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Post-Programme Surveillance Report

Ireland, Autumn 2018

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EUROPEAN ECONOMY

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European Commission
Directorate-General for Economic and Financial Affairs

Post-Programme Surveillance Report

Ireland, Autumn 2018

EUROPEAN ECONOMY

Institutional Paper 098

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This report reflects information available up until 9 January 2019.

([1]) The report was adopted as Commission Communication C(2019)652 on 24 January 2019, accompanied by a Staff Working Document.

([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
AHB	Approved Housing Body
BOI	Bank of Ireland
BTL	Buy-to-let
CBI	Central Bank of Ireland
CET1	Common Equity Tier 1
CSO	Central Statistics Office Ireland
CSRs	Country Specific Recommendations
DHPLG	Department of Housing, Planning and Local Government
DPD	Days past due
ECB	European Central Bank
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ESB	Electricity Supply Board
FTB	First-time buyer
GDP	Gross Domestic Product
GNI*	Modified Gross National Income
GNP	Gross National Product
HBFI	Home Building Finance Ireland
HICP	Harmonised Index of Consumer Prices
ICT	Information and Communication Technology
IDR	In-Depth Review
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
IMHO	Irish Mortgage Holders Organisation
IP	Intellectual property
LTI	Loan-to-income
LTV	Loan-to-value
MIP	Macroeconomic Imbalance Procedure
MREL	Minimum requirements for own funds and eligible liabilities
NAMA	National Asset Management Agency
NESC	National Economic and Social Committee
NPLs	Non-performing loans
NTMA	National Treasury Management Agency
OECD	Organisation for Economic Co-operation and Development
PDH	Primary Dwelling Home
PPS	Post-programme surveillance
PTSB	Permanent TSB Group Holdings plc
RPZs	Rent Pressure Zones
SCSI	Society of Chartered Surveyors Ireland
SME	Small and medium sized enterprises
SOLAS	An tSeirbhís Oideachais Leanúnaigh agus Scileann (Further Education and Skills Service)
SSM	Single Supervisory Mechanism
USC	Universal Social Charges
VAT	Value added tax
y-o-y	Year-on-year

EXECUTIVE SUMMARY

Staff from the European Commission, in liaison with staff from the European Central Bank, visited Dublin from 13 to 16 November 2018 for the tenth post-programme mission to Ireland. This was coordinated with an International Monetary Fund staff visit. Staff from the European Stability Mechanism participated in the meetings in the context of its Early Warning System. The visit also served as specific monitoring in the framework of the EU Macroeconomic Imbalance Procedure (Annex 2).

Private consumption and construction investment are expected to sustain domestic growth momentum in the short term, but risks remain. Strong employment growth, in conjunction with increasing wages, continues to support household income and private consumption. Construction investment is expanding at a fast pace, though from a low base. Significant risks continue to overshadow the economic outlook. Primarily external in nature, they relate to the uncertainties regarding the terms of the UK's withdrawal from the EU as well as changes to the international taxation and trade environment. On the domestic side, signs of overheating could become more apparent in the near future, as the labour market is tightening, spare capacity diminishing and construction activity growing strongly.

While the fiscal position is close to balance, vulnerabilities remain. The budgetary position is expected to have been close to balance in 2018, helped by positive surprises in corporate tax. Overspending emerged in some departments, with a notably large one in healthcare. The public debt ratio has diminished, but the stock of debt remains elevated. The favourable cyclical situation combined with buoyant corporate tax receipts implies a strong case for increasing the resilience to economic fluctuations by broadening the tax base. This could also include building fiscal buffers, inter alia, by strengthening the envisaged rainy day fund.

Non-performing loans (NPLs) have been declining although long-term arrears remain relatively high. The stock of NPLs declined during the first half of 2018, mainly due to NPL sales. The stock of long-term arrears is also declining, yet at a much slower pace. It is crucial to use high capital buffers and the current favourable environment to ensure that NPLs remain on a firm downward path.

The comprehensive macroprudential framework primarily aims to promote the resilience of banks in a forward-looking manner. Property price increases remain high despite some recent moderation. Credit continues to recover although at a slower pace, suggesting that recent macroprudential measures have constrained demand for credit. A countercyclical capital buffer requirement of 1% will apply from July 2019 onwards, and borrower-based measures are in place to restrict the share of loans with high loan-to-income and loan-to-value ratios.

