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Ireland, Spring 2018

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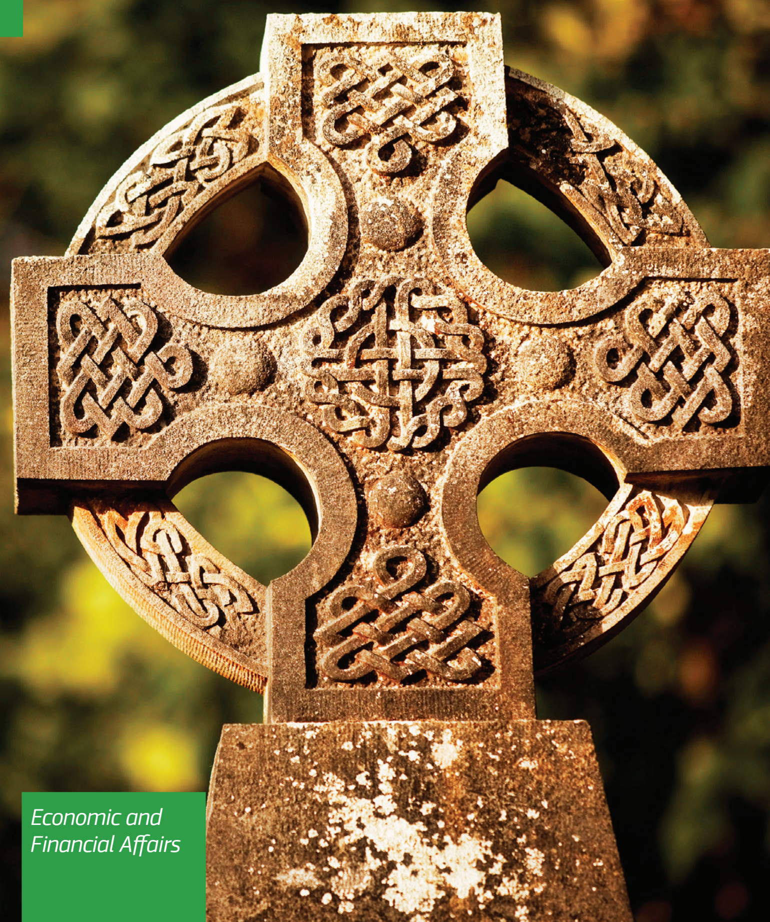
EUROPEAN ECONOMY



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European Commission
Directorate-General for Economic and Financial Affairs

Post-Programme Surveillance Report

Ireland, Spring 2018

EUROPEAN ECONOMY

Institutional Paper 081

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This report reflects information available up until 21 June 2018.

ABBREVIATIONS

CBI	Central Bank of Ireland
CET1	Common Equity Tier 1
CSO	Central Statistics Office Ireland
DHPLG	Department of Housing, Planning and Local Government
ECB	European Central Bank
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ESB	Electricity Supply Board
FTB	First-time buyer
GDP	Gross Domestic Product
GNI*	Modified Gross National Income
GNP	Gross National Product
HICP	Harmonised Index of Consumer Prices
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IP	Intellectual property
MREL	Minimum requirements for own funds and eligible liabilities
NPLs	Non-performing loans
NTMA	National Treasury Management Agency
PDH	Primary Dwelling Home
PPS	Post-programme surveillance
SCSI	Society of Chartered Surveyors Ireland
SME	Small and medium sized enterprises
SOLAS	An tSeirbhís Oideachais Leanúnaigh agus Scileann (Further Education and Skills Service)
SSM	Single Supervisory Mechanism
VAT	Value added tax
y-o-y	Year-on-year

EXECUTIVE SUMMARY

Staff from the European Commission visited Dublin in liaison with staff from the European Central Bank from 14 to 18 May to conduct the ninth post-programme surveillance (PPS) review for Ireland. The main objective of PPS is to assess the country's capacity to repay the loans granted under the former EU-IMF financial assistance programme and, if necessary, to recommend corrective actions. Staff from the European Stability Mechanism participated in the meetings on aspects related to its own Early Warning System.

Domestic economic activity is expected to stay robust in the short term, but risks remain. Underlying domestic demand continues to be supported by favourable labour market developments and strong construction investment. Unemployment is falling rapidly towards pre-crisis levels. The headline national accounts figures remain volatile and heavily influenced by the activities of multinational companies. External risks to the outlook relate primarily to the ongoing negotiations on the terms of the UK's withdrawal from the European Union as well as to changes to the international taxation and trade environment. The shortage of housing supply and continued significant increases in residential property prices and rents remain a major domestic risk.

Public finances have further improved, underpinned by robust output growth. The general government deficit is expected to decline further in the near term. Risks of volatility in some forms of tax revenue, such as corporate income tax, remain. Prudent expenditure management remains crucial, while allowing for essential infrastructure investment. Irish public indebtedness has diminished, but remains elevated. The favourable cyclical situation combined with buoyant corporate income tax receipts implies a strong case for accelerating deficit and debt reduction or creating the envisaged rainy day fund.

The current benign economic environment provides a window of opportunity to continue to reduce legacy non-performing loans (NPLs) in a decisive manner. The stock of NPLs, which remains a key area of focus for the banks and supervisory authorities, continues to decline, supported by restructuring efforts, strong economic growth and investor appetite for Irish assets. Although long-term mortgage arrears are declining, their high level remains a concern. Credit is picking up, initially driven by mortgages, and more recently also supported by lending to non-financial corporations. Although rising property prices have contributed to a reduction in bank loan loss reserves, the sustainability of such developments warrants continued attention. Concerns remain that some legislative proposals could have unintended consequences, including negative implications for the transmission of monetary policy, financial stability and bank competition.

The marked increase in property prices and rents continues, on the back of a still insufficient supply response. Certain indicators, such as price-to-rent or price-to-income (affordability), have exceeded their long-term average. Rents are above their previous peak recorded in 2008. Despite recent increases, housing supply seems to remain below the level needed to address long-term housing demand adequately. Recent government measures to increase housing supply are going in the right direction, and will benefit from timely and efficient implementation.

Risks for Ireland's capacity to service the European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF) debt remain low. The sovereign's financing situation is comfortable and the National Treasury Management Agency (NTMA) plans to maintain strong cash buffers in advance of large redemptions over the medium term, notably in 2019 and 2020. Market access conditions for the Irish sovereign remain favourable. The debt sustainability analysis shows that the public debt-to-GDP ratio is expected to decrease further in the medium-term but remains vulnerable to economic shocks.

The next PPS mission is planned to take place in autumn 2018.

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1. INTRODUCTION

Staff from the European Commission mission, in liaison with the ECB, visited Dublin from 14 to 18 May to conduct the ninth PPS review. Under PPS, the Commission undertakes regular review missions to EU Member States which previously had an EU-supported financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal and financial situation to ensure the Member State maintains its capacity to service its debt to the EFSM, EFSF and bilateral lenders.([1]) Acting upon a proposal from the Commission, the Council could recommend corrective measures. As per Regulation (EU) 472/2013, the results of the PPS mission have to be communicated to the competent committee of the European Parliament, to the Economic and Financial Committee and to the Irish Parliament.

([1]) Ireland has already repaid the outstanding bilateral loans from Denmark and Sweden, early and in full. Under Regulation (EU) No 472/2013, PPS will apply until at least 75% of the financial assistance received under the programme has been repaid. Under the current repayment schedule PPS will last until 2031 at the earliest.

2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1. MACROECONOMIC TRENDS

The growth of the Irish economy is expected to moderate in the short term but to remain solid. Ireland's real GDP grew by 7.8% in 2017, well above the euro area average. The GNP also increased strongly by 6.6%. However, the headline national accounts figures were, again, distorted by the activities of multinational companies. GDP growth is projected to moderate in the near term, but to remain robust at 5.7% in 2018 and 4.1% in 2019.([2])

The domestic economy continues to perform well, underpinned by positive labour market developments. *Modified domestic demand*, a measure of domestic activity that strips out some of the effects of multinationals, grew by 3.9% in 2017. It was driven by private consumption and construction investment.

The labour market continues to perform strongly. Employment, in particular full-time employment, increased strongly last year by 2.9% and 5.8% respectively. The unemployment rate stood at 5.8% in May 2018 and is expected to drop below 5% in 2019. The participation rate increased moderately over the last year to 62.2%, but remains still 4.4 pps below its 2007 high. The participation rate and broader measures of potential labour supply([3]) point to more labour market slack than that suggested by the headline unemployment rate. The large number of individuals classified as inactive, i.e. neither employed nor unemployed, signals that there remains spare capacity in the labour market. However, the potential for increased labour market participation is likely limited, as most of the inactive are weakly attached to the labour market.([4])

Households' finances are improving. In light of the improved outlook for the labour market, household incomes grew, driven by a modest pick-up in hourly wages growth and robust job creation. The tightening of the labour market is expected to put upward pressure on wages and thus support household consumption in the short term.

The volatility in headline investment masks robust underlying developments. In 2017, headline investment dropped by 22.1%, mainly due to the large swings in imports of intellectual property (IP) services and purchases of aircraft. However, building and construction activity increased by 16.7%, though coming from a very low base. Construction is expected to maintain its momentum, supported by various government measures (see section 3.3). Core business investment, i.e. investment in equipment less aircraft, declined by 11.0% in 2017. It is expected to resume growth in the short term, in line with external and domestic demand.

Modest inflation is supporting consumer spending. HICP inflation was 0.3% in 2017, dragged down by lower import prices due to the appreciation of the euro against sterling. Sterling depreciation is estimated to have a significant dampening effect on Irish HICP, with a maximum pass-through to domestic prices after two years.([5]) However, the pace of services inflation increased, reflecting in particular higher rents due to the housing supply shortage. HICP inflation is projected to reach 0.8% in 2018, mainly driven by higher services and energy prices, and by 1.1% in 2019, when services prices are expected to be the main driver.

([2]) According to European Commission 2018 Spring Forecast.

