private debt levels are high but improving

Household debt down nearly €60bn from peak



Source: [CBI]

Debt to after-tax income* improving (145%) but among highest in Europe



Source: [Eurostat]

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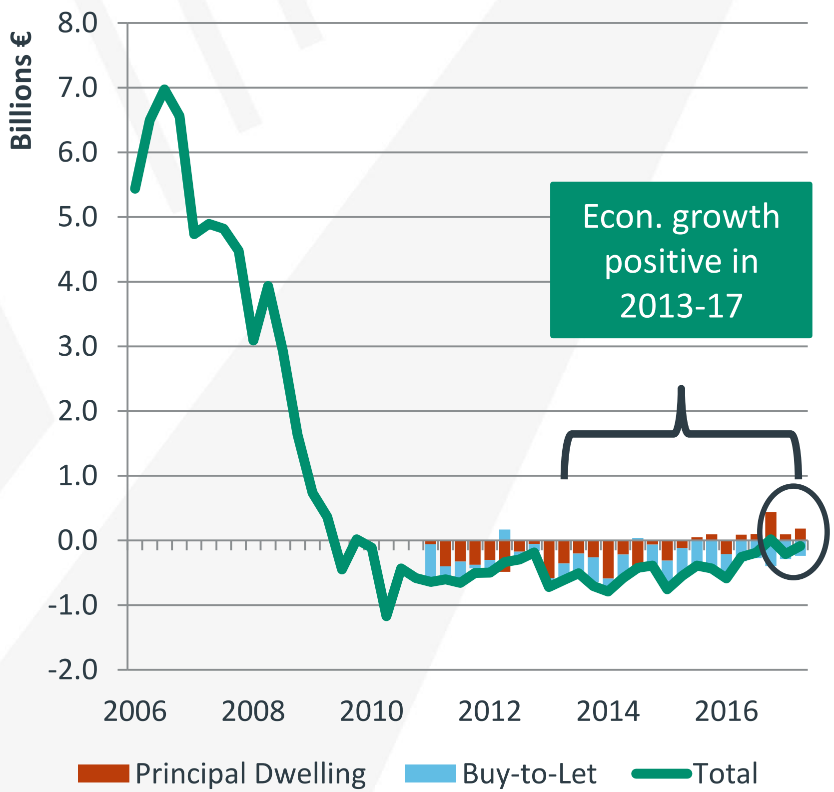
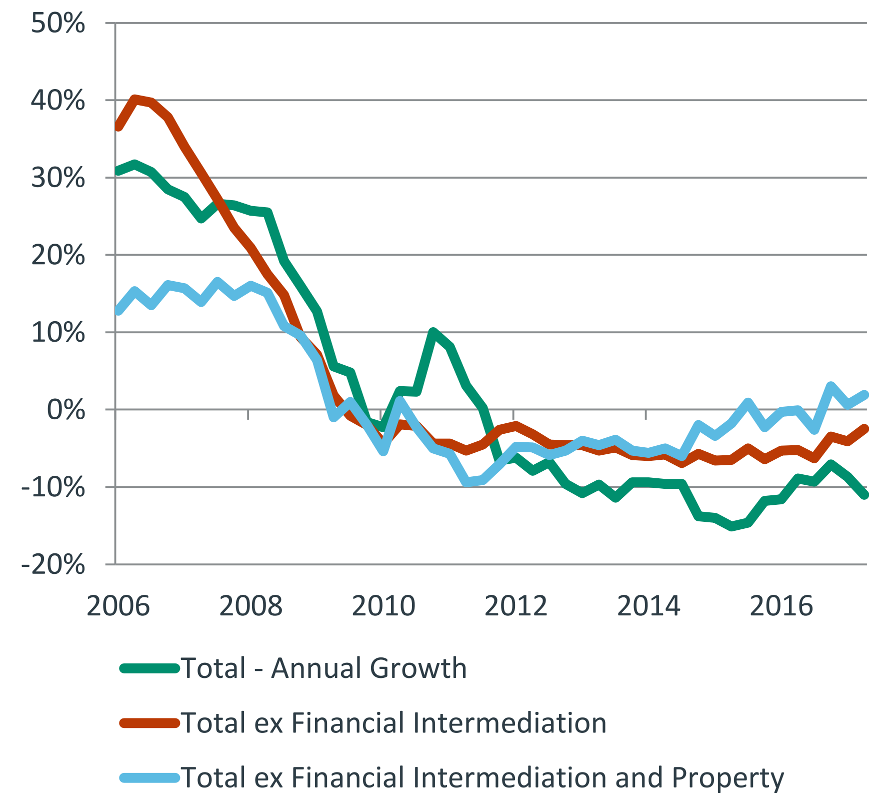
*Measure excludes "other liabilities" from household debt.

Recovery has not been driven by credit

Lending for House Purchase slowly improving (€bn net transactions)

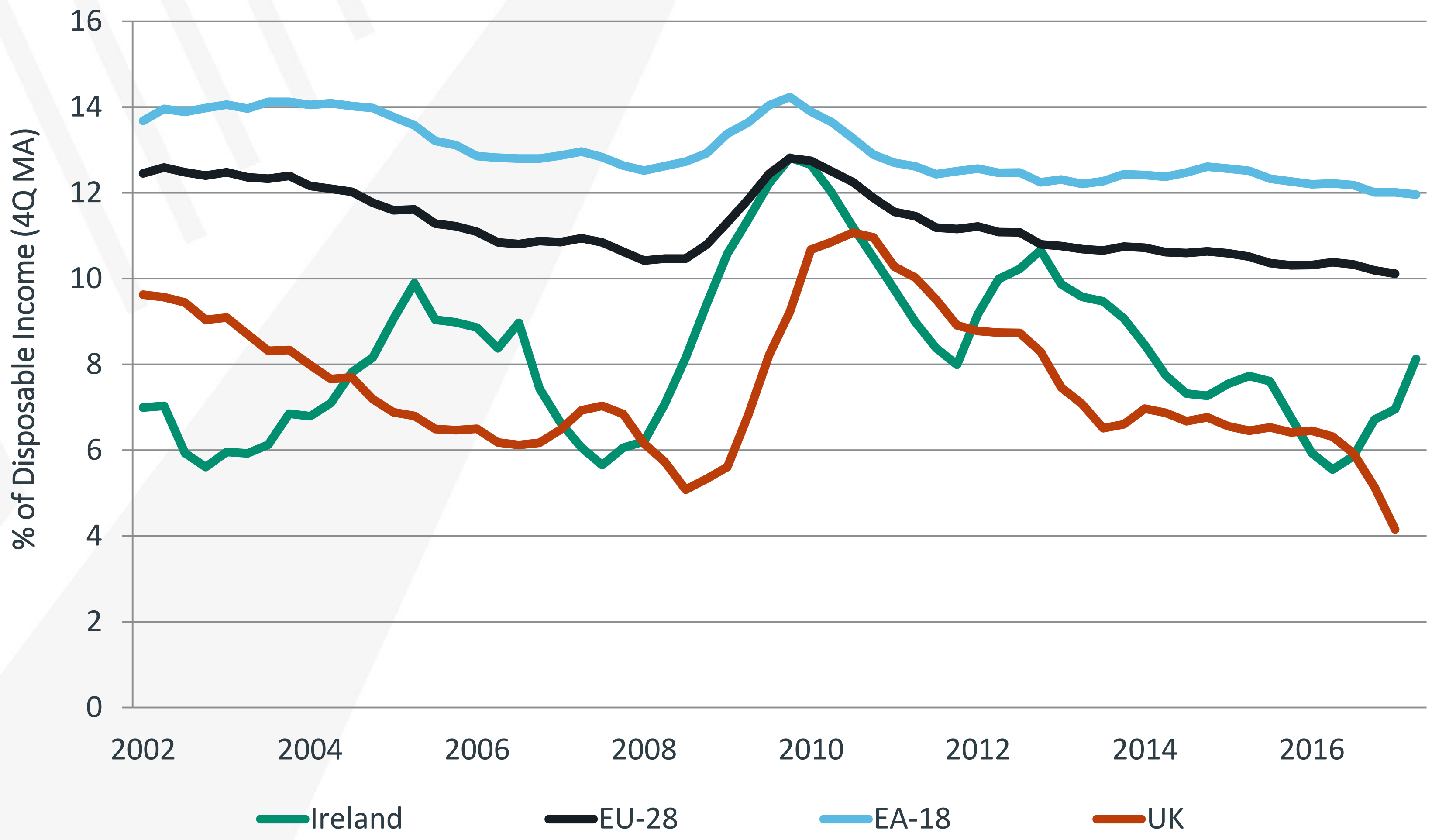


New credit to Businesses only now outweighing deleveraging efforts (y-o-y)



Source: CBI

Gross household saving rate revised downwards recently – more in line with UK than EU

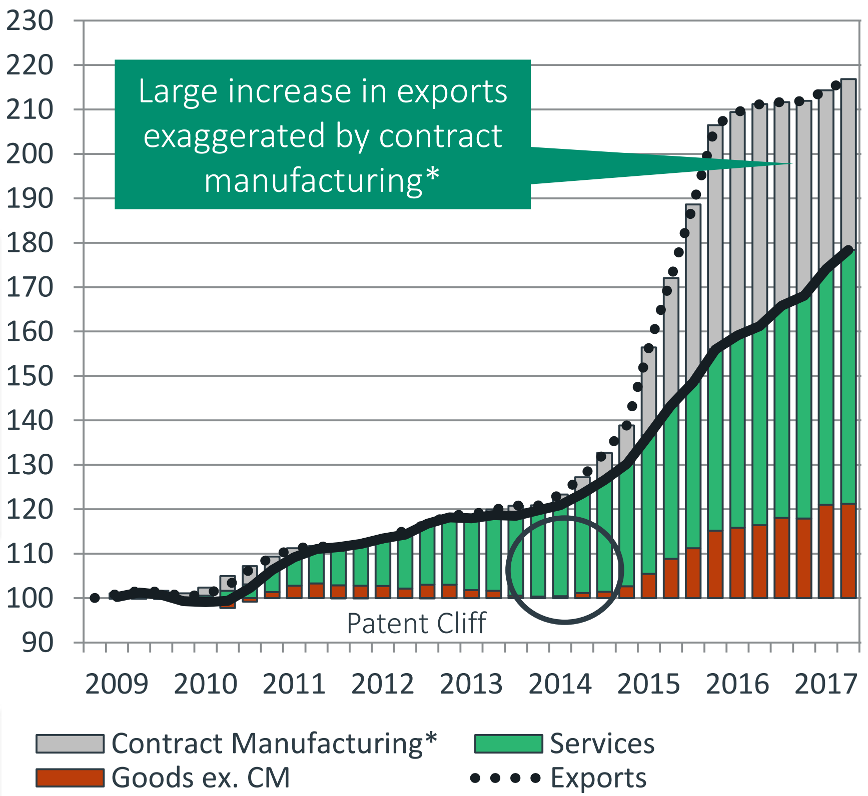


Source: Eurostat, CSO

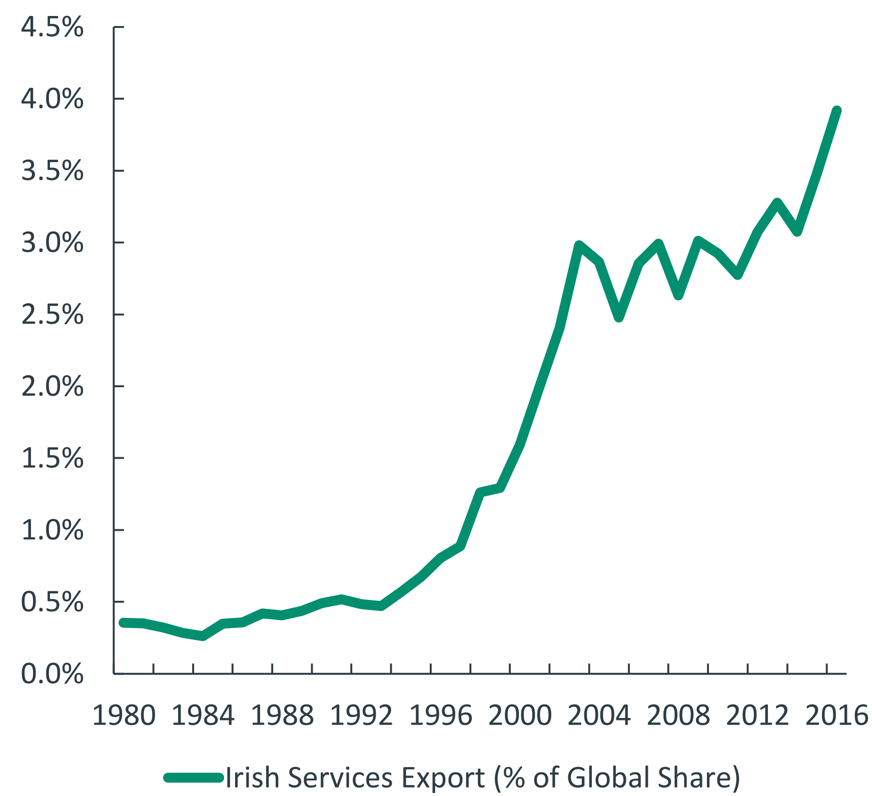
Note: Gross Savings as calculated by the CSO has tended to be a volatile series in the past, some caution is warranted when interpreting this data

Service exports have been very strong post-crisis; goods exports excluding contract manufacturing slower

Cumulative post-crisis exports (4Q sum to end-2008 = 100, current prices)



Ireland has tripled its share of global service exports in the last 15 years



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*Source: CSO, NTMA calculations , * Contract manufacturing proxy ; DataStream*

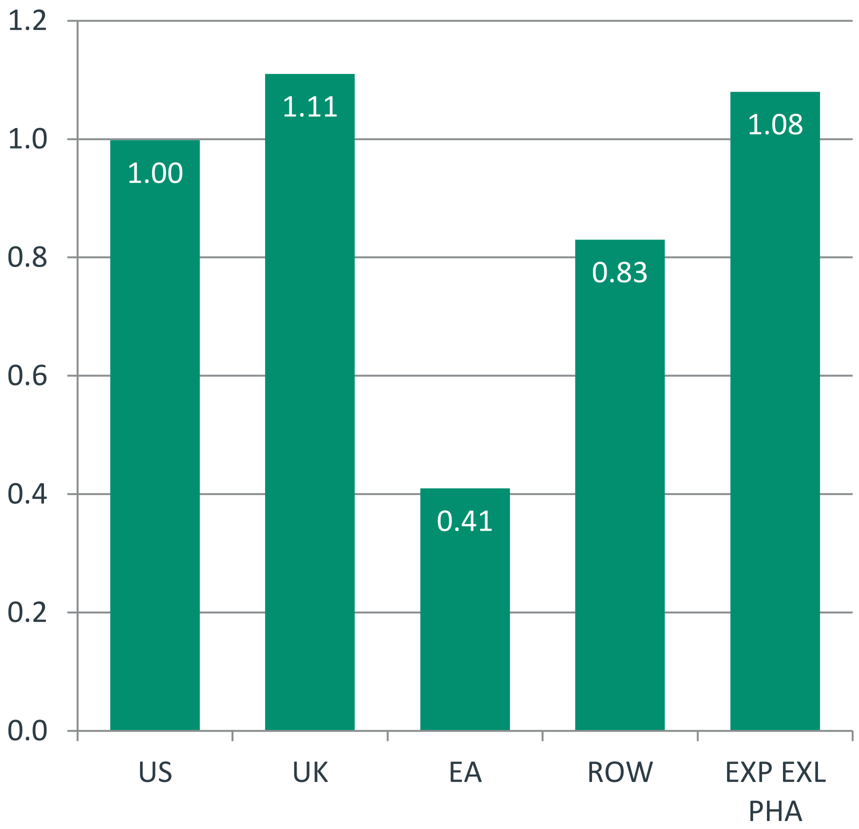
Ireland's goods exports respond vigorously to euro movements – in both directions

- A 1% depreciation of the euro increases Irish goods exports to the US by 1%
- The equivalent response for exports to the UK is 1.1% and to the rest of world is 0.8%. Brexit has the opposite effect on Irish exports.
- The EUR/USD exchange rate has a positive effect (elasticity of 0.4) on Irish goods exports to the euro area, due to Ireland-based multinational companies' exports to EA for onward sale to the rest of the world
- The elasticity of total goods exports excluding pharma to the exchange rate >1

Source: CSO; NTMA empirical analysis

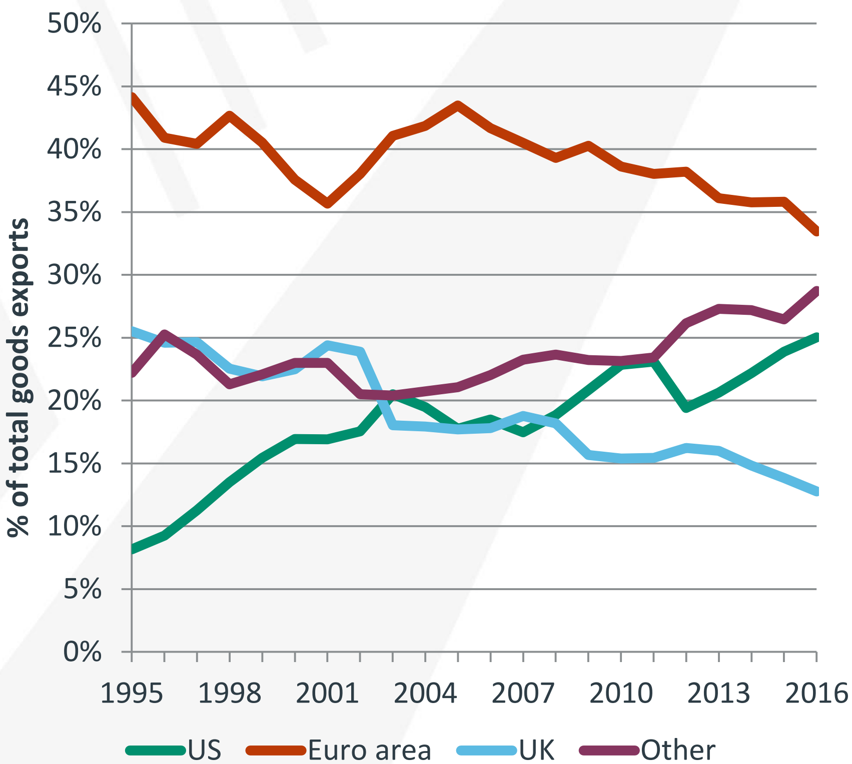
Note: All coefficients significant at 99% level; not affected by contract manufacturing. Time period is 1998 to 2016 Q2. For longer time periods, the UK elasticity is smaller (closer to 0.4-0.5 for 1981 onwards).

Response (% chg.) of Irish goods exports to 1% depreciation of the euro



Ireland's openness has been critical to Irish success; Brexit hinders export-led growth

Ireland benefits from export diversification by destination



Source: CSO

Breakdown of Irish trading partners % of total

	Goods			Services		Total	
2016	Exp.	Imp.	2015	Exp.	Imp.	Exp.	Imp.
US	25.0%	12.6%	US	10.0%	21.0%	16.0%	18.4%
UK	12.8%	23.4%	UK	19.4%	8.0%	16.7%	13.6%
EA	33.5%	27.9%	EA	29.3%	26.4%	32.1%	26.8%
China	3.1%	5.9%	China	2.8%	0.3%	2.4%	2.2%
Other	25.6%	30.2%	Other	38.5%	44.4%	32.8%	39.0%

Source: CSO, NTMA calculations; Data not affected by contract manufacturing

Section 2: Fiscal & NTMA funding

Fiscal accounts are robust;
GDP revisions mean we need to
look beyond usual debt ratios

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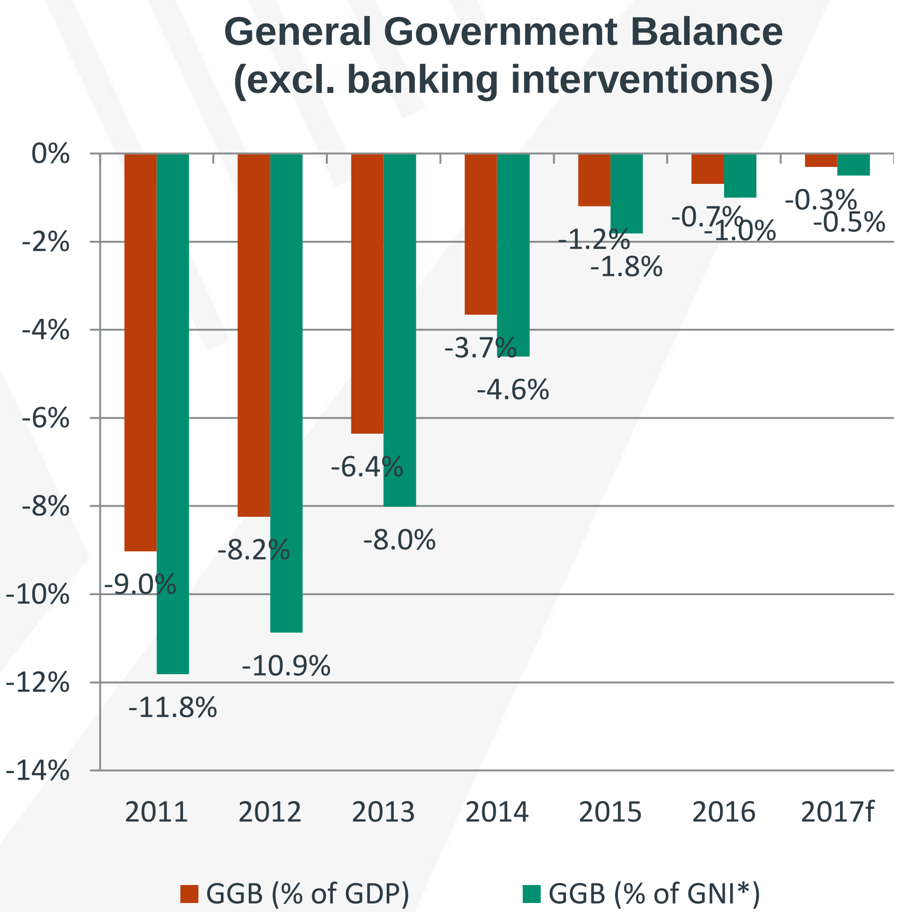
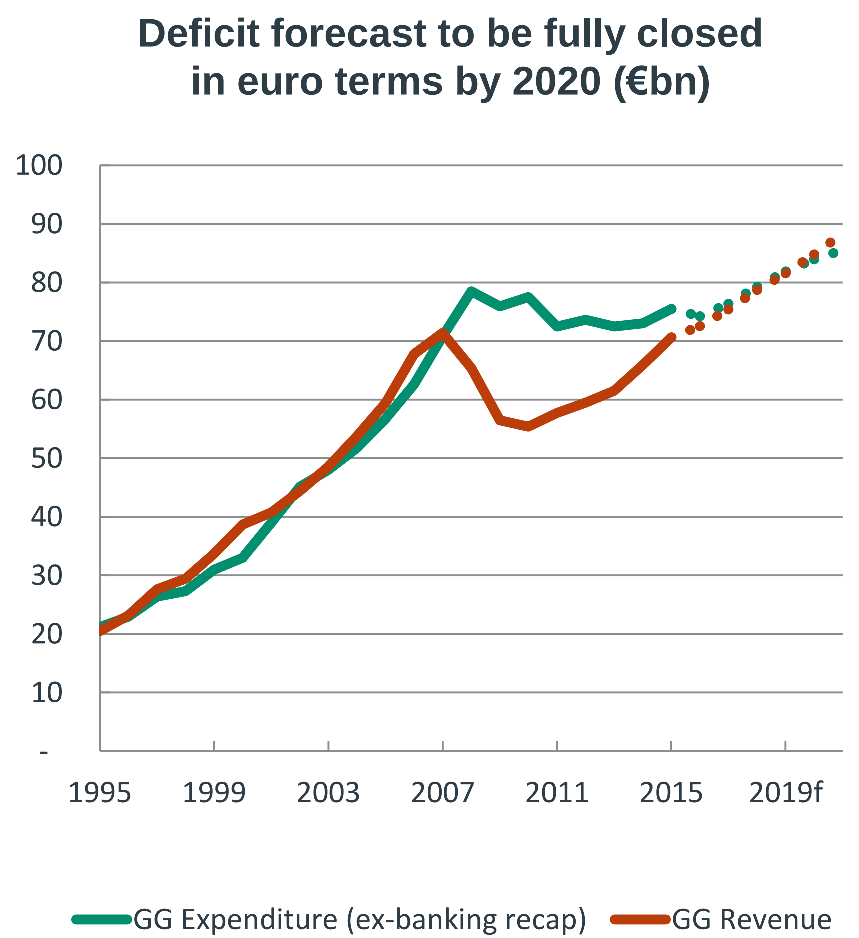
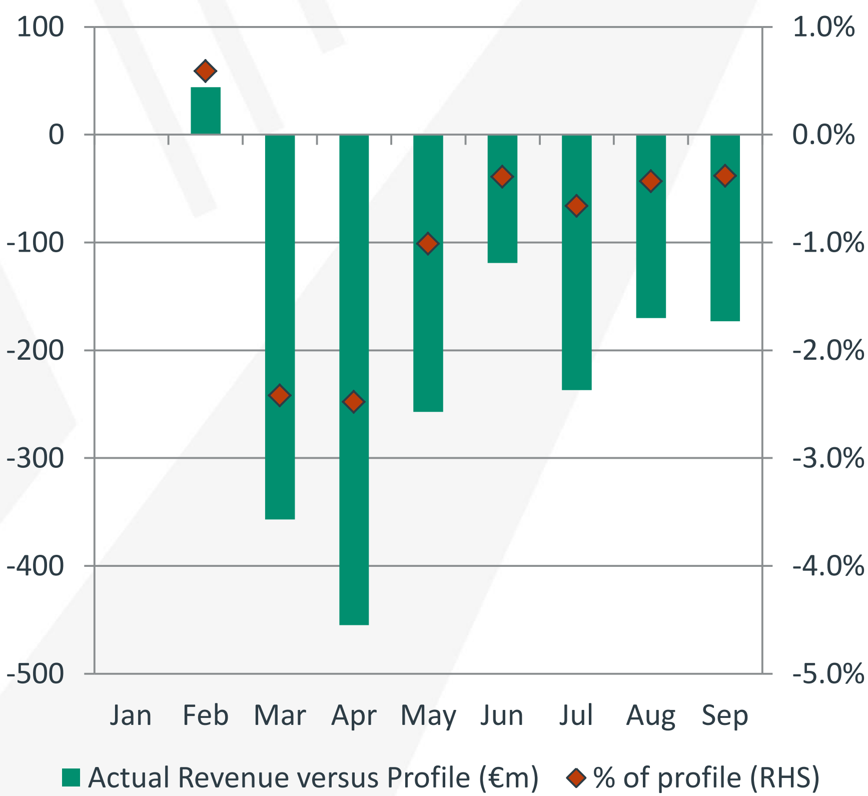
Irrespective of GDP moves, Ireland has had six straight years of fiscal outperformance



