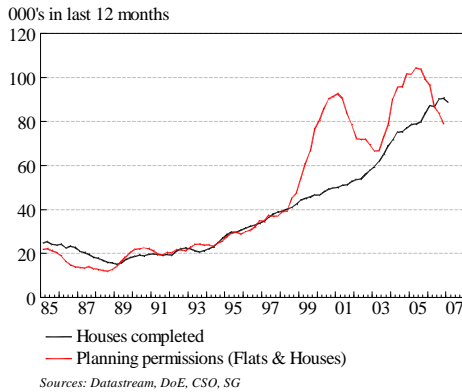


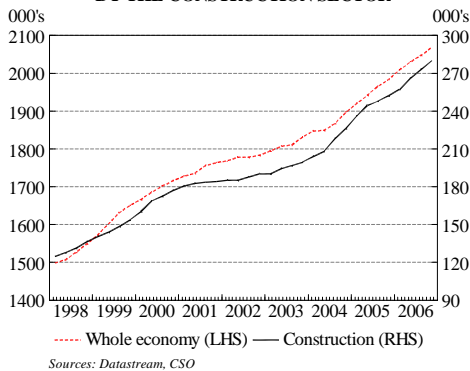
THE HOUSING MARKET IS RUNNING OUT OF STEAM

The Irish economy is expected to slow down markedly in 2007 and 2008, after a record year of growth last year since 2000, after a turnaround in the real estate market. Housing starts have been dropping for several months. Housing prices are falling for the first time since 2002. The scenario remains that of a soft landing, yet a more sudden adjustment is not out of the question.

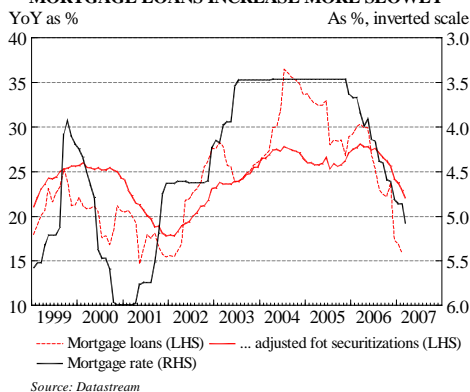
LESS HOUSES WILL BE BUILT IN 2007



EMPLOYMENT BOOSTED BY THE CONSTRUCTION SECTOR



MORTGAGE LOANS INCREASE MORE SLOWLY



¹ In 1996, Ireland had around 350 housing units per 1,000 inhabitants, a ratio that is now 425 per 1,000, hardly more than the European mean and very close to that of the UK.

² The Irish statistics agency (CSO) counted 93,419 housing units completed in 2006, compared with 80,957 in 2005. However, more than 5,000 residences that should have been counted in 2005 were not counted until 2006.

³ The impact of the rates rise will be reduced by the doubling, for first home-buyers, of the mortgage interest tax relief: from € 4,000 to € 8,000 for a single person; from € 8,000 to € 16,000 for a married couple.

2006 was a good year for Ireland

Ireland's Gross Domestic Product (GDP) advanced by 6% in 2006. Even better, the Gross National Product (GNP) – which more accurately reflects Ireland's economic performance, since the profits made by the many foreign companies with offices in the country are excluded from that – leaped by 7.4%, i.e., its strongest growth rate since 2000. Household consumption grew by 6.2% thanks to the sharp increase in revenue. Pay is up more than 4.5%, while employment has grown by 4.2% over the year. The sectors creating jobs are education and health, for women, and construction for men. Construction continues to be one of the major drivers of the nation's economic growth. Investment in non-residential construction grew strongly due to both public spending on infrastructure and the strength of commercial real estate. However, after a decade of robust growth, investment in residential construction has slackened off. Over 10 years, the stock of housing in Ireland has grown by more than half a million units, from 1.267 million to 1.804 million units. The country's strong demographic and economic expansion underlies the strong growth in the housing stock. The growth was also necessary due to inadequate supply previously. The enormous catch-up effort is now coming to an end¹. The number of residences built in Ireland last year went up by the smallest amount since 1993, at around 88,200 units², i.e., a gain of around 2,000 units and a rise of less than 2.5% compared with 2005. Correspondingly, after exploding by 12.6% by volume in 2005, the advance in housing investment fell by around 3% in 2006.

Housing market: fewer constructions and lower prices

This reversal in trend in residential construction is expected to continue. For several months now, the number of permits issued and housing started have fallen markedly. Today, 20% fewer worksites have started than in Spring 2006. This change will have significant repercussions for the whole economy due to the large spot this sector has occupied in the economy for the last ten years. Housing Investment, which represented less than 4.5% of GDP in 1995, amounted to 13% of GDP by 2005. The construction sector overall is directly at the source of more than one quarter of all jobs created, i.e., around 140,000 of the 520,000 created between 1998 and 2006. We are betting on a decline in the number of residences built by about 7,500 units this year, and 7,500 to 10,000 units in 2008. This will deprive GDP of more than 1 point of growth both this year and next. For the next 15 years, the demographic outlook (population will exceed 5 million inhabitants by 2020, compared with 4.2 today) and the continuation of the downward trend in the number of persons per household lead us to evaluate the need for construction of new housing at 55,000 units per year on average.

The drop in the number of buildings being planned for 2007 and 2008 is a reaction to the weakening of demand following the deterioration of households' capacity to buy. With the rise in rates started by the ECB since the end of 2005, the cost of loans has risen sharply. Thus, a household that becomes the owner of a home this year will devote 4-5 percentage points of income more to repaying its loan than a household that bought its home last year³. Under these conditions, the growth of mortgage credit outstanding is losing its strength. Adjusted for securitizations, the year-on-year advance was 22% at the end of March, whereas at the same time a year ago it was 28%.

