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Post-Programme Surveillance Report

Ireland, Spring 2022

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Post-Programme Surveillance Report

Ireland, Spring 2022

EUROPEAN ECONOMY Institutional Paper 177

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This report reflects information available and policy developments that have taken place until 29 April 2022. However, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2022 spring forecast released on 16 May 2022 (with cut-off date 29 April 2022).

([1]) The report was adopted as Commission Communication C(2022)3503 on 18 May 2022, accompanied by a Staff Working Document (SWD(2022)701).

([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

AIB	Allied Irish Banks plc
CBI	Central Bank of Ireland
CBRE	Coldwell Banker Richard Ellis
CCyB	Countercyclical capital buffer
CET1	Common Equity Tier 1
CSO	Central Statistics Office Ireland
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
LTI	Loan-to-Income
NFCs	Non-Financial Corporations
NPL	Non performing loan
NTMA	National Treasury Management Agency
PPS	Post programme surveillance
PUP	Pandemic Unemployment Payment
q-o-q	Quarter-on-quarter
RTB	Residential Tenancies Board
RoE	Return on Equity
SME	Small and medium sized enterprises
SURE	Support to mitigate Unemployment Risks in an Emergency
VAT	Value Added Tax
y-o-y	Year-on-year

EXECUTIVE SUMMARY

The 16th post-programme surveillance mission to Ireland took place online. The mission involved European Commission staff in liaison with European Central Bank staff. European Stability Mechanism (ESM) staff participated on aspects relating to the ESM's Early Warning System. The meetings took place from 28 to 31 March 2022, in the form of videoconferences.

The Irish economy continued to grow strongly in early 2022, but the outlook has become clouded after the Russian invasion of Ukraine and the emergence of new associated challenges. Private consumption has been recovering amid rising confidence and a continuously improving labour market. Employment levels have been increasing, and pandemic support schemes have mostly been discontinued. The corporate sector has proven resilient, and even the sectors particularly affected by the pandemic, such as hospitality, have been recovering and hiring more staff. The Russian invasion of Ukraine has increased general uncertainty, accelerated inflationary pressures, and added new supply bottlenecks. Although Ireland has very limited direct exposure to Russia and Ukraine, it is still affected by the Russian invasion through a number of indirect effects. High inflation, resulting from the global rise in prices for energy and other commodities, is set to curb the real disposable incomes of Irish households, while corporates may have to pass on higher costs to consumers. The capacity of firms to absorb cost increases by lowering their profit margins is limited at present, particularly in the sectors hardest hit by the pandemic. Higher prices and current uncertainties may lead to the postponement of investment decisions, while some investments, such as in construction, suffer from shortages of materials and labour. Similarly, the economic outlook for Ireland's trading partners is being revised down and global trade volumes are set to fall, reducing Ireland's export possibilities. Nevertheless, although Ireland's GDP growth is expected to be lower than projected previously, it is still expected to be robust, with real GDP projected at 5.4% in 2022 and 4.4% in 2023.

The outlook for public finances is favourable, also thanks to surprisingly strong tax revenues. Expenditure related to COVID-19 measures are expected to be mostly discontinued in 2022. Risks to the fiscal outlook are tilted to the downside due to the uncertainty stemming from the cost of welcoming refugees fleeing the Russian invasion of Ukraine. Changes to the international corporate tax framework are unlikely to have any impact on Ireland before the end of 2023. Long-term fiscal sustainability risks due to the cost of ageing persist.

The pandemic did not destabilise the Irish financial sector, with Irish banks recording sound results for 2021. However, downside risks remain, bolstered by the Russian invasion of Ukraine. Irish banks have come out of the pandemic without a major deterioration in asset quality, but risks in their loan books, especially for loans to non-financial corporations, have risen and warrant monitoring. Throughout 2021, Irish domestic banks continued to reduce their non-performing exposures and maintained appropriate levels of capital and liquidity. After a loss-making 2020, the banks returned to profit in 2021, but profitability remains constrained by a high cost base, relatively high risk-weight capital charges, and a strong dependence on net interest income. However, banks are working to improve their operating efficiency and diversify their income streams, and the ongoing withdrawal of two foreign-owned retail banks creates opportunities for economies of scale. The Irish non-bank financial sector kept expanding rapidly in 2021. Non-bank lenders have grown in significance as credit providers to Irish companies, including SMEs, while property funds hold significant exposures to the Irish real-estate sector. Exposures of the Irish financial sector to Russia and Ukraine are limited, and concentrated in Russian-sponsored special purpose entities. Nevertheless, indirect effects such as higher inflation and a slowdown in growth may have repercussions on the asset quality of Irish banks.

The risks to Ireland's capacity to service its debt to the European Financial Stabilisation Mechanism (EFSM) and European Financial Stability Facility (EFSF) are low. Ireland maintains a large positive cash balance that provides flexibility, and it also enjoys favourable access to market financing. Current conditions allow Ireland to easily address the upcoming bond redemptions in 2022. Ireland's funding strategy is focused on preserving smooth market access.

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1. INTRODUCTION

This 16th post-programme surveillance (PPS) report was again conducted virtually, through a set of videoconferences that took place between 28 and 31 March 2022. 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 meetings on aspects related to the ESM's Early Warning System. Under PPS, the Commission carries out regular review missions to EU Member States that have 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 European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility (EFSF) and bilateral lenders ([3]). Acting on 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.

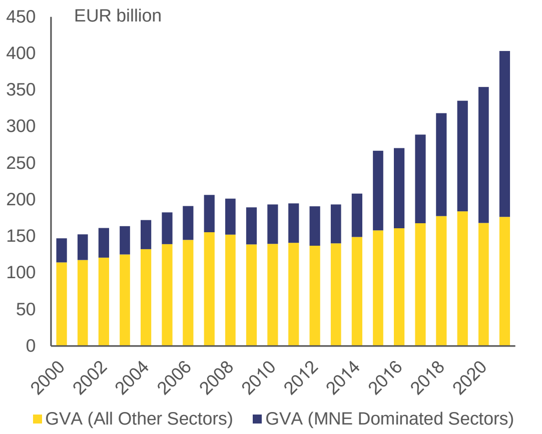
([3]) Ireland already repaid the outstanding bilateral loans from Denmark and Sweden, early and in full. On 26 March 2021, Ireland also completed the repayment of the outstanding bilateral loan from the UK. Under Regulation (EU) No 472/2013, PPS will continue until at least 75% of the financial assistance 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's economy recorded very strong real GDP growth of 13.5% in 2021, thanks to buoyant multinational exports and a strong domestic recovery. Two sectors dominated by multinational corporations performed very well during the pandemic years: pharmaceutical and medical equipment and information and telecommunication technologies. The pharmaceutical sector slowed down somewhat in the second half of 2021, but exports of computer services kept performing particularly strongly, and even accelerated towards the end of the year. At the same time, the domestic economy experienced a robust recovery from COVID-19, with no major scars visible in the business sector as a whole, or in the labour market. Modified domestic demand, a measure better reflecting domestic economy, increased by 6.5% in 2021, while modified investment increased by 9.7%.

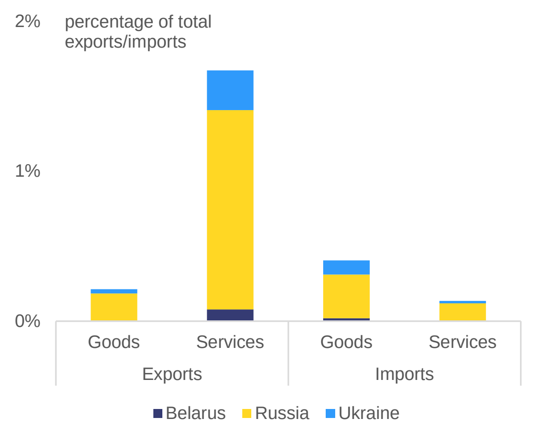
Graph 2.1: **Real gross value added**



Source: Central Statistics Office (CSO).