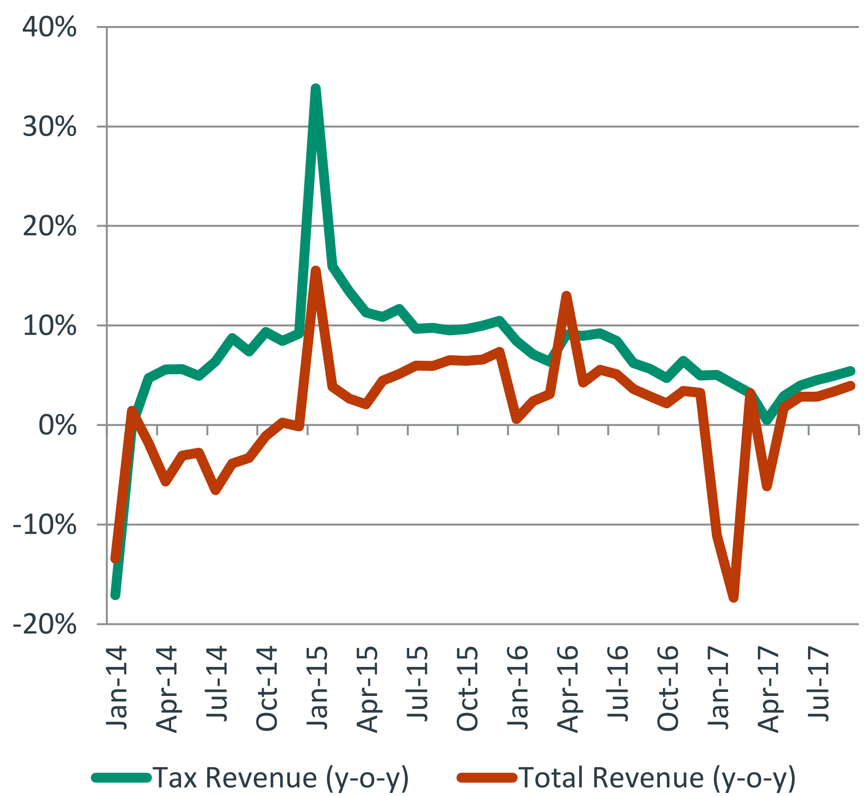


Despite deviations in earlier months, govt. revenue figures are almost back in line with expectations

At end-H1, govt. revenue close to expected profile despite deviations earlier in 2017

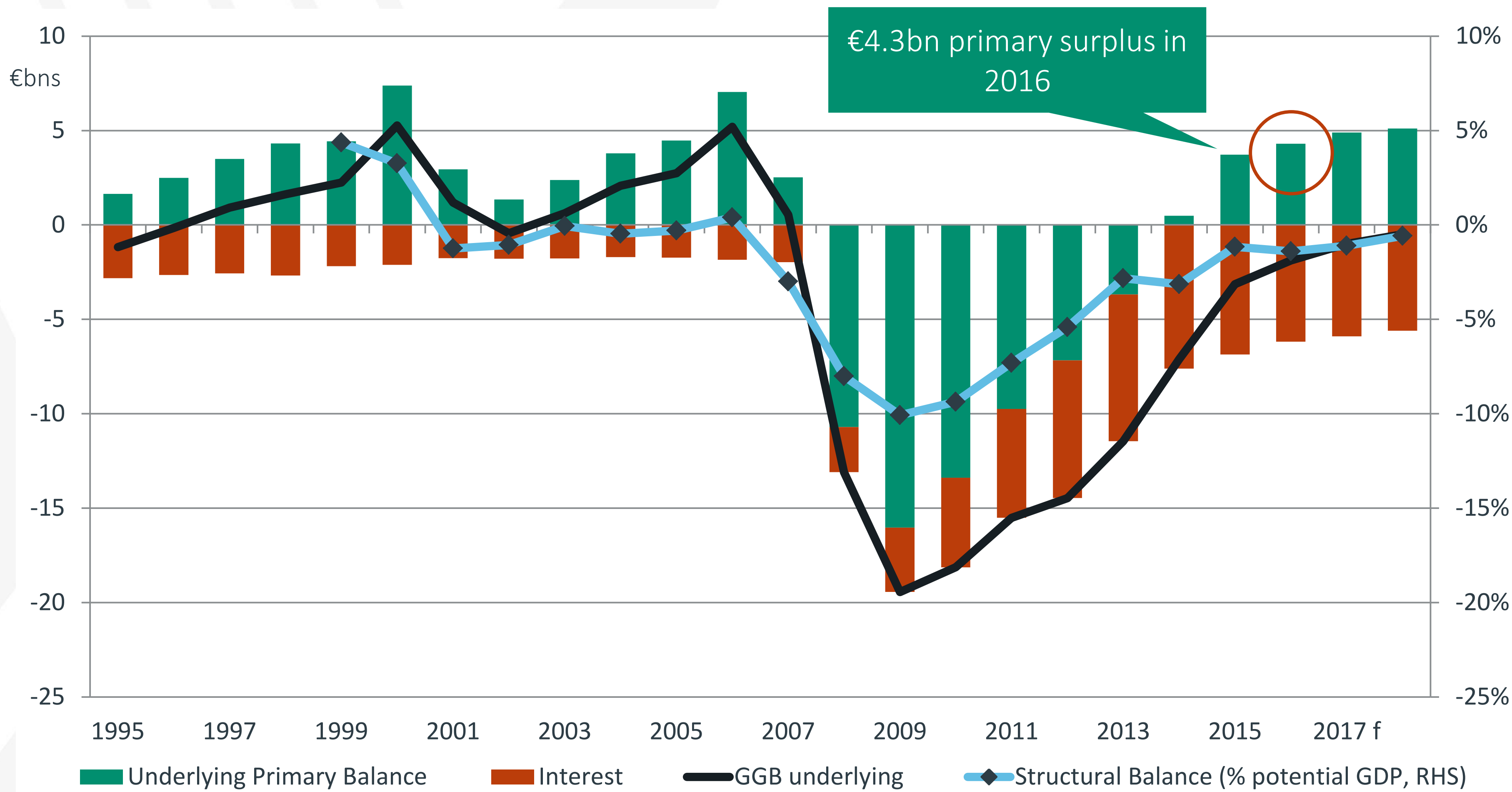


Tax and total revenue growing in line with economic growth



Source: Department of Finance

Medium Term Objective of structural balance of -0.5% of GDP may be achieved in 2018



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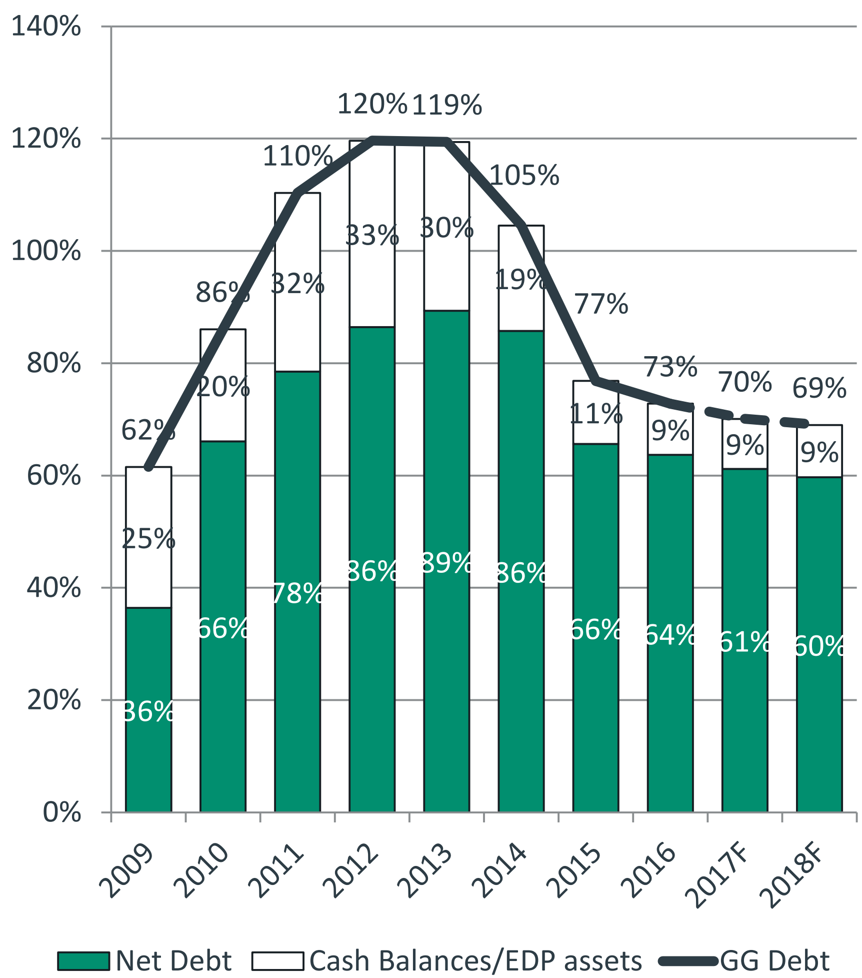
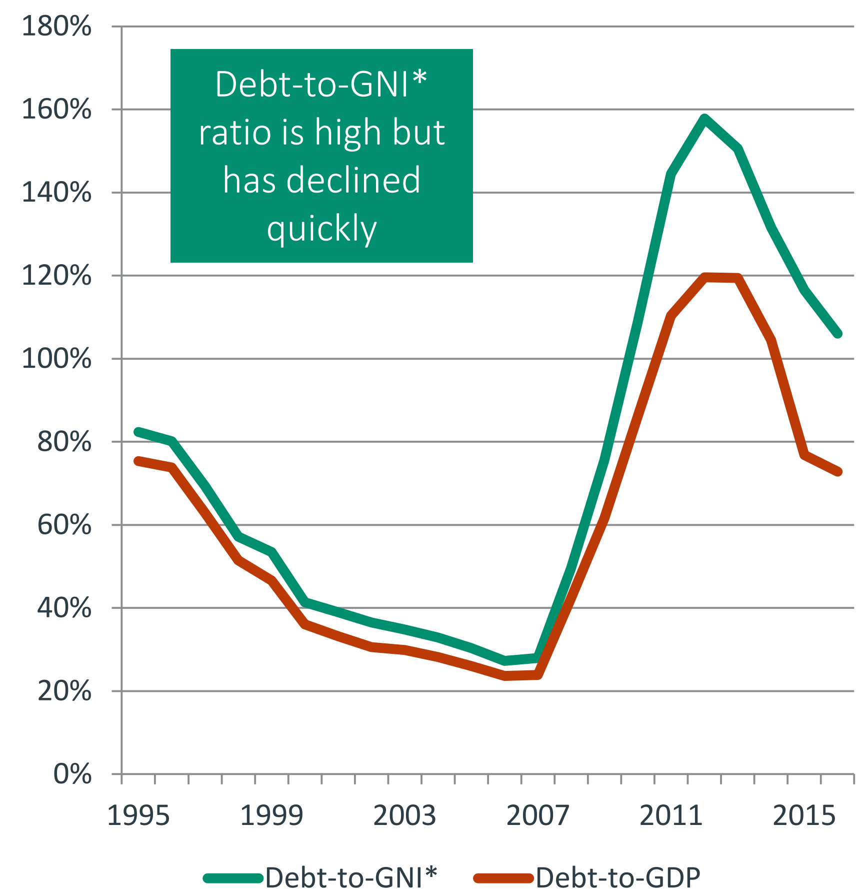
Source: CSO; Department of Finance; IMF

Gross Government debt fell to 73% of GDP in 2016; GG debt to GNI* fell to 106%; reality somewhere in between





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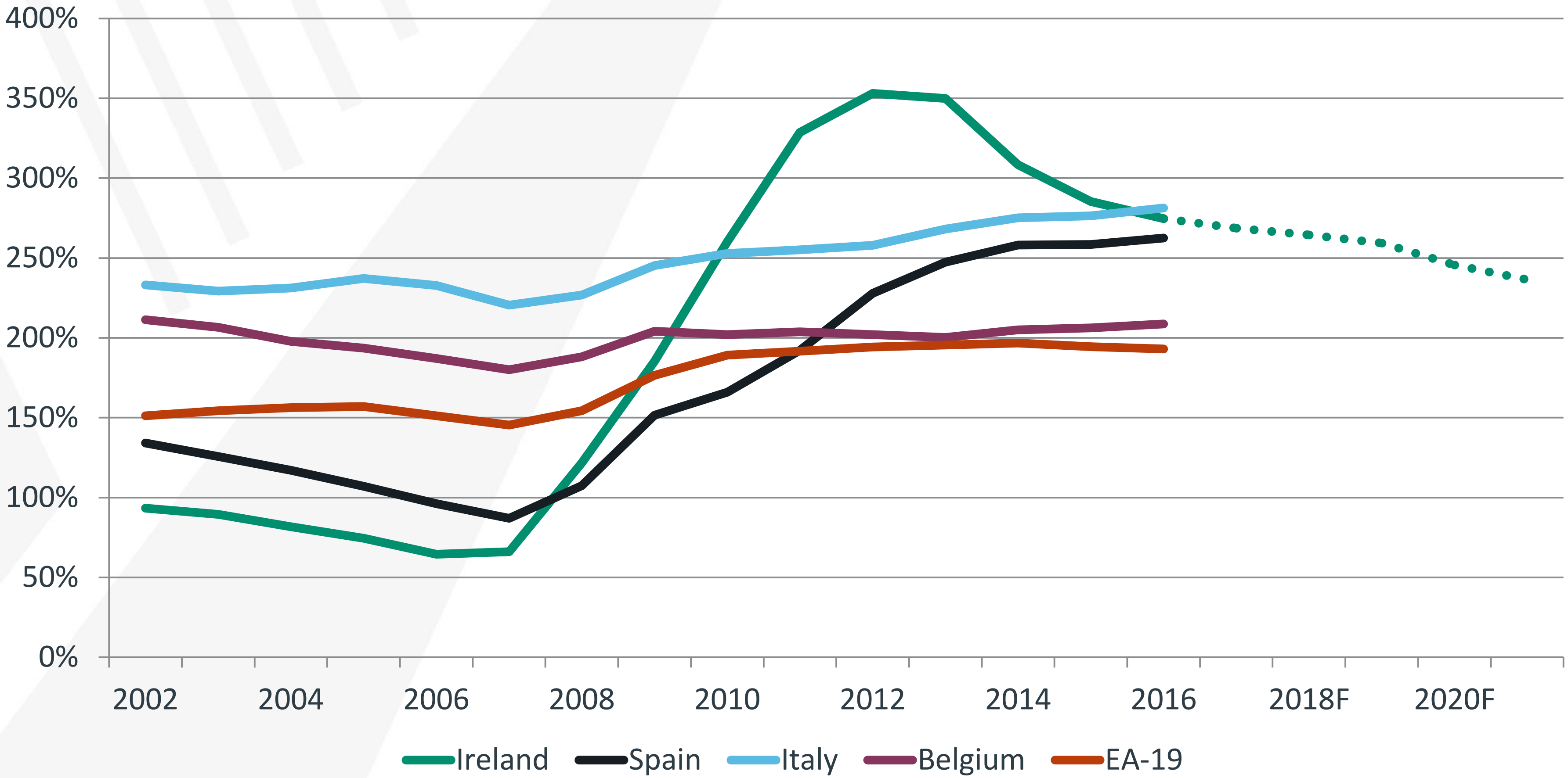
Source: CSO; Department of Finance, NTMA calculations

Alternative debt service metrics must also be used for Ireland e.g. General Government debt to GG Revenue



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Source: CSO; Department of Finance

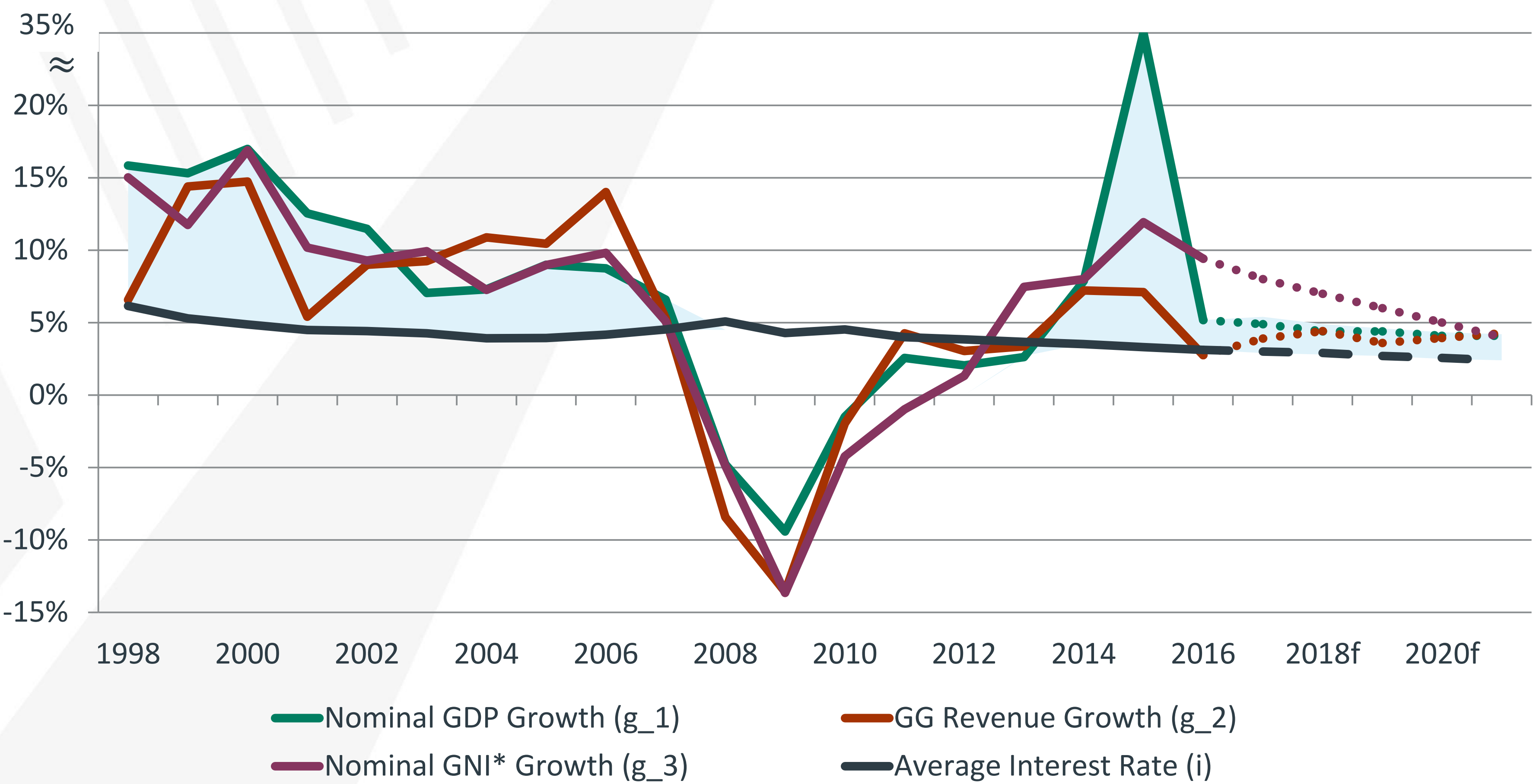
Better to use broad range of debt serviceability metrics

2016	GG debt to GDP %	GG debt to GG revenue %	GG interest to GG rev %
Greece	179.0	360.0	6.5
Portugal	130.4	302.8	9.8
Italy	132.6	281.3	8.4
Cyprus	107.8	274.9	6.6
Ireland	72.8	274.6	8.5*
Spain	99.4	262.5	7.4
UK	85.2	217.3	6.3
Belgium	106.0	208.7	5.6
EA19	89.3	193.0	4.8
EU28	83.6	186.1	4.8
Slovenia	79.7	182.6	7.3
France	96.5	181.8	3.6
Austria	84.6	170.9	4.2
Germany	68.3	151.7	3.1
Netherlands	62.3	141.4	2.5
Slovakia	51.9	130.0	4.1
Finland	63.6	117.2	2.0

Source: Eurostat, NTMA calculations

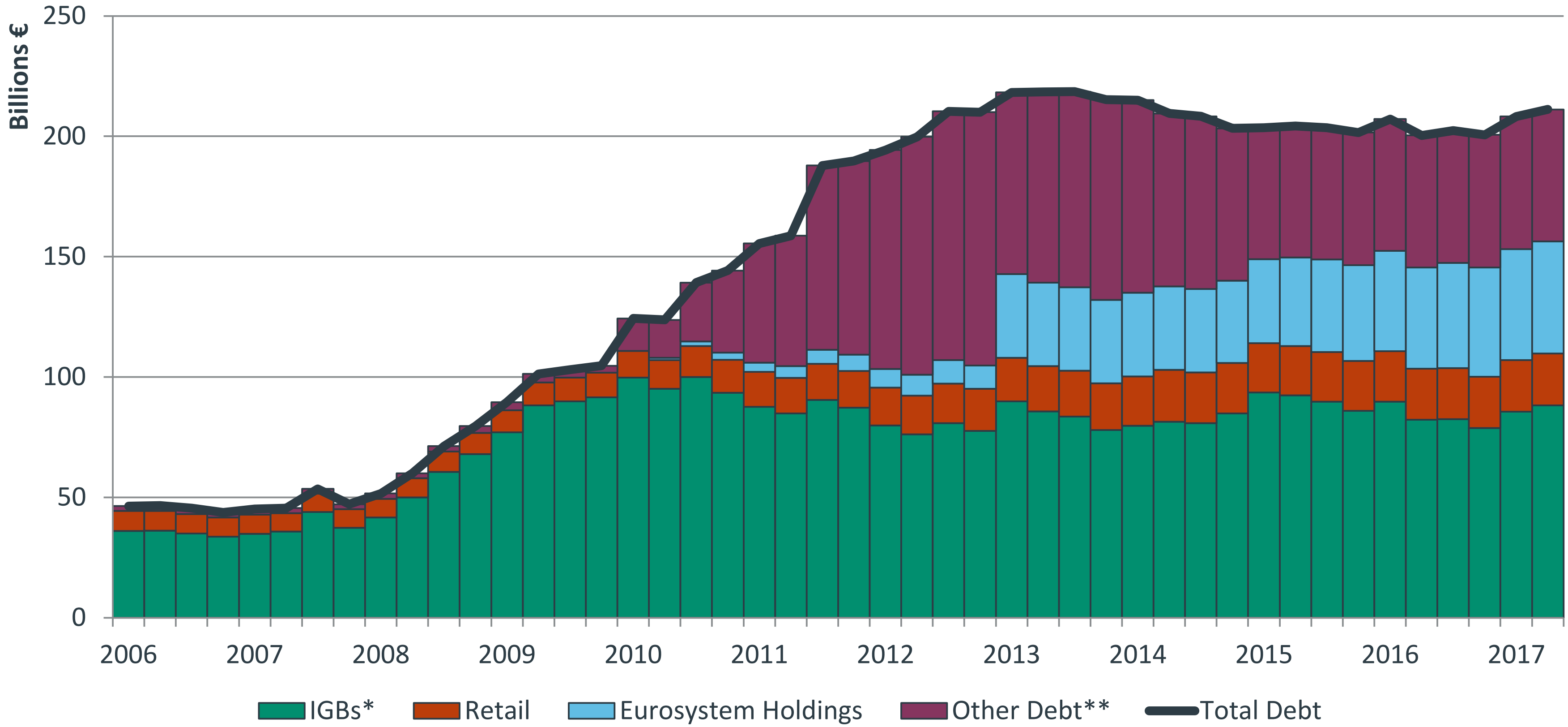
** Closer to 7% of GG Revenue if you exclude the interest paid to CBI. Other countries would also see their interest % of GG Revenue fall under this treatment but Ireland's would fall by more given amount held by CBI (FRNs etc.)*

Snowball Effect (i-g) in Ireland's favour regardless of what "g" metric is used



Source: CSO; Department of Finance, NTMA calculations
Please note the break in the y-axis to incorporate the outsized 2015 GDP growth figure

Over 50% of Irish debt stock held by "sticky" sources



Source: CSO, ECB, NTMA Analysis
**excludes those held by Eurosystem. Euro system holdings include SMP, PSPP and CBI holdings of FRNs. Figures do not include ANFA holdings which are likely to further increase the Eurosystem's holdings.*
*** Includes IMF, EFSF, EFSM, Bilateral as well as IBRC-related liabilities.*
Retail includes State Savings and other currency and deposits. The CSO series has been altered to exclude the impact of IBRC on the data.

