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Post-Programme Surveillance Report

Ireland, Spring 2021

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EUROPEAN ECONOMY

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Directorate-General for Economic and Financial Affairs

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This report reflects information available and policy developments that have taken place until 15 April 2021. However, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2021 spring forecast released on 12 May 2021 (with cut-off date 30 April 2021).

([1]) The report was adopted as Commission Communication C(2021)3947 on 2 June 2021, accompanied by a Staff Working Document (SWD(2021)126).

([2]) ECB Staff participated in this mission, and in the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

ABBREVIATIONS

CBI	Central Bank of Ireland
CBRE	Coldwell Banker Richard Ellis
CCyB	Countercyclical capital buffer
CET1	Common Equity Tier 1
CRE	Commercial Real Estate
CSO	Central Statistics Office Ireland
EBA	European Banking Authority
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ESM	European Stability Mechanism
EWSS	Employee Wage Subsidy Scheme
GDP	Gross Domestic Product
GNI*	Modified Gross National Income
HICP	Harmonised Index of Consumer Prices
NFC	Non-financial corporation
NPL	Non-performing loan
NTMA	National Treasury Management Agency
PPS	Post-programme surveillance
PUP	Pandemic Unemployment Payment
q-o-q	Quarter-on-quarter
RICS	Royal Institution of Chartered Surveyors
SCSI	Society Chartered Surveyors Ireland
SME	Small and medium sized enterprises
SURE	Support to mitigate Unemployment Risks in an Emergency
SyRB	Systemic Risk Buffers
TWSS	Temporary Wage Subsidy Scheme
VAT	Value Added Tax
y-o-y	Year-on-year

EXECUTIVE SUMMARY

The fourteenth post-programme surveillance (PPS) mission to Ireland was again conducted virtually due to the COVID-19 pandemic. It involved European Commission staff, in liaison with staff from the European Central Bank (ECB). Staff from the European Stability Mechanism (ESM) participated on aspects relating to the ESM's Early Warning System. The meetings took place from 22 to 25 March 2021, in the form of videoconferences.

The Irish economy grew in 2020 despite the pandemic due to the strong performance of multinational corporations headquartered in Ireland, and the economic outlook improved. Ireland recorded 3.4% real GDP growth in 2020 as multinational corporations, mostly those specialising in pharmaceuticals and medical equipment and those working in the area of information and telecommunication technologies, performed very well. At the same time, Ireland's domestic economy contracted. Various COVID-19 containment measures curtailed private consumption and discouraged investment. Public spending increased in a countercyclical manner, cushioning the economic and social fallout. The end of the transition period on 31 December 2020 following the UK's withdrawal from the European Union led to trade adjustments and disruptions for some Irish businesses. The pandemic forced the government to introduce a third strict lockdown in early 2021, again putting a high proportion of the labour force on public income support. However, recent economic indicators suggest that people and businesses have adjusted to some extent to a new normal and show that the economic contraction around the turn of the year was likely smaller than at the beginning of the pandemic. Progress in vaccine rollout, an expected decline in historically high household savings and a rapidly improving global economic environment pave the way for strong growth in the second half of 2021 and well into 2022.

The government response to the pandemic had an impact on the general government balance and debt. However, with a general government deficit of 5.0% of GDP, the fiscal outturn in 2020 has been more favourable than expected on the back of resilient revenue and positive GDP growth. A budget deficit is also expected in 2021 as the pandemic support continues. Risks to the fiscal outlook are tilted to the downside and reflect various sources of uncertainty: in the short-term, the speed of recovery from the pandemic and in the medium-term, possible changes in the international corporate taxation environment due to Ireland's significant reliance on potentially volatile corporate tax revenue.

The impact of the ongoing pandemic on the financial sector has been contained so far. The capital and liquidity positions of Irish banks remain strong. The ECB and Central Bank of Ireland have supported bank lending to the economy, while the Irish government's support to businesses and households in turn has mitigated the adverse impact of the pandemic on the financial system. The payment breaks that Irish banks granted to borrowers have almost all expired, with most borrowers resuming full repayments. At the same time, it is likely that some of the adverse effects of the pandemic will be delayed. In particular, they may materialise once general support measures are phased out. Losses faced by the financial system add to the existing profitability challenge, with the pandemic likely to partly undo the continued progress in reducing non-performing loans seen in recent years.

Risks for Ireland's capacity to service the European Financial Stability Mechanism (EFSM) and European Financial Stability Facility (EFSF) debt remain low. Financing conditions for the Irish sovereign are favourable and large cash balances provide flexibility. The debt-to-GDP ratio has risen only moderately despite the extra funding needed to fight the COVID-19 crisis, and the government projects a declining debt-to-GDP trajectory as of 2022. Refinancing needs are virtually absent in 2021, with no bond maturing before March 2022.

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1. INTRODUCTION

The 14th post-programme surveillance (PPS) report was prepared with special arrangements given the ongoing COVID-19 pandemic. Due to the spread of the virus and the related travel restrictions, the 14th PPS mission to Ireland was replaced by a set of videoconferences, which took place between 22 and 25 March 2021. They involved European Commission staff, in liaison with staff from the European Central Bank (ECB). Staff from the European Stability Mechanism (ESM) participated in the conference calls on aspects related to the ESM's Early Warning System. Under PPS, the Commission carries out regular review missions to EU Member States that previously had an EU-supported financial assistance programme. The objective of the PPS mission is to assess the Member States' economic, fiscal and financial situation to ensure that it maintains its capacity to service its debt to the European Financial Stabilisation Mechanism (EFSM), European Financial Stability Facility (EFSF) and bilateral lenders ([3]). 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 relevant committee of the European Parliament, the Economic and Financial Committee, and the Irish Parliament.

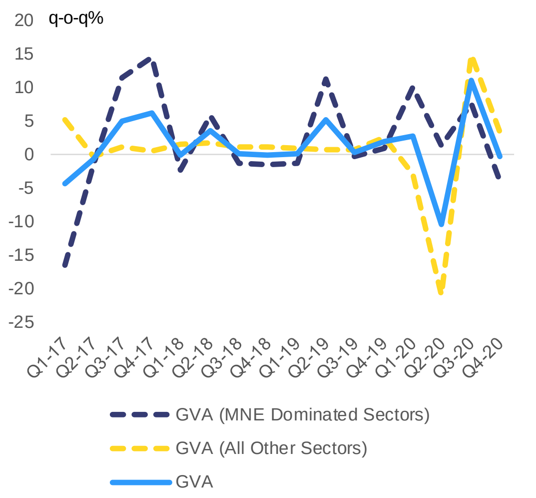
([3]) Ireland already repaid its outstanding bilateral loans from Denmark and Sweden, early and in full. On 26 March 2021, Ireland also completed the repayment of its outstanding bilateral loan from the UK. Under Regulation (EU) No 472/2013, PPS will continue until at least 75% of the financial assistance received under the programme has been repaid. Under the current repayment schedule, PPS will last until 2031.

2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1. MACROECONOMIC TRENDS

Ireland was the only country in the European Union that posted positive GDP growth in 2020. Its real GDP rose by 3.4%. The performance of multinational corporations headquartered in Ireland, particularly those producing pharmaceuticals and medical equipment and those providing information and telecommunication services, was behind this growth (see Graph 2.1). In 2020, multinationals accounted for about half of the value added created in the economy.