Economic activity in 2022 started on a strong footing, with all preconditions in place for robust growth. All major COVID-19-related restrictions were lifted in late February, paving the way for a recovery in spending. With the impact of the pandemic waning, face-to-face activities resumed in the first quarter and the services sector resumed normal operations. Many people dependent on pandemic support schemes returned to work and employment was rapidly expanding. Irish households accumulated large savings during the pandemic that can partly act as a buffer to absorb higher living costs. Credit-card data show that spending picked up markedly in the first quarter of 2022. Similarly, positive business expectations have been supportive of private investment, but may weaken in response to the more tense global business environment. Meanwhile, government plans to provide more affordable housing and proceed with the green transition are set to increase public investment.

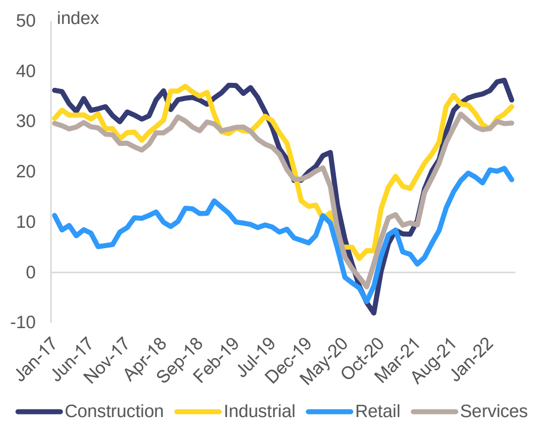
Graph 2.2: **Proportion of ecports and imports between Ireland and Russia, Belarus and Ukraine in 2020**



Source: CSO.

The Russian war on Ukraine has changed the balance of risks and altered the economic backdrop. While direct exposure to Russia, Ukraine and Belarus is minimal, Ireland is set to be affected indirectly by the war, with energy prices the most notable channel. Ireland is not reliant on Russian oil or gas (Ireland largely imports these from the UK), but the increase in global energy prices is affecting Irish households and companies, with some multinational corporations based in Ireland being heavy users of energy. While these multinational corporations are typically resilient to a slowdown in activity and/or higher costs, in an adverse scenario of curtailed energy supply their performance may be materially affected. Rising prices for food and fertilisers (Ukraine is a major food producer and Russia a major producer of both food and fertilisers) are also pushing up Irish consumer price inflation. Some supply-chain disruptions that were present during the pandemic but had largely dissipated have now re-emerged in the form of: (i) weakened trade links; (ii) the disruption of food production in Ukraine; and (iii) a zero-COVID-19 policy in China that has led to the temporary closure of some factories. These factors are causing shortages of particular inputs or final products in Ireland, as in other EU Member States, and have made port and road transportation more complicated and costly.

Graph 2.3: **Employment expectations per main sector**

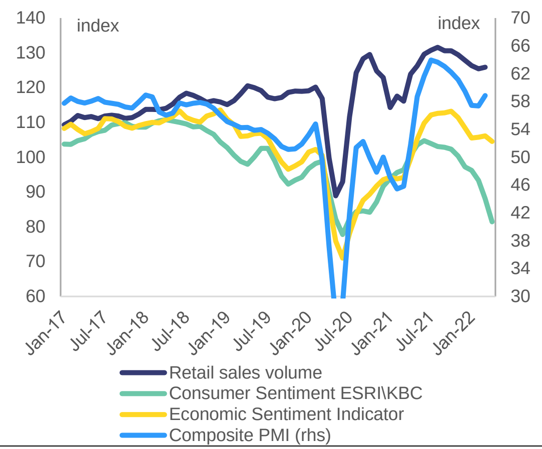


Six-month moving average.
Source: European Commission.

Irish labour market developments have been very encouraging. Positive employment trends seen in the second half of 2021 strengthened further in early 2022 with the lifting of COVID-19 restrictions and the full re-opening of the services sector. The official unemployment rate in Ireland has remained relatively stable over several months, standing at 5.5% in March 2022, while the COVID-19-adjusted unemployment rate has been declining and its publication was discontinued in March 2022. Employment expectations by companies continue to be robust in spite of higher uncertainty, but registered a slight weakening in the latest month of March.

Exceptional labour market support is due to be fully withdrawn very soon. The number of people receiving support under the Pandemic Unemployment Payment (PUP) Scheme fell to below 45 000 at the end of March 2022, down from more than 600 000 at its peak of support in 2021. The scheme was closed at the end of March and can be considered a clear success, which prevented unemployment from becoming entrenched during the pandemic crisis. The closure of this scheme resulted in only a minor uptick in the official unemployment rate to 5.5% in March, once the remaining former PUP recipients entered the regular unemployment statistics. The Employment Wage Subsidy Scheme, which still supported 258 000 workers in March 2022 – some 10% of total employment – expired for the vast majority of companies at the end of April 2022 (except for the most affected companies, for which it is set to expire at the end of May). Given high employment levels and reported shortages of labour in some sectors, the transition of workers away from this scheme is expected to be smooth. Levels of part-time employment are currently high, owing mainly to the entry of young people into the labour force and a marked increase in female participation. Given the tight labour market, a gradual move towards greater full-time employment is expected. Following a hiatus during the pandemic, inward migration is likely to resume, and the arrival of Ukrainian refugees offers the chance to match the newly-arrived with unfilled positions. The likely number of Ukrainian refugees coming to Ireland is hard to estimate; as of early April, around 19 000 had reached Ireland.

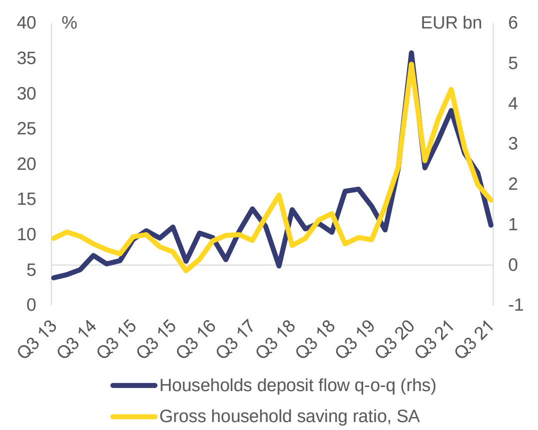
Graph 2.4: **Sentiment indicators and retail sales**



Three-month moving average.
Source: IHS Markit, CSO, European Commission.

Private consumption and investment are experiencing opposing trends. For households, rising employment and savings buffers accumulated during the pandemic provide considerable scope for continued robust spending activity (see Graph 2.5). At the same time, the rise in inflation reduces real disposable income and will not be fully compensated by rising nominal wages in the near term, which is likely to make households more cautious. Retail sales volumes have weakened slightly from their peak in August 2021 (see Graph 2.4). The KBC consumer sentiment survey for March 2022 revealed that around half of the respondents intend to reduce their spending significantly as a result of higher energy costs and uncertainty. Meanwhile, mortgage lending picked up over the second half of 2021, with mortgage drawdowns increasing by over 33% compared to the first half of 2021. There has also been a noticeable increase in spending on home improvement. On the corporate side, borrowing remained weak throughout the pandemic, albeit with some variation across sectors. For SMEs, the best performing sectors, such as manufacturing and construction, have now increased new borrowing [4] to close-to pre-pandemic levels. Instead, the sectors that suffered most from the pandemic, such as accommodation and food, still record very limited new borrowing. The accumulation of own funds by corporates continued in 2021, albeit decreasing somewhat from the heights of the pandemic. Construction investment, which is fuelled by high private demand and expanded public-sector investment plans, is being held back by the lack of certain materials and labour shortages. The multinational sector, meanwhile, is expected to invest less buoyantly than in previous years while still achieving overall investment growth.

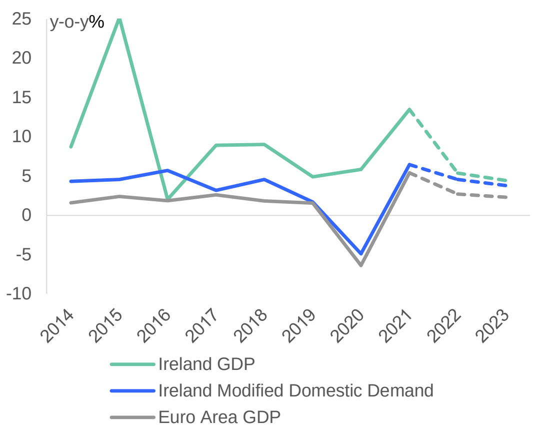
Graph 2.5: **Gross household saving ratio and deposits**



Source: CBI, CSO.