([3]) While the labour force comprises the working age population who are either employed or unemployed, broader measures of non-employment aim at reflecting the potential additional labour supply from individuals that dropped out of the labour force but are available for work (e.g. discouraged workers). S. Byrne and T. Conefrey (2017), "A non-employment index for Ireland", Central Bank of Ireland Economic Letter Series, Vol 2017, N°9 (https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2017-no-9---a-non-employment-index-for-ireland-(byrne-and-conefrey).pdf).

([4]) P. Redmond and A. Whelan (2017), "Educational attainment and skill utilisation in the Irish labour market: an EU comparison", ESRI Special article (https://www.esri.ie/pubs/QEC2017WIN_SA_Redmond.pdf).

([5]) P. Reddan and J. Rice (2017), "Exchange rate pass-through to domestic prices", Central Bank of Ireland Economic Letter Series, Vol 2017, N°8 (https://www.centralbank.ie/docs/default-source/publications/economic-letters/vol-2017-no-8-exchange-rate-pass-through-to-domestic-prices-(reddan-and-rice).pdf?sfvrsn=4).

Trade developments continue to be shrouded in uncertainty. Net exports contributed 14.5 pps to GDP growth last year as exports increased by 6.9%, largely driven by outflows of royalties attributed to the IP assets registered in Ireland. While contract manufacturing, which takes place in third countries but is booked as an Irish export, had a slightly negative overall impact on total exports in 2017, it pushed up strongly the headline exports figures in the second half of the year. Cross-border goods exports captured by customs data, which exclude contract manufacturing and offer a clearer picture of the flows linked to domestic activity, reached a record level in 2017, growing by 9.7%, with the positive trend continuing in 2018. Total imports declined by 6.2% in 2017 driven largely by a fall in IP inflows and royalty fee payments. On the other hand, cross-border imports, which exclude contract manufacturing, increased by 4.7%.

Headline trade figures are expected to remain volatile. Over the next two years, exports are expected to grow in line with global trade and imports to track domestic demand, with net exports contributing positively to GDP growth. However, headline figures may continue to be affected by the impact of contract manufacturing, trade in IP services and royalty fees associated with the stock of IP assets registered in Ireland.

New housing completions are still well below demand. Estimates of housing demand based on different household formation assumptions ([6]) range from an annual requirement of around 21 800 ([7]) to 22 600 ([8]) in 2017 to respectively 27 000 to 53 000 in 2036. The recently published indicator on new housing completions ([9]) reveals that 14 446 new dwellings were completed in 2017, i.e. at least a third less than the amount required to meet housing demand.

([6]) OECD (2018), OECD Economic Surveys. Ireland.
([7]) This estimate considers that the average household size remains constant as of 2016. This would be in line with recent trends in the average household size which has remained broadly constant since 2010.
([8]) This estimate assumes a continuing decline on the average household size as of 2016. This assumption is in line with other studies (see Duffy et al.(2016), *Demographic Change, Long-Run Housing Demand and the Related Challenges for the Irish Banking Sector* - https://www.esri.ie/p ubs/CB201617.pdf)
([9]) CBI (2017) *Macrofinancial Review 2017: II*. Central Bank of Ireland

Residential construction is ramping up. The number of houses and apartments for which planning permission was granted during the first quarter of 2018 increased by 80.8% year-on-year, which represents an acceleration of 30.3 pps with respect to the same period in 2017. The average number of units per permission has also sharply increased by 61% year-on year in the first quarter of 2018. Housing completions increased by 26.8% year-on-year in the first quarter of 2018, which is 14.3 pps lower than for the same period in 2017. Completions will probably continue growing in the short to medium-term reflecting the lagged effect of the acceleration on housing starts.

The surge in Irish house prices continues on the back of the still insufficient housing supply. Annual house price inflation was 13,0% in April 2018, the fastest pace since June 2015. Rapid house price increases continue to be widespread across the country with nearly every region seeing double-digit price gains. However, significant regional differences in absolute terms remain. Residential property transactions have picked up from low levels. This was accompanied by an increase in mortgage lending.

Rental inflation is well above the 4% threshold prescribed by the Rent Pressures Zones. Annual private rent inflation amounted to 7.4% in May 2018, with rents 21.5% above their peak level recorded in 2008. More than a year after their introduction across the major population centres, rent pressure zones seem to be contributing little to containing price rises.

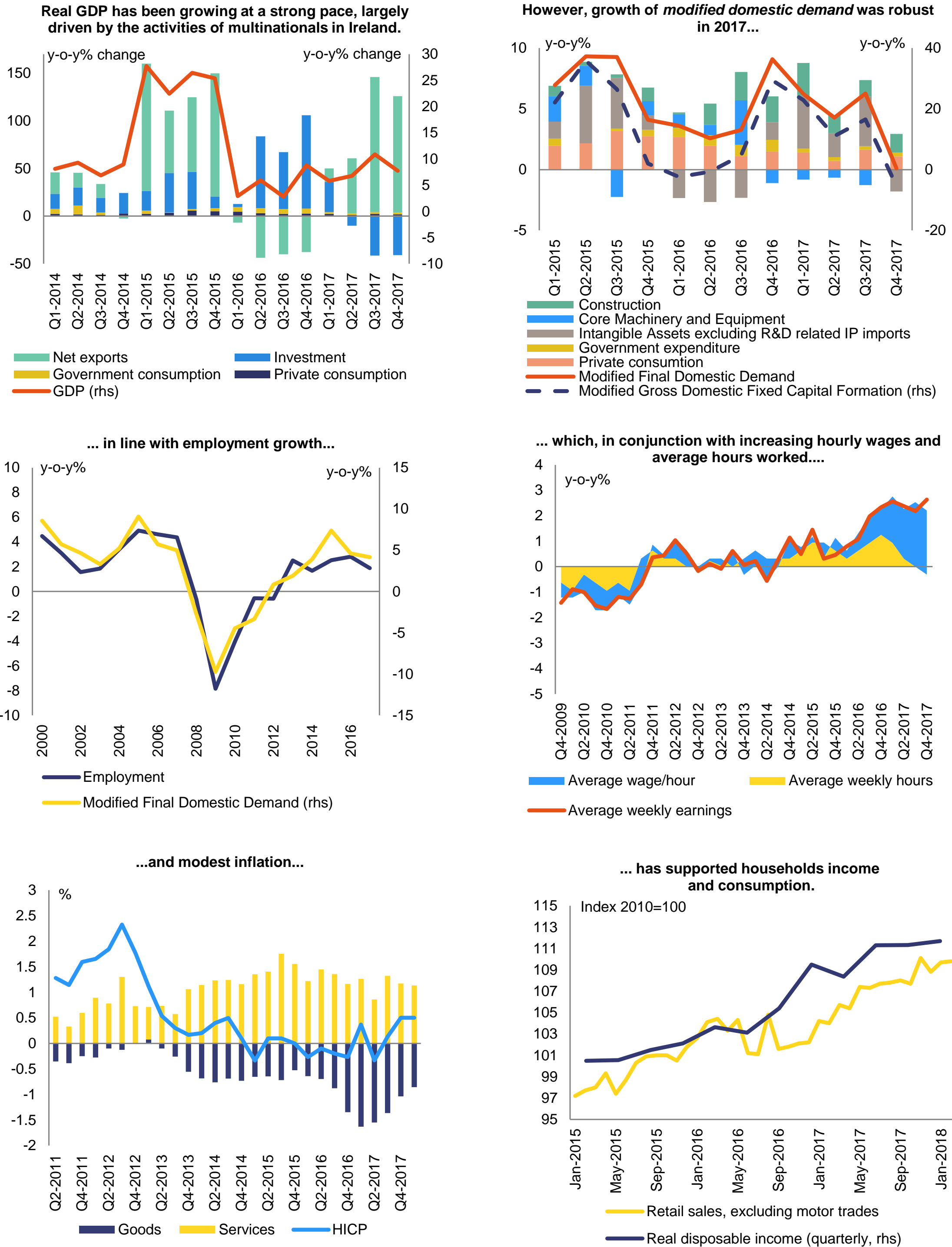
Risks to the macroeconomic outlook remain tilted to the downside. Uncertainty relates primarily to the ongoing negotiations on the terms of the UK's withdrawal from the European Union as well as to changes to the international taxation and trade environment. A high degree of unpredictability remains linked to the activities of multinationals, which could drive headline GDP growth in either direction. The shortage of housing supply and continued significant increases in residential property prices and rents remain a major domestic risk.

Table 2.1: **Main features of country forecast - IRELAND**

	2016		Annual percentage change						
bn EUR	Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP	275.6	100.0	4.0	8.3	25.6	5.1	**7.8**	**5.7**	**4.1**
Private Consumption	90.8	33.0	3.8	2.1	4.2	3.2	**1.9**	**2.5**	**2.4**
Public Consumption	34.1	12.4	1.8	4.1	2.2	5.2	**1.8**	**4.4**	**1.9**
Gross fixed capital formation	87.7	31.8	3.1	18.2	28.2	60.8	**-22.3**	**6.5**	**6.0**
of which: equipment	20.5	7.5	6.4	21.6	-0.7	27.9	**-11.0**	**4.0**	**3.3**
Exports (goods and services)	335.0	121.6	7.3	14.4	38.4	4.6	**6.9**	**5.8**	**4.6**
Imports (goods and services)	274.4	99.6	6.8	14.9	26.0	16.4	**-6.2**	**4.6**	**4.4**
GNI (GDP deflator)	227.7	82.6	3.6	8.7	16.5	9.9	**6.4**	**4.4**	**3.4**
Contribution to GDP growth: Domestic demand			2.8	5.0	7.9	14.2	**-6.3**	**2.9**	**2.4**
Inventories			0.0	1.7	-0.4	0.1	**0.1**	**0.0**	**0.0**
Net exports			1.4	2.3	18.6	-9.2	**14.5**	**2.8**	**1.7**
Employment			1.8	1.7	2.5	2.8	**1.9**	**2.2**	**1.8**
Unemployment rate (a)			8.1	11.9	10.0	8.4	**6.7**	**5.4**	**4.9**
Compensation of employees / head			3.8	1.8	2.1	2.0	**2.9**	**2.5**	**2.7**
Unit labour costs whole economy			1.6	-4.4	-16.6	-0.2	**-2.7**	**-0.9**	**0.5**
Real unit labour cost			-	-4.1	-22.3	-0.2	**-2.4**	**-1.5**	**-0.8**
Saving rate of households (b)			7.9	7.3	6.8	6.7	**7.0**	**6.9**	**6.9**
GDP deflator			2.1	-0.4	7.3	0.0	**-0.3**	**0.6**	**1.3**
Harmonised index of consumer prices			2.2	0.3	0.0	-0.2	**0.3**	**0.8**	**1.1**
Terms of trade goods			0.5	-5.2	8.0	2.3	**-5.5**	**-1.0**	**-0.3**
Trade balance (goods) (c)			21.7	20.9	43.3	38.4	**36.2**	**35.0**	**34.3**
Current-account balance (c)			-1.8	1.6	10.9	3.3	**12.5**	**11.9**	**11.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-1.5	-1.8	10.4	1.5	**3.4**	**3.3**	**3.4**
General government balance (c)			-4.0	-3.6	-1.9	-0.5	**-0.3**	**-0.2**	**-0.2**
Cyclically-adjusted budget balance (d)			-4.1	-3.8	-2.4	-0.7	**-0.1**	**-0.6**	**-0.3**
Structural budget balance (d)			-	-3.7	-1.6	-0.8	**-0.1**	**-0.6**	**-0.3**
General government gross debt (c)			54.3	104.5	76.9	72.8	**68.0**	**65.6**	**63.2**