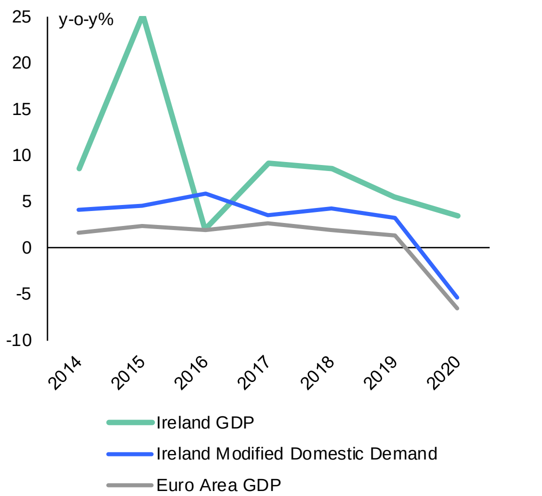
Graph 2.1: **Real gross value added**



Source: CSO

The domestic sector, however, was heavily affected by the pandemic and the associated containment measures. *Modified domestic demand*, a measure of domestic activity that strips out some of the effects of multinationals headquartered in Ireland, fell by 5.4% year-on-year (y-o-y) in 2020, to be more in line with economic developments in other European countries (see Graph 2.2). Private consumption and domestic investment both contracted by around 9%, while public spending rose by 9.8% and cushioned somewhat the economic fallout caused by the pandemic and lockdowns.

Graph 2.2: **Real GDP and modified domestic demand**

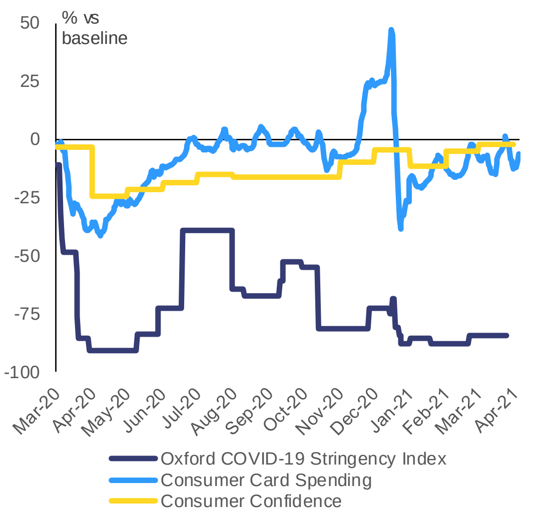


Source: Central Statistics Office (CSO)

The epidemiological development worsened the economic outlook for the first half of 2021. Ireland started the year with a third strict lockdown, as COVID-19 cases rose strongly after Christmas relaxations and more contagious variants of the virus started circulating in the country. The lockdown introduced early in 2021 included closure of schools, most shops and a ban on non-essential construction work. It was imposed throughout the first quarter and a gradual relaxation only started in April. The high stringency of the containment measures is set to affect economic activity substantially, though the impact might be smaller than during the first lockdown as people and businesses have somewhat adjusted to the 'new normal' with a lot of previous face-to-face activities now being conducted online. The early indicators for the first quarter of 2021 provide mixed signals: Central Bank of Ireland (CBI) credit and debit card usage data show a significant fall in spending during January and February, albeit smaller than during the first lockdown in 2020([4]), while consumer confidence indicators have improved as of March 2021, after a dip in January (see Graph 2.3).

([4]) https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/qb-archive/2021/quarterly-bulletin-q2-2021.pdf?sfvrsn=6

Graph 2.3: **Consumer card spending, confidence and stringency index**

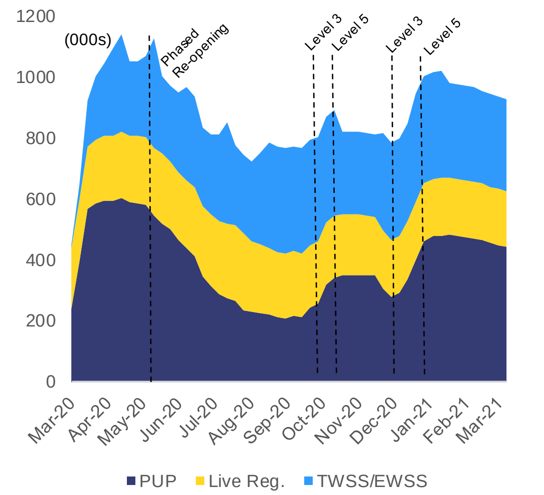


Source: Central Bank of Ireland (CBI), DG ECFIN, University of Oxford

For some firms, the hardship caused by the pandemic was compounded by the impact of the end of the transition period on 31 December 2020 following the United Kingdom's withdrawal from the EU. Trade between Ireland and the UK fell significantly in early 2021. This data has to be interpreted with caution as there was a substantial build-up of inventories in late 2020 to accommodate the forthcoming change of the trading relationship; only few data observations are yet available, and it is difficult to fully discern this impact from that of the pandemic restrictions. Nevertheless, Irish companies, particularly in the agrifood sector, reportedly experienced difficulties with new checks impeding the movement of goods.

The labour market took a heavy hit and the government intervened to cushion the impact. The closure of nearly all sectors requiring face-to-face contact implies that a large part of the labour force depends on Pandemic Unemployment Payments (PUP) or the Employment Wage Subsidy Scheme (EWSS) ([5]) (see graph 2.4). The difference of the official unemployment rate, at 5.8% in March, and a COVID-adjusted rate ([6]), at 24.2%, broadly reflects the scale of the state intervention. It is hoped that much of the currently suppressed activity can resume relatively easily once the pandemic is over, though progression may be uneven across sectors. With this prolonged inactivity, some scarring of the labour market seems inevitable. At the same time, however, there might be a spur in innovation and new business models may be created as existing ones were so deeply disrupted. The pandemic's impact on social mobility is another aspect to be watched in the medium term. Until now, the pandemic has clearly increased inequality, disproportionally affecting young people, women and other vulnerable groups (see Graph 2.5). The opening of customer-facing sectors like retail, accommodation and restaurants is set to benefit mostly the young and less skilled employees, somewhat lowering the pandemic-induced inequality.

Graph 2.4: **Unemployment and income support recipients**

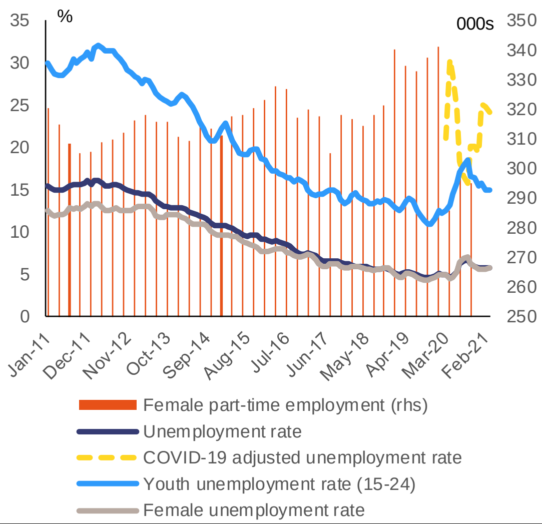


Level 3 – Substantial restrictions
Level 5 – The highest level of restrictions
Source: CSO, Office of the Revenue Commissioners, Department of Social Protection

([5]) The EWSS replaced the Temporary Wage Subsidy Scheme on 1 September 2020.