All in all, despite some headwinds, Ireland's economy is set to grow robustly. The domestic post-pandemic recovery is ongoing. The healthy labour market and rising household incomes are set to support growth in private consumption, despite the current uncertainty and rising costs, although the outlook has become weaker than previously expected. Similarly, the fundamentals are solid for investment growth, but the outlook for investment growth has deteriorated due to much higher uncertainty. The outlook for exports has also weakened, with global trade volumes set to decrease and some of Ireland's European trade partners being much more directly exposed to the effects of Russia's invasion of Ukraine. The Irish domestic economy is projected to expand by 4.6% in 2022 (Modified domestic demand), followed by an expansion of 3.8% in 2023. Real GDP is projected to expand by 5.4% in 2022 and 4.4% in 2023.

Graph 2.6: **Real GDP and modified domestic demand**



Source: Eurostat, Commission 2022 spring forecast.

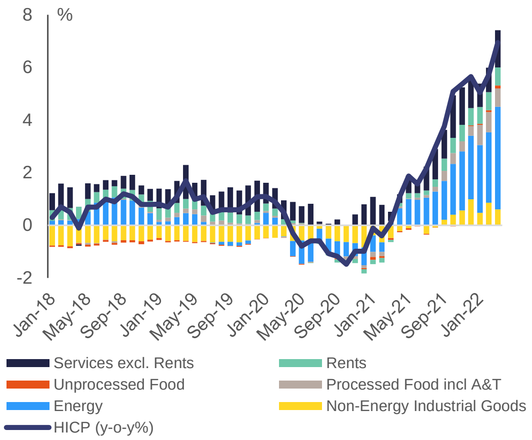
Risks to the Irish economic outlook have increased. These risks are due to: the Russian war on Ukraine; more persistent and pronounced inflation in Ireland; global supply bottlenecks; a possible aggravation of the COVID-19 situation; and the emergence of greater trade frictions between Ireland and the United Kingdom following the UK's departure from the European Union.

Inflation based on the harmonised index of consumer prices (HICP) has been accelerating. Energy prices were by far the dominant driver of inflationary pressures over recent months, rising by around 30% year-on-year in January-February 2022. The war on Ukraine has changed the energy market outlook, with energy prices expected to remain higher for much longer than previously thought and exerting upward pressure on inflation

(4) Irish SMEs borrowing from the five Irish retail banks: Bank of Ireland, AIB Group, Permanent TSB, Ulster Bank Ireland, and KBC Ireland.

in the near term. Food prices also reacted to shortages, as Ukraine and Russia are major producers of crops, and Russia is a major fertiliser producer, although price effects in Ireland have been more modest than in other parts of the EU. The war on Ukraine increased prices of non-energy industrial goods amid supply bottlenecks and the lack of certain raw materials from Russia. Domestically, rising residential rents have been the driving force for increases in the price of services. The inflationary momentum is set to persist for longer compared to previous forecasts, and might be exacerbated further should wage-price spirals emerge in the context of Ireland's tight labour market situation. Overall, HICP inflation in Ireland is projected to be 6.1% in 2022 and 3.1% in 2023.

Graph 2.7: **HICP inflation components**

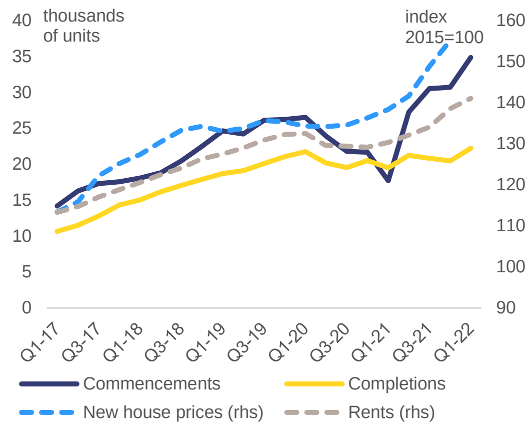


Source: Eurostat.

The housing stock is expanding, although the pace of expansion has stagnated in the last two years. Due to the pandemic-induced lockdown of the construction sector, housing completions continued to stagnate in 2021 at around 20 500 units (see Graph 2.8). After the re-opening of the economy in the second quarter of 2021 construction activity restarted. As a result, the number of housing commencements substantially increased, exceeding 30 000 units in 2021, paving the way for a rise in completions in 2022. Nonetheless, the gap between supply and demand is expected to remain wide in the short term, with the government estimating net additional housing needs to be around 33 000 units annually to 2030 ([5]). Of these, around 14 000 are needed annually in the Greater Dublin Area. To reach these ambitious targets, effective implementation of the government's 'Housing for All' plan will be essential. The capacity of the construction sector is expected to increase, but might be limited by labour constraints and rising costs of materials, which might strain the affordability and delivery of new projects.

House prices in Ireland accelerated in 2021, reflecting the continued supply shortfall. This follows two years of near-zero house price growth. Real house prices are estimated to have increased by 5.0% in 2021. In nominal terms, house prices increased by 8.3% on average in 2021, and followed an accelerating trend throughout the year. The latest data from February 2022 show residential property prices were up by 15.3% y-o-y, with price increases being slightly higher outside of Dublin (16.8%) than in the capital (13.5%).

Graph 2.8: **Housing developments**



Source: CSO, Eurostat, Department of Housing.

In the rental sector, rent increases were similar to house price trends. From the start of 2021 to 12 April 2021, emergency legislation temporarily banned rent increases and evictions. Following the re-opening of the economy in the second quarter of 2021, rental price growth accelerated. Outside of Dublin, the average percentage increase in rental prices was higher than in the capital in 2021, partly due to increased opportunities for tenants to work remotely. Housing stock available for rent reached record lows nationwide in 2021 due to high demand and mainly small-scale landlords leaving the rental market in response to rent controls in Rent Pressure Zones and to realise high sale prices.

([5]) Government of Ireland (2021) Housing for All: A new Housing Plan for Ireland, p. 31.

Growing interest in build-to-let schemes by institutional investors has helped soften the decrease in rental stock, but these schemes still represent a small portion of the rental sector.

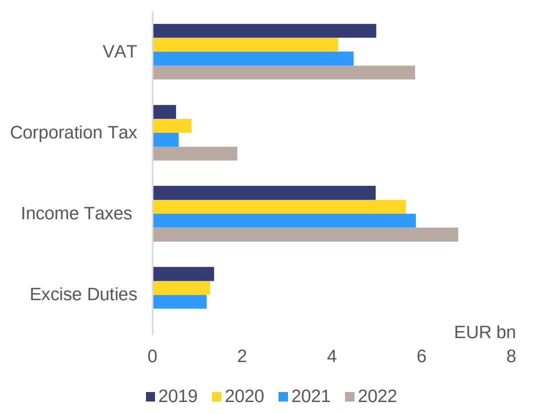
The outlook for commercial real estate varies greatly across segments. The industrial and logistics segments are seeing record levels of investment. This is mainly due to re-shoring of activities following Brexit and extra precautions by companies following supply-chain disruptions ([6]). The office sector has remained stable, as the introduction of teleworking arrangements which decreased the use of offices was compensated by the arrival of new companies in Ireland. The office vacancy rate has remained in single digits, and demand for new offices has begun to grow again ([7]). The retail sector was already in a downturn prior to the pandemic and was hit hardest by the COVID-19 restrictions. As a result, rents for prime retail were 20% lower in 2021 compared to 2019 but are expected to recover in the coming years along with footfall and in-person spending activity.

2.2. PUBLIC FINANCES

In March 2022, the Exchequer balance showed a minor surplus. However, on a twelve-month rolling basis, the Exchequer recorded a deficit of 0.7% of GDP. Tax revenues increased by more than 30% year-on-year in the first three months of 2022, although this increase was flattered by a base effect from the period of lockdown one year earlier. Income tax receipts for the 3 months to the end of March 2022 were up by 16% compared to the same period in the previous year amid record levels of employment compared to the previous year. At the same time, value added tax receipts grew by 30% in the first 3 months of 2022 compared to the previous year, as contact-intensive activities rose (see Graph 2.9). Total gross expenditure decreased by 3% year-on-year in the first 3 months of 2022, driven by the fading out of COVID-19 related social spending (see Graph 2.10).