Despite accelerating supply, the housing shortage persists and affordability indicators remain above their long-term average. Recent government measures to bolster housing supply include the promotion of land development. However, it will take time for the measures to produce significant results. Stepping up the construction of social housing and increasing the productive capacity of the construction sector may also help provide affordable housing.

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

The next post-programme surveillance (PPS) mission is planned to take place in spring 2019.

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1. INTRODUCTION

Staff from the European Commission, in liaison with staff from the ECB, visited Dublin from 13 to 16 November 2018 for the tenth post-programme mission to Ireland. This was coordinated with an International Monetary Fund staff visit. Staff from the European Stability Mechanism participated in the meetings in the context of its Early Warning System. Under PPS, the Commission undertakes regular review missions to EU Member States which previously had an EU-supported financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal and financial situation to ensure the Member State maintains its capacity to service its debt to the EFSM, EFSF and bilateral lenders. ([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 will be communicated to the competent committee of the European Parliament, the Economic and Financial Committee, and to the Irish Parliament.

In line with Council conclusions from 2014 ([4]), the PPS mission included specific monitoring of the adjustment of macroeconomic imbalances. Under the 2018 European Semester, the in-depth review (IDR) on the macroeconomic imbalances procedure (MIP) found that Ireland had imbalances that require specific monitoring of the implementation of MIP-relevant country specific recommendations (CSRs) ([5]) and other policies addressing underlying challenges identified as sources of imbalances, such as the housing market. A review of the policy measures undertaken is provided in Annex 2 of this report.

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

([4]) See Council conclusions on in-depth reviews (IDRs) 2014 from 6 May 2014.

([5]) COM(2018) 120 final, Communication from the Commission to the European Parliament, the Council, the European Central Bank and the Eurogroup: 2018 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1. MACROECONOMIC TRENDS

GDP growth in Ireland is estimated to have been strong in 2018, but to moderate going forward. ([6]) Real GDP grew by 7.4% y-o-y in the first nine months of 2018, well above the euro area average, but inflated by the activities of multinational companies. The European Commission Autumn 2018 forecast projects real GDP growth of 7.8% in 2018 and a moderation in growth to 4.5% in 2019 and 3.8% in 2020.

The domestic economy gained further momentum in 2018. This was underpinned by consumption and investment in construction and in machinery and equipment. *Modified domestic demand*, a measure of domestic activity that strips out some of the effects of multinationals, grew by 5.1% y-o-y in the nine months of 2018. It is projected to expand at an average rate of over 4.0% between 2018 and 2020.

The volatile headline investment figures mask robust domestic activity. In the first nine months of 2018, construction activity increased by 17.9% y-o-y. It is expected to remain strong as housing supply, supported by various government measures, is still catching up with demand. Over the same period, machinery and equipment investment, particularly airplanes but also computers, picked up, with an associated increase in imports in this category. Over the same period, the headline investment increased marginally by 2.8% y-o-y driven largely by intellectual property (IP) investment, which, after a drop in the first half of 2018, recovered in the third quarter. However, these fluctuations were matched by similar swings in imports and therefore with a neutral impact on GDP.

Employment growth remains strong. Employment grew by 3.1% in the first three quarters of 2018 and has now surpassed its pre-crisis level. Over the same period, full-time employment grew by 3.6% and continued to outpace the growth in total employment, as part-time work was being converted into full-time jobs. Employment increased in almost every sector. Construction and accommodation and food services contributed most to the growth in employment, reflecting the strength of domestic activity.

While the unemployment rate is approaching pre-crisis levels, labour force participation remains low. Unemployment continues its downward trend across all affected groups. In the third quarter, the unemployment rate reached 5.7%, while the share of those being unemployed for more than 12 months was 34.9%. The youth unemployment rate fell to 12.3% in November. Job vacancy rates are trending upward in most economic sectors, suggesting a tightening of the labour market. Against this background, the total unemployment rate is forecast to drop below 5% in 2020. The recovery in the participation rate remains slow, with a modest increase by 0.3 pps. to 62.2% over the year to the third quarter of 2018. There remains scope for increased labour market participation, especially by women.