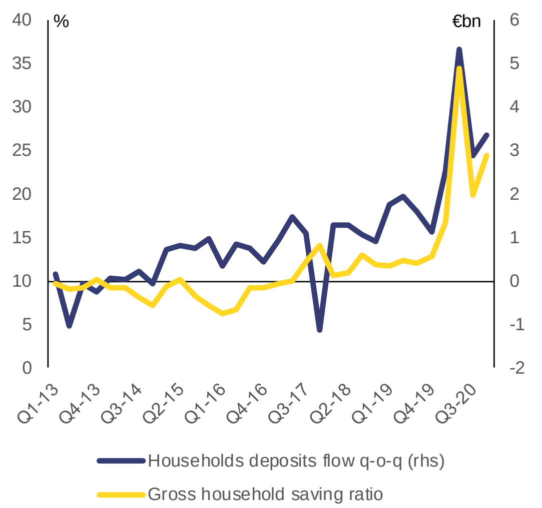
([6]) A definition that classifies all claimants of the pandemic unemployment payment as unemployed.

Graph 2.5: **Unemployment statistics**



Source: CSO

Graph 2.6: **Gross household saving ratio and deposits**



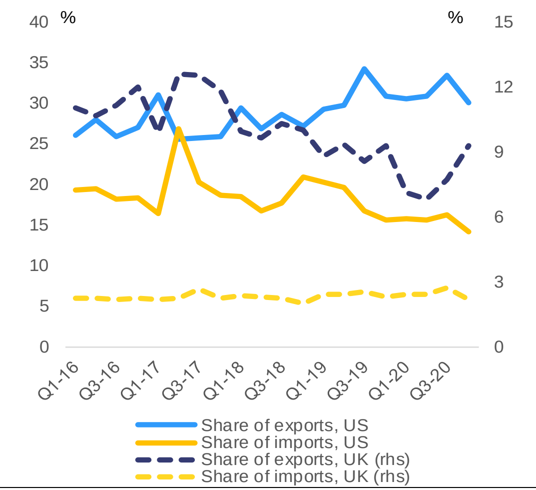
Source: CBI, CSO

Unprecedented levels of household savings could support private consumption once the restrictions are lifted. A very constrained ability of households to spend on services and to a lesser degree on goods, combined with various public income support, has resulted in historically unprecedented savings (see Graph 2.6). These savings are distributed unevenly, with the largest portion occurring in the wealthiest population as their income was least affected (most could easily switch to remote work), while their consumption, typically comprising a large share of services, was severely curtailed. Some of these savings are already channelled to the real estate market (see below), while some are set to unwind once the restrictions are lifted, with services expected to largely benefit. With the expected vaccine rollout, consumption is expected to get a boost in the second half of 2021 and in 2022, with savings gradually returning to more normal levels.

Domestic investment took a hit in 2020 and is set to remain subdued in 2021. Investment contracted sharply in 2020, by 32.3% y-o-y, as a result of lower spending across all investment categories. In 2021, it is expected to remain subdued. The construction sector has lost the first quarter, when all except essential works were banned. Furthermore, data on construction permits and commencements suggest a weaker outlook. While the projections of housing completions vary, they all suggest that supply will largely fall short of the estimated demand. On the equipment and machinery side, persisting uncertainty keeps investment decisions postponed. Hence, no major improvement is expected in domestic investment before the second half of the year. In contrast, multinational companies headquartered in Ireland could increase their investments throughout the year if they continue to perform well, though these investments tend to be volatile.

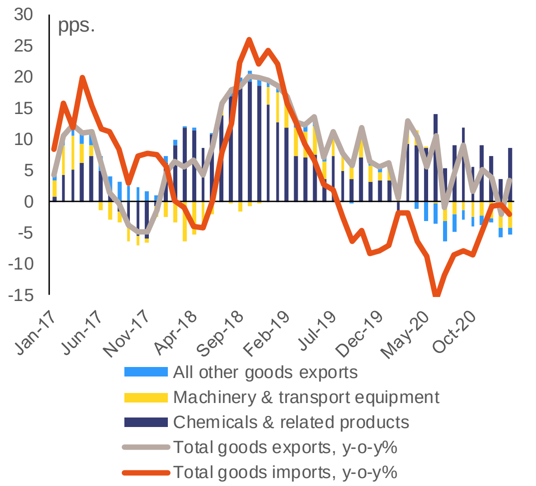
The external environment is becoming more favourable and net exports may contribute to growth, though to a lesser extent than in 2020, when they were a driving force. The global economy has fared better than previously projected and growth in Europe and elsewhere is forecast to resume strongly in 2021. The large US fiscal stimulus is beneficial to Ireland, for which the US is a major trading partner (see Graph 2.7). Multinational corporations headquartered in Ireland reportedly face a very positive outlook. Their concentration in the field of pharmaceuticals and medical devices (with some products directly related to COVID-19), and information and communication technologies, was very advantageous in the pandemic environment and may continue to be beneficial post-pandemic, although there is a risk of reliance on a relatively few companies. Exports of domestic companies are also expected to rebound strongly, though more so in the second half of 2021 and in 2022 (see Graph 2.8). Ireland's imports are expected to recover alongside improving consumption.

Graph 2.7: **Share of trade with US and UK**



Source: CSO

Graph 2.8: **Goods exports and imports**



4-month average.
Source: CSO

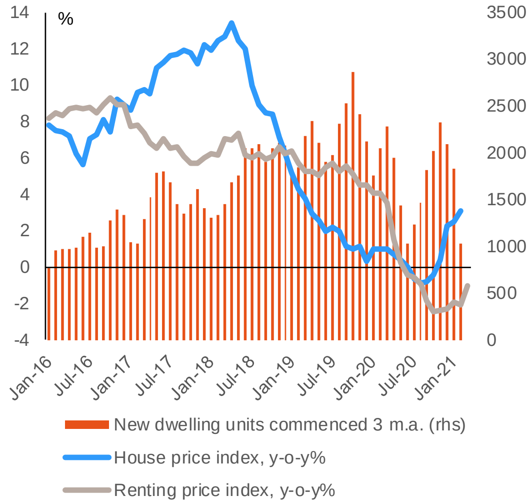
The macroeconomic outlook has become brighter, despite persisting uncertainty. The European Commission spring 2021 forecast projects Ireland's real GDP to grow by 4.6% in 2021 and 5.0% in 2022 on the back of released pent-up domestic demand and a global post-crisis recovery. Risks nevertheless remain, related to pandemic developments and the international tax environment.

Inflation based on the harmonised indices of consumer prices (HICP) has been low in early 2021. In the first quarter, inflation remained negative, with all categories except services contributing to the fall in prices. Energy prices fell the most but unprocessed food prices and non-energy industrial good prices also continued a marked decline. The pandemic also changed the consumption basket. Going forward, oil prices are set to increase energy inflation. The projected domestic recovery, with some services restored gradually and likely facing a sharp increase in demand, may create some inflationary pressures. Nevertheless, HICP inflation in Ireland is expected to remain subdued in 2021, at 0.9%, and increase only gradually to 1.3% in 2022.

House prices in Ireland increased in 2020, reflecting strong demand. After constrained viewings and sales in the second and third quarter of 2020, residential property purchases picked-up strongly in the last quarter of 2020 (see Graph 2.9). House prices started to increase amid constrained supply, recording a 0.3% increase in 2020 for the year as a whole, despite some negative price developments in the third quarter. Residential house prices kept climbing in early 2021, rising by 3.0% y-o-y in February.