(1) Eurostat definition
(2) gross saving divided by adjusted gross disposable income
(3) as a % of GDP
(4) as a % of potential GDP
Source: European Commission

Graph 2.1: **Recent economic developments**



Source: European Commission, Central Statistics Office

2.2. PUBLIC FINANCES

Public finances are further improving. The headline government deficit decreased from 0.5% of GDP in 2016([10]) to 0.3% of GDP in 2017 on the back of a continued strengthening in the economy. Tax revenues, including social security contributions, were up by 5.2% in 2017, driven by the strong performance in corporate income and value added taxes (VAT). Government expenditure, excluding one-offs, increased compared to the previous year by 3.2%. A fall in the interest burden facilitated the deficit reduction.

The short-term fiscal outlook remains favourable, but risks remain. The headline government deficit is projected to fall to 0.2% of GDP in 2018, based on strong revenue growth, with earnings from personal income taxes and VAT reflecting the rise in employment and private consumption. Expenditure is expected to remain buoyant amid infrastructure and demographic pressures. The headline deficit is forecast to remain broadly stable in 2019. Risks to the fiscal outlook remain tilted to the downside, mainly reflecting uncertainty as regards the economic outlook and the sustainability of the current level of corporate income tax. Acknowledging the difficulties in estimating Ireland's position in the economic cycle([11]), after improving in 2017, the structural balance is expected to deteriorate in 2018 and to improve again in 2019. The target for achieving the medium-term objective has been delayed by a year compared to the 2017 Stability Programme, when the aim was to reach it in 2018.

Cash returns to end of May 2018 were in line with government targets. Taxes received in the first five months of 2018 were up 5.0% in annual terms and 0.4% above budget targets. However, they were flattered by the impact of implemented accounting changes concerning corporate income tax. Overall, expenditure was up 8.7% y-o-y, but 1.3% below profile. Current expenditure was up 8.1%, but 0.2% below profile. Health care spending was up by 10% y-o-y and somewhat above its current expenditure limit. Capital expenditure was up 17.8% y-o-y, but significantly (16.6%) below profile. This is largely due to delays in drawing down payments by Irish Water ([12]).

Public debt remains high. Bank asset sales amounting to EUR 3.4 billion in 2018 will contribute to the reduction of the general government debt. This declined to 68% of GDP in 2017 and is projected to further decline to 65.6% and 63.2% of GDP in 2018 and 2019 respectively, contingent on continued stable medium-term economic growth and primary surpluses. Although this represents an impressive turnaround since the programme days, Ireland is not yet out of the woods in terms of its government debt position. As a proportion of GNI* it remains high, just above 100% in 2017 according to Department of Finance. The total debt and interest payments also remain high as a percentage of revenue.

2.3. FINANCIAL SECTOR

The capital position of domestic banks has further improved but the banks continue to face important challenges. The average capital ratios for the consolidated banking sector have strengthened considerably over the year to December 2017 (CET1 at 22.9%)([13]), placing Irish banks well above the EU average. Banks maintain comfortable net interest margins, which is due to lower funding costs for banks and the high interest rates on customers loans. Aggregate provisions have, however, fallen, and the legacy NPLs pose a constraint to the banks' ability to improve their profitability further. Banks' exposure to the property market remains high, and the property driven credit expansion may further increase the sensitivity of banks' balance sheets to developments in the housing market. The growing uncertainty in the external environment represents an additional challenge.

Credit to households has picked up on the back of rising house prices. Growth in credit to

([10]) The 2016 balance has been revised by +0.2% of GDP since the previously published tables under the Excessive Debt Procedure in October 2017 to reflect updated data sources as well as a change to methodology for the treatment of the sale of mobile phone licences and the treatment of the Approved Housing Bodies.

([11]) The estimate of potential GDP growth has been affected by a better-than-anticipated GDP outturn for 2017.

([12]) According to Department of Finance (2018), *Fiscal Monitor, March 2018* (http://www.finance.gov.ie/wp-content/uploads/2018/04/Fiscal-Monitor-March-2018.pdf)

([13]) ECB, Consolidated Banking Data

Table 2.2: Financial stability indicators

Non-performing loans, total	21.6	14.9	14.6	14.4	13.1	11.5	11.6	11.2	9.9
Non-performing loans, foreign entities	18.2	10.1	10.6	10.7	9.2	7.9	7.7	11.2	7.1
Non-performing loans, non-financial corporations	37.8	22.9	19.8	19.1	15.3	14.0	13.7	13.4	11.8
Non-performing loans, households	22.8	19.1	18.4	18.4	17.4	16.7	17.1	16.6	15.5
Coverage ratio	46.7	40.2	38.7	38.5	35.5	34.7	33.0	32.6	29.9
Return on equity (1)	8.5	6.8	7.8	7.0	6.3	5.7	6.5	6.3	5.0
Return on assets (1)	0.9	0.9	1.0	0.9	0.9	0.8	0.9	0.9	0.7
Total capital ratio	22.6	25.3	23.2	23.7	25.0	25.1	25.3	24.9	25.2
CET 1 ratio	20.1	22.3	20.5	21.0	22.2	22.5	22.7	22.3	22.9
Tier 1 ratio	20.5	23.2	21.3	21.8	23.0	23.2	23.5	22.9	23.4
Loan to deposit ratio	98.8	98.7	95.0	95.2	93.2	93.3	93.6	94.0	95.3

(1) Annualised data. The data covers domestic banking groups and standalone banks as well as foreign controlled subsidiaries and branches.
Source: ECB Consolidated Banking Data

households turned positive in April 2017. Since then it has averaged 3% y-o-y,([14]) driven by credit for primary residences. The outstanding credit for buy-to-let properties continues to contract, although the negative rates have moderated somewhat in recent months. Credit to domestic non-financial companies appears to have bottomed out. In January 2018, credit growth turned positive for the first time since June 2009. Its increase was still very small, at 0.3% y-o-y in the first quarter of 2018. In April, however, credit growth turned negative again (-0.3% y-o-y).

Rising property prices are supporting the repair of banks' and households' balance sheets, although the sustainability of such developments warrants continued attention. The strong recovery of property prices amid the limited housing supply has helped a number households rise out of negative equity. Increasing household disposable income, strengthens the households' capacity to repay.

Aggregate provisions were down by a third in the year to the fourth quarter of 2017. This brought Irish banks' coverage ratio([15]) to 29.9% in the fourth quarter of 2017, low compared with the average of their EU peers at 45%, especially given its decreasing trend over the past several years. Although the decline relates to the improving macroeconomic conditions (e.g. rising property prices) and changes in the NPL portfolio, it remains important to retain prudent levels of loan loss reserves, also in the light of supervisory requirements of the IFRS 9 provisioning rules, which are in place since 1 January 2018 (see Policy Issues section).

The stock of non-performing loans remains elevated, with the high share of long-term arrears still being a concern. The NPLs have continued their downward trend. According to the Consolidated Banking Data, published by the ECB (see Table 2.2), the NPL ratio fell to 9.9% of gross loans in the fourth quarter of 2017, down from 13.1% one year earlier. Excluding the public and financial sector loans, the private sector NPL ratio remains elevated, at 14.1% of gross loans in December 2017, down from 16.6% a year ago. The NPL ratio of non-financial corporations displayed a marked decline to 11.8% in December 2017, down from 15.3% a year ago. This reduction has been almost entirely due to successful workout activity in the commercial real estate sector. The NPL reduction for the households has been more modest, with an NPL ratio of 15.5%, down from 17.4%. With these developments, the stock of household NPLs was EUR 21.6 billion, which made up around 70% of all NPLs. Reducing household NPLs, especially for primary dwelling home (PDH) borrowers, continues to be the main challenge.