The government deficit in 2021 decreased compared to 2020 amid high GDP growth and smaller COVID-19 related expenditure. In 2021, the government recorded a deficit of 1.9% of GDP, compared with 5.1% for 2020. A surprisingly strong performance from tax revenues and some underspending compared to government plans contributed to reducing the deficit. General government revenue in 2021 increased by 17.5% compared to the previous year, with direct taxes – corporate and personal income tax – increasing by 22.1% and VAT revenues by 28.7%. Government expenditure increased by 3.2% in 2021 compared to the previous year, with expenditure related to COVID-19 measures falling by approximately 15% compared to 2020. In 2022, the vast majority of spending by the main COVID-19 income and employment support schemes will be discontinued by the end of April, with the remaining schemes set to be discontinued by the end of May. According to the Commission 2022 spring forecast, the general government balance in Ireland is forecast to improve to a smaller deficit of 0.5% in 2022 and turn to a surplus of 0.4% in 2023. This compares to a deficit of 0.4% in 2022 and a surplus of 0.2% in 2023, projected by the authorities in the Stability Programme.

Graph 2.9: **Main exchequer tax receipts cumulative till end-March**



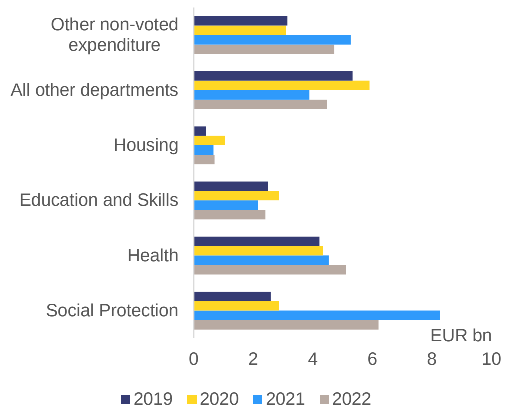
Source: Department of Finance.

While public debt increased in nominal terms in 2021, Ireland's debt-to-GDP ratio declined thanks to strong growth, and the its outlook appears benign. According to the Commission 2022 spring forecast, Ireland's gross general government debt-to-GDP ratio is estimated to have stood at 56.0% in 2021 and is projected to fall to 50.3% and 45.5% in 2022 and 2023. According to

([6]) CBRE (2022) Ireland Market Outlook 2022.
([7]) CBRE (2022) Dublin Office Figures Q1 2022.

the Irish authorities, in GNI* ([8]) terms – a metric to relate the debt burden to the size of the domestic economy – the public-debt ratio is projected to be 96.5% in 2022.

Graph 2.10: **Exchequer expenditure by department cumulative till end-March**



Source: Department of Finance.

Risks to the fiscal outlook are tilted to the downside. Public spending related to COVID-19 measures is already declining in line with the phasing out of measures to support the labour market. However, in response to heightened energy prices, Ireland deployed about EUR 1 billion to: (i) increase the fuel allowance; (ii) provide a EUR 200 (VAT inclusive) payment to all domestic electricity accounts; and (iii) reduce temporarily excise duty on fuels, among other measures, and reduce VAT on electricity and gas. Moreover, uncertainty remains around the cost of welcoming refugees fleeing the Russian aggression in Ukraine. In addition, persistently high inflation could lead to further increases in government support to households. Finally, the reform of the international corporate tax framework is unlikely to have any impact on Irish tax revenues before the end of 2023. Fiscal sustainability challenges for Ireland appear low over the short and medium term, and medium over the long term (see Annex 1).

2.3. FINANCIAL SECTOR

Irish banks have come out of the pandemic without major setbacks. However, the Russian war of aggression against Ukraine poses new risks to the global economic environment that may feed through to the domestic financial system. Irish banks have withstood the impact of the pandemic without major deterioration in their asset quality, even though the risks in their loan book have increased and deserve monitoring. Ireland has very limited direct exposures to Russia or Ukraine, and does not rely in a meaningful way on Russian energy. Nevertheless, the global rise in energy and raw-material prices is bound to lead to higher inflation in Ireland and elsewhere, and to have repercussions on the Irish economy. This is expected to also feed through to Irish financial institutions. Meanwhile, the withdrawal of two foreign-owned banks from the Irish market has triggered a sectoral restructuring which creates opportunities for the incumbent banks and other financial institutions. The increasing presence of non-bank lenders is further changing the banking landscape in Ireland, as is the presence of fintechs.

Capital levels of Irish retail banks remain solid ([9]). Their total capital ratio increased slightly during 2021 to an aggregate level of 23.5%, up from 22.2% in the previous year. Irish retail banks' leverage ratio is higher than European banks' average, with a leverage ratio of 8.1% in December 2021, down from 9.0% a year earlier, versus a European average of 5.7% at the end of 2021 ([10]).

Irish banks benefit from ample liquidity, driven by an increase in deposits and Eurosystem borrowing. As the government provided income substitution during the pandemic, consumers were able to accumulate savings amidst curtailed spending opportunities. Between February 2021 and February 2022, deposits from the Irish private sector surged by EUR 44.5 billion to

([8]) 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.

([9]) The five retail banks are Bank of Ireland, AIB Group, Permanent TSB, Ulster Bank Ireland, and KBC Ireland, together comprising about 45% of bank capital allocated in the Republic. Given the significance of the retail banking sector for the Irish domestic economy, in particular lending to households and SMEs, they are the main focus of this analysis.

([10]) Leverage ratios on a transitional basis, computed as: total capital/total assets.

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

	Ireland											Euro area	EU
in %	Q4-2016	Q4-2017	Q4-2018	Q4-2019	Q1-2020	Q2-2020	Q3-2020	Q4-2020	Q1-2021	Q2-2021	Q3-2021	Q3-2021	Q3-2021
Non-performing loans	13.1	9.9	5.5	3.4	3.1	3.5	3.5	3.4	3.1	2.8	2.4	2.1	2.1
o/w foreign entities	9.2	7.1	-	-	-	-	-	-	-	-	-	-	-
o/w NFC & HH sector	16.6	14.1	8.2	5.6	5.3	6.0	6.3	-	-	-	-	-	-
o/w NFC sector	15.3	11.8	5.7	3.2	3.1	4.5	5.3	6.2	6.3	6.2	5.9	4.2	4.1
o/w HH sector	17.4	15.5	10.1	7.2	6.9	7.1	7.0	6.8	6.3	5.8	5.0	2.5	2.5
Coverage ratio	35.5	29.9	28.5	27.5	27.9	29.7	28.8	30.2	28.3	29.1	28.5	46.7	46.5
Return on equity(1)	6.3	5.0	4.9	3.7	-0.3	-5.4	-3.0	-2.2	3.8	4.4	4.2	6.9	7.1
Return on assets(1)	0.9	0.7	0.7	0.5	0.0	-0.7	-0.4	-0.3	0.4	0.5	0.4	0.5	0.5
Total capital ratio	25.0	25.2	25.4	24.9	24.7	25.2	25.7	25.4	25.6	26.0	25.7	19.1	19.3
CET 1 ratio	22.2	22.9	22.9	22.3	22.2	22.4	22.6	22.3	22.4	22.6	22.3	15.8	16.0
Tier 1 ratio	23.0	23.4	23.4	23.0	22.9	23.4	23.7	23.3	23.5	23.7	23.4	16.9	17.1
Loan to deposit ratio	93.2	95.3	90.2	91.5	90.3	84.7	82.1	83.9	81.2	76.9	75.7	83.4	86.5

(1) For comparability reasons, annualised values are presented.

Source: ECB - Consolidated Banking data; own calculations.

EUR 298.7 billion ([11]). Irish banks' borrowing from the Eurosystem increased slightly in 2022 and totalled EUR 21.1 billion in March 2022, also due to larger TLTRO borrowing. Irish banks hold EUR 678.8 billion in assets and report a comfortable net stable funding ratio (150%) and liquidity coverage ratio (187%), as at September 2021. Given weak demand for loans, most of this liquidity is held as cash or central bank deposits. However, due to the prevailing negative-interest-rate environment, these large stocks of cash and other liquid assets represent a cost for banks, which are now trying to pass on part of these costs to their customers without significantly eroding their deposit base. To this end, some banks have already begun to charge negative interest rates to large depositors.