Lockdown restrictions for the construction sector impacted housing supply. While housing completions were down only 1.9% y-o-y in 2020, housing commencements had dropped 17.3% as builders prioritised completing existing projects. Looking ahead, the ban on non-essential construction, which was in place from the start of the year until 12 April, suggests that demand will continue to outstrip supply.

Graph 2.9: **Housing developments**



Source: CSO, Eurostat

Rental price growth is low as rental supply remains temporarily high. Due to a return to a strict COVID-19 lockdown at the start of 2021, the government continued with emergency legislation from 31 December 2020 to 15 April 2021. The measure banned evictions and rent increases for tenants financially impacted by COVID-19. Moreover, the lack of international tourism has led landlords to switch from short-term letting to regular renting. As a result, rental supply was 64% higher in Dublin at the beginning of February 2021 than at the same time last year. Annual rent inflation continued to be negative in early 2021, with a drop in rent prices visible in all regions, and particularly in Dublin. However, despite the sharp increase in rental supply and higher unemployment, the decline in rental prices was relatively modest, 1.0% in March 2021 compared with the same period last year. This was due to rental supply picking up from relatively low levels and the COVID-19 income support cushioning the fall in disposable income.

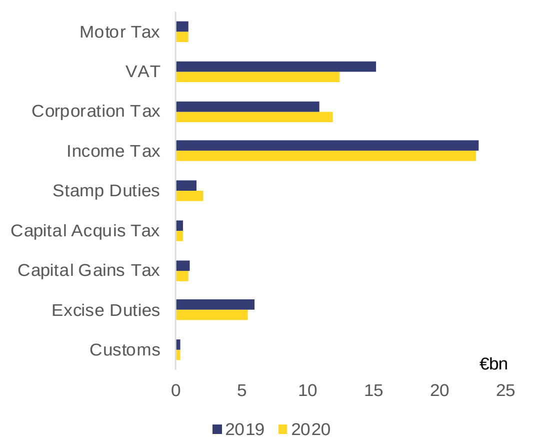
The overall outlook for commercial real estate (CRE) is negative given the pandemic's impact, but shows considerable differences across segments. CRE was hit substantially by the pandemic as the 'new normal' implied less need for office and retail space. The Occupier and Investment Sentiment Indexes fell in Q2 2020 and showed no real improvement during Q3 2020([7]). Retail returns were particularly affected as buying activity moved online([8]). The vacancy rate also increased in the office sector, although it remains considerably below the levels of the financial crisis, partly due to the considerable pre-pandemic demand for office space. Meanwhile, most other sectors, such as manufacturing and logistics, demonstrated remarkable resilience in 2020 in terms of pricing and vacancy rates([9]).

2.2. PUBLIC FINANCES

Public support mitigated the adverse economic and social impact of the pandemic. The headline government position turned into a deficit of 5.0% of GDP in 2020. General government revenue dropped by 3.9% from 2019 to 2020 amid repeated lockdowns, as taxes and social contributions fell by 3.2%.

The increase in spending reflected the crisis response. General government expenditure increased by 19.1% from 2019 to 2020, driven largely by the government's fiscal supports to cushion the effects of the pandemic, including generous income support in the order of 3% of GDP.

Graph 2.10: **Exchequer tax-receipts cumulative, 2020**

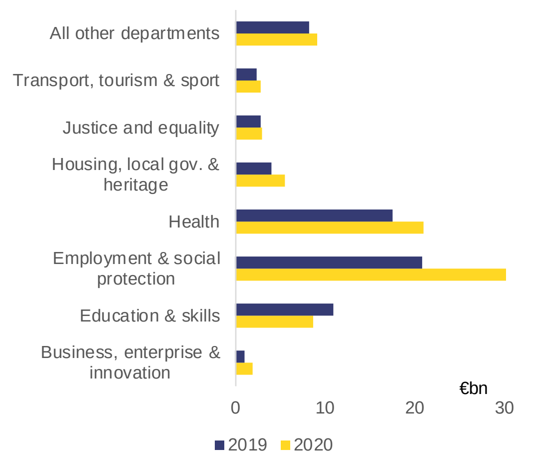


Source: Department of Finance, Fiscal Monitors

([7]) RICS & SCSI (2020) Q3 2020: Ireland Commercial Property Report.
([8]) CBRE (2021) Bi-monthly research report, March 2020
([9]) CBRE (2021) 2021 Ireland Market Outlook

In 2020, the Exchequer balance surprised on the upside. Tax receipts were down by 3.6% y-o-y but 15.3% higher than expected under the government's Stability Programme from April 2020. This reflects the continued increasing trend of corporate income tax receipts, which were up by 8.7% from 2019 to 2020 (see Graph 2.10). Personal income taxes have also been resilient, down by only 1% y-o-y, due to a more pronounced impact of the crisis on sectors whose employees are at the lower end of income distribution. In addition, payments by the National Asset Management Agency to the Exchequer (EUR 2 billion in 2020) improved the fiscal balance. Total expenditure increased by 23.3% y-o-y in 2020, driven by health and social protection. At the end of 2020, an Exchequer deficit of EUR 12.3 billion was recorded, compared to a surplus of EUR 0.6 billion in 2019.

Graph 2.11: **Exchequer tax-expenditure cumulative, 2020**



Source: Department of Finance, Fiscal Monitors

The pandemic weighed on public finances in 2020. This is due to both the operation of automatic stabilisers and the discretionary fiscal measures taken by the government in response to the lockdown (see Graph 2.11). In the first three months of 2021, the Exchequer revenue kept on showing resilience and potential for rebound, while expenditure was significantly higher on a y-o-y basis, driven by a large increase in social protection. According to the Commission 2021 spring forecast, the general government balance is expected to post a deficit of 5.0% of GDP in 2021 and improve in 2022. This is broadly in line with the projections in Ireland's Stability Programme Update 2021.

The public debt ratio is expected to increase in 2021 on the back of a sustained deficit. In 2020, the debt ratio increased to 59.5% of GDP despite nominal GDP growth of 2.9% in 2020. The debt-to-modified GNI (GNI*) ([10]) ratio, a metric that better captures the public debt burden on the domestic economy, is projected to have reached almost 106% in 2020, up from 95.6% in 2019. According to the Commission 2021 spring forecast, the gross general government debt-to-GDP ratio is projected to reach 59.5% in 2021 and 61.4% in 2022. There might be concerns about long-term debt sustainability due to increasing cost of ageing (see Annex 1).

Risks to the fiscal outlook are tilted to the downside. They reflect various sources of uncertainty, such as the speed of removal of the COVID-19 restrictions in the short term. In the medium term, potential changes in the international corporate taxation environment might reduce revenue. Corporate tax receipts represent an increasingly important source of revenue in Ireland, but their continued solid growth remains uncertain in the medium term.