Long-term mortgage arrears remain the most critical part of the NPL stock. As of end-2017, the total balance of mortgage loans that were more than 90 days past due was EUR 14.7 billion (representing 12.2% of all loans), down from EUR 16.6 billion (13.4%) a year ago.([16]) Of those mortgage loans, approximately two-thirds have been related to PDHs, while the remaining were related to buy-to-let properties. At end-2017, the

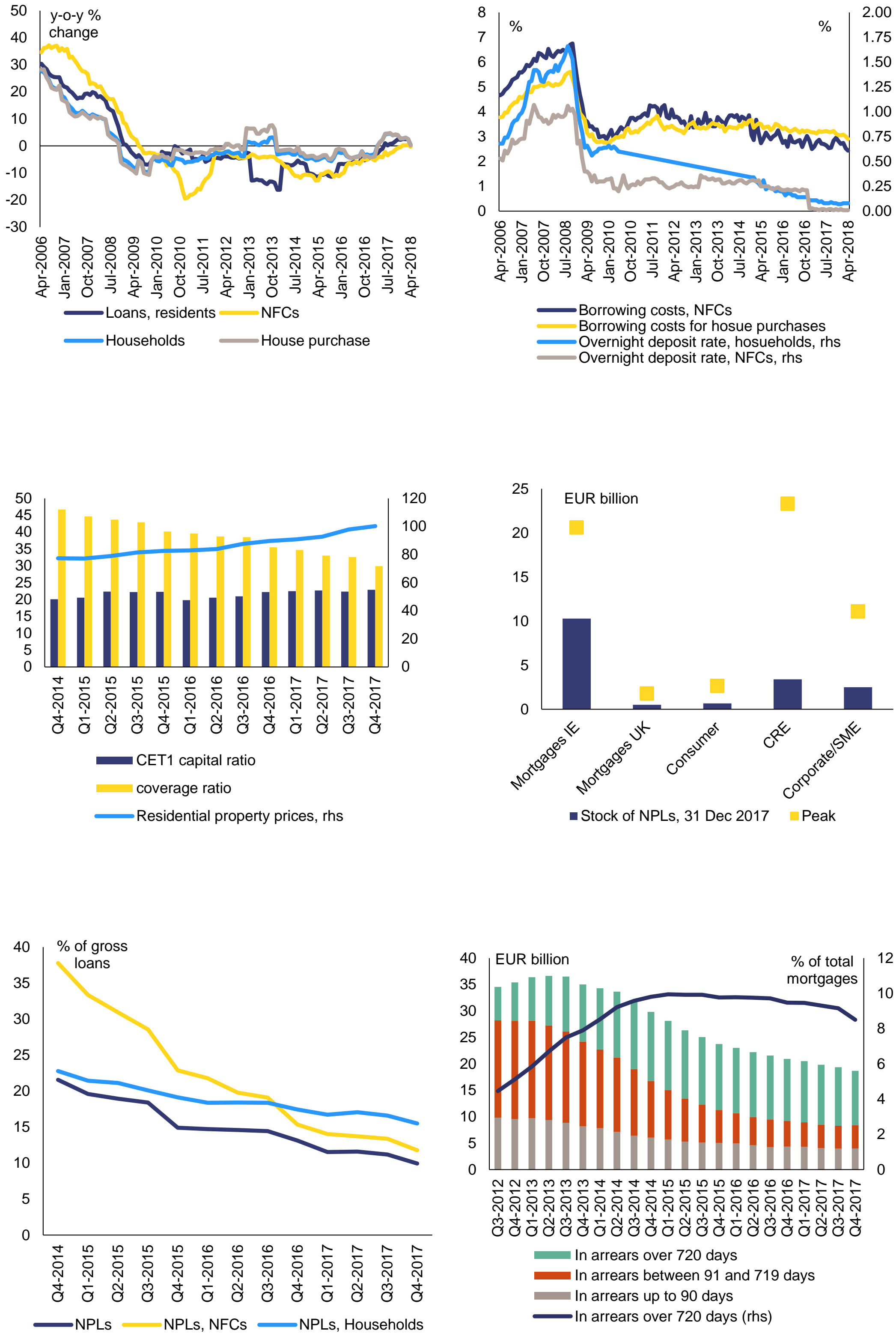
([14]) ECB, Balance Sheet Items Data, transactions
([15]) The coverage ratio refers to provisions as a share of total gross non-performing loans and advances.
([16]) CBI, Residential Mortgage Arrears and Repossessions Statistics

total stock of long-term mortgage arrears (i.e. more than 720 days past due) was EUR 10.2 billion, representing 8.5% of all loans or 70% of all mortgage loans with arrears of 90 days or more. Despite a sizeable reduction in the last quarter of 2017, the reduction in long-term arrears has been quite gradual. This is partly due to the heavy use of loan restructuring solutions, which has left behind a substantial number of borrowers with long-term arrears that are unwilling - or unable - to engage with their banks. At the same time, repossession activity remains relatively limited, as banks face reputational concerns for exercising collateral enforcement options, especially on vulnerable borrowers, while the length of proceedings continues to be protracted. The use of contractual write-offs is also limited.

Doubts remain as regards to the sustainability of existing restructured loans. While the rate at which loans turn into arrears has dropped gradually, the composition of new arrears remains a concern. Moreover, recent research by the Central Bank of Ireland (CBI)([17]) shows that one third of in-arrear mortgages, which make full payments, will face an increase in the monthly payment once the interest-only or temporary payment moratoria periods end. In summary, these results highlight that loan restructuring practices may still leave certain underlying vulnerabilities, which may surface along the road or if the underlying economic conditions worsen.

([17]) McCann, F: Resolving a Non-Performing Loan crisis: The ongoing case of the Irish mortgage market, CBI, 2017.

Graph 2.2: Recent financial sector developments



Source: ECB, European Commission

3. POLICY ISSUES

3.1. PUBLIC FINANCES

The assessment of compliance with the EU fiscal rules points to a risk of some deviation in 2018 and in 2017 and 2018 taken together. The structural balance indicator shows a significant deviation based on the frozen requirement.([18]) However, given the very open nature of the Irish economy and the volatility of potential GDP estimates, the expenditure benchmark provides a more appropriate yardstick for fiscal policy. Government expenditure, net of discretionary revenue measures and one-offs, is expected to grow above the rates which would ensure convergence to a balanced budget in structural terms. Hence, managing the public finances in a prudent manner remains key.

The authorities are targeting a structurally balanced budget by 2019. In the 2018 Stability Programme, the government expects the headline deficit to decrease slightly to 0.2% of GDP in 2018, gradually turning into a surplus of 0.4% of GDP by 2021.([19]) The Stability Programme estimates a structural deficit of 0.4% of GDP in 2019, consistent with the achievement of Ireland's medium term objective (structural deficit of 0.5% of GDP). The new deficit targets include the comprehensive Budget 2018, including overall deficit-increasing measures worth 0.2% of GDP. These measures consist of personal income tax cuts and spending increases and are partially offset by revenue increasing measures, and other government initiatives. Beyond 2018, the government has acknowledged the need to avoid "adding fuel to the fire"([20]) given that the economy is already operating close to its capacity, independent of what is allowable under EU fiscal rules. However, not spending all the available money or not reducing some income taxes could face political hurdles. Increased expenditure or reduced taxes might repeat the pro-cyclical stance of the past.

The government has approved drafting of rainy day fund legislation. The envisaged rainy day fund to be established in 2019 could act as a shock absorber. The current proposals do not specify detailed economic triggers of pay-outs by the fund.([21]) Rule-based triggers could provide more certainty. It is notable that the proposed annual contribution of EUR 500 million represents a halving of the EUR 1 billion per annum originally announced in 2016.([22]) The Summer Economic Statement 2018 announced that some of the historically high levels of corporate income tax will be set aside for this purpose.([23]) Furthermore, improving domestic expenditure rules could guide policy decisions more accurately. Reinforced public debt reduction could lock in savings on interest payments and improve debt sustainability. While the general government debt ratio to GDP has been declining since 2012, it remains high if expressed as a proportion of GNI* or using other metrics.

While the overall fiscal outlook is positive, tax revenues face downside risk. Tax receipts have recovered from their crisis trough, also thanks to record years for corporate income tax revenues. These amounted to EUR 8.2 billion in 2017, an increase of 11.5% compared to 2016.([24]) Corporate income tax now represents 16.2% of exchequer tax receipts, compared to an average of 13.4% since 2012 (see Graph 3.1). However, it is possible that the corporate income tax revenues might not continue to increase at the same rate in the future. The latest data demonstrate that the substantial concentration of these tax revenues among a small number of large multinationals only increased in 2017. The US tax reform may encourage US firms

([18]) European Commission, Directorate-General for Economic and Financial Affairs (2018), Assessment of the 2018 Stability Programme for Ireland (https://ec.europa.eu/info/sites/info/files/economy-finance/07_ie_sp_assessment_0.pdf)

([19]) Stability Programme Update 2018 (https://www.finance.gov.ie/wp-content/uploads/2018/04/spu-final-final.pdf)

([20]) Reply of Minister of Finance and Public Expenditure and Reform to Irish Fiscal Advisory Council Fiscal Assessment Report, November 2017 (http://www.finance.gov.ie/wp-content/uploads/2017/12/171222-Reply-by-Minister-Donohoe-to-November-FAR-2017.pdf)

([21]) https://www.finance.gov.ie/updates/government-approves-drafting-of-rainy-day-fund-bill/

([22]) The intention is to transfer to the rainy day fund an initial tranche of EUR 1.5 billion from the Ireland Strategic Investment Fund.

([23]) Summer Economic Statement 2018 (https://www.finance.gov.ie/wp-content/uploads/2018/06/180619-Summer-Economic-Statement-2018.pdf)

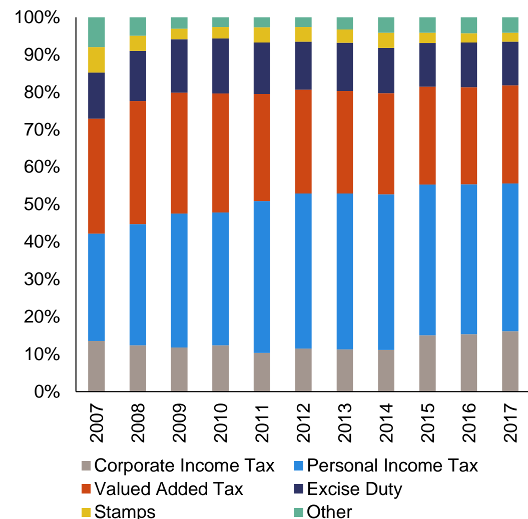
([24]) Revenue Commissioners (2018), *Corporation Tax 2017 Payments and 2016 Returns* (https://www.revenue.ie/en/corporate/documents/research/ct-analysis-2018.pdf)

to invest domestically rather than overseas. In addition, while stamp duty receipts to end of May 2018 are performing well year-on-year, medium term proceeds from the main revenue-raising measure in Budget 2018, a higher rate of stamp duty on non-residential property, may turn out lower than anticipated.