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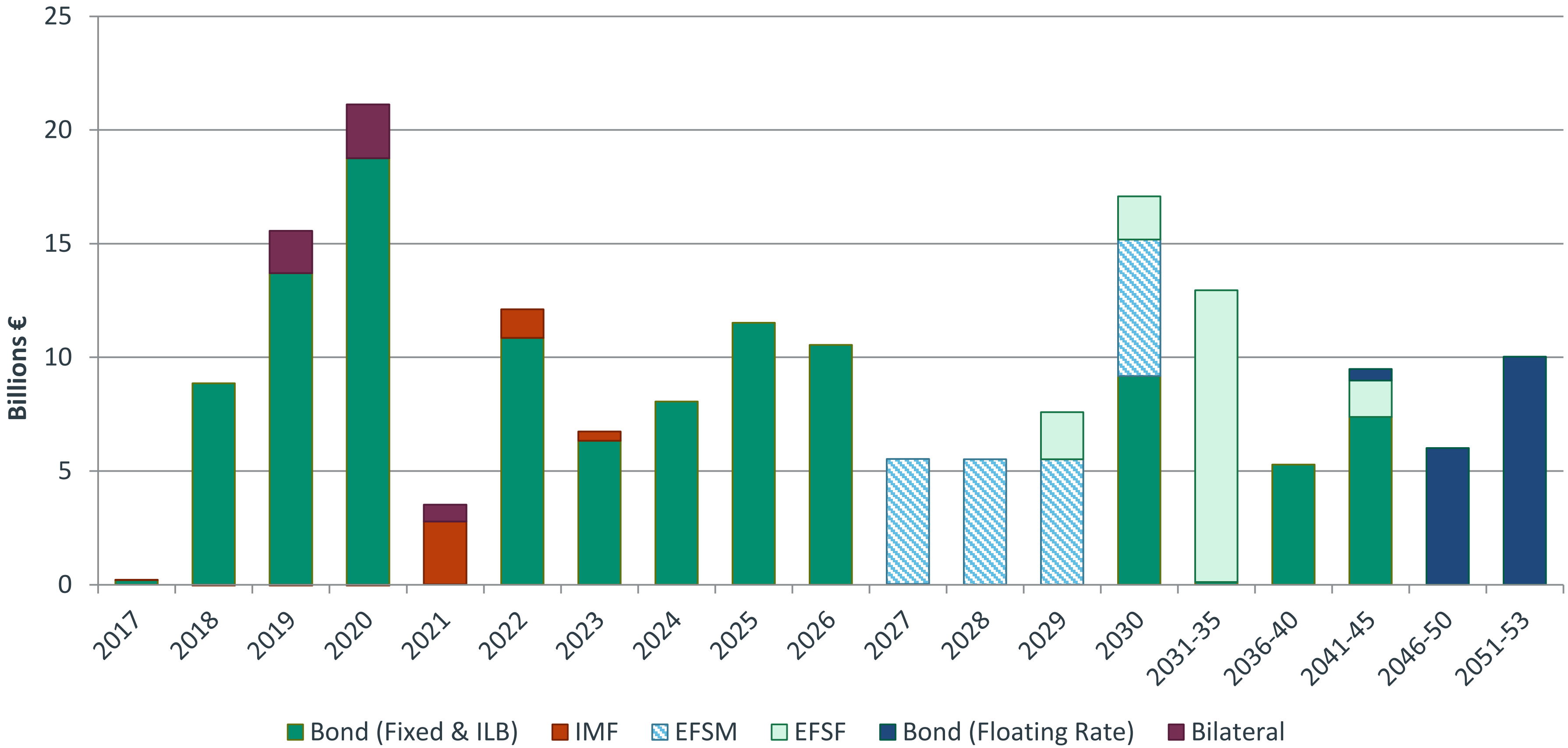
Ireland intends to repay IMF and Bilateral facilities early; €150m in expected interest savings plus extra QE capacity

- The Minister for Finance and Public Expenditure & Reform has announced that Ireland intends to repay its remaining loans from the IMF (approx. €4.5bn), together with bilateral facilities agreed with Sweden (€0.6bn) and Denmark (€0.4bn), a total of circa €5.5bn.
- This is not the first time Ireland has made an early repayment of programme loans. The NTMA has previously implemented arrangements to repay over €18bn in IMF facilities to take advantage of reduced market borrowing costs and create savings for the Exchequer.
- The NTMA estimates that <u>interest savings</u> for the Exchequer from the early repayment of c. €5.5bn could be of the order of <u>€150m over the remaining lifetime of the loans</u>.
- Early repayment of the loans requires agreement from our European lenders to waive the proportionate early repayment clauses in our respective loan agreements.
- <u>Any replacement of programme loans with marketable debt also increases the ECB's purchase capacity for Irish government bonds</u>.
- In addition there are secondary market liquidity and operational benefits.

Maturity profile – modest refinancing in 2017 and 2018



Source: NTMA

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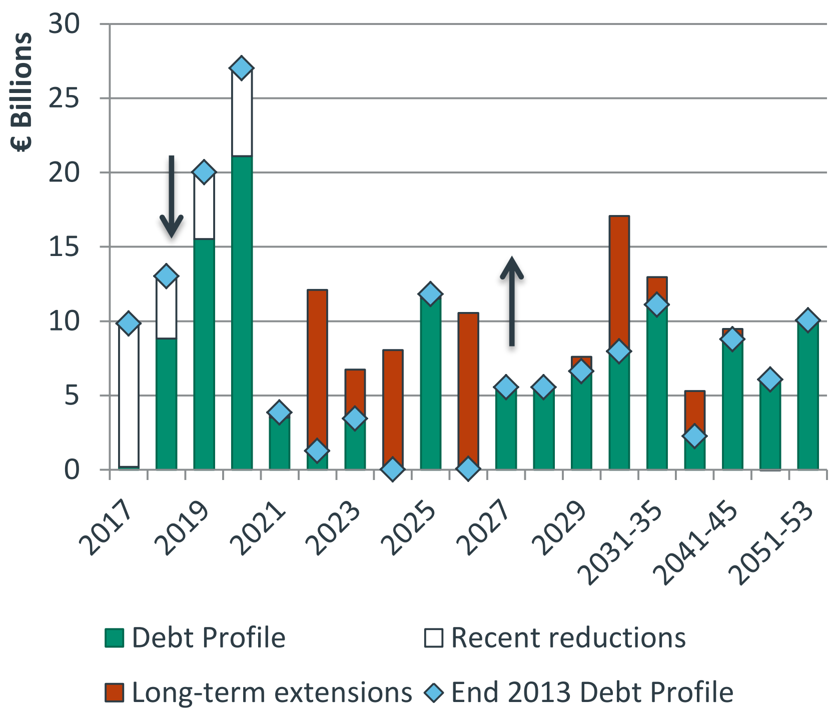
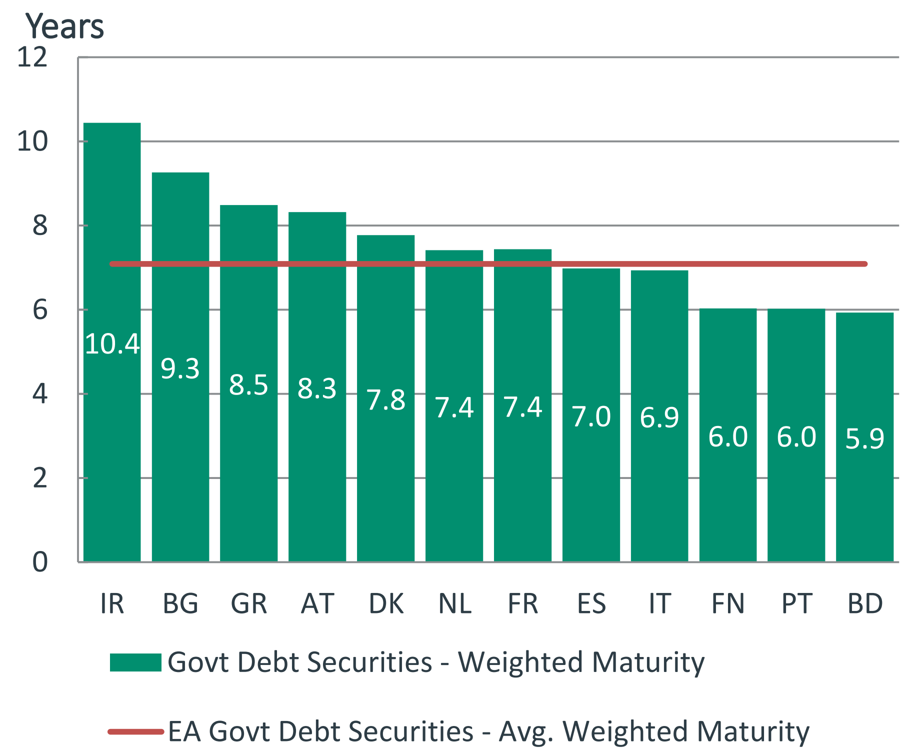
Note: EFSM loans are subject to a 7-year extension that will bring their weighted-average maturity from 12.5 years to 19.5 years. It is not expected that Ireland will refinance any of its EFSM loans before 2027. As such we have placed the EFSM loan maturity dates in the 2027-30 range although these may be subject to change.

We improved our 2017-2020 maturity profile significantly in recent years

Various operations since 2013 have led to an extension of maturity…



…Ireland compares favourably to other European countries



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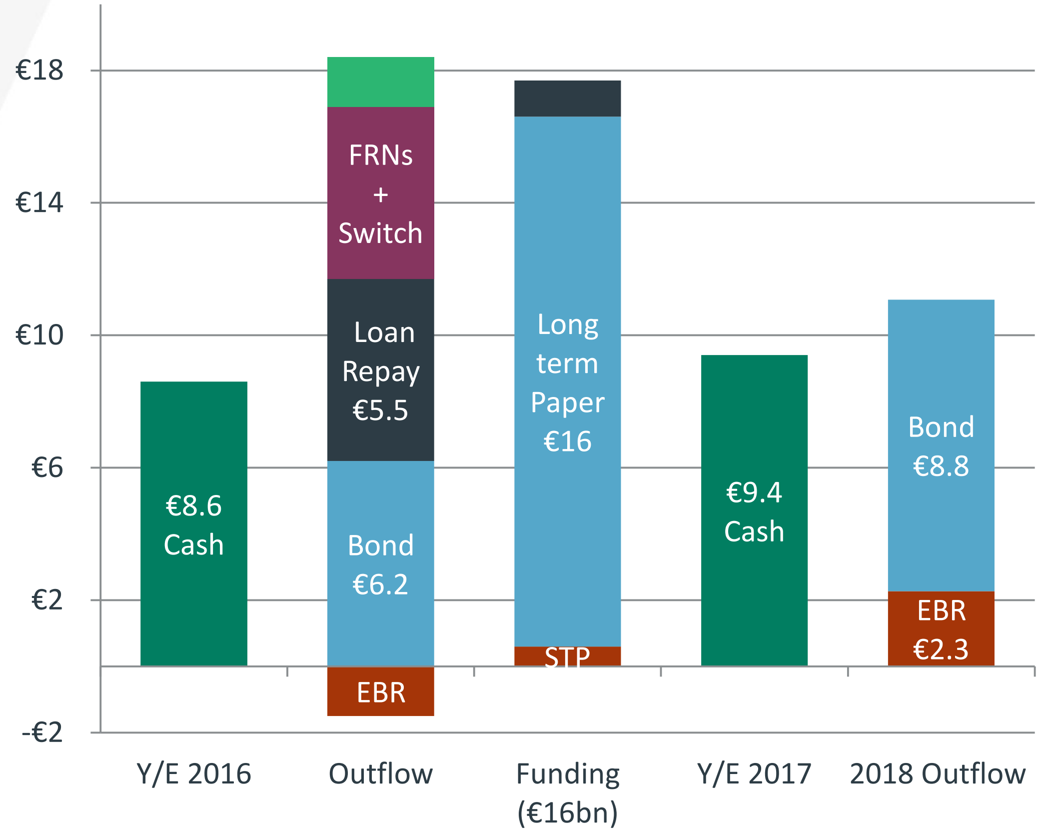
Source: NTMA; ECB

**excludes programme loans. Ireland's maturity including these loans is still similar.*

NTMA funded approximately three to four quarters in advance; 2017 issuance to be larger than 2016

- Ireland redeemed €6.2bn bond in October 2017.
- Our next bond redemption will be in October 2018 - €8.8bn.
- NTMA indicated it would issue €9-13bn worth of long term bonds in 2017. However, in light of the expected repayment of IMF and SWE/DEN loans, Ireland is expected to issue €16bn.
- Exchequer cash balance at end Q3 2017 was €21bn.

Source: NTMA



- EBR is the Exchequer Borrowing Requirement (Department of Finance estimate)
- Cash balances excludes non-liquid asset classes such as Housing Finance Agency (HFA) Guaranteed Notes.
- Other outflows includes contingencies.
- Other funding includes Retail (State Savings).
- Rounding may occur.

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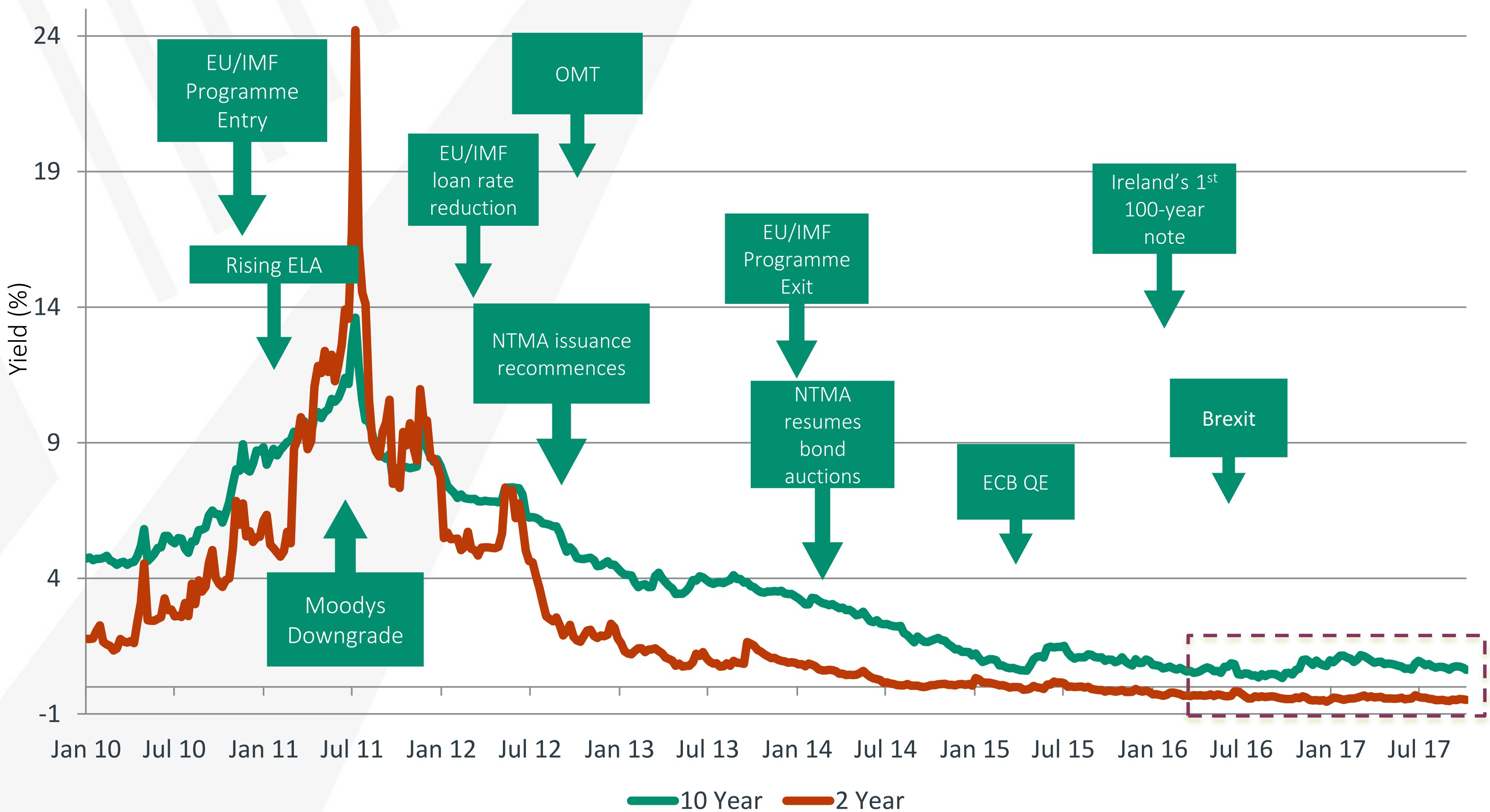
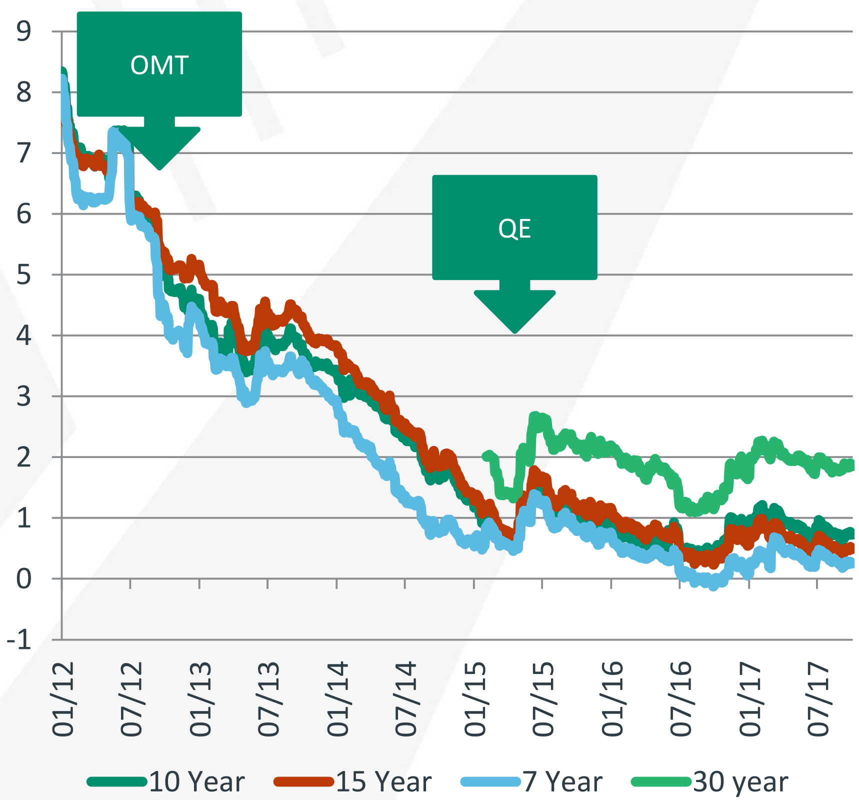
Ireland's bond market performance has been underpinned by prudent domestic policy and ECB action



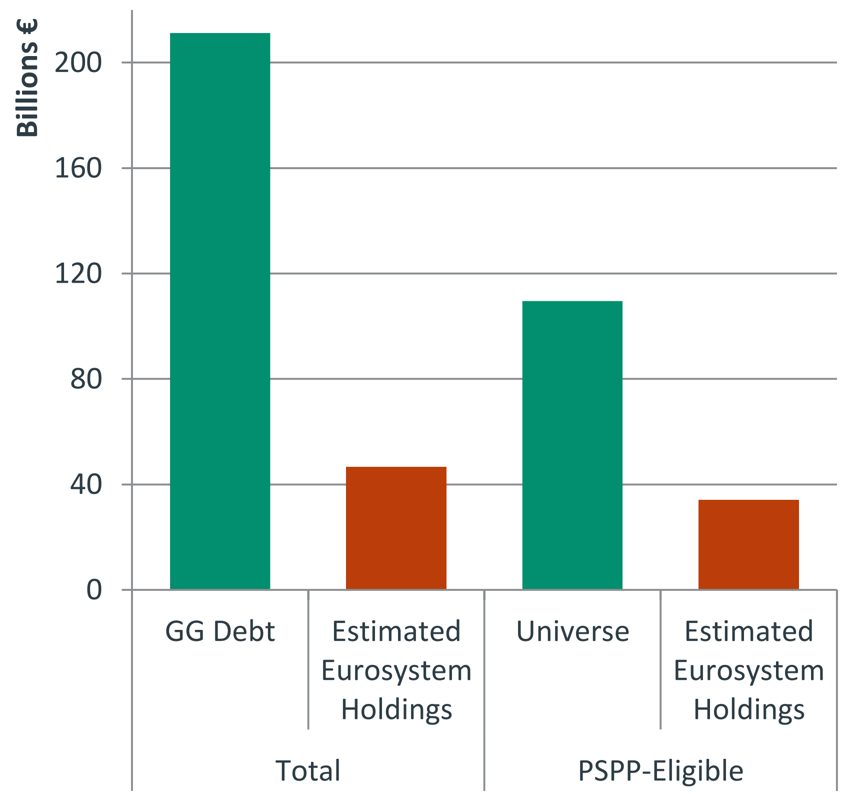
Source: Bloomberg (weekly data)