2.3. FINANCIAL SECTOR

The impact of the ongoing pandemic on the financial sector has been contained so far, but the full extent of its impact will only become fully visible over time. The COVID-19 pandemic has been an unprecedented shock for the Irish economy. A range of fiscal support measures, including a wage subsidy scheme, tax deferrals, and more recently a credit guarantee scheme, as well as rent, trade credit and loan payment breaks, have cushioned the impact on the real economy. However, it is likely that some of the adverse effects will be delayed. In particular, they may

([10]) Modified Gross National Income (GNI*) reflects the income standards of Irish residents more accurately than GDP. It differs from actual GNI in that it excludes, for example, the depreciation of foreign-owned, but Irish resident, capital assets (notably intellectual property and assets associated with aircraft for leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

Table 2.1: **Financial soundness indicators, all domestic and foreign banks in Ireland**

	Ireland									EU	Euro area
	2014	2015	2016	2017	2018	2019	2020q1	2020q2	2020q3	2020q3	2020q3
Non-performing loans	21.6	14.9	13.1	9.9	5.5	3.4	3.1	3.5	3.5	2.7	2.7
o/w NFC & HH sectors	28.4	20.5	16.6	14.1	8.2	5.6	5.3	6.0	6.3	n.a.	n.a.
o/w NFC sector	37.8	22.9	15.3	11.8	5.7	3.2	3.1	4.5	5.3	4.9	5.1
o/w HH sector	22.8	19.1	17.4	15.5	10.1	7.2	6.9	7.1	7.0	3.0	3.1
Coverage ratio	46.7	40.2	35.5	29.9	28.5	27.5	27.9	29.7	28.8	46.7	46.9
Return on equity(1)	8.5	6.8	6.3	5.0	4.9	3.7	-0.3	-5.4	-3.0	2.8	2.6
Return on assets(1)	0.9	0.9	0.9	0.7	0.7	0.5	0.0	-0.7	-0.4	0.2	0.2
Total capital ratio	22.6	25.3	25.0	25.2	25.4	24.9	24.7	25.2	25.7	19.1	19.0
CET 1 ratio	20.1	22.3	22.2	22.9	22.9	22.3	22.2	22.4	22.6	15.8	15.6
Tier 1 ratio	20.5	23.2	23.0	23.4	23.4	23.0	22.9	23.4	23.7	16.8	16.7
Loan to deposit ratio	98.8	98.7	93.2	95.3	90.2	91.5	90.3	84.7	82.1	91.8	88.6

(1) For comparability reasons, annualised values are presented.
Source: ECB consolidated banking data

materialise once general support measures are being phased out.

The capital and liquidity positions of Irish banks remain strong. Regulatory reforms, an improved supervisory framework, and the implementation of macro-prudential policies since the global financial crisis a decade ago have ensured that the Irish banking system entered the pandemic in a more robust position than it did the financial crisis. Irish banks are well capitalised. The aggregate Common Equity Tier-1 (CET1) ratio for the banking sector, including both domestic and foreign-owned banks, stood at 22.6% in the third quarter of 2020 (Table 2.1), well above the EU average of 15.8%. They also have ample liquidity, well above regulatory requirements, further supported by increasing deposits during the pandemic, on the back of higher savings.

Pandemic-induced losses compound the Irish financial sector's existing profitability challenge. Since Irish banks rely heavily on net interest income rather than fee income, they have been facing pressure from declining net interest margins amidst growing excess liquidity and weak loan demand. Their cost-to-income ratios remain high. Growing impairment charges since the start of the pandemic have caused losses. The average return on equity and average return on assets both turned negative in the first half of 2020 as a result (Table 2.1).

The pandemic is likely to result in higher levels of non-performing loans (NPLs). Before the pandemic, Irish banks made substantial progress in addressing their NPLs, through successful restructurings, sales and securitisations of NPL portfolios. Since the beginning of the pandemic, two proposed sales of NPLs have been postponed. At the end of the first quarter of 2020, the NPL stock accounted for 3.1% of the gross value of loans. Since then, it has increased slightly to 3.5% in the third quarter of 2020. The increase is due to both a revised definition of default – resulting in a reclassification of assets to NPL – and the impact of the pandemic. NPL rates of non-financial corporations (NFCs) increased from 3.1% in the first quarter of 2020 to 5.3% in the third quarter of 2020, driven largely by SME exposures (Table 2.1). The overall NPL stock increased by around EUR 1.7 billion by the third quarter of 2020.

The payment breaks (moratoria) that were granted under the EBA-compliant moratorium scheme(11) have almost all expired, with most borrowers resuming capital and interest payments in full. From March 2020 to September 2020, Irish banks provided payment breaks of up to 6 months (12 months for large corporations) under a national industry-led scheme. At the peak in June 2020, 13% of loans (18% for NFC loans) were subject to such a payment break. The moratorium scheme stopped accepting applications at end-September 2020, but support can still be provided to borrowers that need assistance on a

(11) EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis (EBA/GL/2020/02) introduced on 2 April 2020.

case-by-case basis. By end-December, according to the Banking and Payment Federation Ireland, the vast majority of these payment breaks had resumed a full repayment schedule, with active payment breaks representing less than 1% of total outstanding loans in terms of outstanding value.

Irish banks' loan-loss provisioning levels remain relatively low. The EBA recorded a coverage ratio of 30.8% for NPLs at the end of 2020, which is significantly below the EU average of 44.9%. The prevalence of collateralised loans in Ireland may explain part of this difference. Nonetheless, provisions are also relatively low for more comparable individual exposure types, such as CRE exposures (27.8% in Ireland vs EU average of 36.4%), and SMEs (31.4% vs 48.7%). On the positive side, provisioning levels for household exposures have risen over the past years and, while they are still relatively low in general (28.2% in Ireland vs 42.4% in the EU), this is driven by the prevalence of mortgage exposures in the household NPL stock. For mortgages specifically, they have reached levels closer to the EU average (24.6% in Ireland vs 26.0% in the EU) in December 2020.

Bank lending declined in 2020, driven by a combination of supply and demand factors. As the economic situation became more uncertain, banks tightened their lending standards due to concerns over the pandemic's impact on companies' and households' creditworthiness. Given banks' ample capital buffers, this tightening of credit conditions was not due to binding capital restrictions. At the same time, companies reduced their demand for investment, out of caution, and were able to fulfil immediate liquidity needs to a large extent using government support programmes. Lending to companies was therefore weak throughout 2020. For 2020 in its entirety, new lending to SMEs was 23.2% below 2019 levels. Surveys suggest that many SMEs may face challenges fulfilling their liquidity needs when government support measures are unwound. On the other hand, lending to households, which also declined with the onset of the pandemic, recovered in the fourth quarter on the back of lending for home purchases.

Fears of major disruptions to the financial sector due to the UK leaving the EU have not materialised, even though internal market provisions facilitating the provision of cross-border financial services, such as passporting rights, have been lost. This is all the more remarkable since the EU-UK Trade and Cooperation Agreement has only a limited scope on the cross-border provision of financial services. As to central counterparties, the European Commission's decision to grant temporary equivalence to the UK in terms of central clearing under the European Market Infrastructure Regulation defers the cliff edge to June 2022 ([12]). In addition, the decision to grant temporary equivalence to UK-established Central Securities Depositories (CSDs) expires on 30 June 2021 ([13]). In March 2021, the Irish corporate securities market successfully migrated from a UK CSD to one in Belgium, following extensive support by the Irish public authorities, including through the implementation of dedicated legislation. In that context, the Irish financial sector has been preparing itself in view of the significant changes still to occur.