In view of the heightened external risks, reducing tax expenditures and broadening the tax base would be prudent. Reducing the number of tax expenditures and broadening the tax base could support the public finances in the event of a negative shock, while not distorting the efficient allocation of resources. It is less painful to revamp the tax system when the economy is experiencing an upswing. For example, while revenue from the VAT registered strong increases in the recent years, the latest Commission analysis of VAT gaps([25]) indicates that the already relatively high actionable policy gap([26]) has increased to 18.4%, above the EU average of 16.4%. Furthermore, the government has announced a review of the Local Property Tax to be advanced in 2018. Currently, the tax is based on residential property valuations in May 2013 even though average house prices have risen by almost 75% since then. The review could consider more regular revaluation of the base, which may broaden the tax base, while addressing the horizontal inequality issues embedded in the current system([27]). An analysis by the Economic and Social Research Institute concludes that an equalisation of the excise rate of diesel up to the current rate for petrol would provide a revenue boost to the exchequer, while reducing fuel consumption and vehicle-related emissions.([28]) Although a possible vacant property tax can also potentially broaden the tax base, its stated objective would be to increase the supply of homes for rent or purchase to meet demand, rather than increasing tax revenues.([29])

The National Development Plan entails further increases in public investment. In February 2018, the government launched a EUR 116 billion, ten-year capital investment plan (National Development Plan), aiming at removing infrastructure bottlenecks. This is central to balanced and sustainable growth, provided it delivers the gradual increase in public investment consistent with sustainable fiscal policy.

Graph 3.1: Tax revenue contributions (as % of the total tax)



Source: Department of Public Expenditure and Reforms (Databank)

The government has recently announced major changes to the pension system. According to the *Roadmap for Pensions Reform 2018-2023*, the measures aim at greater flexibility to work beyond "what may be considered the traditional retirement age of 65".([30]) Others include introducing a "total contributions approach" to replace the current "average contributions test" for the state contributory pension from 2020 onwards. Total accrued-to-date liabilities of occupational pension schemes in Ireland were estimated at EUR 436.3 billion or 252% of GNI* at the end of 2015. State

([25]) European Commission (2017), *Study and Reports on the VAT Gap in the EU-28 Member States* (https://ec.europa.eu/taxation_customs/sites/taxation/files/study_and_reports_on_the_vat_gap_2017.pdf)
([26]) Where the loss of theoretical revenue depends on the decision of policymakers.
([27]) As the values of properties that were of similar value may have changed since 2013.
([28]) Morgenroth et al. (2018), *The Environmental Impact of Fiscal Instruments* (http://www.esri.ie/pubs/BKMNEXT351.pdf)
([29]) https://www.finance.gov.ie/updates/invitation-to-make-a-submission-to-public-consultation-on-review-of-issues-re-possible-introduction-of-a-vacant-property-tax/
([30]) Roadmap for Pensions Reform 2018-2023 (https://m.welfare.ie/en/pressoffice/pdf/PensionsRoadmap.pdf)

pension schemes equated to 53% of the total liability or EUR 231 billion.([31]) While Ireland's liability as a share of GDP may be low compared to other countries, a timely implementation of the presented roadmap for pension reform is imperative for strengthening the fiscal sustainability of the Irish pension system.

3.2. FINANCIAL SECTOR POLICIES

Authorities should finalise initiatives that aim to address the social and economic impacts of the NPL workout process while taking account of unintended consequences. Introduced for discussion in Parliament on 22 February 2018, the draft Consumer Protection (Regulation of Credit Servicing Firms) (Amendment) Bill 2018 aims to expand the scope of the consumer protection framework. In finalising this legislative initiative, the authorities should avoid introducing any legal uncertainties or undue obstacles to secondary market sales, ensuring that the same consumer protection rules are applicable to loan purchasers, servicers, and originators, i.e. credit institutions.([32]) Another recently proposed relevant initiative is the draft Mortgage Arrears Resolution (Family Home) Bill 2017. Introduced for discussion in July 2017, the bill builds on the Personal Insolvency Act of 2012 by setting up a new agency within the Insolvency Service, the Mortgage Resolution Office, to administer restructuring solutions, including write-offs, for qualifying applications.([33]) While maintaining all restructuring options, including debt relief, as viable options could be an important driver of comprehensive NPL reduction, authorities should refrain from blanket solutions and remain within the existing insolvency framework to maintain legal certainty.([34]) Lastly, concerns remain that a third draft bill enabling the Central Bank of Ireland (CBI) to cap interest rates on variable rate mortgages, if enacted, could have negative implications for the transmission of monetary policy, financial stability and bank competition.

It is too soon to tell whether the revised mortgage-to-rent scheme will have a significant impact on reducing long-term arrears. Several major banks have entered into agreements with approved housing associations to offer qualifying borrowers the option to convert their mortgage to a long-term rental contract. Under the enhanced mortgage-to-rent scheme, only borrowers that qualify for social housing and living in homes whose values are below a pre-determined threshold are eligible. Despite increased interest, the number of cases that were finalised remains limited, but may grow as banks turn to alternative ways to resolve their NPLs.

Activity in personal insolvency proceedings continues to grow. Since the launch of the *Abhaile* Aid and Advice scheme for distressed mortgage borrowers in the second half of 2016, the number of applications for personal insolvency has visibly increased, albeit from a low base. The total number of applications in 2017 was 4 626, which was 39% higher than the total number of applications in 2016, mostly due to the relative success of the *Abhaile* scheme. However, the number of debtors entering into an arrangement with their lender was 1 115, which was 13% lower than in 2016. Similarly, the number of bankruptcy cases has also declined to 473, which was 10% less than in 2016. Both developments put into question the effectiveness of the latest efforts. In many cases, the insolvency arrangements proposed by the personal insolvency practitioners, who act as an intermediary between the lender and the borrower, were rejected by the former. Authorities have put in place a court-based review process that could be initiated by the borrower to assess whether the rejections were well grounded, which is currently under review in an attempt to streamline the process.

([31]) Central Statistics Office (2018), *Press Statement Estimates of Irish Pension Liabilities 2015* (https://www.cso.ie/en/csolatestnews/pressreleases/2018pressreleases/pressstatementestimatesofirishpensionliabilities2015/)

([32]) The principle of maintaining a level-playing field between loan purchasers, servicers and originators is also a crucial provision of European Commission's recent proposal for a directive on credit servicers, credit purchasers and the recovery of collateral, COM(2018)135.

([33]) According to draft text, only applications made by families whose disposable incomes, non-essential assets and total personal debts are below a pre-ordained level will be considered.

([34]) In its March 2018 legal opinion, (CON/2018/13), the ECB has remarked that the bill was not subject to an impact assessment and highlighted that while debt forgiveness could be appropriate in specific cases, it should not be used as a blanket solution.

Despite some variability, Irish banks are expected to reach their minimum requirements for own funds and eligible liabilities (MREL) without major problems. The MREL amounts were set by the Single Resolution Board (SRB) in late 2017 and early 2018. With total capital positions close to or exceeding 20%, most Irish banks will have little difficulty in issuing the necessary amounts. However, the cost of raising the amounts could prove costly for banks with high NPL ratios, which once again highlights the importance of a comprehensive NPL reduction strategy.

The impact of the IFRS 9 accounting rules has been manageable so far. Partly owing to improving real estate prices, the impact of the phased-in introduction of the IFRS 9 rules has been quite benign on most banks. In some cases, the combination of the introduction of the IFRS 9 and enhanced supervisory focus on impairment policies has led to additional provisioning charges, especially concerning "split mortgages".([35])

Implementation of the central credit register progresses as planned. Following public awareness campaigns, enquiries from borrowers and lenders have commenced in March 2018. Lenders will be obliged to consult the register for each loan application for EUR 2000 or more starting from end-September 2018.

The government continues to facilitate SMEs' access to credit through numerous initiatives. In preparation for possible negative implications of the UK's decision to leave the EU, the Irish government announced in October 2017 a scheme of loans up to EUR 300 million to help SMEs meet their short-term working capital needs. Separately, a further EUR 25 million was allocated to provide loans for the agri-food industry in anticipation of UK withdrawal. These funding tools may help offset a downturn in specific sectors exposed to the UK, in particular in the farming and livestock industries.

The Irish banks have provided redress to almost all borrowers identified in the Tracker Mortgage Examination. In 2015, the CBI initiated a systemic examination of borrowers that were wrongfully taken off a tracker rate([36]) or received an incorrect margin on the tracker. As of March 2018, 37 100 customers have been identified as being impacted across several lenders. Around 88% of these customers have received some form of redress.

Authorities should continue to monitor potential risks from the heavy presence of non-bank financial institutions. Ireland is one of the jurisdictions with a large presence of non-banks, mostly investment funds. A substantial proportion of these funds only conduct their administration activities in Ireland, with much of the financial exposures and day-to-day investment decision-making made in other jurisdictions, most notably in the UK. Ireland has been an attractive jurisdiction due to its low-tax regime and its common law system, which draws UK and US parents or those wishing to interact with those systems. In light of the heightened external economic risks, including those linked to the UK's decision to leave the EU, it is important for the authorities to keep monitoring any new developments in this sector. It is also important to continue collaborative work in the international fora to identify any data gaps that may hide risks.

3.3. PROPERTY MARKET AND CONSTRUCTION

While the labour market is recovering fast, skills shortages in key construction trades are a concern. With employment in the construction sector on the rise since the second quarter of 2013 skill shortages are emerging across all construction trades.([37]) According to the CBI, a large proportion of construction workers who lost their jobs during

([35]) "Split mortgages" are divided into a "main component" for which the borrower continues to make payments, and a "warehoused component", for which a partial payment may be due at maturity. The treatment of the warehoused part, and in particular the extent of write-offs or provisioning for that amount, has received increased supervisory scrutiny in recent months. According to latest data from CBI, these solutions have become quite popular over the past few years, representing up to 15% of all restructured loans.