ECB action has helped Ireland's bond performance

OMT and QE (PSPP) have both helped Ireland and other EA sovereigns



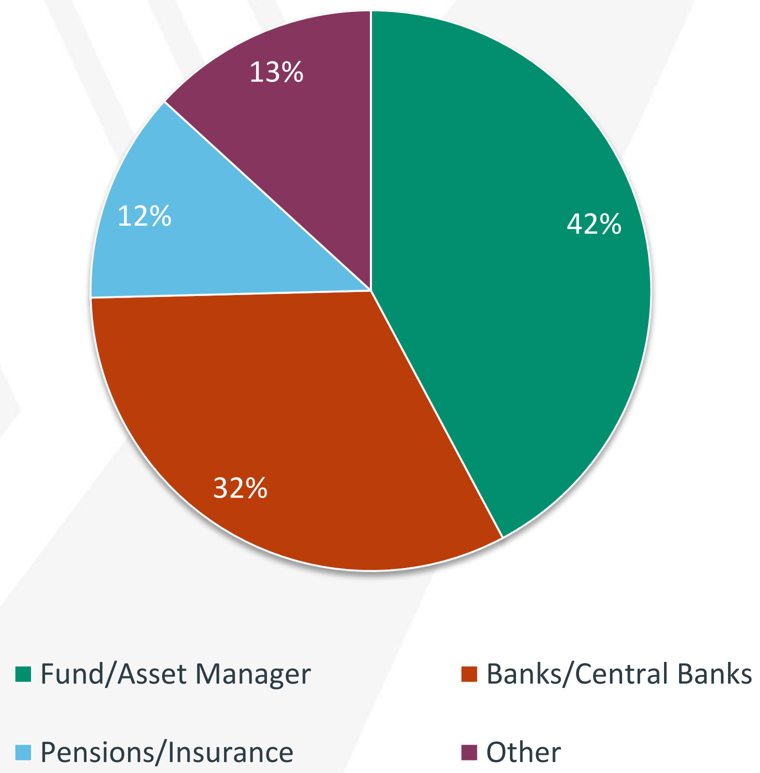
Purchases of IGBs under PSPP will slow in 2017 to c.€6bn but still significant



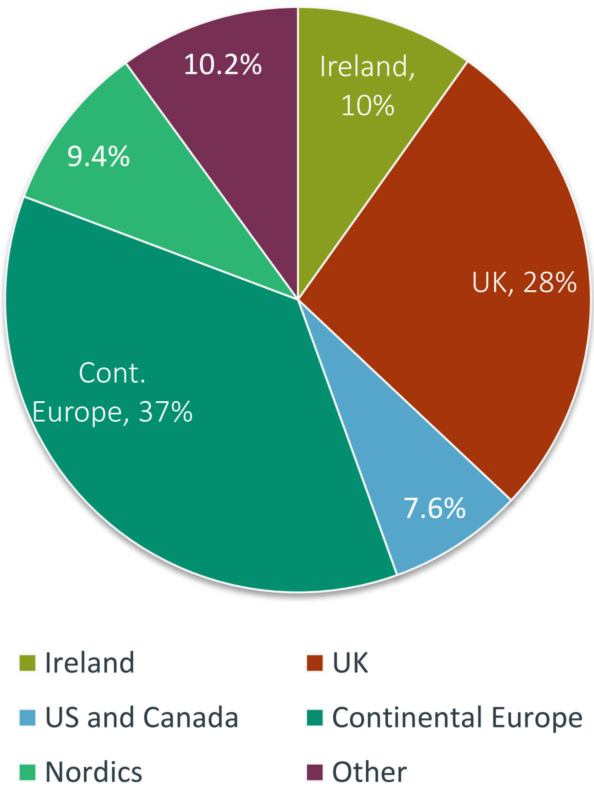
Source: DataStream, Bloomberg; ECB, NTMA Analysis
Note: As of end-Q2 2017

Investor base for Government bonds is wide and varied

Investor breakdown: Average over last 5 syndications



Country breakdown: Average over last 5 syndications



Source: NTMA

Central Bank of Ireland holdings increase domestic share of Irish Government bonds (IGBs) through PSPP

€ Billion				
End quarter	Dec 2014	Dec 2015	Dec 2016	**Jun 2017**
1. Resident	50.8	50.8	54.6	**55.7**
(as % of total)	(43.7%)	(40.6%)	(44.9%)	**(43.4%)**
– Credit Institutions and Central Bank*	45.9	46.9	51.1	**52.5**
– General Government	1.6	0.8	0.5	**0.4**
– Non-bank financial	2.9	2.8	2.7	**2.4**
– Households (and NFCs)	0.4	0.3	0.3	**0.3**
2. Rest of world	65.5	74.2	67.1	**72.6**
(as % of total)	(56.3%)	(59.4%)	(55.1%)	**(56.6%)**
Total MLT debt	116.3	125.1	121.6	**128.3**

Source: CBI

Breakdown of Ireland’s General Government debt

€ Billion	2012	2013	2014	2015	2016	2017 H1
Currency and deposits (mainly retail debt)	62.1	31.4	20.9	20.7	21.3	21.5
Securities other than shares, exc. financial derivatives	87.3	112.7	119.1	125.6	124.0	134.9
- Short-term (T-Bills, CP etc)	2.5	2.4	3.8	1.2	2.3	5.9
- Long-term (MLT bonds)	84.8	110.3	115.3	124.4	121.8	129.0
Loans	60.6	71.3	63.3	54.9	55.2	54.8
- Short-term	1.9	1.4	1.3	1.1	0.7	0.4
- Long-term (official funding and prom notes 2009-12)	58.7	69.8	62.0	53.8	54.5	54.4
General Government Debt	210.0	215.3	203.3	201.1	200.6	211.2
EDP debt instrument assets	58.7	54.6	36.8	29.6	*25.1*	*38.5*
Net Government debt	151.3	160.7	166.5	171.5	175.5	172.7

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Source: [CSO]

Ireland: “A”grade from all major credit rating agencies

Rating Agency	Long-term	Short-term	Outlook/Trend	Date of last change
Standard & Poor's	A+	A-1	Stable	June 2015
Fitch Ratings	A	F1	Stable	Feb. 2016
Moody's	A2	P-1	Stable	Sept 2017
DBRS	A(high)	R-1 (middle)	Stable	March 2016
R&I	A	a-1	Stable	Jan. 2017

Section 3: Brexit

Brexit is likely net negative for Ireland but opportunities may arise too

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Negative for the Irish economy: each 1% drop in UK GDP may lower Ireland's GDP by between 0.3-0.8%

Cons

- Trade
  - Lower demand from UK/ tariffs
  - FX: £ lower v € (1% annual avg. move = 1% hit to Irish exports to the UK)
  - British market as test-bed less feasible
- Higher import prices possible in long-term: tariffs may outweigh FX benefit. Non-tariffs costs could also be significant.
- Regions suffer (agriculture, tourism), while Dublin may benefit (via FDI that leaves Britain)
- Banking sector likely to suffer because of its UK operations
- Political economy (border?, ally on direction of EU economic policy)

Pros

- Increased FDI, as multinationals avoid turmoil
  - Financial services (passporting)
  - Other multinationals - especially IT and business services
- Commercial property occupancy could rise; there may also be an influx of well paid workers
- ECB and fiscal response in Europe
- Some trade offsets
  - Irish companies may steal EU market share from British ones

Trade channel is likely to be negatively impacted

Source: CSO (2015)

- **Irish/UK trade linkages will suffer following Brexit**
  - The UK is the second largest single-country export destination for Ireland's goods and the largest for its services
  - At the same time, Ireland imports 25-30% of its goods from the UK. Consumer goods, capital equipment and inputs into the export process will become cheaper thanks to FX.
- **There is significant employment related to Ireland's trade with the UK**
  - The UK might only account for 17% of Ireland's total exports, but Ireland is more dependent than that, when you consider the employment related to those exports
- **SMEs (particularly agri-food and tourism) likely to be more affected than larger companies by the introduction of tariffs and barriers to trade**

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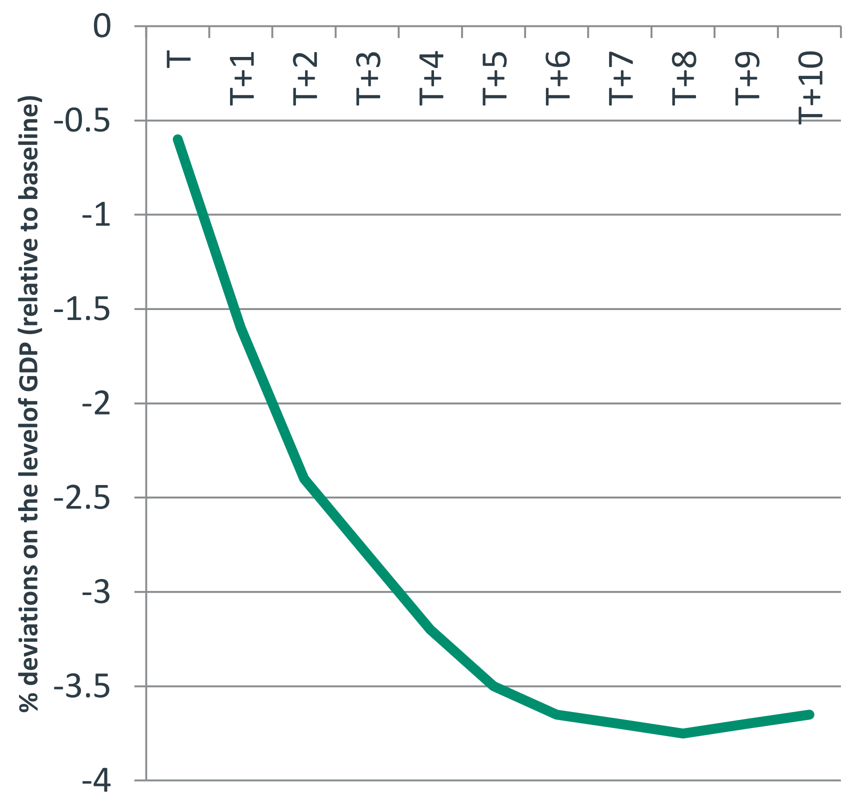
There could be significant trade impacts on Ireland in drastic "hard" Brexit scenario

Estimated Trade Reductions in "WTO rules Hard Brexit" Scenario

	% of exports lost with UK	% of total exports lost		% of UK exports lost with EU partner	% of total UK Exports lost
Ireland	30.6	4.2		27.6	1.5
Belgium	35.1	3.1		25.7	1.0
Spain	38.6	2.9		25.6	0.7
Germany	34.1	2.5		19.4	2.0
Denmark	39.8	2.5		24.4	0.2
Portugal	33.0	2.2		27.7	0.1
EU Total	30.5	2.1		22.3	9.8
Poland	30.6	2.1		20.8	0.3
NL	22.1	2.0		15.6	0.9
Italy	29.9	1.7		26.9	0.8
France	24.9	1.6		20.9	1.2
Greece	28.4	1.2		27.2	0.1

Estimated GDP impact "WTO rules Hard Brexit" Scenario



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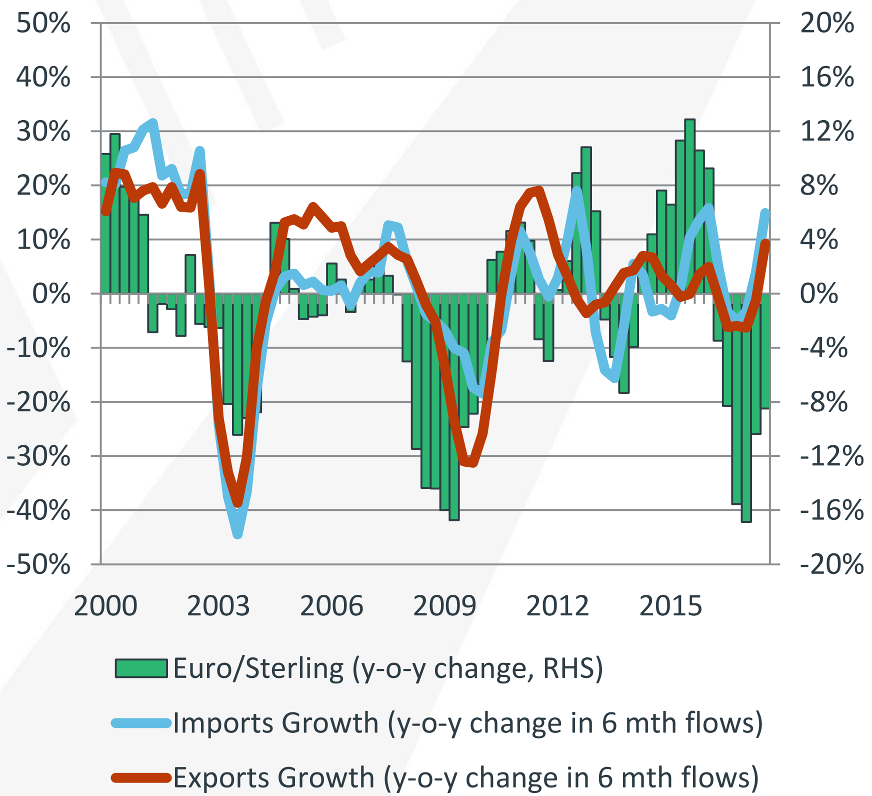
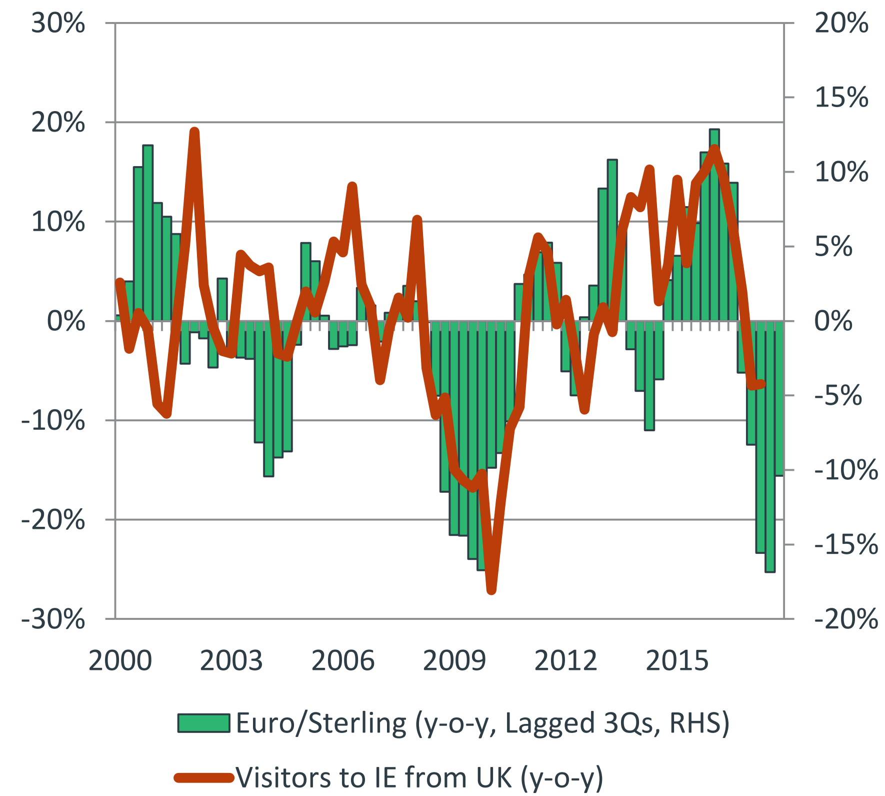
Source: ESRI and Department of Finance analysis

Effects of Brexit already visible from currency impact

IE/UK goods trade slowed on back of currency moves before recent rebound



UK visitor numbers have fallen (note time lag in effect)



Source: CSO; DataStream; CSO

Foreign firms in the UK might consider relocation following Brexit

FDI: Ireland may benefit

- Ireland could be a beneficiary from displaced FDI. The chief areas of interest are
  - Financial services
  - Business services
  - IT/ new media.
- Dublin is likely to compete with Frankfurt, Paris and Amsterdam for financial services, if the UK (City of London) loses EU passporting rights on exit. There may be opportunities too in the clearing of trades in €.
- Ireland's FDI opportunity will depend on the outcome of post-exit trade negotiations.

Why choose Ireland

Research has shown that FDI decisions are based on a wide range of factors:

- EU Membership
- Common language (important for US companies)
- Law system (Ireland and UK both have common law structure)
- Pro-business environment
- Corporate tax
- Educated workforce
- Cost competitiveness
- Regulatory environment (financial sector)

Irish banks have exposure to UK market: challenging environment following Brexit

BoI UK exposure

	End-2016	% of Group Total
Total Income	€600m	19.3%
Credit Outstanding	€33.4bn	40.0%
Operating Profit	€188m	15.6%
Impairment charge	(€99m)	55.6%

AIB UK exposure

	End-2016	% of Group Total
Total Income	€310m	11.8%
Credit Outstanding	€9.3bn	14.3%
Operating Profit	€171m	13.6%
Impairment writeback	€37m	12.6%

Source: Published bank accounts

Section 4: Long term fundamentals

Ireland's long run future looks bright. Key is retaining competitiveness by keeping wages and, hence, costs down

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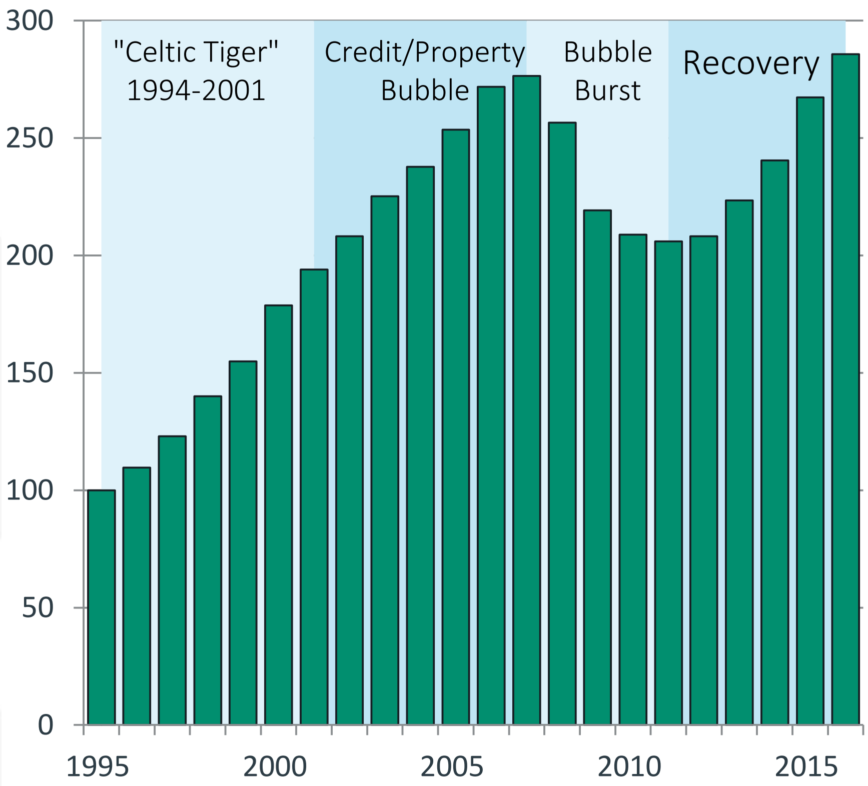
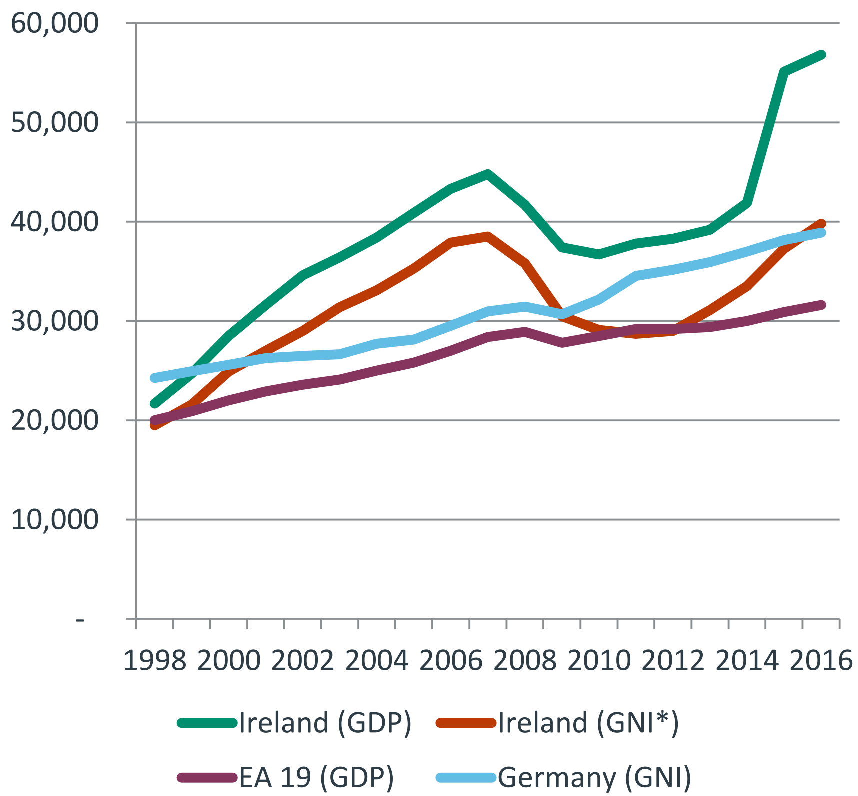
Much rebalancing has taken place; GNI* per capita surpassed 2007 levels in 2016

Gross National Income* at current prices (1995=100)