Ireland's non-bank financial sector has grown rapidly over the past years, reaching an asset volume of roughly EUR 5.6 trillion in assets at end-2020. The sector is composed of a diverse set of institutions: investment and money market funds, securitisation and non-securitisation vehicles, as well as other financial institutions, which are mainly treasuries of non-financial corporations. A large part of these institutions invest in international assets. The Irish authorities are stepping up their efforts to collect data from entities in the non-bank financial sector to better understand the interlinkages with and risks to the Irish domestic economy. They are also engaged in domestic, European and international discussions regarding the appropriate regulatory framework,

([12]) Commission Implementing Decision (EU) 2020/1308 of 21 September 2020 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with Regulation (EU) No 648/2012 of the European Parliament and of the Council (notified under document C(2020) 6539) (Text with EEA relevance).

([13]) Commission Implementing Decision (EU) 2020/1766 of 25 November 2020 determining, for a limited period of time, that the regulatory framework applicable to central securities depositories of the United Kingdom of Great Britain and Northern Ireland is equivalent in accordance with Regulation (EU) No 909/2014 of the European Parliament and of the Council including potential new tools, for the specific requirements of this sector. Some funds have a liquidity mismatch, meaning shareholders can redeem their shares faster than assets can be liquidated. While investment funds experienced increased redemptions during March and April 2020, they dealt with the crisis in a way that enabled them to continue to meet redemption requests as normal, with limited use of Special Liquidity Arrangements (SLAs) during the period.

This assessment should be considered against the backdrop of the extraordinary support provided by governments and central banks around the world to the markets in which these funds invest. Had governments and central banks not intervened in such a manner, it is unclear whether the sector could have continued to manage along the same lines it had until mid-March.

Ulster Bank and KBC Ireland are progressing plans that, if concluded, will ultimately result in their exit from the Irish market, which could weaken competition in the Irish banking sector. In February 2021, NatWest announced that it would withdraw from the Irish banking market, and wind down its Irish subsidiary, Ulster Bank. Two of the remaining Irish banks, Permanent TSB and AIB, have expressed interest in parts of Ulster Bank's business. In April 2021, KBC Ireland also announced it had entered into a non-binding memorandum of understanding with Bank of Ireland to sell performing assets and liabilities. It is also analysing its options to divest its NPL portfolio. Execution of these transactions would result in KBCI's withdrawal from the Irish market.

3. POLICY ISSUES

3.1. PUBLIC FINANCES

In response to the COVID-19 pandemic, Ireland has adopted a broad range of measures with a significant impact in 2020, extending partly into 2021. The total value of the measures, predominantly on the side of expenditure, is estimated at around EUR 16 billion (5% of GDP or 9% of GNI*) in 2020, and a further 12 billion in 2021. The 2021 measures include a contingency reserve and a domestically funded recovery fund, together amounting to around 1.5% of GDP. They had been set aside for additional expenditure to address the impact of the pandemic and the UK's withdrawal from the EU, and are likely to be fully used up in 2021. In the 2021 Budget, Ireland also expanded its healthcare capacity, partly temporarily, and partly permanently.

Welfare support measures have helped preserve employment, as well as prevent insolvency and increasing private debt. The suite of policies included the Pandemic Unemployment Payment (PUP), the Illness Benefit Payment for employees in self-isolation, the Temporary Wage Subsidy Scheme (TWSS) and its successor, the Employee Wage Subsidy Scheme (EWSS). To support the financing of the TWSS, Ireland received a EUR 2.5 billion loan under the European Support to mitigate 'Unemployment Risks in an Emergency' (SURE) ([14]). The PUP and the EWSS are expected to run until end-June 2021.

Ireland has also implemented liquidity support measures for businesses, with a focus on SMEs. As of mid-April 2021, COVID Restrictions Support Scheme payments of over EUR 450 million have been made to businesses. In the 2021 Budget, Ireland announced contingent supports in response to COVID-19 of about EUR 5 billion. Contingent liabilities have been estimated at 0.2% of GDP in 2020. The main items included in this value are: the COVID-19 Credit Guarantee Scheme; a counter-guarantee to the risk being borne by the European Union in offering SURE; and a guarantee relating to the EIB's Pan-European Guarantee.

Despite the currently favourable age structure, Ireland's pension system is facing sustainability challenges. The State pension age, although legislated to increase to 67 in 2021 and 68 in 2028, was kept at 66. The possible implementation of the increase depends on the outcome of the deliberations of a newly established Pensions Commission. Their report is expected by end-June.

A question mark remains over the sustainability of corporate tax collection. Its solid growth might not persist over time, and a sudden reversal cannot be ruled out. The high concentration of tax receipts among a few large firms, their volatility and potentially transitory nature, along with the rising share of corporation tax in total tax revenue, underline the risks of relying on this revenue source.

A broader tax base remains key to strengthening the resilience of public finances. Base broadening could be achieved in a revenue-neutral way, accompanied by mitigating measures, for instance, on personal income tax rates. The Rainy Day Fund, whose initial allocation of EUR 1.5 billion in 2019 was drawn down in 2020 to face the current crisis, could be replenished when macroeconomic conditions allow. In addition, government plans to develop tailor-made fiscal and macroeconomic indicators to better reflect the idiosyncrasies of the Irish economy remain welcome ([15]).

3.2. FINANCIAL SECTOR POLICIES

Credit guarantee schemes generally saw less brisk demand than grant schemes. The COVID-19 Credit Guarantee Scheme, which provides an 80% state guarantee of up to EUR 2 billion to support SME lending, saw approvals of only EUR 246 million by end-March 2021. This may be due to the late start of the scheme in September 2020, following the formation of a new government. It thus missed the early pandemic peak in liquidity demand. The COVID-19 Working Capital and Brexit Loan schemes, which together provide up to EUR 425 million in short-term loans to qualifying firms, have seen demand of less than half of the

([14]) SURE – disbursement under various bond maturities (30 March 2021)

([15]) For more details, see the 13th post-programme surveillance (PPS) report for Ireland.

overall sum allocated. In contrast, the amount earmarked for the Future Growth Loan Scheme provides up to EUR 800 million of long-term lending to help firms finance strategic investments) has almost been exhausted, pointing to companies' notable interest in longer-term investment. Finally, the Pandemic Stabilisation and Recovery Fund has up to EUR 2 billion available to enable larger businesses to make debt and equity investments.

The ECB and CBI have supported bank lending to the economy. Since March 2020, banks can use their capital conservation buffer and operate below their Pillar 2 guidance and liquidity coverage ratio. Further, they are allowed to meet their Pillar 2 requirements with Additional Tier 1 capital as a result of the early introduction of a Capital Requirements Regulation II amendment. On the macro-prudential side, the CBI set the countercyclical capital buffer (CCyB) to zero. Moreover, the CBI does not expect to increase the CCyB in 2021. Meanwhile, the other systemically important institutions capital buffer is available to absorb the impact of the current situation, and the CBI has announced that the Systemic Risk Buffers (SyRB) will not be implemented in 2021. In addition, the CBI confirmed that payment breaks are not recorded as a specific field on a borrower's credit report with the Central Credit Register, if granted under the national, EBA-compliant moratorium scheme. The overall regulatory capital relief should help banks maintain credit supply to the real economy and absorb potential losses. The banking sector has substantial headroom above regulatory requirements.