The Irish banking sector reported positive returns in 2021 amidst ongoing profitability challenges. Retail banks returned to profitability in 2021, with a return on equity (RoE) of 4.9%, following the sizeable losses booked for 2020 (RoE at -6.7%). The improvement was driven mainly by the lower – or in some cases reversed – impairment charges, which had been especially heavy at the onset of the pandemic in 2020. Net interest income in 2021 remained slightly short of the levels seen in 2020. In this respect, the net interest margins of retail banks decreased further, from 1.91% at the end of 2020 to 1.64% at the end of 2021. Although their return on assets of 0.47% for 2021 was in line with the EU average of 0.48%, their RoE of 4.70% fell significantly short of the EU average of 7.11% ([12]). On the cost side, banks continued their restructuring efforts in 2021. These efforts partly aimed at reducing operating costs, which remain high, with cost-to-income ratios close to 80%, well above the EU average (61% in September 2021). Irish banks have also been burdened by temporary restructuring costs. Such restructurings aimed, among others, at helping to diversify banks' revenues, which remain strongly dependent on interest income, accounting for 79% of total operating income in 2021 (82% in 2020).

In the future, banks' income situation may improve thanks to rising interest rates and consolidation in the sector. Irish banks are likely to benefit from a rising interest rate environment, notwithstanding the risk of slowdowns in economic activity created by these higher rates. Irish banks hold a large share of variable or tracker mortgages that generate higher income when rates rise. Meanwhile, their deposit base is sticky, with more stable interest rates, making it unlikely that deposit rates will rise proportionally. This creates an opportunity to widen net interest rate margins. The withdrawal of two foreign-owned banks provides some consolidation opportunities, which should allow the incumbent banks to realise economies of scale, improving their cost-income-ratio in the medium term.

Irish retail banks continued disposing of their non-performing loan (NPL) exposures, reducing them to the lowest levels since the

([11]) Deposits from Irish residents, all sectors with all banks.

([12]) European averages refer to the annualised values of Q3 2021.

financial crisis. After a slight increase in 2020 (to 5.5%), the NPL ratio kept decreasing in 2021, falling to 3.7% at year-end. This was driven by a reduction in Irish retail banks’ stock of NPLs over 2021, from EUR 12.9 billion to EUR 9.3 billion ([13]). The reduction was achieved mainly through sales and securitisations, which regained momentum in 2021 after stalling in 2020, with sales for EUR 3 billion of NPLs in 2021, compared with EUR 1.1 billion one year earlier. Sales of loans in long-term arrears accounted for the largest share of NPL sales, and have been especially significant for residential mortgages, which accounted for only 46% of total NPLs in 2021, down from 75% in 2019. Notwithstanding these overall positive developments, some concerns remain for some bank exposures to non-financial corporations (NFCs), where defaults have increased. In this context, the limited enforceability of collateral, especially important for mortgage loans, remains a weakness for retail banks, leading to high loss-given-default estimates, high risk-weights on loans, and lower recovery rates.

The pandemic keeps weighing on banks’ asset quality, and especially on their NFC loans. The phasing out of most pandemic-relief measures has so far not translated into noticeably high rates of default, and credit quality at end-2021 had improved compared to end-2020. Retail banks’ exposures to NFCs remain the most vulnerable part of their loan book but saw improvements in their risk profile. This is because: (i) the share of stage 2 loans within this portfolio decreased from 37.7% at the end of 2020 to 26.3% at the end of 2021; and (ii) the share of stage 3 loans remained roughly stable at 7.3%. Loans to NFCs where a payment holiday had been granted but has now expired (EUR 21.1 billion) kept showing some signs of distress, with large amounts in forbearance (25% of total) and weak asset quality. This was especially the case for SMEs and corporate loans, over 70% of which were in stage 2 or 3. More positive developments were recorded for mortgages, as households were able to maintain their income levels and keep up with their mortgage payments. In addition, increased household savings helped to reduce the share of risky loans (loans in stages 2 and 3) and forbearances, to 35% and 17% respectively for private-dwelling home mortgages exiting payment holidays. Finally, the wage-subsidy scheme still covers a significant share of wage costs in several of the sectors most affected by the pandemic, some of which show high-risk profiles. The phasing out of this wage-subsidy scheme in April and May 2022 could be a further source of stress.

Lending to households and NFCs remains below pre-pandemic levels. Lending to households was buoyed by strong demand for mortgages in 2021. Many households were able to maintain income levels, helped by government support schemes during the pandemic, while demand for services was forcibly reduced by lockdown measures. Some household segments used accumulated savings as a good opportunity for making down-payments on mortgages. Mortgage lending thrived, and nominal prices for homes climbed to highs last seen in 2008, even if in real terms the rise is less pronounced. In the second half of 2021, new lending for house purchases was EUR 6 267 million, 1.7% above levels of the same period in 2019, and up 9.7% on the same period in 2020.

Lending to the business sector remains subdued. Lending to SMEs has been in decline since the beginning of the pandemic. Total new credit advanced to Irish-resident SMEs fell by 16.6% year-on-year in December 2021. This may be due to two main reasons: (i) government support schemes may have reduced liquidity needs in the business sector; and (ii) the ongoing uncertainty around the outcome of the pandemic has dampened the appetite for investment. More recently, this climate of uncertainty has been compounded by Russia’s invasion of Ukraine and the energy crisis. The winding-down of government support schemes will likely lead to an increase in credit demand, as also expected by Ireland’s central bank. In the second half of 2021, new lending to SMEs was 10.5% below the level of the second half of 2020, and 29.8% below the level of the same period in 2019. Credit applications had been on a declining trend for years, but the pandemic has pushed them even lower. The shrinking of lending was especially visible in the accommodation and food sectors, which were the most affected by the pandemic. In

([13]) In Q4-2021, the reclassification of mortgages held by an exiting bank (to the ‘held for sale’ category), contributed to reducing the overall stocks of NPLs.

this context, non-banks are playing an increasingly significant role in SME lending.

The Irish retail banking sector is undergoing major structural changes that may provide profitable opportunities for incumbent banks, as they see their market shares increase. KBC and Ulster Bank, a subsidiary of British banking conglomerate NatWest, are withdrawing from Ireland. The three retail banks that remain, AIB, Bank of Ireland and Permanent TSB (PTSB), have entered into agreements to buy different parts of the departing banks' loan portfolios: AIB is acquiring from Ulster EUR 4.2 billion of commercial loans and EUR 3.8 billion of associated undrawn facilities. Meanwhile, Bank of Ireland has agreed to acquire nearly all of KBC's performing assets of about EUR 9 billion and customer liabilities of about EUR 4.4 billion. PTSB has agreed with NatWest to buy Ulster's performing non-tracker mortgage book, their performing micro-SME loans, and the asset finance arm of the business, altogether amounting to EUR 7.6 billion. This is a substantial purchase for PTSB, given their current performing loan book size of EUR 14.9 billion. In turn, NatWest is set to acquire an equity stake in PTSB to facilitate the transaction. To diversify their income sources, AIB completed the acquisition of Goodbody stockbrokers in August 2021, while Bank of Ireland agreed to buy Davy stockbrokers. Beyond that, banks are investing in their IT systems and advancing their digitalisation projects. While the related investments are initially costly, they should increase efficiency and achieve savings in the future.

Ireland's market-based financial sector continued expanding in 2021, with assets worth about 25 times national GNI*. The market-based finance sector is composed of a diverse set of institutions such as investment and money-market funds, securitisation and non-securitisation vehicles, as well as other financial institutions. The sector kept expanding in 2021, driven especially by the marked growth of equity funds, and the Central Bank of Ireland currently estimates that the sector holds over EUR 5.6 trillion of combined assets. The market-based finance sector is dominated by investment funds (including money-market funds), whose activities and investments remain focused on international assets, with a very small share allocated to the domestic economy, mostly through property funds. Equity and bond funds remain the largest, at EUR 1.45 trillion and EUR 1.1 trillion under management respectively, and have been recording the highest absolute growth of any type of investment fund in Ireland in recent years. In particular, equity funds more than doubled in size since the end of 2016, when they had EUR 600 billion under management. This expansion is due to both increases in activities and the revaluation of their equity assets. Special purpose entities (SPEs) also represent a significant share of the sector, and can be split between securitisation vehicles (EUR 580 billion) and other vehicles (EUR 440 billion). The latter are generally linked to investment funds, or set up to provide companies with intra-group or external financing. Irish SPEs came under closer scrutiny in 2022, given their significant exposures to Russia, estimated at EUR 35.5 billion at the end of 2021. In most cases, these SPEs are linked to large Russian companies and banks, who use these vehicles for external financing. However, they appear to have no ties to the Irish economy, and most of their activities have stalled since sanctions were introduced in 2014. Finally, Irish domestic and international banks have kept reducing their claims on the Irish non-bank financial sector, and by the end of 2020 these amounted to EUR 31 billion, compared to EUR 52 billion in March 2017, mostly linked to retained securitisations.