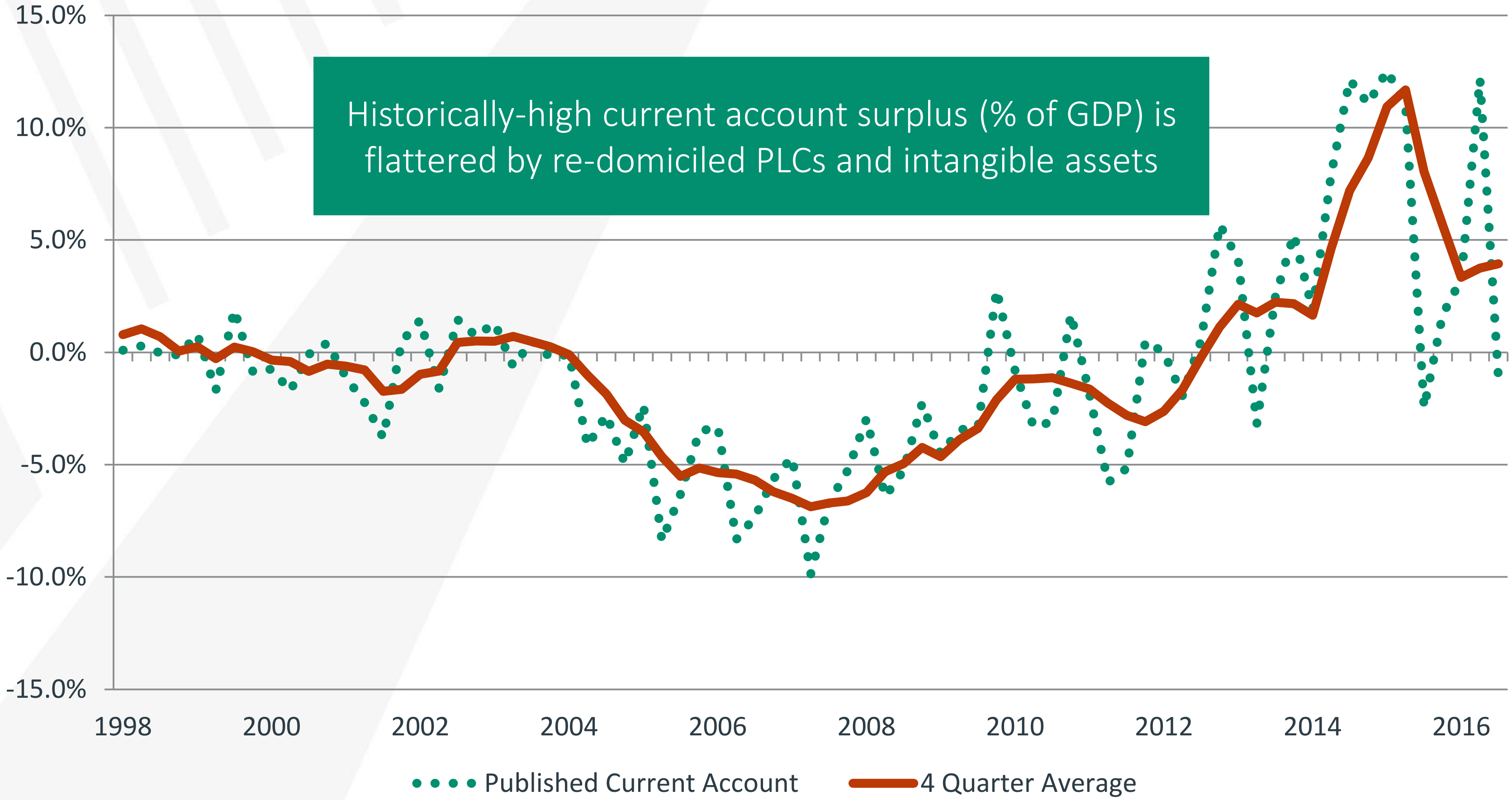


Ireland's GNI* per capita compares favourably to EA counterparts



Source: CSO

Ireland’s current account in surplus but heavily affected by MNC activity and re-domiciled PLCs



Source: [CSO]

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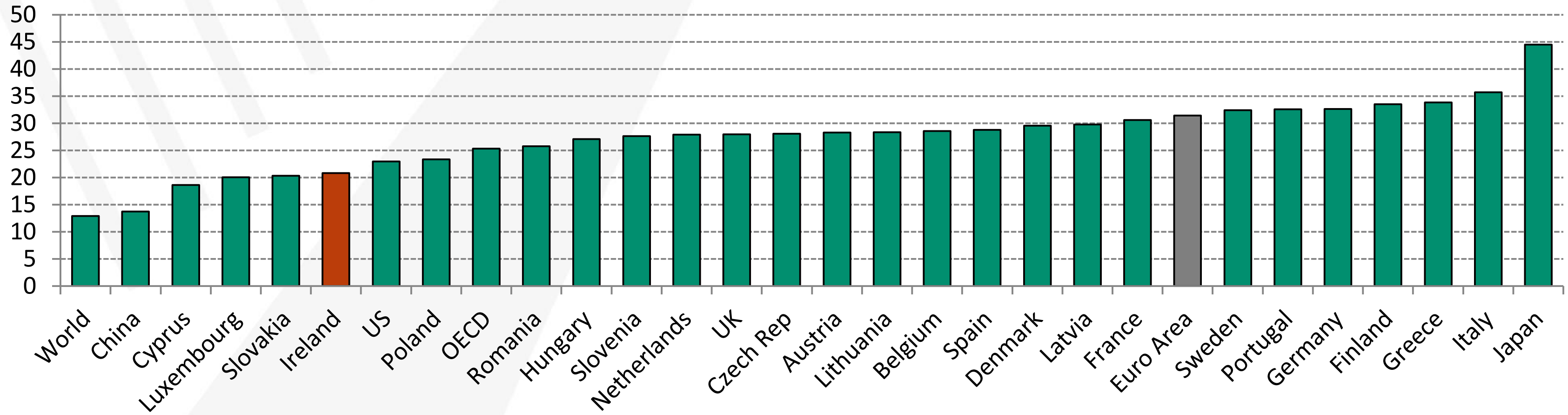
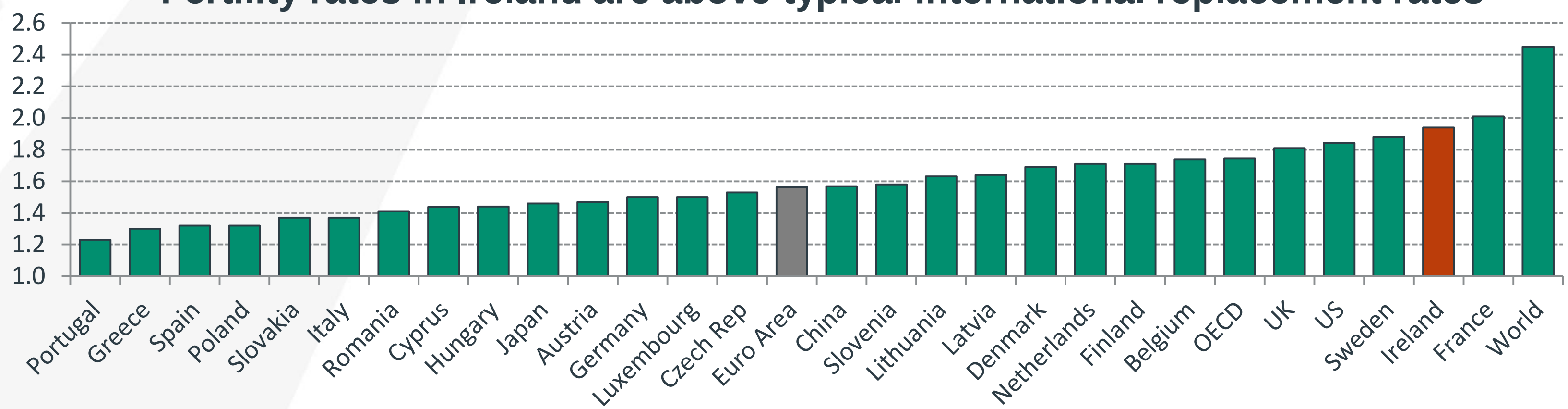
* For discussion on the undistributed profits of redomiciled PLCs see Fitzgerald, J. (2013), ‘The Effect of Redomiciled PLCs on GNP and the Irish Balance of Payments’

Favourable population characteristics underpin debt sustainability over longer term

Old age dependency ratio (65+ : ages 15-64) compares well against OECD countries



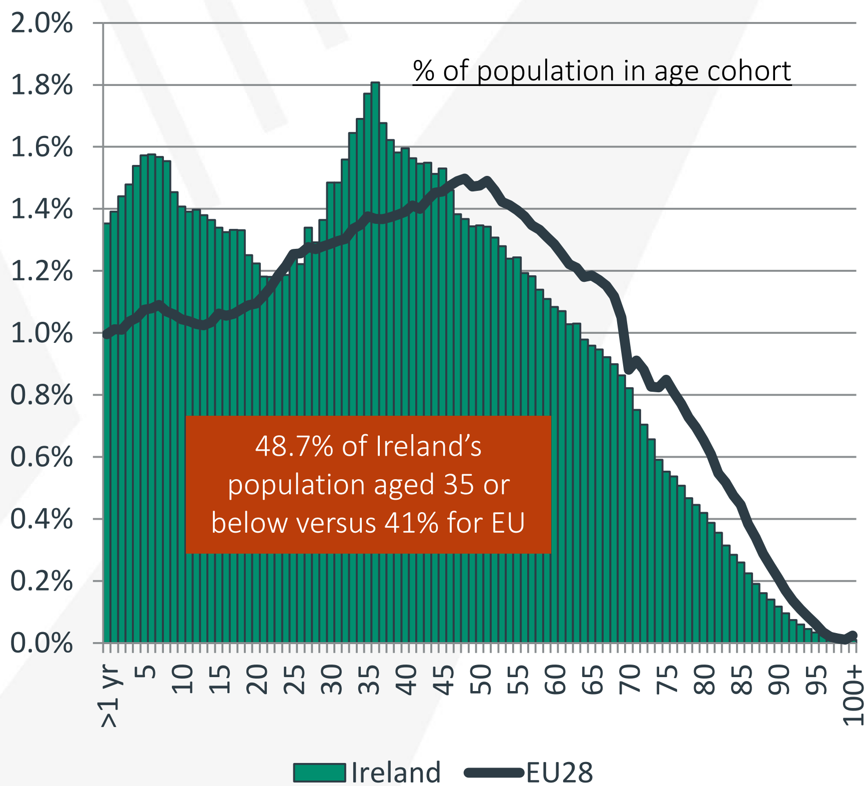
Fertility rates in Ireland are above typical international replacement rates



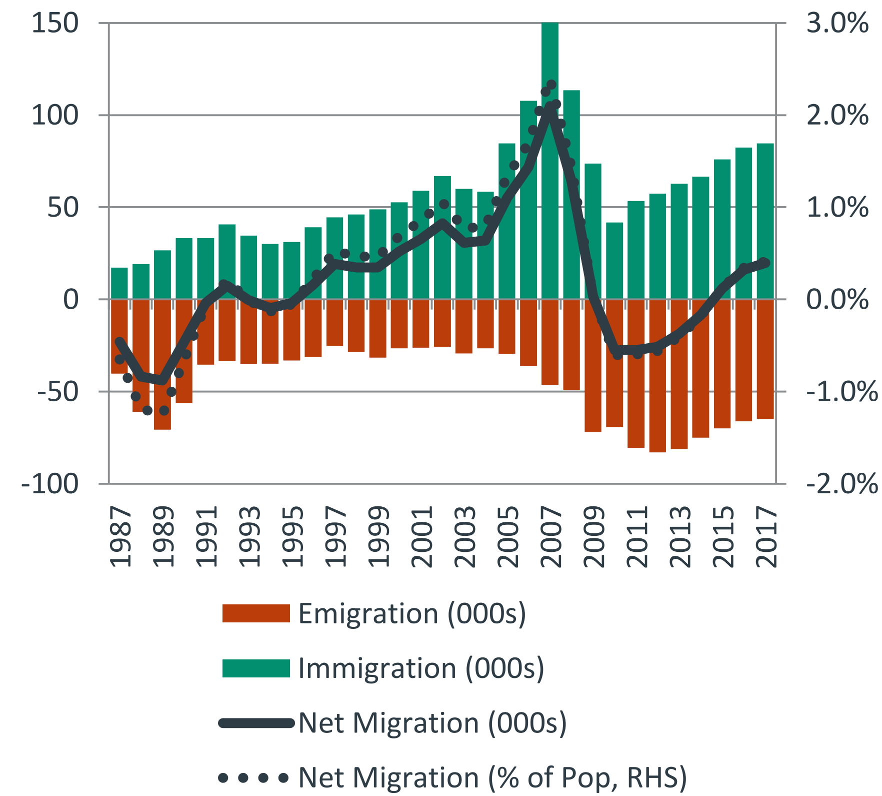
Source: World Bank WDI (2016 for OAD ratio, 2015 for Fertility)

Ireland's population jumped to 4.79m in 2017 – up 200,000 on the 2011 Census

Ireland's population profile healthier than the EU average



Latest Census data show net migration positive since 2015 – mirroring economy



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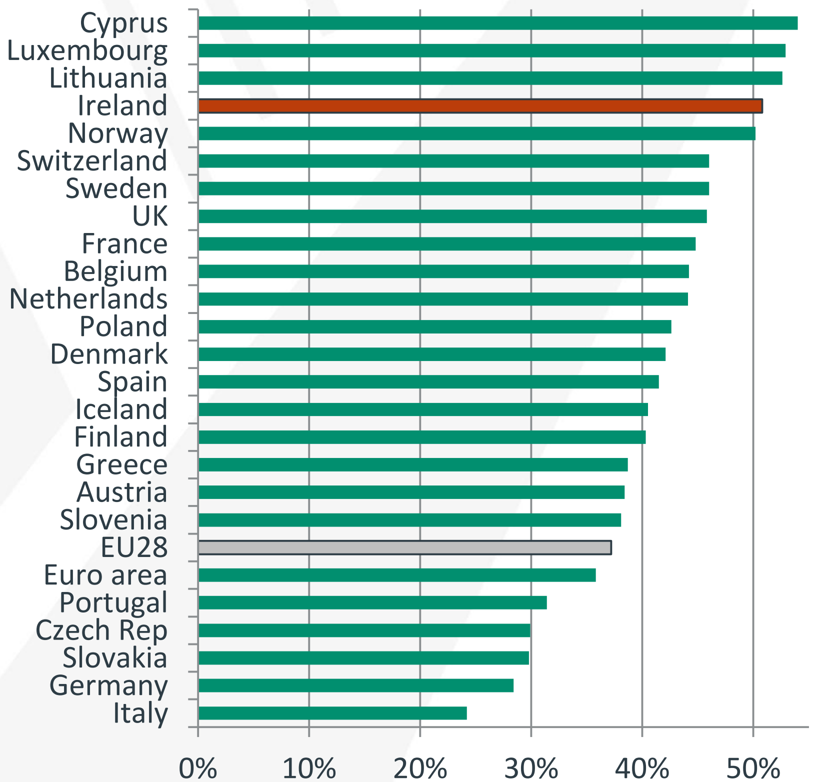
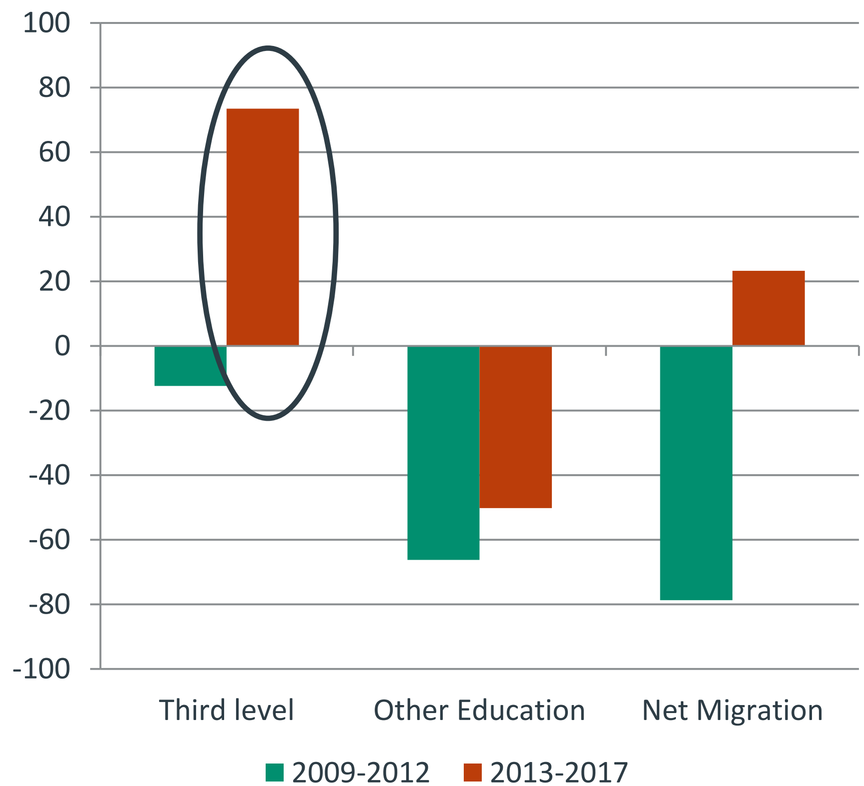
Source: Eurostat (2016) CSO; CSO

Workforce is young and educated – "Reverse Brain Drain" in effect

Ireland has large % of 25-34 years old with a third-level degree (2014 data)…



… with highly educated migrants moving to Ireland in recent years (000s persons)



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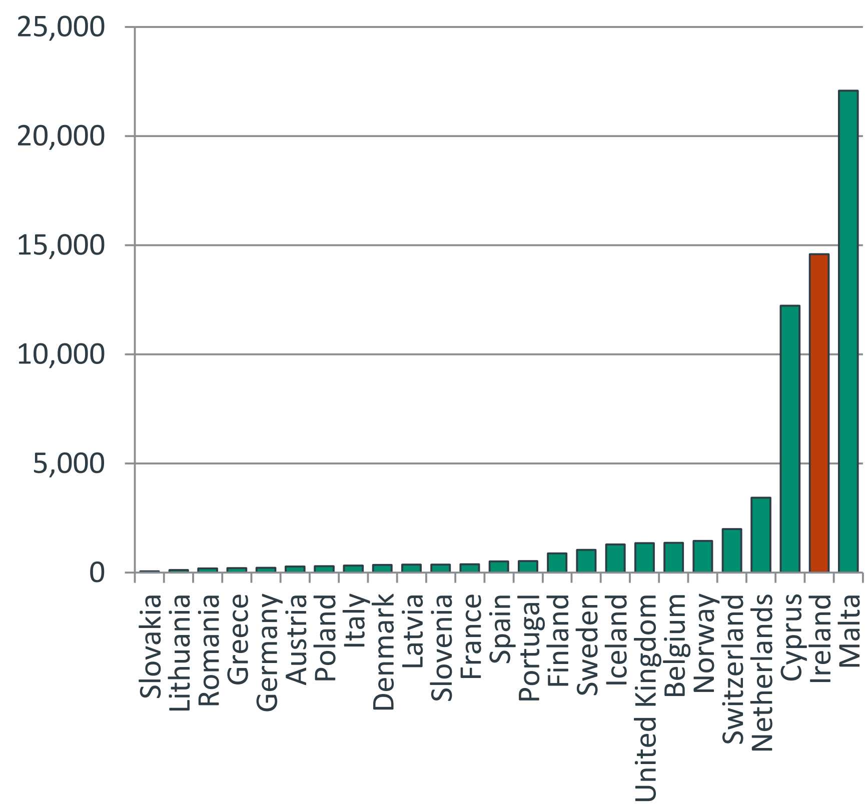
Source: Eurostat; CSO

Ireland continues to attract foreign investment: educated workforce one key reason

Average PISA score for selected countries across maths, reading and science

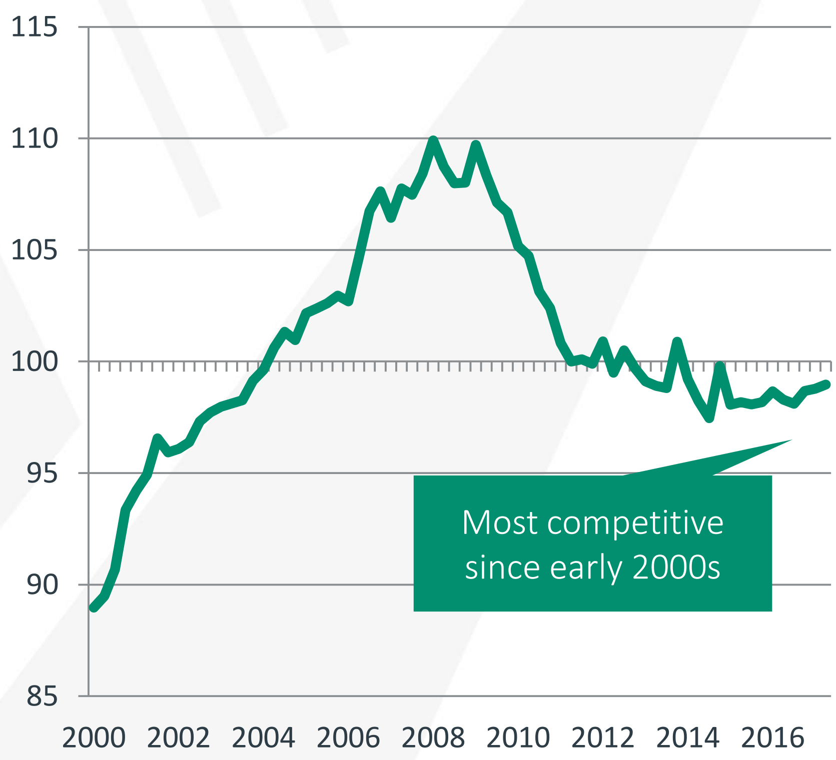
Average FDI inflow in $ per capita, 2011–16



*Source: OECD; [Unctad (UN) database](#) * Luxembourg excluded for presentation purposes – average $68,700 per capita over period.*

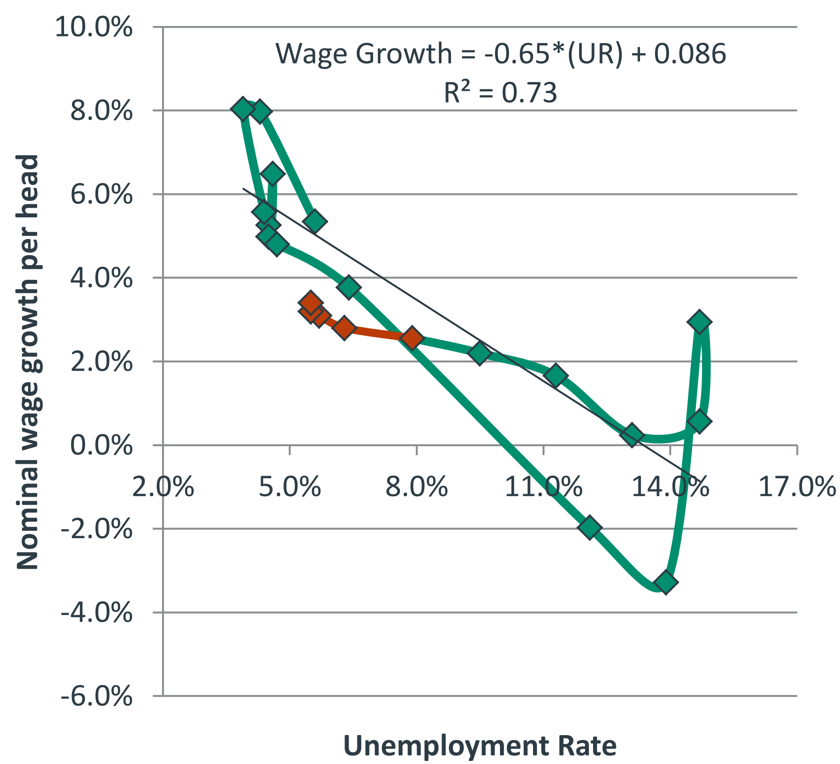
Ireland really competitive now, so we need to avoid repeat of mid-2000s

Nominal Labour Cost Ratio – IE vs Euro Area



*Source: Eurostat, NTMA analysis *Ratio = IE Nom. Labour Costs/ EA Nom. Labour Costs*

Wage growth a natural consequence of improving labour conditions (1999-2021)



*Source: CSO, NTMA analysis *red dots are Budget 2018 forecasts (2017-2021); Non-Agriculture employment /wage data*