([36]) A tracker loan consists of a variable rate loan, which tracks a publicly available rate, typically the European Central Bank's main borrowing rate, plus a margin. In turn, a standard variable rate loan is a loan where the interest rate is set by the issuing bank, usually in relation to the bank's funding costs.

([37]) DHPLG (2018) *Review of Delivery Costs and Viability for affordable Residential Developments*. Department of Housing, Planning and Local Government; DIT (2018) *Trades and Apprenticeships Skills Survey.* Dublin Institute of Technology; and DKM (2017) *Demand for Skills in Construction 2020.*

the crisis are likely to have emigrated.([38]) Combined with the low numbers entering construction-related education since 2008, this could explain the significant shortfall in labour. In the short term, the construction sector could innovate to increase its productivity while becoming less dependent on labour input through for instance the increased utilisation of prefabrication methods.([39]) The announced investments in enterprise, innovation and skills under the National Development Plan and the engagement of the Department of Education and Skills and SOLAS (Further Education and Skills Service) with industry in order to look for solutions could help tackle skill shortages in the long-term.

Viability of residential developments is challenging. The review of delivery costs and viability for affordable residential developments published by the government in April 2018 showed that urban residential apartment schemes are often not viable. A higher ratio of 1 to 2 bed units and an apparent optimum height of 6 storeys([40]) would help increase viability. Suburban affordable housing development is marginally viable. Requirements for public open space much above 10% of the total site area reduce viability especially in areas where land is expensive or scarce. Resorting to duplex units could increase volume delivery and help improve viability.

New apartment guidelines could give housing supply a boost. Updated guidelines for planning authorities on design standards for new apartments were published in March 2018. They might help reduce construction costs by 3 to 15% ([41]), depending on the nature of the apartment development. Building height will be subject to separate guidance. The Housing Minister announced early in May that height restrictions would be removed in July for new city buildings. Some developers may be waiting until then to start construction, temporarily slowing down the recovery of housing supply.

It is important to bridge the gap between supply and demand for residentially zoned land so as to reduce market volatility and housing delivery costs. According to the Society of Chartered Surveyors Ireland (SCSI)([42]), there has been sustained growth in the demand and value of development land in 2017. The value of the residential development land increased by 14%, with Dublin and the rest of Ireland displaying similar trends. This is almost 2 percentage points above residential property price inflation. The SCSI expects that demand for adequately serviced development land will outstrip supply in 2018. This may continue fuelling development land inflation. There is limited data regularly available on residential and commercial development land prices and transaction volumes. Collecting these data would help in monitoring the effect of the new apartment design standards on land inflation as well as the influence of recent policy reforms such as the vacant site levy or the Budget 2018 changes in the capital gains tax on reducing land hoarding.

The effective implementation of the National Development Plan could help remove the infrastructure constraints currently limiting the supply of housing. Under this plan, EUR 14.5 billion will be provided for investment in housing and sustainable urban development. Around 80% of these investments will support the provision of 112 000 social housing homes by 2027. The remaining funds are allocated to an Urban and a Rural Regeneration and Development Fund that will promote co-ordinated public and private investments. The identification and best use of public land is crucial to increase land supply. This will be supported by the creation of the National Regeneration and Development Agency.

A fast-track Strategic Housing Development process for large-scale housing and student accommodation schemes was set-up in July 2017. Applications for large-scale developments are now sent directly to the *An Bord Pleanála*, bypassing local authorities. The well-functioning

([38]) CBI (2018) Where are Ireland's Construction Workers?. Quarterly Bulleting/April 2018. Central Bank of Ireland.

([39]) DHPLG (2018) Review of Delivery Costs and Viability for affordable Residential Developments. Department of Housing, Planning and Local Government.

([40]) Higher rise development can be more expensive due to the increased requirements from a structural and fire safety perspective.

([41]) DHPLG (2018) Cost Analysis of the Updated "Sustainable Urban Housing: Design Standards for New Apartments, Guidelines for Planning Authorities". Department of Housing, Planning and Local Government.

([42]) SCSI (2018) Annual Commercial Property Review & Outlook 2018

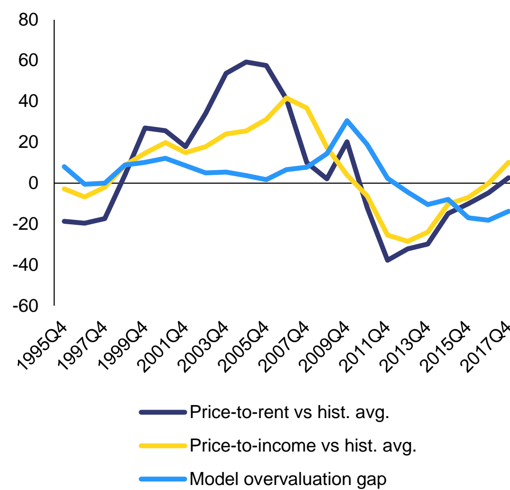
of this new time-bound planning approval process is crucial to more rapidly bring about the supply of new homes and reduce financial costs for housing construction. The assignment of sufficient staff with the right skills to the *An Bord Pleanála* is important to ensure the effectiveness of the process.

A prudent and robust selection framework under the upcoming *Home Building Finance Ireland* Bill will help ensure its effectiveness. The legal drafting of the *Home Building Finance Ireland* Bill started in January 2018. It aims at increasing the availability of debt funding to commercially viable residential development projects. Up to EUR 750 million of the Ireland Strategic Investment Fund will be made available for the establishment of this fund. It would be important that this scheme defines a robust and prudent methodology to assess project viability so as to help reduce risks to public finances. Moreover, this scheme should not displace funding already in the market but target developers with limited access to bank loans.

Certain house price indicators have exceeded their long-term average. Regression-based equilibrium price indicators indicate that house prices were still below their fundamental levels in 2017 (see Graph 3.3). Other indicators, such as the price-to-income (affordability), although with large regional discrepancies, or the price-to-rent indicator, now exceed their long-term averages.

Demand-side measures should remain limited in scope so as to prevent their potential inflationary effects. In February 2018, the government launched the *Rebuilding Ireland Home Loan* scheme. Through this scheme local authorities can provide mortgages to first time buyers (FTB) at a reduced interest rate. This scheme can circumvent Central Bank Loan-to-Income limits([43]). FTBs of new homes can also apply for the 5% tax rebate available under the *Help-to-Buy* scheme, which could increase the latter's take-up. The funds allocated to the *Rebuilding Ireland Home Loan* scheme (EUR 200 million over three years) only amounted to around 4% of the FTB's mortgage loans approved in Ireland in 2017, limiting the inflationary impact on the housing market and the risks for public finances. It would be important that both the *Rebuilding Ireland Home Loan* and *Help-to-Buy* schemes remain limited in scope so as to avoid that the gap between supply and demand widens, putting further upward pressure on prices.

Graph 3.2: **Overvaluation gap with respect to price/income, price/rent and fundamental model valuation gaps**



Source: European Commission

Property investment remains strong. The volume of real estate transactions amounted to over EUR 930 million in the first quarter of 2018, almost twice as much as for the same period in 2017. The increase could be partly due to the reduction of the capital gains tax holding period from 7 to 4 years as of 1 January 2018. Around 63% of the transactions corresponded to overseas investment. Dublin has continued to stand out as the most popular location, attracting 74% of the total investments. Office was the dominant sector accounting for 53% of the total sales while the mixed-use and private rented sectors accounted respectively for 22% and 14% of total sales volumes([44]). Some real estate advisers estimate

([43]) First time buyers with a maximum gross income of EUR 50 000 (single) or EUR 75 000 (couple) can borrow up to 90% of the market value of a property. The maximum market value can go up to EUR 320 000 in some areas therefore the maximum loan could amount to EUR 288 000, i.e. 3.84 times the income of a couple and 5.76 times the one of a single person.

([44]) JLL (2018), Ireland Investment Market Report-Q1 2018 (http://www.jll.ie/ireland/en-ie/research/193/ireland-investment-market-report-q1-2018).

that demand for built-to-rent and purpose built student accommodation heightens in 2018.([45])

Irish commercial property returns have increased, absorbing the effect of the stamp duty changes.([46]) The increase in the stamp duty rate on the sale of commercial property from 2% to 6% took effect on 10 October 2017. The Irish commercial property returns increased by 4.1% in the last two quarters to March and by 10.7% year-on-year. This annual increase is approximately one percentage point lower than the equivalent level recorded one year earlier.

([45]) QRE (2017) QRE 2017 Investment Market Review (http://qre.ie/docs/investment-market-in-review-2017.pdf 0), JLL (2018), Ireland Investment Market Report-Q1 2018 (http://www.jll.ie/ireland/en-ie/research/193/ireland-investment-market-report-q1-2018).

([46]) JLL (2018) JLL Irish Property Index- Q1 2018 (http://www.jll.ie/ireland/en-ie/research/194/jll-irish-property-index-q1-2018).

4. SOVEREIGN FINANCING ISSUES

The state has considerable cash and liquid asset buffers. The sovereign held EUR 20.2 billion in cash and other liquid assets at the end of April 2018. Around EUR 9.6 billion of government bonds are due to mature in 2018 (Graph 4.1). National Treasury Management Agency's (NTMA) prudence in raising cash ahead of larger redemptions in 2019 (EUR 14.8 billion) and 2020 (EUR 19.5 billion) is a sensible strategy. The early repayment of loans to the IMF, Denmark and Sweden and buy-backs of floating rate notes, issued in 2013 to replace the Irish Bank Resolution Corporation promissory notes held by the Central Bank of Ireland, are expected to reduce refinancing risk and to simplify the product mix.