Non-bank lenders play an increasingly important role in the Irish commercial real-estate market and in lending to SMEs. While most non-bank financial institutions have very limited links to the Irish economy, property funds are active in the Irish real-estate market, especially in the buy-to-let market and in real-estate development finance. At the end of 2021, Irish property funds held EUR 27.6 billion of assets, accounting for approximately 40% of the investable Irish commercial real-estate market. These are mainly concentrated in offices (37%), and in the retail (26%) and residential (15%) sectors. While regulatory requirements for property funds are less stringent than for credit institutions, the Central Bank of Ireland recently proposed to introduce liquidity and leverage limits for funds with over half of their assets in Irish properties. The purpose of these proposed limits is to safeguard the resilience of this growing form of financial intermediation, so that such funds would be better able to absorb – rather than amplify – future adverse shocks. In addition, in recent years, non-bank lenders have also increased their market share in SME lending. In 2021, non-bank lenders accounted for over 20% of new lending in most SME sectors, with the largest shares recorded in the real-estate and construction (47%) and wholesale and retail trade (41%) sectors. Over the course of 2021, the share of non-banks' new lending to SMEs increased in all sectors, except for manufacturing.

Irish banks show limited exposures to Russia and Ukraine, but remain exposed to second- and third-round effects. The Russian war of aggression against Ukraine is clouding the global economic outlook with higher uncertainty. Although the Irish economy shows very limited direct links to the countries directly involved in the war, indirect effects, especially on energy and food prices, could weigh strongly on corporates and households. In particular, energy-intensive sectors are likely to face cost pressures, which could lead to a deterioration in the quality of banks' loan books. Irish banks are closely monitoring these developments, and it will be important for them to identify possible vulnerabilities and take remedial actions in a timely manner. In parallel, higher costs might impact consumption and reduce economic activity, possibly also eroding banks' deposit bases. More positively for banks, if central banks continue to normalise monetary policy, retail banks would likely benefit by increasing their interest margins and net interest income. Among other non-bank financial-sector entities, as mentioned previously, Irish Russian-sponsored SPEs hold large amounts (EUR 35.5 billion) of Russian assets, used mostly for external financing. Irish investment funds also report material direct exposures to Russian bonds and assets. These, although sizeable (EUR 11.5 billion at the end of 2021), represent only a small fraction of their assets (0.3%) and are mainly composed of Russian government bonds (EUR 5.1 billion) and equity holdings in Russian NFCs and banks (respectively EUR 4.3 billion and EUR 1.4 billion).

As the risks from the pandemic dissipate, new geopolitical challenges have appeared. The Irish financial system has weathered the pandemic well and without major setbacks. Although banks' asset quality has deteriorated since March 2020, especially in the hospitality sector, the risks seem manageable. New risks stem mainly from the rising energy and commodity prices that feed through to both higher inflation and disruptions in value chains. Beyond that, a global tightening of financial conditions and the uncertain impact of changes in the international tax environment could prove challenging for Ireland. Macroeconomic risks associated with the Russian invasion of Ukraine and the energy crisis need to be monitored and their potential impact on the banking sector assessed.

3. POLICY ISSUES

3.1. PUBLIC FINANCES

Ireland's pandemic-response measures are being wound down. On the expenditure side, the fiscal cost of shoring up the economy amounted to EUR 14.7 billion in 2020 (3.9% of GDP or 7.1% of GNI*) and EUR 12.5 billion in 2021 (3.0% of GDP or around 5.5% of GNI*). As of the time of Budget 2022, the Irish authorities planned COVID-19-related expenditure of EUR 7 billion in 2022 (1.5% of GDP), of which EUR 4 billion was assigned to an unallocated contingency reserve. As of the first quarter of 2022, EUR 1.5 billion from this contingency fund had been effectively committed. The rest of the fund may be used to meet costs associated with helping Ukrainian refugees fleeing Russia's aggression against Ukraine, in addition to any other costs associated with changes in the virus or the labour-market impact of removal of supports. In the Stability Programme, the Irish authorities assume a refugee inflow of 80 000 to 100 000 people. From the end of March 2022, recipients of the PUP have started transitioning to the standard terms of support for jobseekers, and the Employment Wage Subsidy Scheme is expected to end on 30 April 2022 for most sectors and at the end of May for certain exceptional sectors. On the revenue side, the 'tax warehousing' scheme ended for most businesses on December 2021, although it was extended for some businesses to April 2022. As of January 2022, the payment of over EUR 3 billion in taxes was delayed under the scheme.

The Irish government is considering policy options to meet fiscal-sustainability challenges emanating from the pension system. Public spending on pensions is expected to increase by 2.3 pps of GDP between 2019 and 2040. The Irish government repealed an increase in the pensionable age from 66 to 67 that was expected to enter into force in January 2021. A report by the independent Pensions Commission suggests a gradual incremental increase in the state pension age by 3 months each year, beginning in 2028 and reaching 67 in 2031, with further increases of 3 months every 2 years, reaching 68 in 2039 ([14]).

([14]) Report of the Commission on Pensions https://www.gov.ie/en/publication/6cb6d-report-of-the-commission-on-pensions/.

Ireland has joined more than 130 countries in committing to reforms aimed at strengthening the international tax framework. In October 2021, Ireland announced that it would join the global deal of the OECD/G20 Inclusive Framework on base erosion and profit shifting, aimed at reforming international tax rules. The European Commission has proposed a directive setting out how EU Member States, including Ireland, will apply the principles of an 15% effective corporate tax rate. According to the Irish authorities the revenue impact of the implementation of this deal is broadly estimated at EUR 2 billion relative to baseline by 2025, phased in from end-2023.

The sensitivity of tax revenues to the income and profit developments of corporations has risen. Corporate tax revenues now account for 22.4% of total Irish tax revenues. This significant source of income is driven by a small number of firms. In 2020, the top 10 corporate taxpayers accounted for around half of corporation tax revenues. In particular, the performance of the pharmaceutical and information and communications technology (ICT) sectors were extraordinary due to the strong demand for their products during the pandemic, but may not show the same buoyancy in the future. In addition, the structure of taxes on individual or household income is associated with a narrow tax base: one in three income earners in 2021 was exempt from taxes as their standard rate liability was covered by credits or age-exemption limits.

3.2. FINANCIAL SECTOR POLICIES

Government support schemes cushioned the impact of the pandemic on the financial sector, and their phasing out requires close monitoring. Several relief schemes were introduced since the start of the pandemic, the most significant ones being the Employment Wage Subsidy Scheme (EWSS) and the Pandemic Unemployment Payment (PUP). By the end of 2021, these schemes jointly accounted for over EUR 17.5 billion of disbursements made since the outbreak of COVID-19 in early 2020. As mentioned earlier, the PUP was closed in March 2022, with 44 747 people still registered, while the EWSS still recorded over 258 000 registered users (as at

February 2022), and will close between April and May 2022. The closure of these programmes could have an impact on households and on certain business sectors that are still reliant on wage subsidies, possibly affecting credit quality in banks' loan books. On the corporate side, most direct support schemes expired in the second half of 2021. However, the COVID-19 credit guarantee scheme, which targets SMEs and mid-cap businesses, registered approvals for the scheme totalling EUR 667.2 million since the outbreak of the pandemic and is still open for applications. Although NFC defaults and insolvencies remained at low levels during the pandemic, there are some sectoral pockets showing signs of financial tension, which could also persist in the medium term. Supervisory and regulatory vigilance towards potential emerging instabilities is advisable.