As for the prices of housing, which have exploded in the space of 10 years, rising from less than € 80,000 in 1996 to more than € 310,000 in 2006 (i.e., 3.9 times, in nominal terms and 2.8 times in real terms), they are recording a marked halt. They contracted in March for the first time since 2002 (declining 0.6% for the month), which reduces the y-o-y rise to less than 7.5%. Housing prices will remain on a downward trend over the next few months. Housing affordability will decline again due to new rises in the ECB's rates; one in June and the other most likely at the end of summer.

Supportive factors...

The soft landing of the real estate market will, as we have seen, almost certainly have a significant impact on the whole economy, but it will not prevent the Irish economy from posting growth of more than 4% in 2007.

The 2007-2013 National Development Plan, which posits € 184 billion in investment in five priority areas, will also make it possible to mitigate the loss of the engine that housing investment indeed was. The sum of € 54.7 billion has been set aside to modernise infrastructure (transportation, energy, etc.), which will support the investment in non-residential construction.

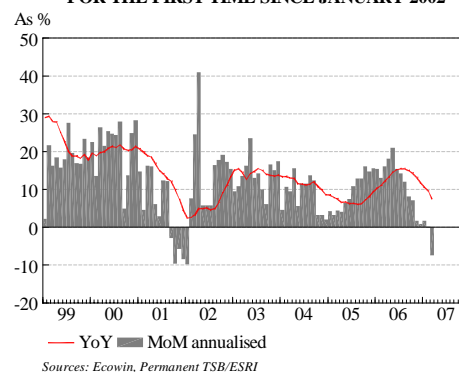
Households' consumption will receive a boost, though, from the maturation of the SSIA's. SSIA's, or Special Savings Incentive Accounts, are savings plans subsidized by the State for five years, which the Irish could take out between May 2001 and the end of April 2002. Most of these plans matured last April. Since 1 January, Irish citizens have been able to redeem € 9.3 billion, or nearly 5% of GDP. Even on the assumption that much of this saving will be reinvested, there is likely to be a positive impact on household expenditure. Our expectation is that consumption will jump by 6.9% in 2007.

... and risk factors

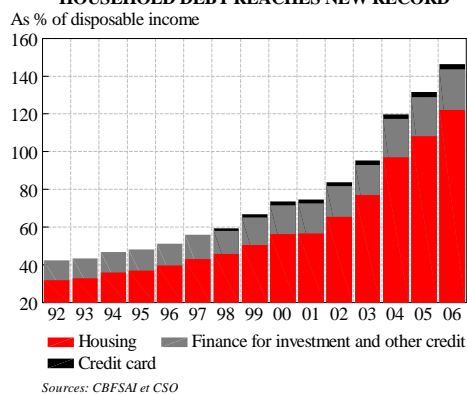
In 2008, the end of the beneficial effect of the maturation of the SSIA's will result in a negative base effect for the consumption of households whose rise in volume should be restricted to 2.5%. A figure that may prove too optimistic. Not that we fear that the decline in house prices might be translated by negative wealth effects, since those seem limited⁴, but rather that the record debt of households leads us to display caution. Household debt, which represented around 60% of disposable income at the time Ireland joined the euro zone, was 147% of disposable income by the end of 2006. An explosion in debt which is of more concern since nearly 84% of the outstanding is at a variable rate, which, in the current rising interest-rate environment, means a significant and fast increase in the debt burden. In such a context, the consequences of a negative shock on jobs and/or on households' income are something to fear. A more sudden adjustment in the residential construction sector than expected⁵, due to the effects it would have on jobs, would lead to a worsening in the financial situation of households, which would have a deleterious effect on consumption. Lastly, due to the high degree of openness of its economy, Ireland is still extremely vulnerable to an external shock. The slowdown in the world economy from 2001 to 2004 had led to a significant flattening of activity. A more pronounced slowdown in the US economy than we expect, which would also be accompanied by a fall in the dollar, now appears to be a major risk for Ireland.

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HOUSE PRICE FELL FOR THE FIRST TIME SINCE JANUARY 2002



HOUSEHOLD DEBT REACHES NEW RECORD



⁴ BARKET, SIMON, "Growing risk of a downward correction to the housing market," *Monthly economic report*, p. 28, November 2004.

O'DONNELL, "Housing Wealth and Consumption", *Quarterly Bulletin Q1 2007*, CBFSAI

⁵ Adjustment that could be brought on by a retreat by investors from the housing market. Buy-to-let investors represent an increasingly large portion of the real estate market: In late 2006, nearly 25% of mortgage loans were for investors, as against 16.7% in late 2003. A huge retreat by investors, however, now seems unlikely in the short term, given the fact that rents have increased since 2005.

KELLY and MENTON, "Residential Mortgages: Borrowing for Investment", *Quarterly Bulletin Q2 2007*, CBFSAI

As %	2004	2005	2006	2007(f)	2008(f)
Real GDP	4.3	5.5	6.0	4.1	2.8
Consumer prices (CPI)	2.3	2.2	2.7	2.3	2.3
Unemployment rate	4.4	4.4	4.4	4.7	5.2
Current acc. bal. (% GDP)	-0.6	-2.6	-3.3	-3.0	-2.0
General govt. bal. (% GDP)	1.4	1.0	2.9	1.0	0.5

WORTH WATCHING

Elections. In Ireland, Fine Gael (the centre left) made a strong advance with 51 seats (20 more than in 2002). However, Fianna Fail was well in the lead at the 24 May general elections, winning 41.6% of the votes and 78 of the 166 seats (down 3). Consequently, Bertie Ahern, the outgoing Taoiseach (Prime Minister), is almost sure to retain his job on 14 June. All the same, he will have to make deals to put together a majority in light of the loss of so many democratic allies.

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