Section 5: Property

Property prices are rising thanks to lack of supply and capital inflows

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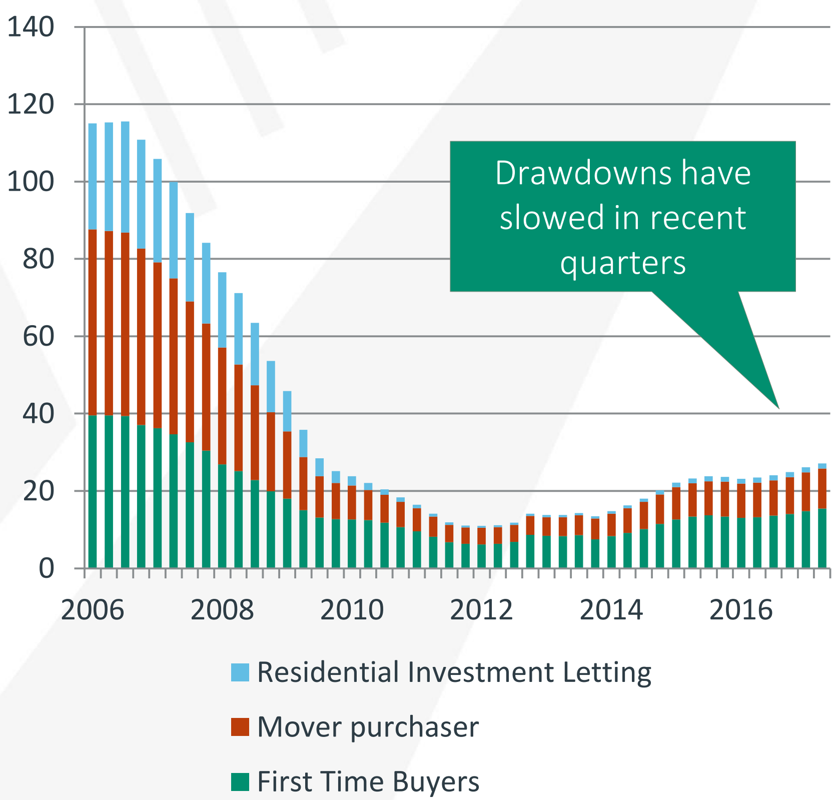
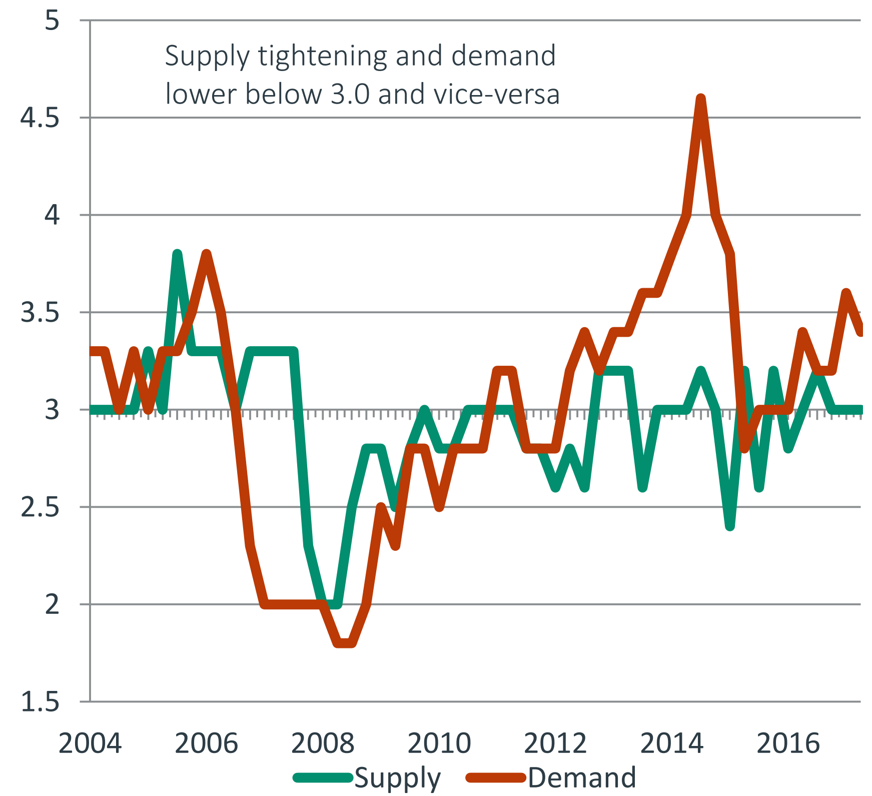
Demand has picked up again having cooled in 2015; amendments to CBI rules have boosted buying power

Mortgage drawdowns rise from deep trough (000s)



Source: BPFI *4 quarter sum used

Demand increased following CBI rules adjustment



Source: ECB and CBI (Bank lending survey)

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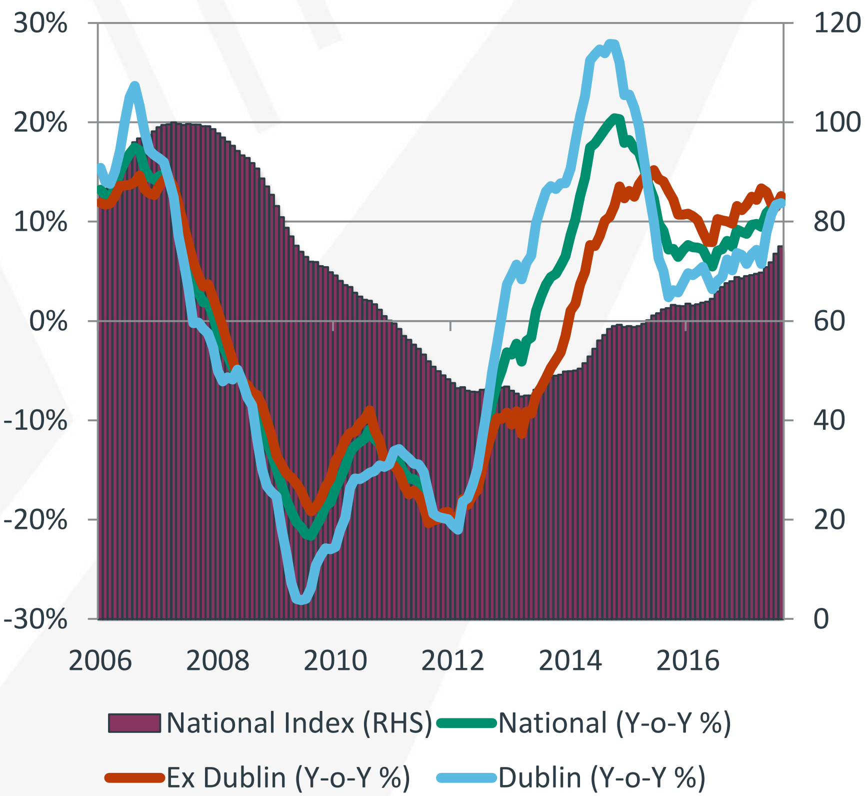
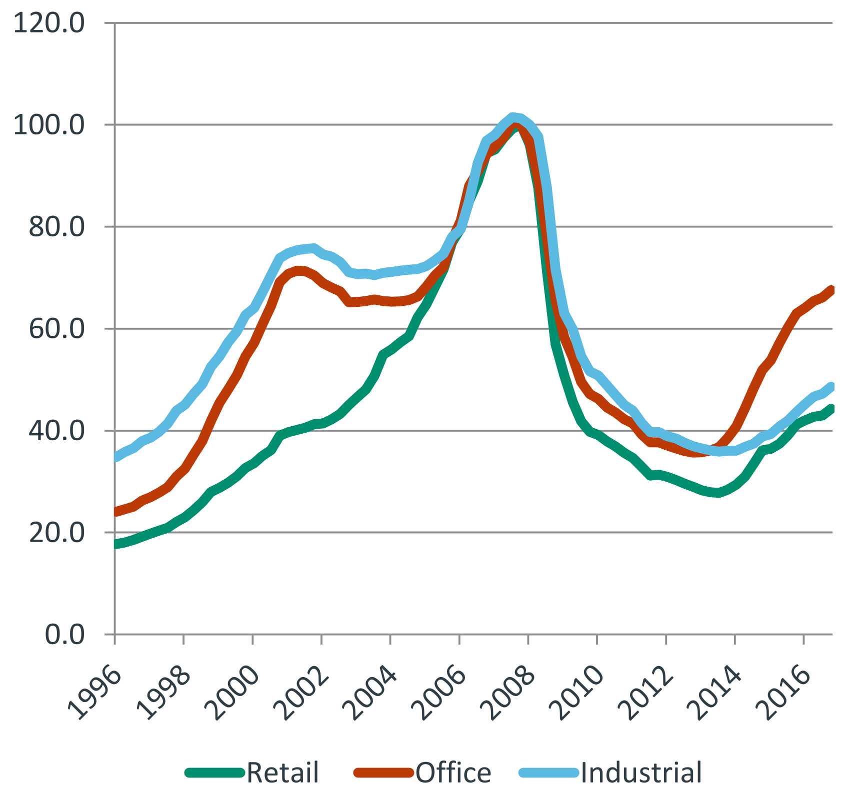
Property prices have rebounded strongly since 2012 (peak = 100 for all indices)

House prices rising strongly but some way off peak (Y-o-Y change, RHS peak =100)



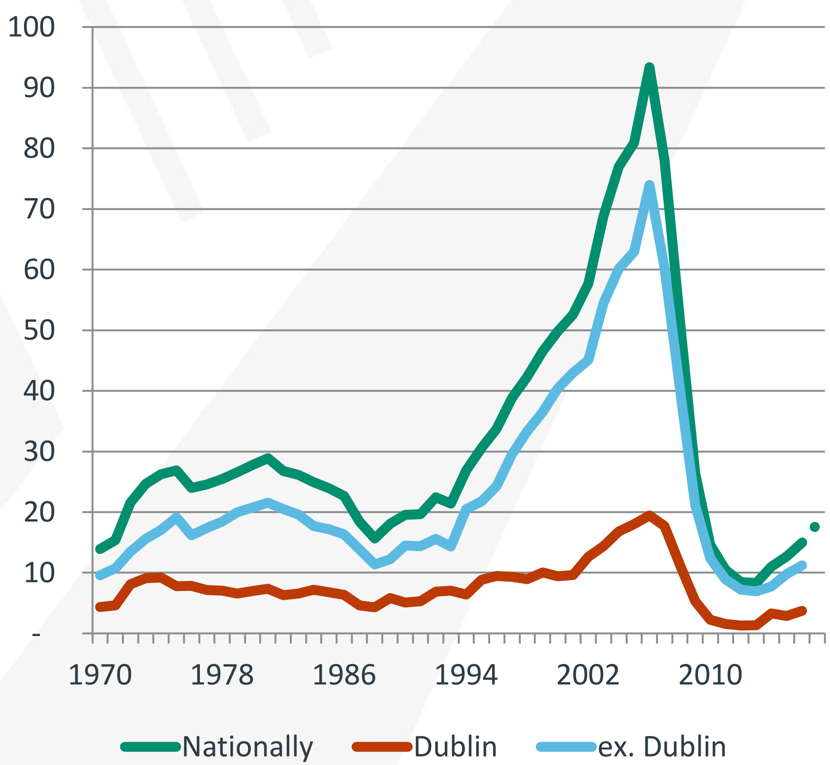
Office leads commercial property



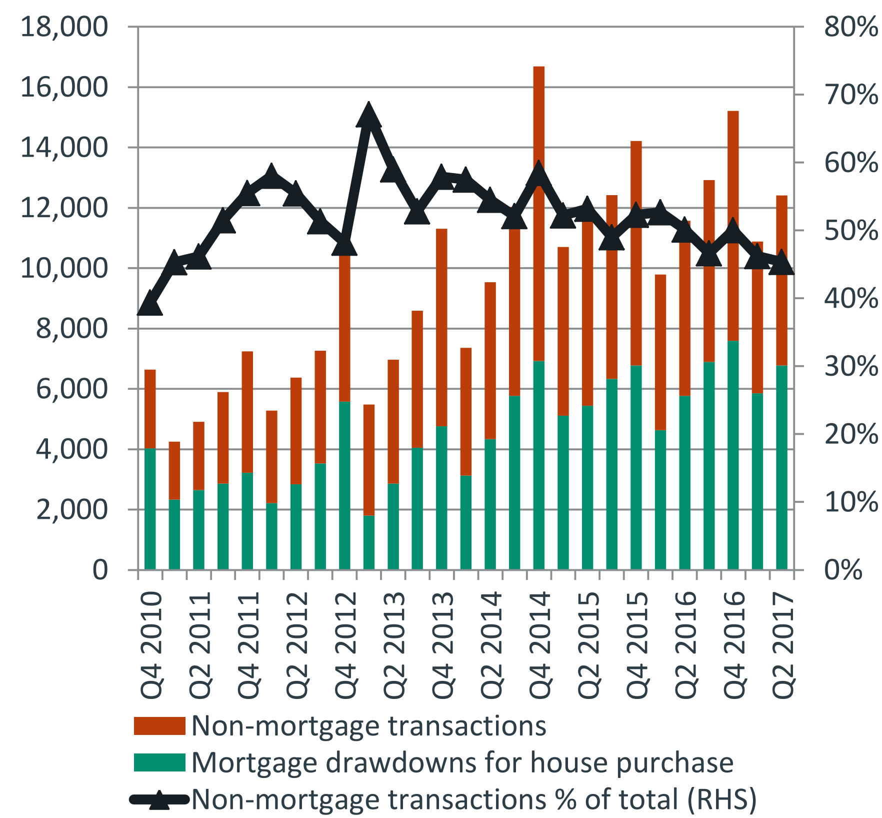
Source: CSO; IPD

Residential market continues to be boosted by non-mortgage purchasers although impact has lessened

Housing Completions above 14,000 in 2016 but still low historically (000s)



Non-mortgage transactions still important but falling below 50% of total



Source: DoHPCLG, BPFI; Property Services Regulatory Authority

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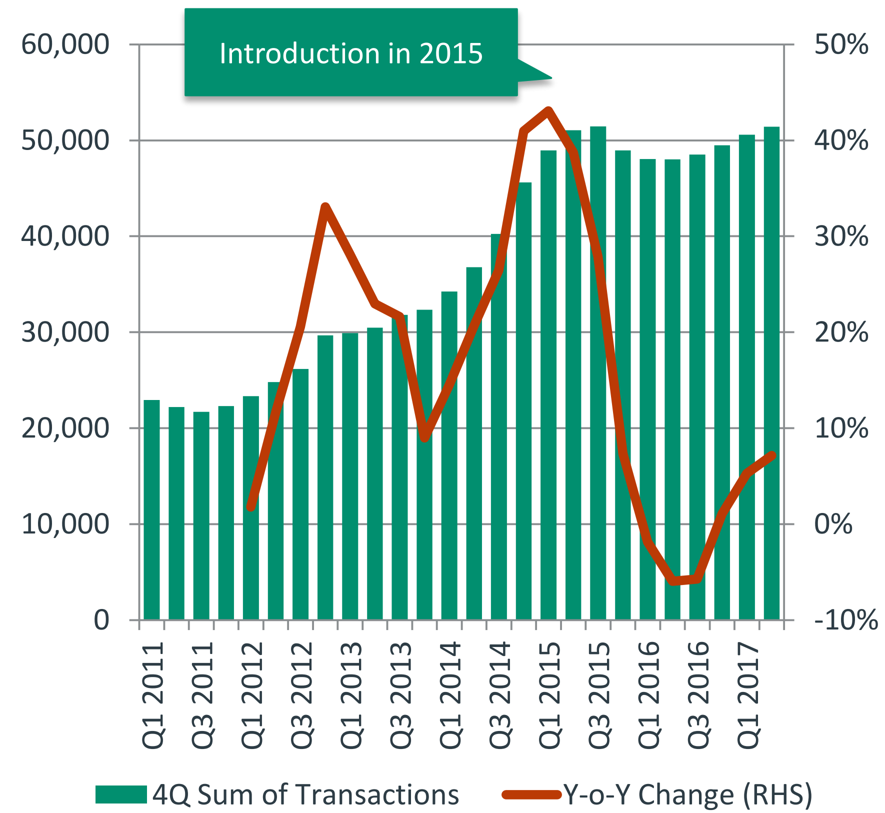
Note: Non-mortgage transactions are implied by difference between total transactions on property price register and BPFI mortgage data

CBI's macro-prudential rules increase resilience of banking and household sector

CBI's amended macro-prudential rules

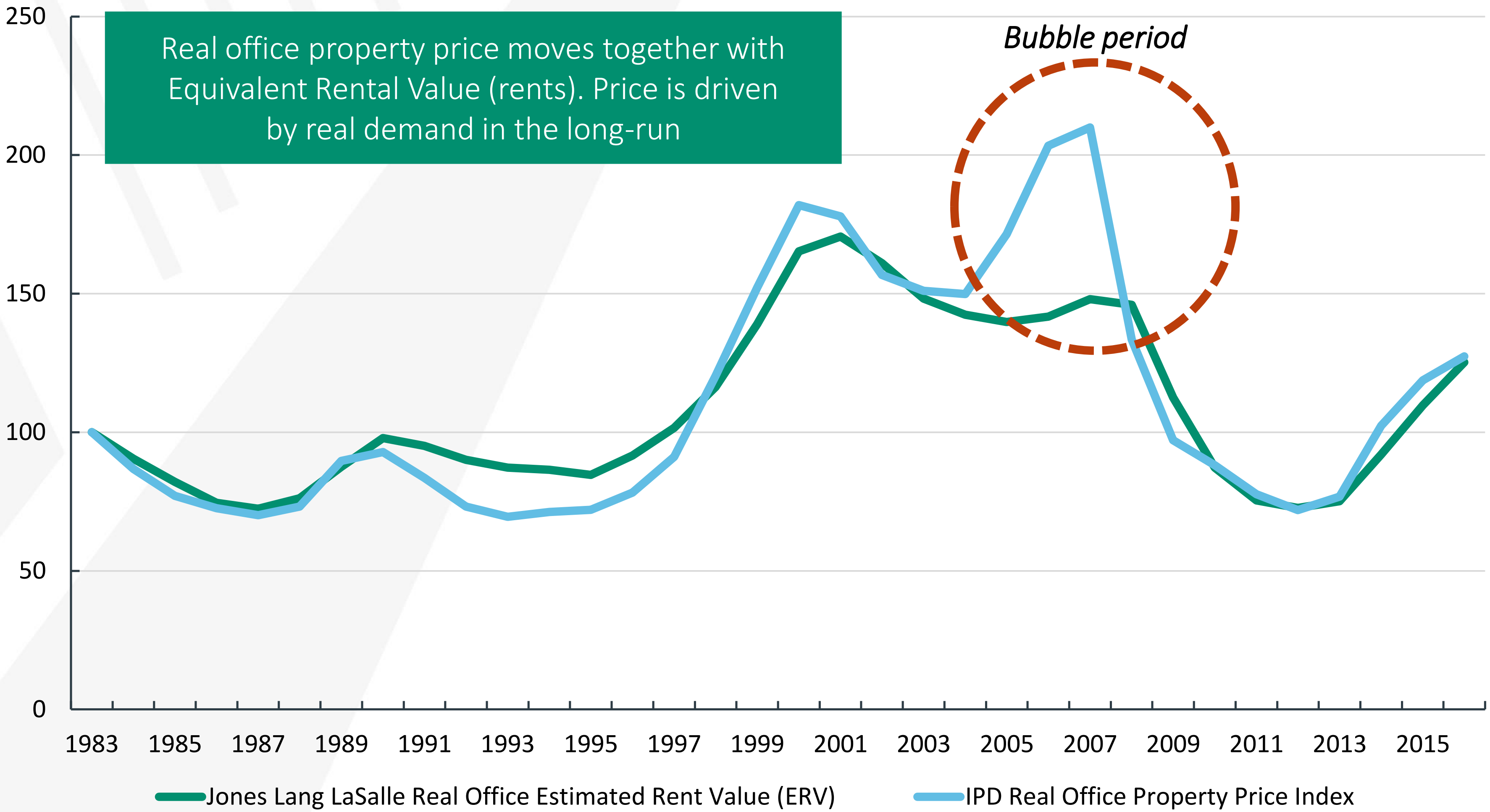
- First time buyers (FTBs) can borrow 90% of the value of a home (10% minimum deposit). Five per cent of the total new lending to FTBs will be allowed above the 90% LTV limit.
- For second and subsequent buyers (SSBs), banks must restrict lending for primary dwelling purchase above 80 per cent LTV to no more than 20 per cent of new lending to SSBs.
- Bank must restrict lending for primary dwelling purchase above 3.5 times LTI to no more than 20 per cent of that aggregate value
- Banks must limit Buy-to-Let loans (BTL) above 70 per cent LTV to 10 per cent of all BTL loans.

Transactions have slowed since macro-prudential rules introduced



Source: [Residential Property Price Register]

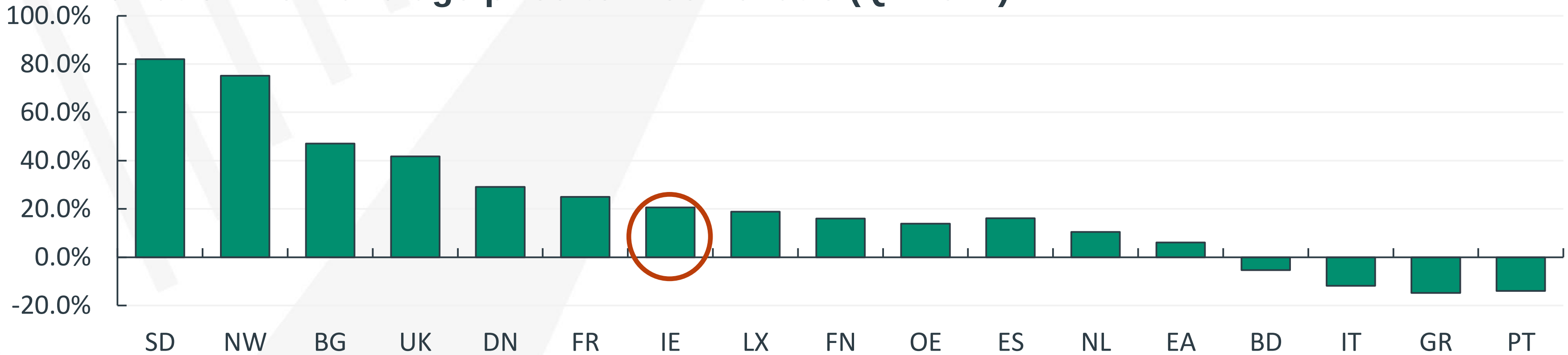
Real commercial property prices down 40% from peak (index 1983 = 100)



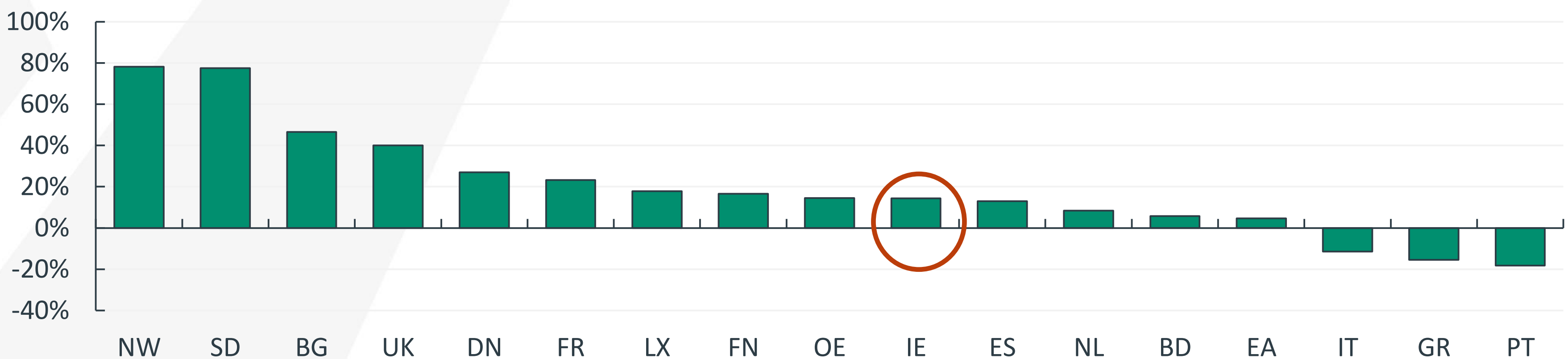
Source: IPD; NTMA

Irish house price valuations have risen relative to other European countries in 2017

Deviation from average price-to-income ratio (Q2 2017)



Deviation from average price-to-rent ratio (Q4 2016)



Source: OECD, NTMA Workings

Note: Measured as % over or under valuation relative to long term averages since 1980.

Section 6: Other data

Worries about contingent liabilities no longer; Ireland now has legacy assets

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Ireland has legacy banking-related assets

- Banking
  - Banks are now profitable; Income, cost and balance sheet metrics are much improved.
  - Interest rates on mortgages and to SMEs still high compared to EU.
  - An IPO of AIB stock (28.8%) was completed in June. This returned c. €3.4bn to the Irish Exchequer.

- NAMA
  - NAMA has repaid 98% of its senior debt; it forecasts a profit of €3bn subject to market conditions.