The Central Bank of Ireland is currently reviewing the capital framework in order to assess the appropriate level of capital for financial institutions and the appropriate composition of this capital across the different types of capital buffer. This review will take into account the experience from the pandemic and give insights into the optimal CET1 ratios through the cycle. The countercyclical capital buffer (CCyB) was set at zero in the context of the pandemic. In November 2021, the Central Bank outlined that it would expect to announce a gradual rebuilding of the CCyB in 2022, given the macro-financial outlook at that time. However, since then the war in Ukraine has raised the uncertainty around the macro-financial environment. The institution-specific capital buffers for other systemically important institutions range between 0.5 and 1.5%. The systemic risk buffer is currently kept at zero.

Mortgage measures capping individual borrowing were kept constant in 2021. Currently, mortgages are capped at 3.5 times borrower's income, while a minimum deposit of 20% of the purchase price is required. For first-time buyers, the deposit minimum is lower at 10%. For buy-to-let, a minimum deposit of 30% is required. In recent years, the effects of the maximum loan-to-income (LTI) ratio have become more widely felt as the distribution of LTIs has moved closer to its ceiling due to the upward trend in real-estate prices. Even if higher house prices raise concerns over affordability, they are becoming less worrying from a financial-stability perspective as household debt as a percentage of GDP and disposable income has been on a declining trend in recent years. Household debt stood at 108% of disposable income in September 2021.

The Central Bank of Ireland is currently reviewing the mortgage framework. The review aims to make sure that the framework is still appropriate and entails a fresh assessment of the framework's objectives, instruments and decision making. The review was launched in July 2021 with a public survey, and was followed by consultations with external stakeholders. The Central Bank will make a decision on any potential changes in mortgage measures in the second half of this year, after examining the findings from the consultation, and in light of the insights from a related conference held in April 2022.

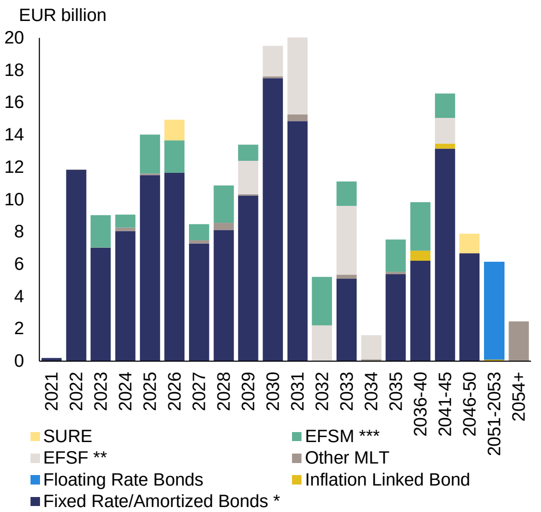
Non-banks' increasing activities and lending to the domestic economy require a careful delineation of policy options and regulations. While Ireland-based investment funds have international ownership and invest globally, they also have significant ties to the domestic real-estate sector. Meanwhile, non-bank lenders have also grown in significance as finance providers to Irish SMEs. The increasing overlap of the activities of non-bank lenders with those of retail banks requires a level playing field and a sufficient degree of competition. To ensure that property funds are resilient to real-estate downturns and do not act as shock amplifiers, the Central Bank of Ireland proposed to introduce measures to limit leverage and provide guidance on liquidity mismatches for property funds concentrated on the domestic market. In parallel, fintechs are growing in Ireland's dynamic financial landscape, and their varied business models can complicate the adoption of proper policy options and regulations, both at national and at European level. Against this background, and given the limited transparency of the market-based financial sector, the Central Bank of Ireland is strengthening its monitoring activities.

4. SOVEREIGN FINANCING ISSUES

Ireland holds healthy cash balances, and the government funding strategy is focused on preserving smooth market access. The National Treasury Management Agency (NTMA) issued EUR 18.5 billion in long-term bonds in 2021 ([15]), at an average maturity of more than 14 years and a weighted average yield below 0.2%. The 2022 funding strategy foresees a range of EUR 10-14 billion in issuance for the year, of which EUR 4.5 billion was issued in the first quarter of the year with a weighted average yield of 0.5% and a weighted average maturity of more than 11 years. Cash balances were EUR 27.5 billion at the end of 2021 and are projected to decrease to approximately EUR 21 billion by the end of 2022. There are two bond redemptions in 2022, for a total of EUR 11.8 billion.

Ireland continues to enjoy good market presence despite recent increases in interest rates. The ten-year bond yield for Ireland was around 1.5% at the end of April 2022, and the spread against the German benchmark was stable at around 0.6%, somewhat wider than at the beginning of the year. The Irish sovereign credit-rating outlook is stable. Despite the large cash balance, Ireland has announced that it plans to issue in a range of EUR 10-14 billion of bonds in 2022. This will provide liquidity and depth to the Irish government bond market. Interest expenditure in Ireland is estimated to have fallen to 0.8% of GDP in 2021 (1.5% of GNI*) from 1.0% in 2020, and is expected to remain close to the 2021 level this year and next. A possible adjustment of the ECB's very accommodative monetary policy stance is unlikely to have a significant impact on Ireland's interest bill in the near term thanks to the proportion of fixed rate debt and the maturity profile of public debt. Going forward, however, rate increases and a withdrawal of non-standard monetary policy measures could still affect Irish sovereign bond yields. Additional risk factors include geopolitical developments, possible adverse development from the legacy of the pandemic, and high inflation.

Graph 4.1: **Maturity profile of medium- and long-term marketable and official debt (end-September 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 reflects 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 next EFSM maturity is scheduled for 2023 and Ireland does not have to repay any of its EFSF loans before 2029 ([16]). As of the third quarter of 2021, 'sticky' sources — such as official loans, Eurosystem bond holdings, and domestic retail holdings — accounted for over 60% of Irish government debt, pointing to low risks for the servicing of government debt in general.

([15]) EUR 19.3 billion including funds raised in non-competitive bond auctions.

([16]) The maturity of EFSM loans to Ireland can be extended, to a weighted maximum of 19.5 years.

Table 4.1: **Government financing plans**

EUR billion	2021	2022
Funding requirement		
Exchequer borrowing requirement (EBR) (1)	7.4	1.1
Bond maturities	0.0	11.8
Net short-term paper	4.2	0.0
UK bilateral loan	0.5	0.0
Other (2)	3.6	4.7
Total requirement	***15.7***	***17.6***
Funding sources		
Government bonds (3)	20.4	10.0
SURE Programme	2.5	0.0
Other (4)	2.9	1.3
Use of cash (- represents an increase)	-10.1	6.3
Total sources	***15.7***	***17.6***
Financial buffer (5)	**27.5**	**21.1**

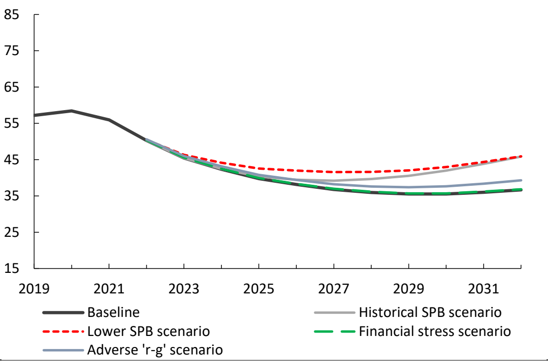
Rounding may affect totals. Provisional outturn figures for 2021; 2022 figures are estimates, as of April 2022.
(1) 2022 estimate as per Department of Finance, Stability Programme Update 2022 (April 2022).
(2) Includes FRN purchases, and for 2022 general contingencies, including for potential bond purchases.
(3) 2021 reflects cash proceeds from bond syndications and auctions, including non-competitive auctions and inflation-linked issues. The NTMAs bond funding range for 2022 is EUR 10-14 bn. EUR 10 bn, the lower bound of the range, is reflected in this presentation.
(4) This category is mostly comprised of net State savings (retail) funding, and other medium/long-term borrowing.
(5) Exchequer cash; excludes other non-liquid Exchequer financial assets.

Source: NTMA.