As the labour market tightens, net inward migration is increasingly contributing to the labour supply. In the year to the third quarter, non-Irish nationals accounted for 60% of the growth in total employment, with the share of non-Irish nationals in the labour force returning to its 2008 peak of 16.3%. In particular, non EU nationals play an increasing role in the labour supply: they explained half of the increase in non-Irish nationals' employment in the year to the third quarter, compared to one third on average between 2015 and 2017. As migrants' qualifications have improved - 50% of immigrants had tertiary education in 2018 - immigration may become an important source of skilled labour. New immigrants have typically found employment in the fastest-growing sectors (accommodation and food services, construction, administrative and support services, information and communication technology (ICT)), which are experiencing increasing labour or skills shortages. Most of those sectors have also displayed the highest increases in average weekly earnings in recent quarters.

([6]) Given the uncertainties regarding the terms of the UK withdrawal from the EU, projections are based on a purely technical assumption of status quo in terms of trading relations between the EU and the UK. This is for forecasting purposes only. The risk of a no-deal Brexit would entail abrupt changes in trade relations between the UK and the EU after March 2019 and Ireland's economic outlook would be subject to significant uncertainties.

Household earnings are bolstered by robust job creation and wage growth. Average weekly earnings accelerated slightly to 3.0% in the first three quarters of 2018. The largest increase was recorded in the most productive ([7]) sector (ICT). However, earnings also increased significantly in low-productivity sectors (accommodation and food services, construction, transportation and storage). In all sectors except ICT, increases in average weekly and hourly earnings were larger in enterprises smaller than 250 employees, which are typically less productive. ([8]) Wage increases above productivity growth may hamper the competitiveness of domestic firms. In the near term, the tightening of the labour market is expected to fuel wage inflation, which, combined with subdued inflation, would continue to support household real disposable income.

Overheating pressures could become more apparent. The tightening of the labour market and diminishing spare capacity point to an economy possibly operating above its potential. The rapid growth in the construction sector, though of critical importance in the context of persistent housing undersupply, could contribute to potential overheating if not counterbalanced by other measures. ([9])

Inflation is rising from moderate levels. Average HICP inflation was 0.7% in the first eleven months of 2018, with some acceleration in the second half of the year due to higher oil prices. However, core inflation remains dampened by the subdued inflation in non-energy industrial goods prices, which reflects both low import prices due to appreciation of the real exchange rate towards sterling and a downward bias related to quality adjustments methods. ([10]) HICP is projected to increase by 0.7% in 2018, driven by higher energy and services prices, accelerating further to 1.2% in 2019 and 1.4% in 2020, with services being the main driver in line with strong domestic demand.

([7]) For labour productivity distribution across sectors, see Department of Finance (2018), Firm level productivity in Ireland, Department of Finance Policy Conference, March 2018.

([8]) European Commission (2018), 2018SBA Fact Sheet-Ireland

([9]) Irish Fiscal Advisory Council (2018), Fiscal Assessment Report, June 2018

([10]) J. Keating and M. Murtagh (2018), Quality adjustment in the Irish CPI, CSO meeting of the Group of Experts on Consumer Prices Indices, 7-9 May 2018.

Trade developments remain highly volatile. The activities of multinationals continue to overshadow the underlying developments in trade. In the first three quarters of 2018, total exports increased by 9.2% y-o-y, reflecting a very strong trend in pharmaceutical goods exports, while the impact from contract manufacturing ([11]) was neutral. Exports of services grew only modestly, partly due to a significant decline in exports of business services. Over the same period, total imports increased by a modest 3.0% y-o-y with a negative impact from imports of research and development services. By contrast, imports of goods increased by 10.8%.

Increased housing supply and credit demand contraints are curbing house price inflation. Annual residential property price inflation declined from 13.3% in April 2018 to 8.2% in September 2018, the lowest rate since October 2016. The slow-down was more pronounced in Dublin, with annual inflation running at 5.8%, 7.2 pps. lower than in April 2018. In 2017, 20% of housing buyers got a loan above the 3.5 loan-to-income limit set by the macroprudential rules. ([12]) In 2018, separate allowances of respectively 20% and 10% were introduced for first time buyers and second or subsequent buyers. ([13]) Banks make sure that mortgage drawdowns do not exceed these boundaries by limiting the number of mortgage approvals over the year. Given that there is a time gap between the mortgage approval and draw-down, some loans approved by banks in 2017 under more flexible rules, have been drawn down in 2018, reducing further the margin of discretion for mortgage approvals in this year. This may have dampened demand for housing at higher prices.