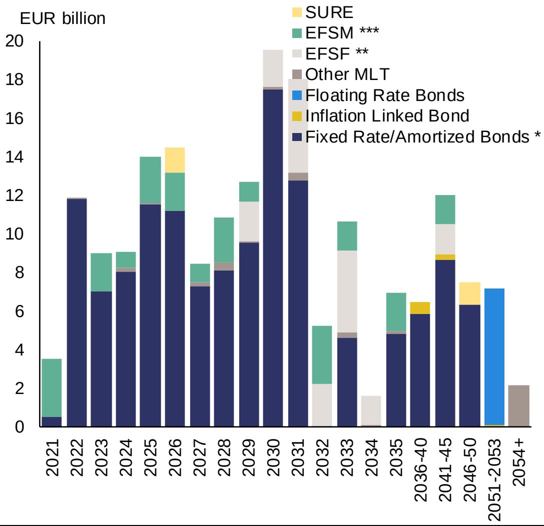
The 2020 review of mortgage measures found that these were meeting their objectives. Mortgage credit contracted at the onset of the pandemic, driven by a very sharp fall in credit demand. However, lending recovered quickly as the household sector remained resilient, in particular benefiting from government support, such as wages subsidies.

4. SOVEREIGN FINANCING ISSUES

Government funding requirements have been adapted to the crisis amid favourable market conditions. The National Treasury Management Agency (NTMA) issued EUR 24 billion in long-term bonds during 2020 ([16]), at an average maturity of 11.5 years and a weighted average yield slightly above 0.2%. The cash balance was over EUR 17 billion at the end of 2020. There are no long-term bond maturities arising in 2021, and on 26 March 2021 the NTMA completed the repayment of Ireland's bilateral loan from the UK (see Graph 4.1). The bond funding range for 2021 is between EUR 16 and 20 billion.

Access to market financing remains favourable for the sovereign. Borrowing and debt servicing costs have declined over the last decade, also supported by monetary policy action, including the recent pandemic emergency purchase programme. The 10-year bond yield for Ireland was low at around -0.3% in December 2020. As of April 2021, the spread against the German benchmark has fallen to pre-crisis levels, after a peak in mid-March 2020 and a downward trend throughout 2020. Irish sovereign credit ratings are robust and their outlook is stable. Interest expenditure in Ireland has fallen from 1.3% of GDP in 2019 to 1% in 2020 and expected to drop further to 0.9% in 2021. As a share of GNI*, interest expenditure still amounted to 2.1% in 2019 and an estimated 1.8% in 2020.

Graph 4.1: **Maturity profile of medium- and long-term marketable and official debt (end-March 2021)**



The Irish programme was the second euro area assistance programme, and the first financed by two new financial assistance instruments established in 2010, the EFSF and the EFSM.
* Includes NTMA Repo activity.
** EFSF loans reflect the maturity extensions agreed in June 2013.
*** EFSM loans are also subject to extension, such that their original aggregated weighted average maturity will be a maximum of 19.5 years. However the revised maturity dates of individual EFSM loans will only be determined as they approach their original maturity dates. The table and graph above reflect both original and revised maturity dates of individual EFSM loans.
Source: NTMA

Risks for Ireland's capacity to service EFSM and EFSF debt are low. The maturity of EFSM loans to Ireland can be extended, to a weighted maximum of 19.5 years.

([16]) Excluding funds raised in non-competitive bond auctions.

Table 4.1: **Government financing plans**

EUR billion	2020	2021
Funding requirement		
Exchequer borrowing requirement (EBR) (1)	12.3	16.9
Bond maturities	17.1	0.0
UK bilateral loan	1.9	0.5
Other (2)	1.8	4.6
Total requirement	**33.1**	**22.1**
Funding sources		
Government bonds (3)	25.5	18.3
SURE Programme	0.0	2.5
Other (4)	8.5	1.5
Use of cash (- represents an increase)	-0.9	-0.3
Total sources	**33.1**	**22.1**
Financial buffer (5)	**17.4**	**17.6**

Rounding may affect totals. 2021 figures are estimates, as of April 2021.
(1) 2021 estimate as per the Department of Finance, Stability Programme Update (SPU) for 2021.
(2) Includes floating-rate note purchases, and for 2021 general contingencies, including for potential bond purchases.
(3) 2020 reflects cash proceeds from syndications and auctions, including non-competitive auctions. The NTMA bond funding range for 2021 is EUR 16 – EUR 20 billion. While €18bna EUR 18billion nominal amount (the mid-point of the range) is reflected in this table, it also includes the cash proceeds of syndications and auctions, including non-competitive auctions, to end-April.
(4) This category is mostly comprised of net state savings (retail), net short-term paper funding and other medium/long-term borrowing.
(5) Exchequer cash; excludes other non-liquid Exchequer financial assets.
Source: NTMA

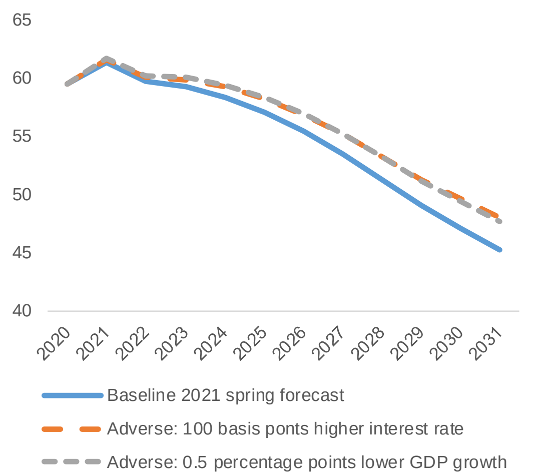
Overall, the profile of government debt remains favourable. The weighted average maturity was lengthened from approximately 10 years to more than 11 years. Interest payments are expected to decrease between 2020 and 2021, both in absolute terms and as a percentage of revenue. As of end-2020, government bonds accounted for two thirds of Irish government debt, and about 52% of Irish debt was held by non-residents.

ANNEX 1
Debt sustainability analysis

The debt position appears sustainable over the medium term. The debt sustainability analysis, based on the Commission 2021 spring forecast, confirms that Ireland faces low debt sustainability risk in the medium-term.

Public debt relative to GDP is forecast to peak in 2021. Although the public debt to GDP ratio deteriorated in 2020 and is projected to increase further in 2021, in the baseline scenario it is expected to follow a declining trajectory over the medium term (See Graph A1.1). Based on the Commission 2021 spring forecast and the no-policy-change assumption beyond the forecast period, the ratio is projected to reach its peak in 2021 and decline thereafter – initially driven by a progressive unwinding of government measures related to the COVID-crisis – until reaching about 45% of GDP in 2031. Under more adverse macro-financial scenarios (100 basis points higher interest rates or 0.5 percentage points lower GDP growth), the debt ratio would still remain on a downward trajectory, reaching about 48% in 2031 under both scenarios.

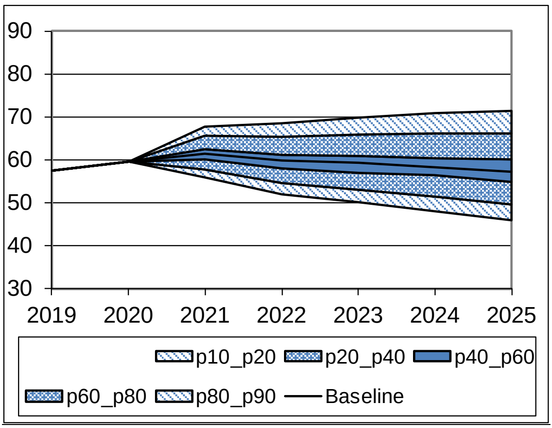
Graph A1.1: **Debt as percentage of GDP**



Calculations based on the Commission 2021 spring forecast. The baseline generally assumes a gradual return to pre-crisis underlying assumptions, as embedded in the European Commission 2019 autumn forecasts.
Source: European Commission

To highlight potential risks for the debt dynamics stemming from the uncertainty surrounding the macroeconomic and fiscal projections, stochastic projections take into account a large range of possible temporary shocks to macroeconomic and fiscal variables. The uncertainty surrounding the baseline scenario can be measured by the difference between the 10th and 90th debt distribution percentiles (See Graph A1.2) ([17]). In the case of Ireland, this measure shows an intermediate degree of uncertainty compared to the other EU member states.