ANNEX 1
Debt sustainability analysis

Fiscal sustainability challenges for Ireland appear low over the short and medium term, and medium over the long term. The debt to GDP ratio peaked at around 58% of GDP in 2020 and fell to 56% in 2021. According to the debt sustainability analysis based on the Commission 2022 spring forecast **(**[17]**)**, this ratio is projected to decline further between 2021 and 2030. Initially, the decline is supported by the phasing out of the pandemic-related support to companies and households, a buoyant outlook for the labour market, and nominal GDP growth. In the baseline scenario (Graph A1.1), the debt ratio is expected to remain broadly stable at around 36% of GDP from 2028 onwards, notwithstanding a slight projected increase in the primary deficit in the outer projection years. No additional fiscal effort is required to keep the debt ratio below 60% of GDP within 15 years (S1 indicator) ([18]).

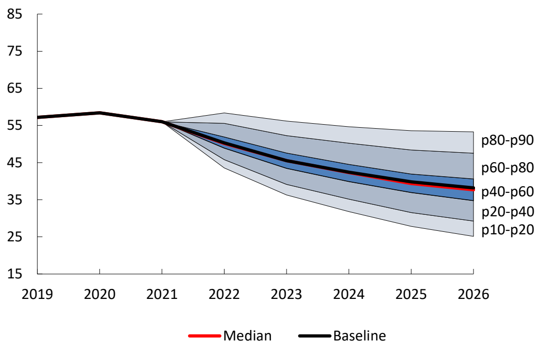
Graph A1.1: **Deterministic debt projections (% of GDP)**



Source: European Commission.

The robustness of these projections against alternative assumptions is high. Four alternative scenarios around the baseline illustrate the impact of changes in assumptions (Graph A1.1). The 'historical SPB' scenario assumes that the structural primary balance (SPB) gradually returns to its past average level. In the 'lower SPB' scenario, the SPB is permanently weaker than in the baseline. The 'adverse interest-growth rate' scenario assumes a less favourable snowball effect ([19]) than in the baseline. In the 'financial stress' scenario, the country temporarily faces higher market interest rates in 2022. In all the scenarios, the debt ratio remains below the 2019 level of 57.2% of GDP by 2032.

Graph A1.2: **Stochastic debt projections (% of GDP)**



Source: European Commission.

The robustness of these projections against plausible unforeseen events is also high. Stochastic projections show the impact on debt of 2 000 different shocks affecting the government's budgetary position, economic growth, interest rates and exchange rates (Graph A1.2). The cone covers 80% of all the simulated debt paths, therefore excluding tail events. The uncertainty surrounding the baseline scenario – measured by the difference between the 10th and 90th debt distribution percentiles – is moderate compared to the other EU Member States.

Ageing costs pose challenges to debt stabilisation over the long term. The consolidation effort required to stabilise debt over an infinite horizon, at 5.3 pps of GDP, points to medium fiscal sustainability risks in the long term (S2 indicator). The *initial budgetary position* measures the gap between the initial and the debt-stabilising structural primary balances. At 0.3 pps of GDP, it points to only a very limited required fiscal effort. The *ageing costs* component accounts for the need to absorb the projected change in public expenditure on pensions, health care and long-term care. It is the main driver of the S2 in the case of Ireland, with rising ageing costs requiring an estimated fiscal effort of 5 pps of GDP to stabilise government debt over time.

([17]) See Fiscal Sustainability Report 2021 for methodological details.
([18]) See Country Report Ireland 2022 for the indicators
([19]) The difference between interest payments and nominal GDP growth.

Risks to the outlook are balanced. Risks related to a potential increase in interest rates are low because only a small amount of Irish public debt has to be repaid in the short term. Moreover, the Irish government has committed to capping overall core expenditure growth at a rate in line with the trend growth of the economy (estimated by the authorities at 5%). On the other hand, future potential rises in capital expenditure related to increasing the housing stock and transitioning to a climate neutral economy could test this commitment. Additional risk-increasing factors are related to contingent liability risks stemming from the private sector, including via the possible materialisation of state guarantees granted to firms and self-employed during the COVID-19 crisis. However, this risk remains currently limited due to relatively low take-up so far. The negative net international investment position could be an aggravating factor, though it largely reflects presence of multinationals and International Financial Services Centre. Finally, alternative metrics to GDP – such as GNI* – suggest more important fiscal sustainability risks.

ANNEX 2
Supplementary tables

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

	2020	2021	2022	2023
		% of GDP		
Indirect taxes	6.3	6.8	6.7	6.7
Direct taxes	10.0	10.8	10.5	9.9
Social contributions	4.0	3.8	3.7	3.7
Sales	1.1	0.9	0.8	0.8
Other current revenue	0.5	0.4	0.4	0.3
Total current revenue	**21.9**	**22.7**	**22.1**	**21.3**
Capital transfers received	0.3	0.3	0.3	0.4
Total revenue	**22.2**	**23.0**	**22.5**	**21.7**
Compensation of employees	6.6	6.2	5.9	5.6
Intermediate consumption	4.0	3.9	3.5	3.3
Social transfers in kind via market producers	1.9	1.8	1.7	1.6
Social transfers other than in kind	8.2	7.1	6.5	5.6
Interest paid	1.0	0.8	0.8	0.7
Subsidies	1.7	1.6	0.6	0.4
Other current expenditure	1.1	1.1	1.3	1.2
Total current expenditure	**24.5**	**22.5**	**20.2**	**18.4**
Gross fixed capital formation	2.3	2.0	2.3	2.3
Other capital expenditure	0.5	0.4	0.5	0.5
Total expenditure	**27.3**	**24.9**	**22.9**	**21.2**
General government balance	**-5.1**	**-1.9**	**-0.5**	**0.4**
General government balance net of one-offs	**-5.1**	**-1.9**	**-0.5**	**0.4**
		EUR billion		
Indirect taxes	23.6	28.7	31.2	33.7
Direct taxes	37.2	45.6	49.1	50.1
Social contributions	15.0	16.1	17.2	18.7
Sales	3.9	3.8	3.8	3.8
Other current revenue	1.8	1.5	1.7	1.6
Total current revenue	**81.6**	**95.7**	**103.0**	**107.8**
Capital transfers received	1.0	1.2	1.4	1.7
Total revenue	**82.6**	**97.0**	**104.4**	**109.5**
Compensation of employees	24.6	26.0	27.3	28.3
Intermediate consumption	14.9	16.2	16.5	16.9
Social transfers in kind via market producers	7.2	7.5	7.8	8.0
Social transfers other than in kind	30.4	29.9	30.3	28.2
Interest paid	3.8	3.3	3.6	3.5
Subsidies	6.4	6.9	2.6	2.2
Other current expenditure	4.0	4.8	6.0	5.8
Total current expenditure	**91.4**	**94.7**	**94.0**	**93.0**
Gross fixed capital formation	8.5	8.5	10.6	11.8
Other capital expenditure	1.8	1.8	2.2	2.3
Total expenditure	**101.8**	**105.1**	**106.8**	**107.2**
General government balance	**-19.1**	**-8.1**	**-2.4**	**2.3**
General government balance net of one-offs	**-19.1**	**-8.1**	**-2.4**	**2.3**

Source: Eurostat and European Commission.

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

	2020	2021	2022	2023
Real GDP growth (% change)	**5.9**	**13.5**	**5.4**	**4.4**
levels, EUR billion				
Government balance	**-19.1**	**-8.1**	**-2.4**	**2.3**
Gross debt	217.9	235.9	234.1	230.0
Change in gross debt	13.9	18.0	-1.8	-4.1
Real GDP	353.8	401.5	423.1	441.8
% of GDP				
Government balance	**-5.1**	**-1.9**	**-0.5**	**0.4**
Gross debt ratio	58.4	56.0	50.3	45.5
Change in gross debt	1.2	-2.5	-5.6	-4.8
contribution to change in gross debt				
Primary balance	-4.1	-1.1	0.3	1.1
'Snow-ball' effect*	-1.5	-6.0	-4.4	-3.3
of which				
Interest expenditure	1.0	0.8	0.8	0.7
Real growth effect	-3.2	-7.0	-2.7	-2.1
Inflation effect	0.7	0.2	-2.4	-1.9
Stock-flow adjustments	**-1.4**	**2.3**	**-0.9**	**-0.4**
Implicit interest rate	*1.9*	*1.5*	*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 changes in the debt ratio.

Source: Eurostat and European Commission.

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