- IBRC
  - Liquidation of the IBRC could return in excess of €1bn to the Irish Exchequer in the coming years.
  - In 2016, €280m was returned to the Exchequer as interim dividend.

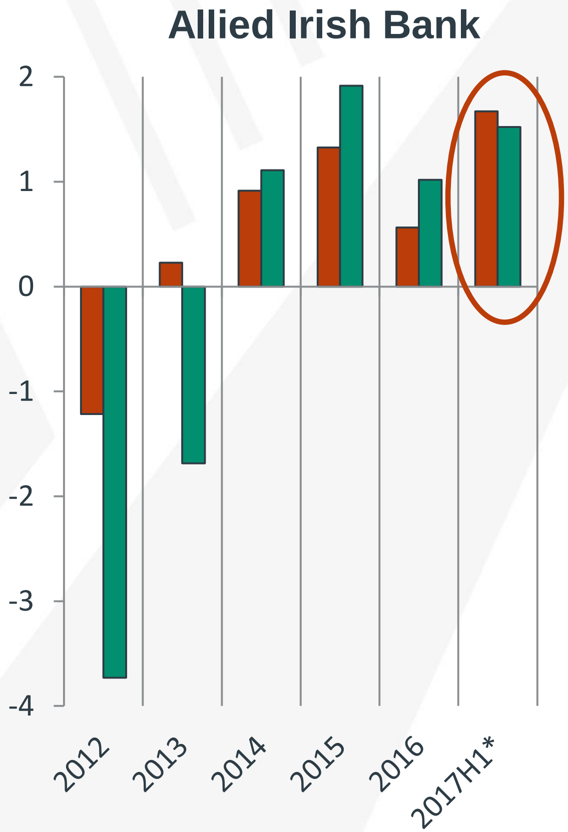
All three pillar banks in profit (€bn) for at least 24 months

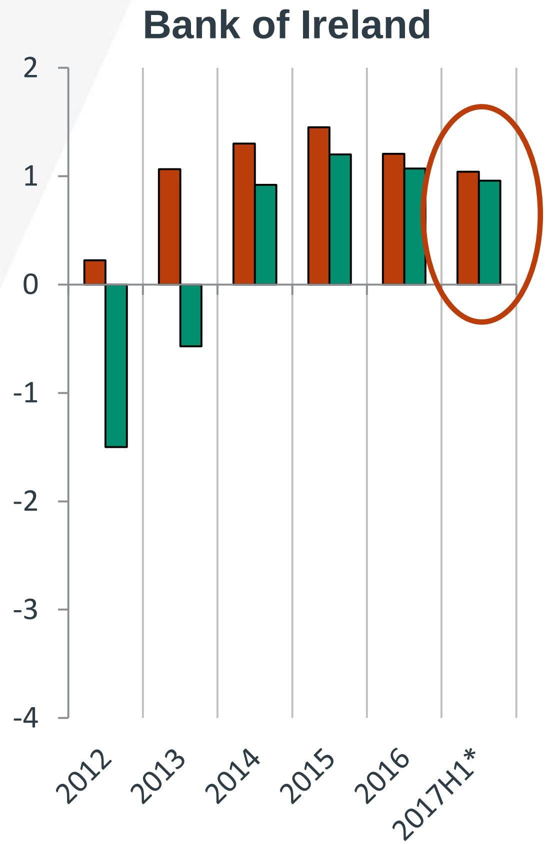
State Ownership

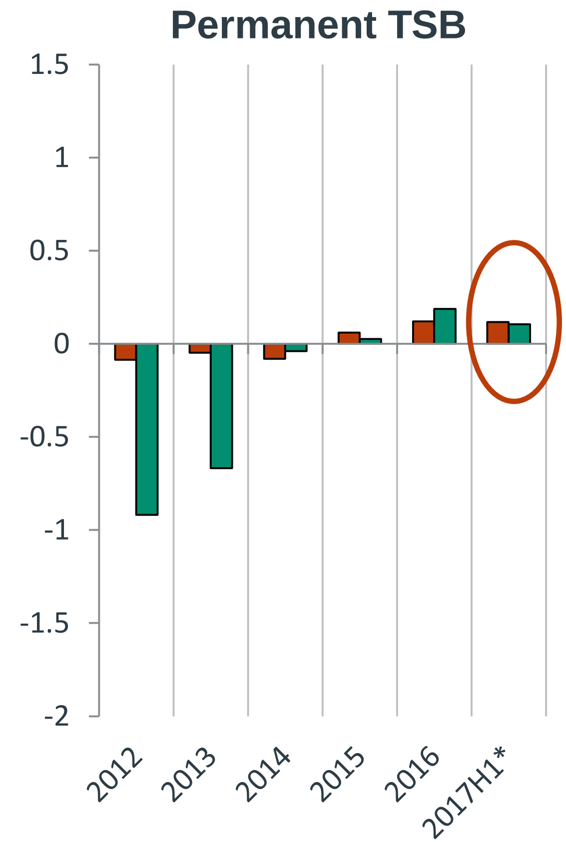
71% owned

14% owned

75% owned







Pre-Provisions Post-Provisions

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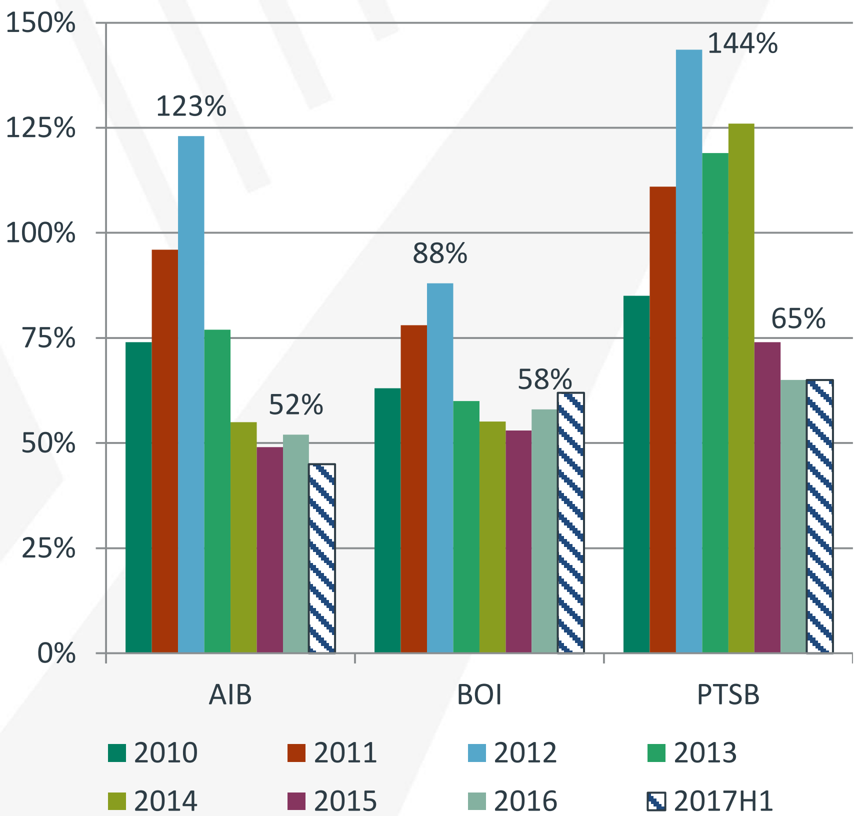
Source: Annual reports of banks - BOI, AIB, PTSB

* Half year results annualised

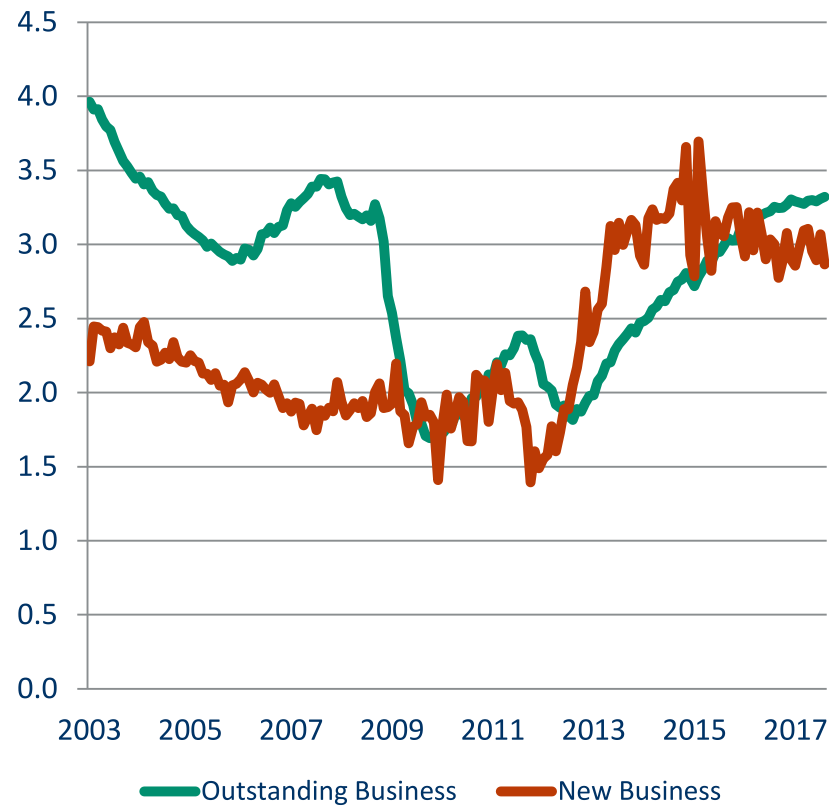
Banks fundamentally rebuild their profitability

Cost income ratios improve dramatically



Source: Annual reports of Irish domestic banks

Net interest margins (%) recover

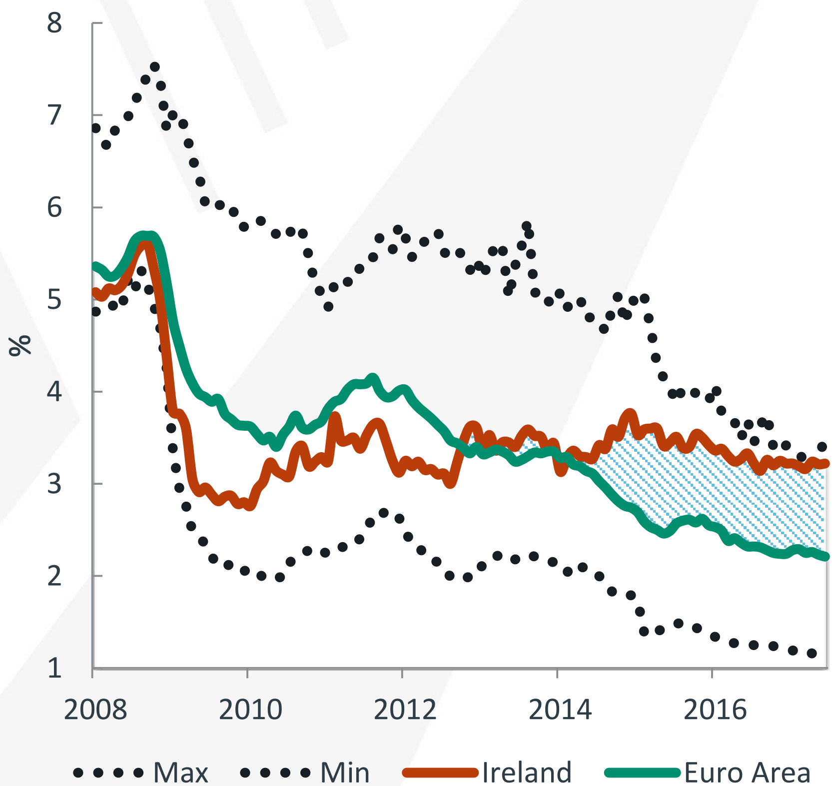


Source: CBI, NTMA Calculations

Note: Margins are derived from weighted average interest rates on loans and deposits to and from households and non-financial corporations

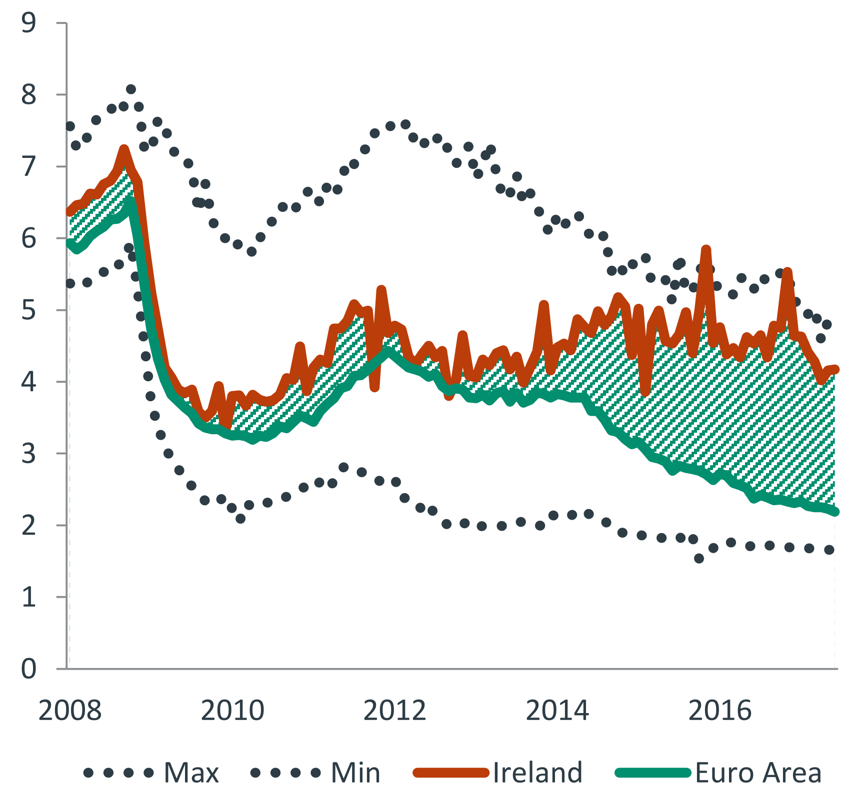
Profitability aided by higher interest rates than EA peers

Ireland's interest rates on lending for house purchase the highest in euro area



Source: ECB

Rates on SME loans* over euro area average



*SME loans proxy of loans <1year and <€1m to Non-Financial Corporates

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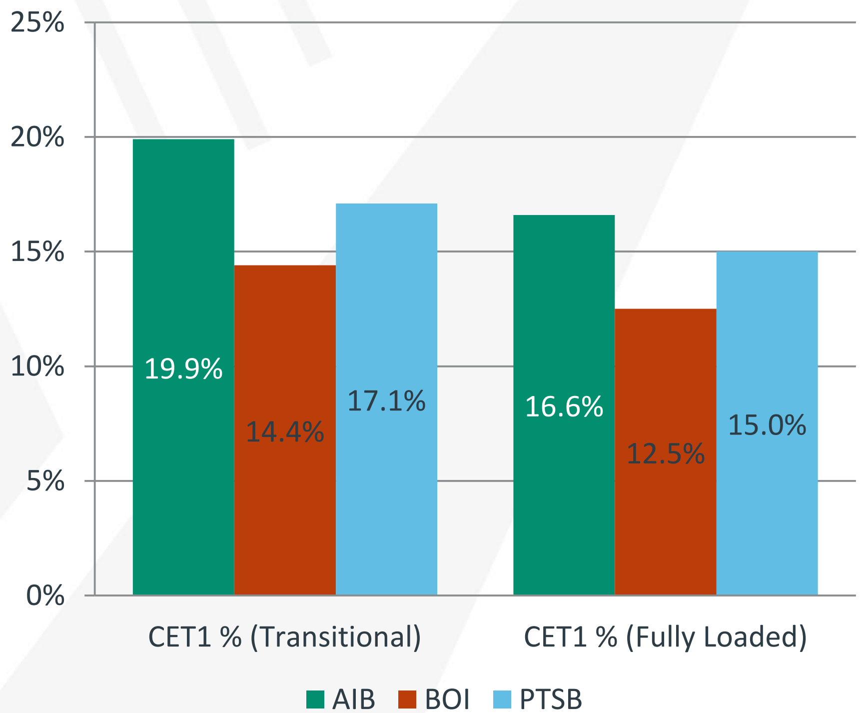
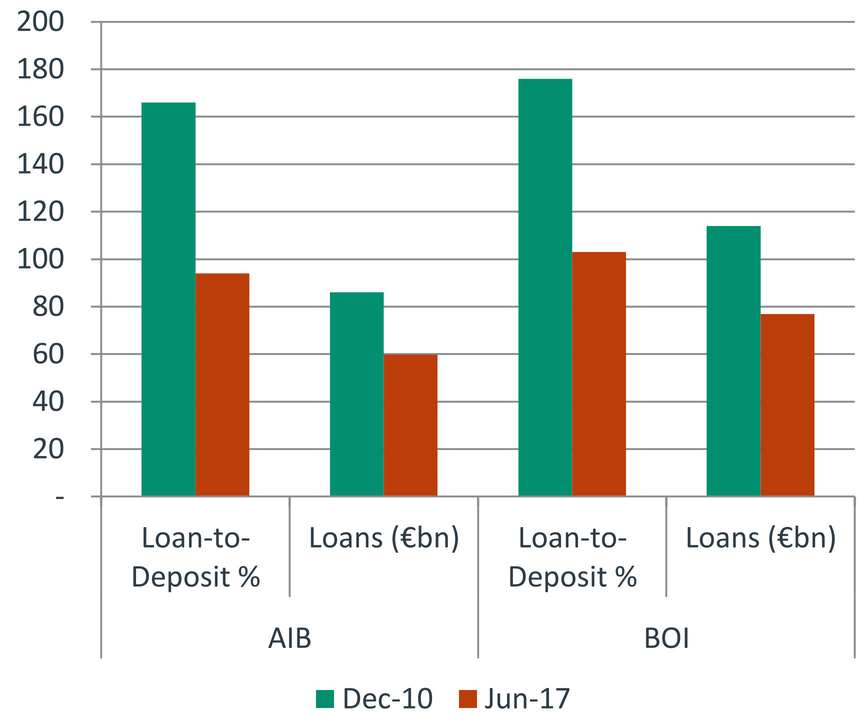
Capital ratios strengthened as banks slimmed down and consolidated

CET 1 capital ratios (Jun-17)



Source: Published bank accounts

Loan-to-deposit ratios have fallen significantly as loan books have been slimmed down



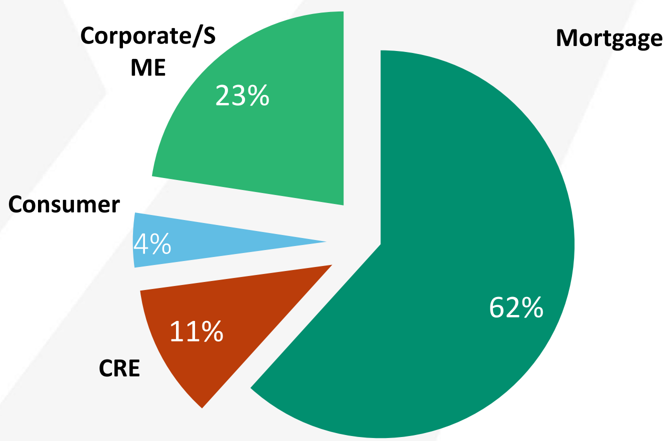
Source: Published bank accounts

Note: "Transitional" refers to the transitional Basel III required for CET1 ratios
"Fully loaded" refers to the actual Basel III basis for CET1 ratios.

Asset quality continues to improve: impaired loans and provisions fall in 2017

All 3 PCAR banks (€bn)	Dec-15	Dec-16	Jun-17
Total Loans	186.5	168.9	165.0
Impaired	29.0	20.3	17.9
(Impaired as % of Total)	15.5%	12.0%	10.8%
Provisions	14.7	9.9	9.4
(Provisions as % of book)	7.9%	5.9%	5.7%
(Provisions as % of Impaired)	50.6%	48.8%	52.5%

Loan Asset Mix (3 banks Jun 17)



Source: Published bank accounts

Impaired loans % (coverage %)[1] by bank and asset					
		Dec-15	Dec-16	Jun-17	*Book (€bn)*
BOI	Irish Residential Mortgages	9.3(52)	6.0(45)	5.3(42)	24.0
	UK Residential Mortgages	1.6(22)	0.7(15)	0.7(15)	23.1
	Irish SMEs	21.9(52)	15.7(55)	15.9(56)	8.8
	UK SMEs	11.1(51)	6.3(55)	6.3(56)	1.9
	Corporate	4.6(59)	3.5(54)	3.0(66)	9.0
	CRE - Investment	28.5(53)	21.1(57)	19.7(53)	8.6
	CRE - Land/Development	84.8(76)	68.8(73)	54.8(68)	0.7
	Consumer Loans	4.1(105)	2.7(66)	2.4(65)	4.1
		11.6(56)	7.6(54)	6.7(52)	80.1
AIB	Irish Residential Mortgages	16.6(38)	13.1(44)	11.2(45)	32.7
	UK Residential Mortgages	10.8(50)	10.8(46)	8.8(37)	1.6
	SMEs/Corporate	11.5(63)	8.0(60)	6.8(55)	17.4
	CRE	37.4(61)	29.0(53)	26.0(50)	9.1
	Consumer Loans	19.9(70)	13.9(58)	12.8(60)	3.1
		18.6(47)	14.0(44)	12.1(53)	63.9
PTSB	Irish Residential Mortgages	23.6(49)	23.4(49)	23.1(50)	20.5
	UK Residential Mortgages	3.9(39)	0.0(0)	0.0(0)	0
	Commercial	35.8(69)	29.6(113)	29.4(112)	0.2
	Consumer Loans	27.0(93)	22.3(88)	18.0(95)	0.3
		21.1(49)	23.1(51)	23.1(51)	21.0

[1] Total impairment provisions are used for coverage ratios (in parentheses)

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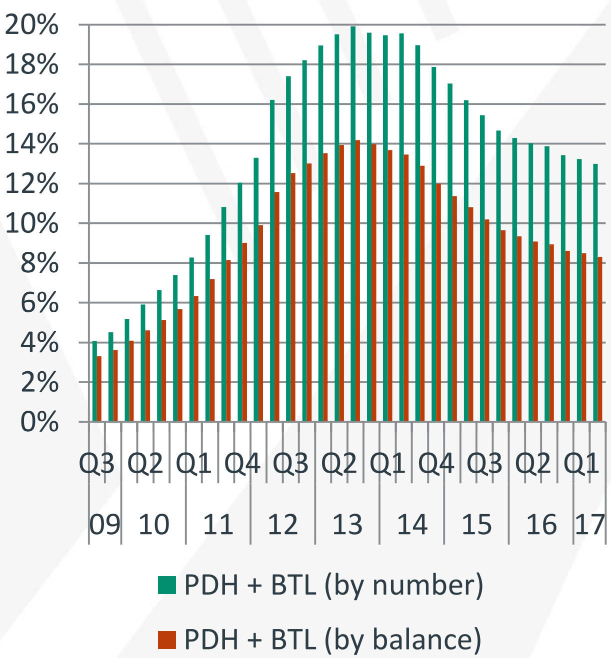
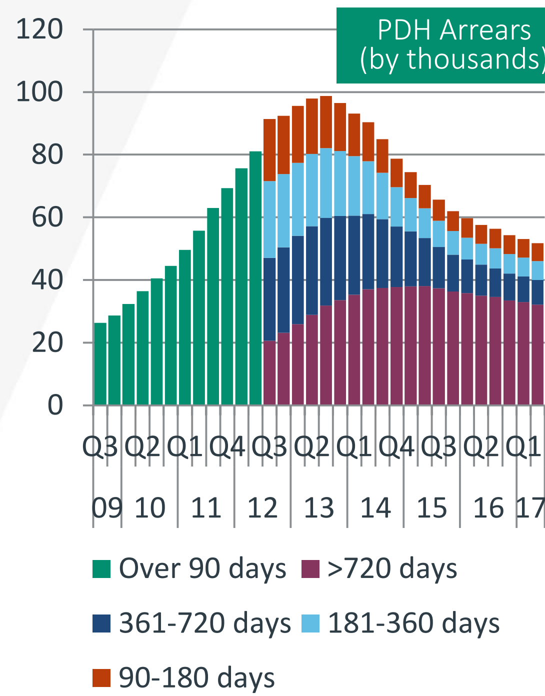
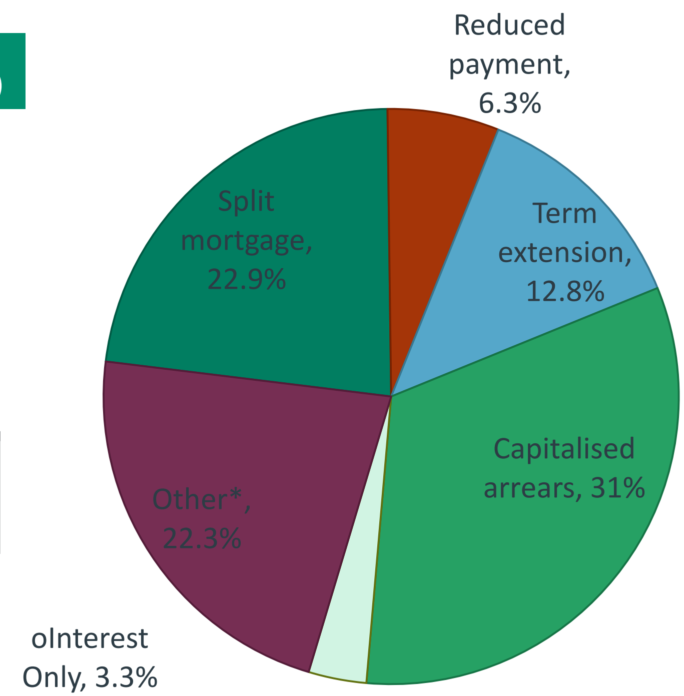
Irish residential mortgage arrears are improving across all duration categories; environment still dysfunctional

Mortgage arrears (90+ days)





Total restructurings



Source: CBI

- PDH mortgage arrears have fallen steadily since 2013. The smaller BTL market (c. 25% of total) has higher arrears but also saw declines in the same period.
- 120K PDH mortgage accounts were classified as restructured at end Q2 2017. Of these restructured accounts, over 87% were meeting the terms of the restructured arrangement.