Graph A1.2: **Public debt-to-GDP ratio 2019-25**



Source: European Commission

The maturity profile of sovereign debt is favourable. At end-2020, the estimated weighted average maturity of the medium-to long-term debt portfolio was over 11 years, which reduces rollover risks. Around two-thirds of gross national debt is at rates of 2% or less, and the majority of this debt is at fixed rates([18]). So-called "sticky" sources - official loans, Eurosystem, retail - make up over 50% of Irish debt([19]).

Nevertheless, in the long-term there appear to be a "medium" risk according to the debt sustainability analysis. A projected increase in

([17]) Stochastic debt projections allow assessing the uncertainty surrounding macroeconomic and fiscal projections. Projections have a 5-year projection horizon. Results are based on 80% of all possible debt paths obtained by simulating 2 000 shocks to the primary balance, nominal growth and interest rates (the lower and upper lines delimiting the cone represent respectively the 10th and the 90th distribution percentiles). In the chart, the projected debt path under the baseline (around which shocks apply) is reported as a solid black line at the centre of the cone. The differently shaded areas within the cone represent different portions of the distribution of possible debt paths. The dark blue area (delimited by the 40th and the 60th percentiles) includes the 20% of all possible debt paths that are closer to the baseline.

([18]) Department of Finance (2021), Annual Report on Public Debt in Ireland 2020, January 2021.

([19]) NTMA's May 2021 Investor Presentation age-related costs over the long run – such as pensions and health care – drives this risk. Moreover, alternative debt metrics, based on modified gross national income (GNI*) indicate a higher debt burden than that measured by the debt-to-GDP ratio.

ANNEX 2
Supplementary tables

Table A2.1: **Fiscal accounts (based on Commission 2021 spring forecast)**

	2019	2020	2021	2022
	% of GDP			
Indirect taxes	7.7	6.6	6.6	6.7
Direct taxes	10.3	10.2	9.7	9.5
Social contributions	4.5	4.3	4.2	4.1
Sales	1.7	1.5	1.7	1.6
Other current revenue	0.7	0.5	0.5	0.4
Capital taxes	0.1	0.1	0.1	0.1
Total current revenue	**24.9**	**23.2**	**22.8**	**22.4**
Capital transfers received	0.1	0.2	0.2	0.5
Total revenue	**25.1**	**23.4**	**23.0**	**22.9**
Compensation of employees	6.5	6.8	6.7	6.6
Intermediate consumption	3.5	4.0	4.1	3.9
Social transfers in kind via market producers	2.1	2.1	2.0	1.9
Social transfers other than in kind	6.8	8.6	8.3	6.9
Interest paid	1.3	1.0	0.9	0.9
Subsidies	0.5	1.5	1.6	0.8
Other current expenditure	1.0	1.2	1.1	1.2
Total current expenditure	**21.7**	**25.2**	**24.7**	**22.2**
Gross fixed capital formation	2.4	2.7	2.9	3.0
Other capital expenditure	0.5	0.6	0.4	0.6
Total expenditure	**24.6**	**28.4**	**28.0**	**25.7**
General government balance	**0.5**	**-5.0**	**-5.0**	**-2.9**
General government balance net of one-offs	**0.5**	**-5.0**	**-5.0**	**-2.9**
	EUR billion			
Indirect taxes	27.5	24.1	25.8	27.5
Direct taxes	36.6	37.6	37.6	39.3
Social contributions	15.9	15.8	16.2	17.0
Sales	6.0	5.4	6.5	6.8
Other current revenue	2.3	1.8	2.0	1.5
Capital taxes	0.5	0.5	0.5	0.5
Total current revenue	**88.8**	**85.2**	**88.6**	**92.5**
Capital transfers received	0.5	0.6	0.8	2.1
Total revenue	**89.2**	**85.8**	**89.4**	**94.6**
Compensation of employees	23.1	24.8	26.2	27.5
Intermediate consumption	12.6	14.7	15.8	16.2
Social transfers in kind via market producers	7.5	7.6	7.7	7.8
Social transfers other than in kind	24.2	31.4	32.3	28.4
Interest paid	4.5	3.7	3.4	3.7
Subsidies	1.7	5.7	6.1	3.4
Other current expenditure	3.7	4.3	4.5	4.9
Total current expenditure	**77.2**	**92.2**	**95.9**	**91.8**
Gross fixed capital formation	8.4	9.8	11.1	12.3
Other capital expenditure	1.9	2.1	1.7	2.3
Total expenditure	**87.5**	**104.2**	**108.8**	**106.4**
General government balance	**1.8**	**-18.4**	**-19.3**	**-11.8**
General government balance net of one-offs	**1.8**	**-18.4**	**-19.3**	**-11.8**

Source: Eurostat and European Commission

Table A2.2: **General government debt projections (based on Commission 2021 spring forecast)**

	2019	2020	2021	2022
Government balance (% of GDP)	**0.6**	**-5.0**	**-5.0**	**-2.9**
Government gross debt (% of GDP)	57.4	59.5	61.4	59.7
	levels, EUR billion			
Government balance	**1.8**	**-18.4**	**-19.3**	**-11.8**
Gross debt	204.2	218.2	238.8	246.8
Change in gross debt	-1.7	13.9	20.7	7.9
Nominal GDP	356.1	366.5	389.1	413.5
Real GDP	335.2	346.6	362.6	380.6
Real GDP growth (% change)	**5.6**	**3.4**	**4.6**	**5.0**
Change in gross debt (% of GDP)	-5.6	2.2	1.9	-1.7
Stock-flow adjustments (% of GDP)	0.1	-1.2	0.3	-0.9
	% of GDP			
Gross debt ratio	**57.4**	**59.5**	**61.4**	**59.7**
Change in gross debt ratio	-5.6	2.2	1.9	-1.7
	contribution to change in gross debt			
Primary balance	1.7	-4.0	-4.1	-2.0
'Snow-ball' effect*	-3.8	-0.6	-2.6	-2.7
of which				
Interest expenditure	1.3	1.0	0.9	0.9
Real growth effect	-3.2	-1.9	-2.6	-2.9
Inflation effect	-1.8	0.3	-0.8	-0.7
Stock-flow adjustments	**0.1**	**-1.2**	**0.3**	**-0.9**
Implicit interest rate	*2.2*	*1.8*	*1.5*	*1.5*

The projections assume no borrowing for precautionary contingencies envisaged in the programme's financing plan.
*The 'Snow-ball' effect, interest expenditure, real growth effect and inflation effect are derived from the Commission forecast analysis. Snow-ball effects refer to the net impact of the counteracting effects of interest rates, inflation and real GDP growth on the evolution of the debt ratio.

Source: Eurostat and European Commission

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