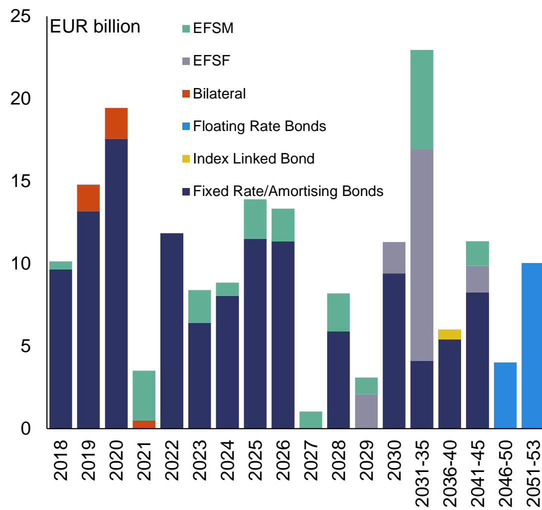
The issuance level in 2018 is to be similar to 2017. The NTMA raised around EUR 17 billion in 2017. It began its 2018 annual financing drive by selling EUR 4 billion of syndicated 10-year bonds in January, covering around a quarter of its sovereign funding target for 2018 just three days into the year. It further moved more than halfway to its target of EUR 14-18 billion by May. The recent issuance has attracted considerable demand, with the yield on the latest issued bonds maturing in 2028 at 0.958%. This signals sustained market confidence in the sovereign.

Future market conditions may be impacted by monetary policy developments. ECB actions, in particular through the non-standard asset purchase programmes, have compressed sovereign borrowing costs. As the current strong monetary policy accommodation will eventually unwind and interest rates would rise, this will increase the sovereign financing costs. However, more than two thirds of Ireland's long-term marketable debt consists of fixed rate treasury and amortising bonds. This supports public debt sustainability.

The repayment risks for EFSM and EFSF loans remain low. The average maturity of Irish public debt compares favourably to other European countries, with a weighted maturity of government debt securities slightly above 10 years. More than 40% of long-term debt (including loans) matures after 2027, and the general government debt-to-GDP ratio is forecast to continue to decline. Redemptions of EFSF and EFSM loans currently extend until 2042. For EFSF, there are no maturities until 2029. The 2018-2026 EFSM maturities are subject to a lengthening option. In June 2018, the Commission adopted a Decision([47]) for the EU to borrow in order to extend the maturities of loans to Ireland under EFSM. This will allow for the maturity of EFSM loans to Ireland, including EUR 3.9 billion originally due in 2018 (of which EUR 3.4 billion were due in April and EUR 500 million in October) to be extended, within the limit of 19.5 years of average maturity established by the Council Decision on Union financial assistance to Ireland([48]). It is therefore not expected that Ireland will actually have to repay any of its EFSF and EFSM loans before 2027. This Decision and the ensuing operations entail financial benefits for Ireland, linked to the EU's favourable funding conditions. While Ireland has good access to financial markets, the maturity extensions of EFSM loans offer savings in debt service costs and provide an opportunity to further smoothen and extend its debt maturity profiles. This decision contributes to continued prudent debt management by Ireland and the enhanced debt sustainability outlook sends a positive signal to financial markets.

([47]) Commission Decision C(2018)3786
([48]) Council Implementing Decision 2011/77/EU

Graph 4.1: **Maturity profile of long-term marketable and official debt (end-May 2018)**



(1) Bilateral loans were provided from the United Kingdom
(2) EFSF loans reflect the maturity extensions agreed in June 2013. EFSM loans are also subject to a seven year extension. It is not expected that Ireland will have to refinance any of its EFSM loans before 2027. However the revised maturity dates of individual EFSM loans will only be determined as they approach their original maturity dates.
(3) While the principal repayment of the index-linked bond will be linked to the Eurostat Harmonised Index of Consumer Prices for Ireland, excluding tobacco, it is protected against a fall in the index over the life of the bond.
Source: National Treasury Management Agency, NTMA

Table 4.1: **Government financing plans (April 2018)**

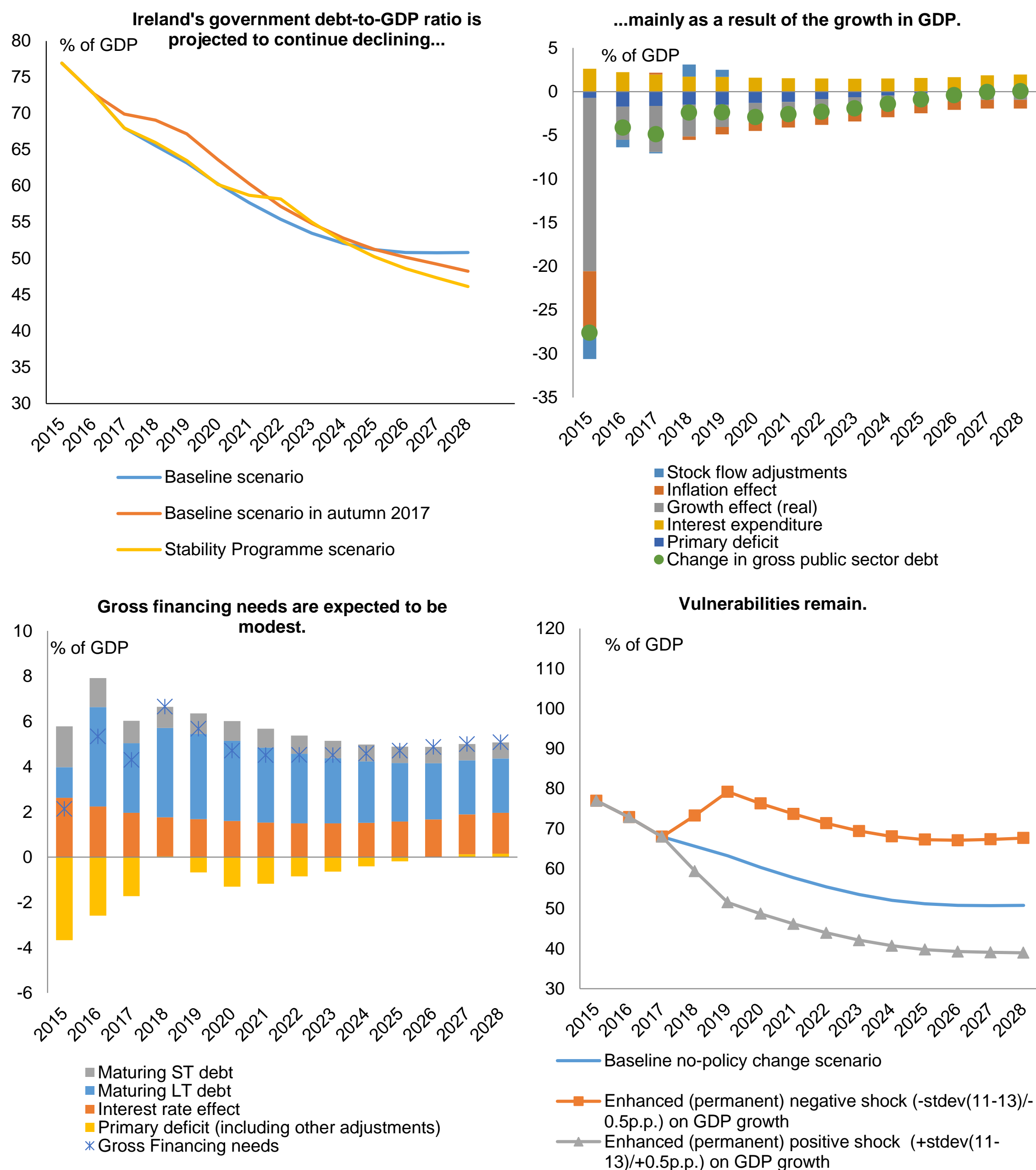
EUR billion	**2017**	**2018**
Funding requirement		
Exchequer borrowing requirement (EBR) (1)	-1.9	1.5
Bond maturities (2)	6.2	8.9
EU/IMF Programme loans (3)	5.4	0.0
Other bond flows (4)	6.7	2.0
Other (5)	0.7	3.3
Total requirement	**17.1**	**15.7**
Funding sources		
Government bonds (6)	17.0	16.0
Other (7)	2.0	2.2
Use of cash & other short-term investment balances (- represents an increase)	-1.9	-2.5
Total sources	17.1	15.7
Financial buffer (8)	**10.5**	**13.0**

2017 figures are provisional outturns, subject to revision. 2018 figures are estimates, as of April 2018. Rounding may affect totals.

(1) 2017 EBR includes proceeds from AIB share sale; 2018 estimate as per SPU 2018.
(2) Includes Amortising Bonds.
(3) Early repayment of residual IMF loan facility and Swedish/Danish bilateral loans in 2017; includes hedging related flows.
(4) 2017 includes bond (including FRN) buy-backs/switching; 2018 reflects bond (including FRN) buy-backs/switching in Q1.
(5) 2018 figure includes general contingencies and provisions for potential further bond buy-backs/switching.
(6) In its 2018 Funding Statement, the NTMA announced plans to issue €14 - €18bn of Government bonds in 2018. €16bn is used as an indicative amount in this presentation.
(7) Includes net State Savings (Retail), net short-term paper funding and other Medium/Long-Term funding.
(8) Exchequer cash and liquid assets. Excludes non-liquid financial assets.
Source: European Commission

ANNEX 1
Debt sustainability analysis

Graph A1.1: **Debt sustainability analysis**



(1) Baseline scenario: assumes forecasts for the forecast years, no policy change afterwards, with a structural primary balance kept constant at last forecast year (cyclical effects until closure of output gap estimated using standard budgetary semi- elasticity). Costs of ageing are included.
(2) The Stability Programme scenario: built under Stability Programme assumptions for main macro-fiscal variables and unchanged fiscal policy after Programme horizon.
(3) Enhanced sensitivity tests on real GDP growth: assumes -1 standard deviation/+1 standard deviation on real GDP growth for first 2 projection years, followed by -0.5/+0.5 p.p. over remaining of projection period. The shock is symmetrically applied to actual and potential GDP growth, so that the output gap remains unchanged. The cyclical component of the balance is therefore not affected by these shocks to growth.
(4) Details of the gross financing needs projections can be found in European Commission (2018), 'Debt Sustainability Monitor 2017' Directorate-General for Economic and Financial Affairs, European Economy, Institutional Paper 071/2018.
Source: European Commission

Ireland's government debt-to-GDP ratio is projected to continue declining. In 2017, the debt-to-GDP ratio dropped by 4.8 pps to 68.0%. High nominal GDP growth, a decrease in the headline deficit and asset operations, including use of income from the sale of government's shares in the state-owned-banks, contributed to the drop. Based on Commission 2018 spring forecast and a no-fiscal-policy-change scenario beyond the forecast horizon, it is expected to decrease to 50.8% in 2028, thus also falling below the 60% of GDP Treaty threshold. Overall, this highlights low public debt sustainability risks for Ireland in the medium term. However, the stock of public debt remains high and is planned to increase by EUR 10.1 billion over the period 2017-2021. The full implementation of the Stability Programme would put debt on a more clearly decreasing path, reaching 46.1% of GDP in 2028. Recognising the improved fundamentals, Ireland currently benefits from creditor confidence. Contingent liabilities fell from 5.3% of GDP in 2015 to 0.9% of GDP in 2017. ([49]) The debt projections do not include potential sales of equity shares in a number of financial institutions. During the mission, the government confirmed its policy not to hold these investments long-term and that, subject to market conditions, it is willing to exit in a manner that generates value for the taxpayer. The total expected value of state bank investment to be recovered was estimated at around EUR 31.1 billion at the end of 2017.