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* 'Other' comprises accounts offered temporary Interest rate reductions, payment moratoriums and long-term solutions
pending six months completion of payments.

NAMA: 98% of its original senior debt has been repaid: only €500m left; likely to deliver surplus of around €3bn

- **NAMA's operating performance is strong**
  - Acquired 12,000 loans (over 60,000 saleable property units) related to €74bn par of loans of 780 debtors for €32bn
  - NAMA continues to generate net profit after impairment charges.

- **It has repaid €29.7bn (98%) of €30.2bn of original senior debt**
  - NAMA is meeting and exceeding its senior debt redemption targets well ahead of schedule. It remains on course, subject to market conditions, to redeem all senior debt (€30.2 billion) by end-2017 and its subordinated debt (€1.6 billion) by 2020.

- **NAMA remains on course to deliver a surplus for Irish taxpayers which is currently estimated at €3bn, according to its management team - if current market conditions remain favourable.**

- **In October 2015, NAMA announced a new initiative to develop up to 20,000 housing units by 2020 – <u>subject to commercial viability.</u>**

NAMA's residential development funding programme

- **In reaction to the lack of housing supply, NAMA hopes to fund 20,000 housing units to the market by 2020 subject to commercial viability**

- **The focus will be on starter homes and will be concentrated in the Greater Dublin Area**
  - 75% of units will be houses, the remainder apartments
  - 93% of units in Greater Dublin Area (Dublin, Wicklow, Kildare & Meath)

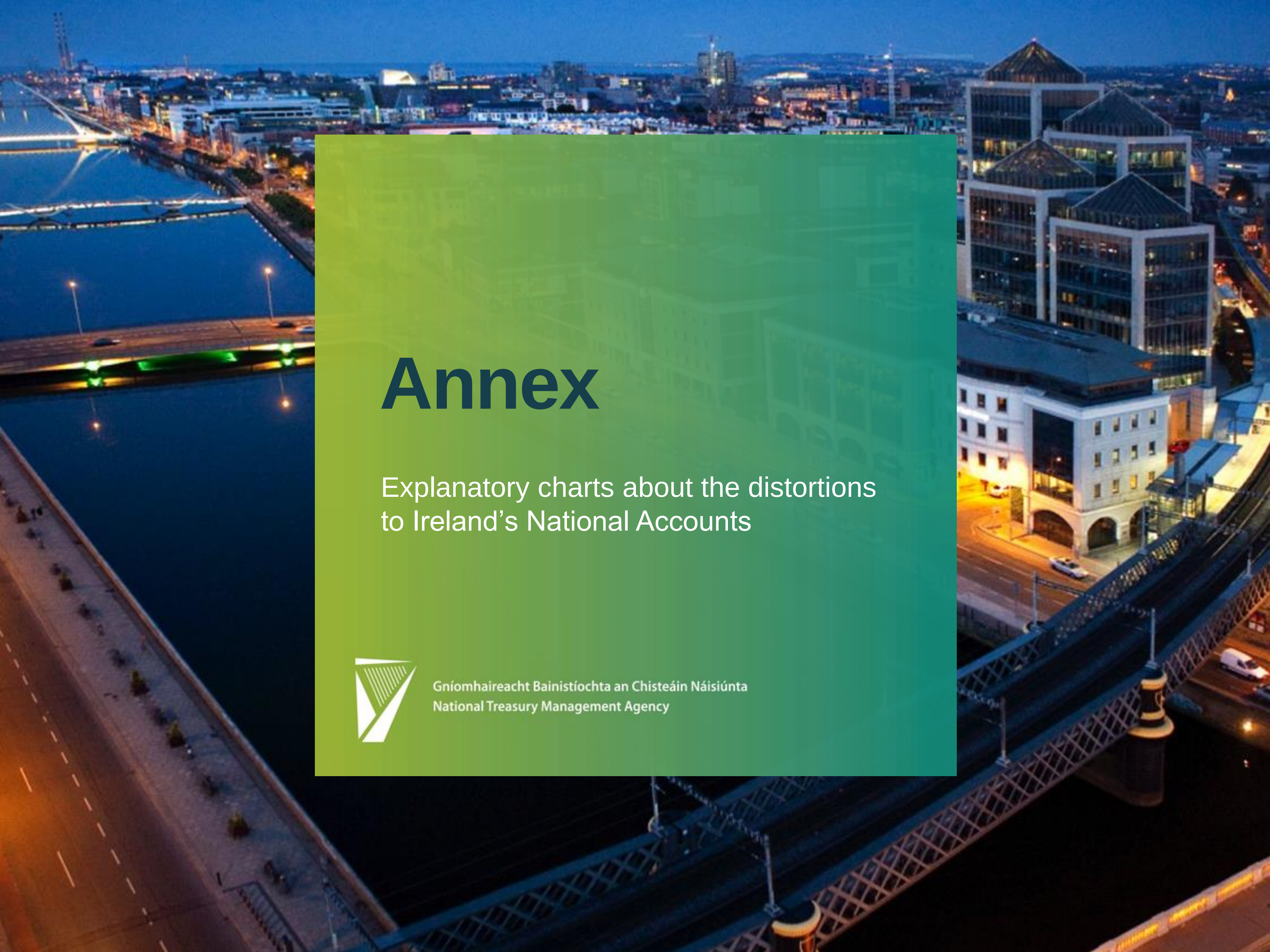
- **Progress of its building programme has been strong so far**
  - 4,840 units completed since the start of 2014 to March 2017;
  - Another 2,064 under construction; 1,114 soon to be commenced*;
  - Planning permission have been granted for another 7,475;
  - Planning applications lodged or will be lodged in 2017 for a further 10,500 units

- **Existing NAMA commitments are unaffected by this new programme**
  - Plans for all senior debt to be repaid by end 2017 and subordinated debt repaid by March 2020 are still in train.

*The units in this category are a combination of residential projects for which funding has been approved and preparations are underway to commence construction in Spring 2017. It also includes funding for developments where the next phase of residential construction will start once an earlier phase is completed.

The European Commission's ruling on Apple's tax affairs does not change the NTMA's funding plans

- The EC has ruled that Ireland illegally provided State aid of up to €13bn, plus interest to Apple. This figure is based on the tax foregone as a result of a historic provision in Ireland's tax code. This was closed on December 31st 2014. This case has nothing to do with Ireland's corporate tax rate. In its press release the EC stated: **"This decision does not call into question Ireland's general tax system or its corporate tax rate".**
- **Apple is appealing the ruling, as will the Irish Government.** This process could be lengthy. Pending the outcome of the appeal, Apple is expected to pay approximately €13bn plus EU interest to the Irish Government. The funds will sit in escrow.
- An escrow agent/custodian will be appointed by Apple and the Minister for Finance to hold and administer the fund. The services of the escrow agent/custodian will be procured in accordance with the EU Regulations. The NTMA will run this procurement process.
- **The NTMA has made no allowance for these funds.** In any case, if the appeal is unsuccessful it is possible that other EU countries where Apple makes sales would seek a share of back tax.



Annex

Explanatory charts about the distortions to Ireland’s National Accounts

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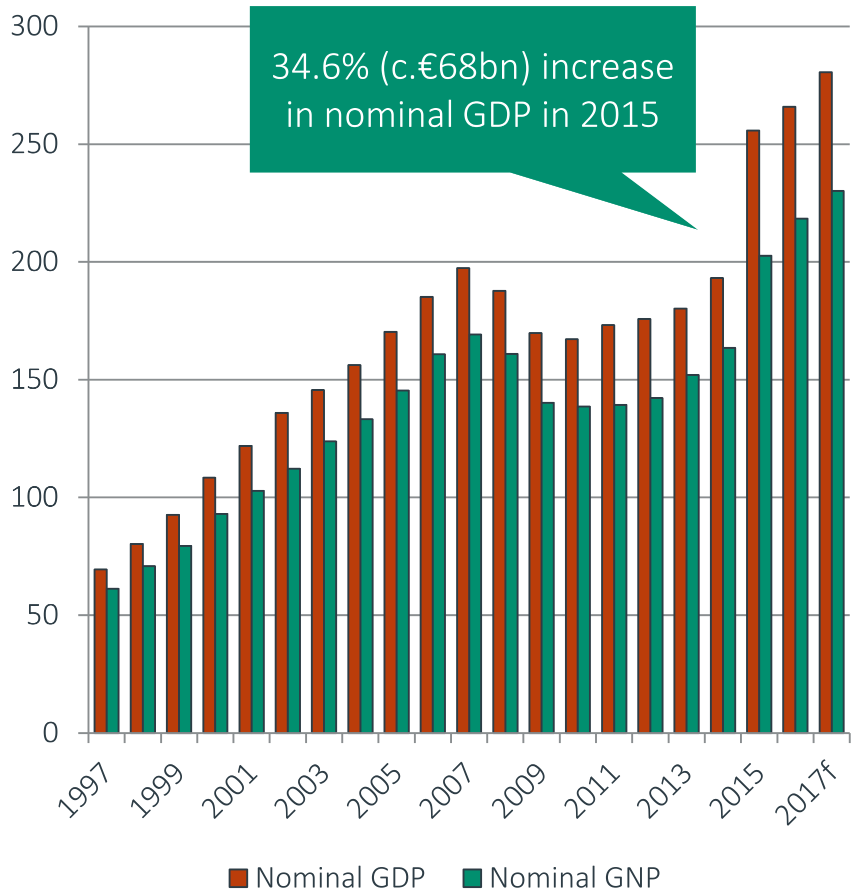
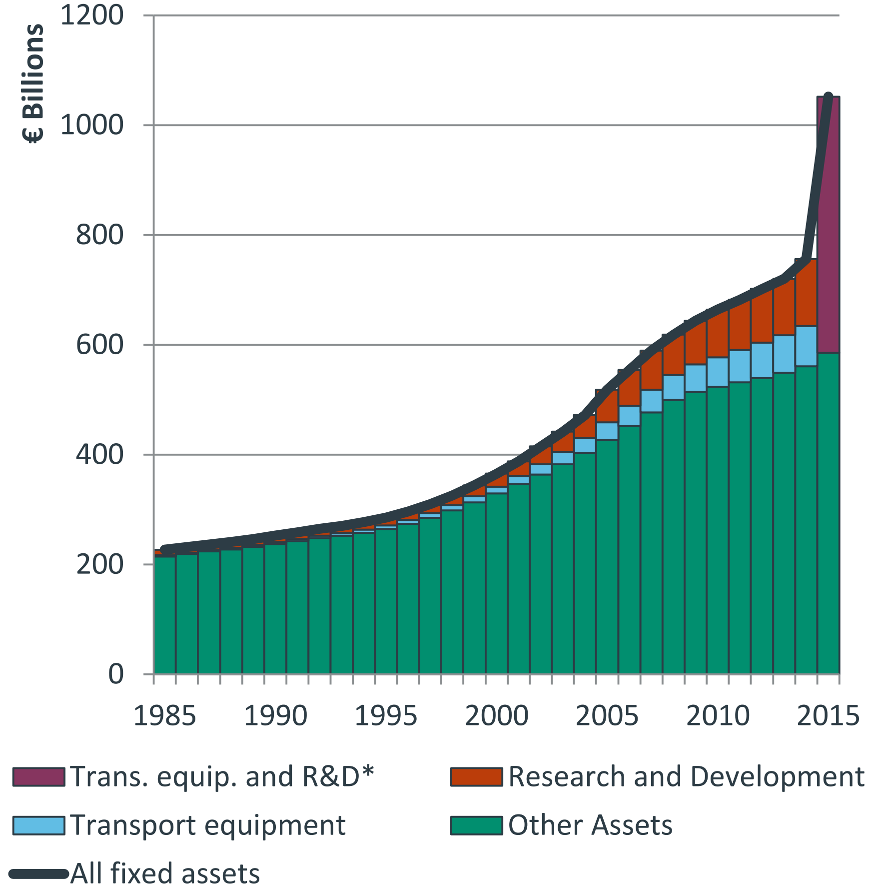
Reclassification of several companies and "onshoring" of IP led to step change in GDP & capital stock in 2015

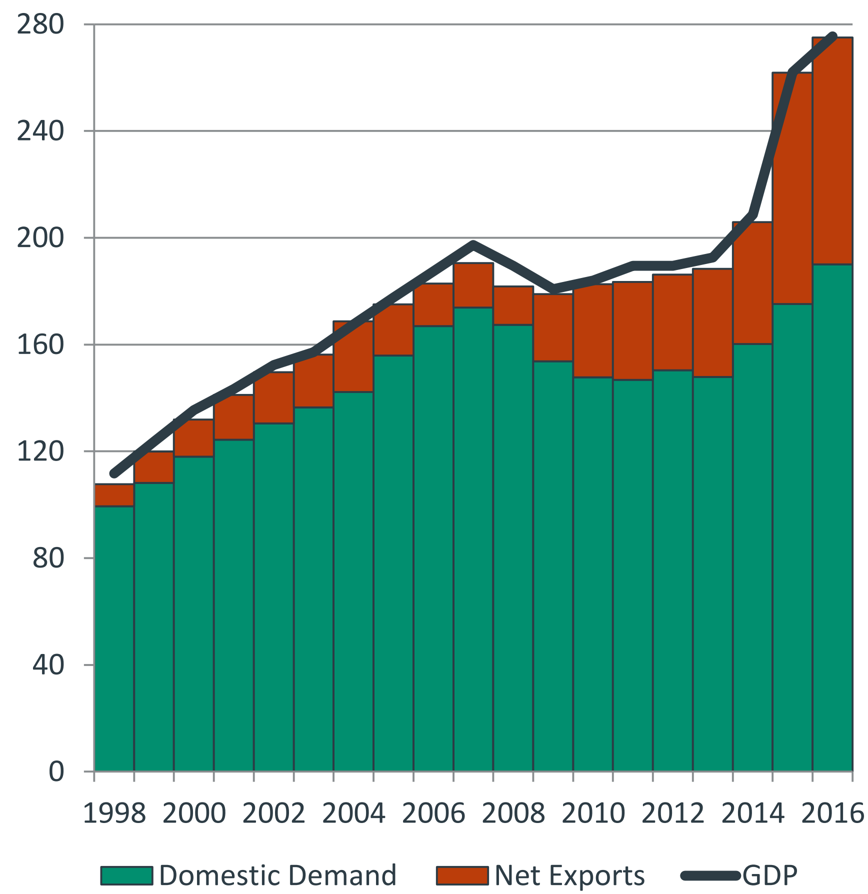




Source: CSO; Department of Finance
**due to confidentiality some sector data for 2015 has been restricted*

The change in capital stock resulted in large increase in net exports

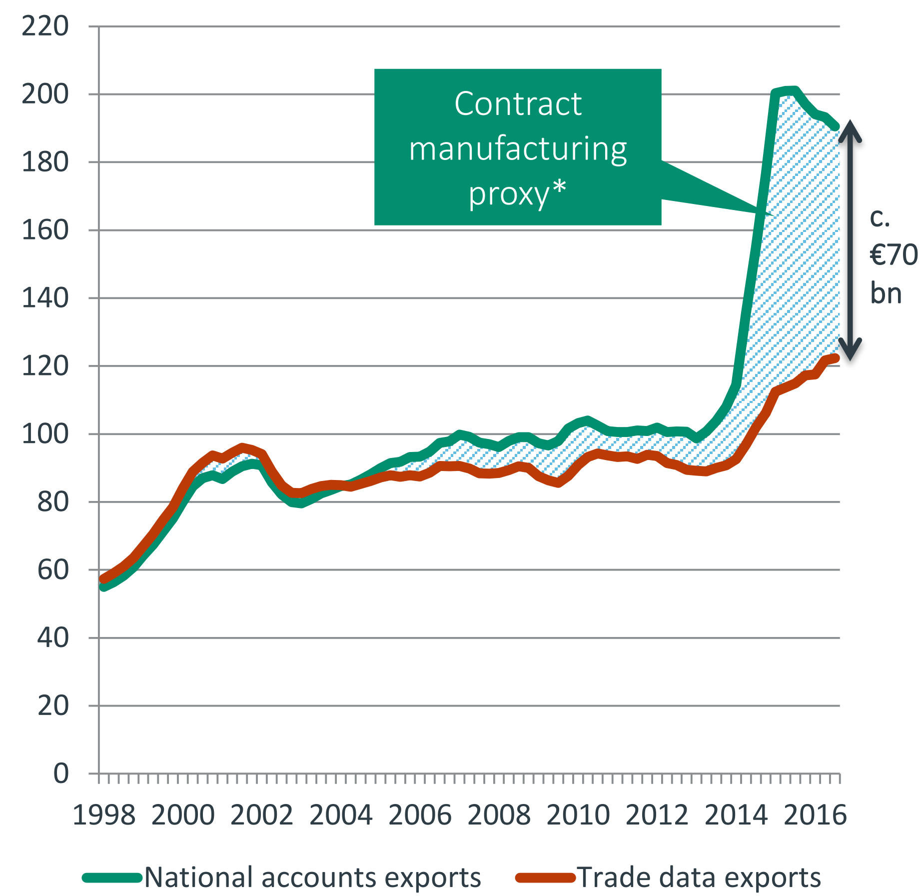
- The capital stock expanded in 2015 by c. €300bn or c. 40%. This is due to:
  - Re-domiciling/inversions of several multinational companies
  - The "onshoring" of IP assets into Ireland by multinationals
  - The movement of aircraft leasing assets in Ireland.
- The transfer of whole entities and assets of this size is not something seen before in Ireland.
- Goods produced by the additional capital were mainly exported. Complicating matters, the goods were produced through "contract manufacturing" (explained in detail overleaf).
- Little or no employment in Ireland results from this contract manufacturing.



Source: CSO

Contract manufacturing (CM) overstates the extent of goods export growth in the last two years

- CM occurs where a company in Ireland engages another abroad to manufacture products on its behalf.
- Crucially, the foreign contract manufacturer supplies a manufacturing service to the Irish entity but the overseas contractor never takes ownership of the product. When the product is sold abroad, a change of economic ownership takes place between Ireland and the country where the product is sold.
- **This export is recorded in Ireland's statistics even though it was never produced in Ireland.**
- Previously, contract manufacturing did not have a significant net impact on GDP as the company would send royalties back to where the intellectual property (IP) was "owned" – it was a royalty import. Now that the IP is here, Ireland's GDP is artificially inflated.

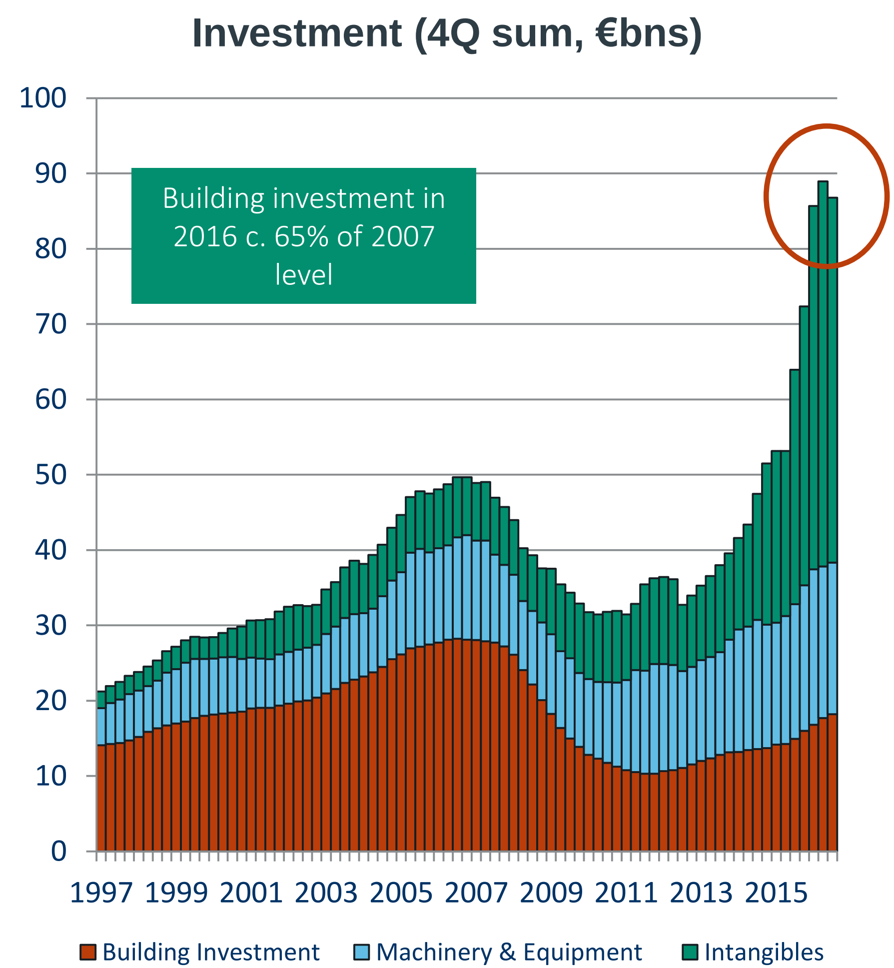


Source: CSO, NTMA Calculations

*Contract manufacturing proxy is calculated by taking the difference between the monthly International trade exports statistics and the National Accounts/BOP measure for goods exports. The monthly data is based on the actual volume of goods flowing through Ireland's various ports/airports whereas the national accounts/BOP makes adjustments for, among other items, contract manufacturing.

Investment distorted by multinationals importing IP into Ireland

- Investment is now above the pre-crisis level due to MNCs importing intangibles into Ireland.
- Ireland has become an ICT hub in recent years with this investment impacting the real economy.
- However the recent sharp increase in intangibles investment overstates Ireland's position and should be discounted accordingly.
- Building investment grew by 22% y-o-y Q2 2017 highlighting pent up demand for housing.
- **However, building investment is a much smaller part of overall investment - in 2017 Q2 it was c.65% of the unsustainable 2007 level.**



Source: CSO,

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