Gross funding needs are expected to be modest. This reflects the relatively long maturity of public debt, the government's fiscal stance, as well as high nominal GDP growth. Ireland's gross financing needs are estimated to average at around 5% of GDP over 2018-2028, with a peak below 7% in 2018.

Debt dynamics remain vulnerable to economic shocks. Ireland's economy is highly open and relatively concentrated in a small number of sectors. Combined with the still high level of public debt, this makes government debt projections very sensitive to variations in economic conditions. According to the Commission's debt sustainability analysis, adverse shocks to real GDP growth — of a magnitude reflecting the country's historical variability of output ([50]) — would increase the public debt-to-GDP ratio by 16.8 pps by 2028 compared to the baseline scenario, to about 67.6%.

([49]) Stability Programme Update 2018 (https://www.finance.gov.ie/wp-content/uploads/2018/04/spu-final-final.pdf)

([50]) The negative enhanced sensitivity test on real GDP is designed based on a one standard deviation reduction in real GDP growth for the first two projection years. Afterwards, -0.5/+0.5 pp. permanent shocks on GDP growth would be applied until the end of the projection period.

ANNEX 2
European Commission Macroeconomic and Fiscal projections

Table A2.1: **Fiscal accounts (based on 2018 spring forecast)**

	2013	2014	2015	2016	2017	2018	2019
			% of GDP				
Indirect taxes	10.7	10.9	8.6	8.5	8.2	8.0	8.0
Direct taxes	12.7	12.8	10.6	10.5	10.4	10.4	10.5
Social contributions	5.8	5.6	4.3	4.4	4.3	4.2	4.1
Sales	2.7	2.5	2.0	2.0	1.9	1.7	1.6
Other current revenue	1.9	1.7	1.1	0.7	0.7	0.5	0.4
Total current revenue	**33.8**	**33.5**	**26.8**	**26.1**	**25.5**	**24.9**	**24.6**
Capital transfers received	0.2	0.2	0.1	0.3	0.1	0.1	0.1
Total revenue	**34.0**	**33.8**	**26.9**	**26.5**	**25.6**	**25.0**	**24.7**
Compensation of employees	10.3	9.4	7.2	7.1	7.0	6.8	6.7
Intermediate consumption	4.5	4.6	3.5	3.5	3.3	3.4	3.4
Social transfers in kind via market producers	2.8	2.6	2.1	2.1	2.0	1.9	1.8
Social transfers other than in kind	13.1	11.8	8.8	8.3	7.7	7.3	6.9
Interest paid	4.3	3.9	2.6	2.2	2.0	1.7	1.7
Subsidies	1.1	1.0	0.7	0.6	0.6	0.6	0.6
Other current expenditure	1.6	1.4	1.0	1.1	1.1	1.0	1.1
Total current expenditure	**37.7**	**34.7**	**25.9**	**24.8**	**23.7**	**22.8**	**22.2**
Gross fixed capital formation	2.0	2.2	1.7	1.8	1.9	2.1	2.4
Other capital expenditure	0.6	0.6	1.3	0.5	0.5	0.4	0.4
Total expenditure	**40.2**	**37.6**	**28.9**	**27.1**	**26.1**	**25.4**	**25.0**
General government balance	**-3.6**	**-1.9**	**-0.5**	**-0.3**	**-0.2**	**-0.2**	**0.0**
Underlying government balance (EDP)	**-3.5**	**-1.1**	**-0.7**	**-0.3**	**-0.2**	**-0.2**	**0.0**
			EUR billion				
Indirect taxes	19.3	21.2	22.5	23.4	24.4	25.3	26.5
Direct taxes	22.9	24.9	27.9	29.1	30.8	32.9	34.8
Social contributions	10.4	11.0	11.4	12.0	12.6	13.1	13.5
Sales	4.9	4.8	5.4	5.4	5.5	5.5	5.5
Other current revenue	3.4	3.3	3.0	2.1	2.0	1.7	1.4
Total current revenue	**60.9**	**65.3**	**70.2**	**72.0**	**75.4**	**78.5**	**81.7**
Capital transfers received	0.3	0.6	0.3	0.3	0.4	0.3	0.9
Total revenue	**61.5**	**66.0**	**70.9**	**73.4**	**76.2**	**79.3**	**82.6**
Compensation of employees	18.6	18.4	19.0	19.5	20.7	21.6	22.3
Intermediate consumption	8.2	8.9	9.2	9.5	9.8	10.8	11.2
Social transfers in kind via market producers	5.0	5.1	5.4	5.7	6.0	6.0	6.1
Social transfers other than in kind	23.5	23.0	23.0	22.7	22.9	22.9	23.0
Interest paid	7.8	7.6	6.8	6.2	5.8	5.4	5.6
Subsidies	1.9	1.9	1.7	1.7	1.8	1.8	1.8
Other current expenditure	2.9	2.8	2.5	3.0	3.1	3.3	3.8
Total current expenditure	**67.9**	**67.6**	**67.8**	**68.3**	**70.2**	**71.9**	**73.8**
Gross fixed capital formation	3.5	4.2	4.6	5.1	5.5	6.8	8.0
Other capital expenditure	1.1	1.2	3.5	1.5	1.5	1.4	1.4
Total expenditure	**72.5**	**73.1**	**75.8**	**74.8**	**77.2**	**80.1**	**83.2**
General government balance	**-7.1**	**-5.0**	**-1.4**	**-1.0**	**-0.8**	**-0.6**	**0.0**
Deficit-increasing financial sector measures	0.44	0.01	-1.83	-0.02	-0.24	0.00	0.00
Underlying government balance (EDP)	**-6.4**	**-2.1**	**-1.7**	**-0.9**	**-0.7**	**-0.6**	**0.0**

Source: European Commission

Table A2.2: **General Government debt projections (based on 2018 spring forecast)**

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Government deficit (% of GDP)	**12.7**	**8.0**	**6.1**	**3.7**	**1.9**	**0.7**	**0.4**	**0.2**	**0.2**
Government gross debt (% of GDP)	110.3	119.6	119.4	104.5	76.9	72.8	68.0	65.6	63.2
	levels, EUR billion								
Government deficit	**14.1**	**11.0**	**7.1**	**5.0**	**1.4**	**1.0**	**0.8**	**0.6**	**0.0**
Gross debt	189.7	210.0	215.3	203.4	201.6	200.7	201.3	206.4	209.8
Change in gross debt	45.5	20.3	5.3	-12.0	-1.7	-0.9	0.6	5.2	3.3
Nominal GDP	171.9	175.6	180.3	194.5	262.0	275.6	296.2	314.9	332.0
Real GDP	172.6	172.6	175.5	190.1	238.7	250.9	270.5	285.9	297.5
Real GDP growth (% change)	**3.0**	**0.0**	**1.6**	**8.3**	**25.6**	**5.1**	**7.8**	**5.7**	**4.1**
Change in gross debt (% of GDP)	24.3	9.3	-0.2	-14.9	-27.6	-4.1	-4.9	-2.4	-2.4
Stock-flow adjustments (% of GDP)	13.7	3.5	-3.2	-9.8	-2.6	-1.1	-0.2	1.4	0.8
	% of GDP								
Gross debt ratio	**110.3**	**119.6**	**119.4**	**104.5**	**76.9**	**72.8**	**68.0**	**65.6**	**63.2**
Change in gross debt ratio	24.3	9.3	-0.2	-14.9	-27.6	-4.1	-4.9	-2.4	-2.4
	Contribution to change in gross debt								
Primary balance	-16.1	-6.8	-3.2	0.5	1.9	4.7	4.8	4.7	5.0
"Snow-ball" effect*	-0.5	-2.3	1.2	-4.8	-24.3	-1.5	-1.7	-1.6	-1.2
of which									
Interest expenditure	*2.5*	*0.0*	*4.3*	*3.9*	*2.6*	*2.2*	*2.0*	*1.7*	*1.7*
Real growth effect	*0.0*	*0.0*	*-1.9*	*-9.2*	*-19.8*	*-3.8*	*-3.3*	*-2.6*	*-2.0*
Inflation effect	*-3.0*	*-2.2*	*-1.2*	*0.5*	*-7.1*	*0.0*	*-0.3*	*-0.8*	*-0.9*
Stock-flow adjustments	**13.7**	**3.5**	**-3.2**	**-9.8**	**-2.6**	**-1.1**	**-0.2**	**1.4**	**0.8**
Implicit interest rate	*4.0*	*3.8*	*3.7*	*3.5*	*3.4*	*3.1*	*2.9*	*2.7*	*2.7*

(1) The projections assume no borrowing for precautionary contingencies foreseen in the programme's financing plan. Stock-flow adjustments include a reduction in cash balances from around 14% of GDP at end-2013 to around 4% by end-2016 and other and other financial transactions.
*"Snow-ball" effect, Interest expenditure, Real growth effect and Inflation effect are derived from the Debt sustainability monitor update
Source: European Commission

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