The low number of new tenancies available for rent coupled with rapidly rising rents may

([11]) Contract manufacturing refers to the exports of goods produced abroad by foreign firms contracted by Irish-based companies.

([12]) Under the macroprudential rules, mortgages are capped at 3.5 times the income. In 2018, a system of allowances permits that 20% of the value of new mortgage lending to first time buyers and 10% of the value of new mortgage lending to second and subsequent buyers may exceed the 3.5 loan-to-income limit per lending institution. In 2017, the system of allowances was more flexible and permitted 20% of the value of new mortgage lending to exceed the limit.

([13]) Buyers of a principal dwelling home who do not buy a house for the first time.

hamper the entry of new tenants to the housing rental market. In the second quarter of 2018, the growth of rental prices for new tenancies (8.1%) almost doubled that for existing tenancies with a renewed contract (4.9%) ([14]) that were subject to rental inflation caps within the rent pressure zones (RPZs). ([15]) As a result, rental prices of new tenancies were on average 21% higher than those for existing tenancies. In addition, there were less than 3 100 properties newly offered for rent nationwide, well below the peak (23 000) observed in 2009. Since 2016, just one year after the introduction of RPZs, the share of contracts for new tenancies has lost ground against contract renewals for existing tenancies. This may reflect the unwillingness of tenants living in rent-controlled dwellings to move and lose their below market levels rents which may hinder labour mobility. ([16])

Ireland's commercial property market remains strong. The volume of real estate transactions amounted to EUR 2.5 billion in the year to September, almost twice as high as in the same period in 2017. Investments remained focused on Dublin, which has attracted 85% of the total. Offices were the dominant sector, accounting for 45% of the total sales, while the private rented sector accounted for 27% of total sales volumes. ([17])

Rental and capital value growth in the Irish commercial property market has slowed down. Capital and rental values recorded an annual growth of 5% and 5.9%, respectively, in the year to June 2018. This means a deceleration of respectively 0.5 and 1.9 pps. as compared with last year. ([18]) Commercial property returns increased by 10.2% in the year to June 2018, 0.9 pps. less than for the same period last year.

A number of risks continue to overshadow the economic outlook. Primarily external in nature, they relate to the uncertainties regarding the terms of the UK's withdrawal from the EU as well as changes to the international taxation and trade environment. On the domestic side, signs of overheating could become more apparent. Labour and skills shortages are increasingly apparent in quickly growing sectors. The persistent undersupply in the housing market and rapidly increasing property prices and rents could have a negative impact on Ireland's competitiveness by, inter alia, limiting labour mobility and increasing the cost of living. A large degree of unpredictability remains linked to the activities of multinationals, which could drive headline growth in any direction.

2.2. PUBLIC FINANCES

Aggregate 2018 revenues were boosted by a non-recurrent factor. Revenues were up 7.3% in 2018 compared to 2017, thanks to the continuously strong corporate income tax receipts (up 26.6%). ([19]) Irrespective of the difficulties in estimating Ireland's corporate tax revenues, these exceeded even the EUR 9.6 billion estimated just three months earlier in Budget 2019. The figures are flattered by an unexpected, non-recurrent, EUR 0.7 billion influx, which is partly linked to changes in international tax accounting rules. The corporate income tax helped revenues stay on target despite some shortfalls against the targets, including in excise duties (EUR 402 million) and stamp duties (EUR 217 million).

Overall government expenditure in 2018 exceeded budget allocations. In 2018, Ireland is projected to have respected its medium-term budgetary objective. However, the pace of fiscal consolidation has slowed in recent years following several in-year expenditure increases. Overall spending was 1.2% above the 2018 target. Net overspending of around EUR 810 million emerged in some departments, especially in the frequently overspending health sector (EUR 654 million). Current expenditure was up by 6.5% y-o-y and above profile (1.6%). Capital expenditure was up 31.1% y-o-y and 3.2% above profile.

([14]) Residential Tenancies Board (2018) Rent Index 2018, Q2 https://onestopshop.rtb.ie/images/uploads/Comms%20and%20Research/RTB_RI_2018_Final.pdf

([15]) Rent pressure zones (RPZs) are designated areas where rent can only be increased by 4% per year. At present there are 5 local authorities and 16 Local Electoral Ares which have been designated as RPZs.

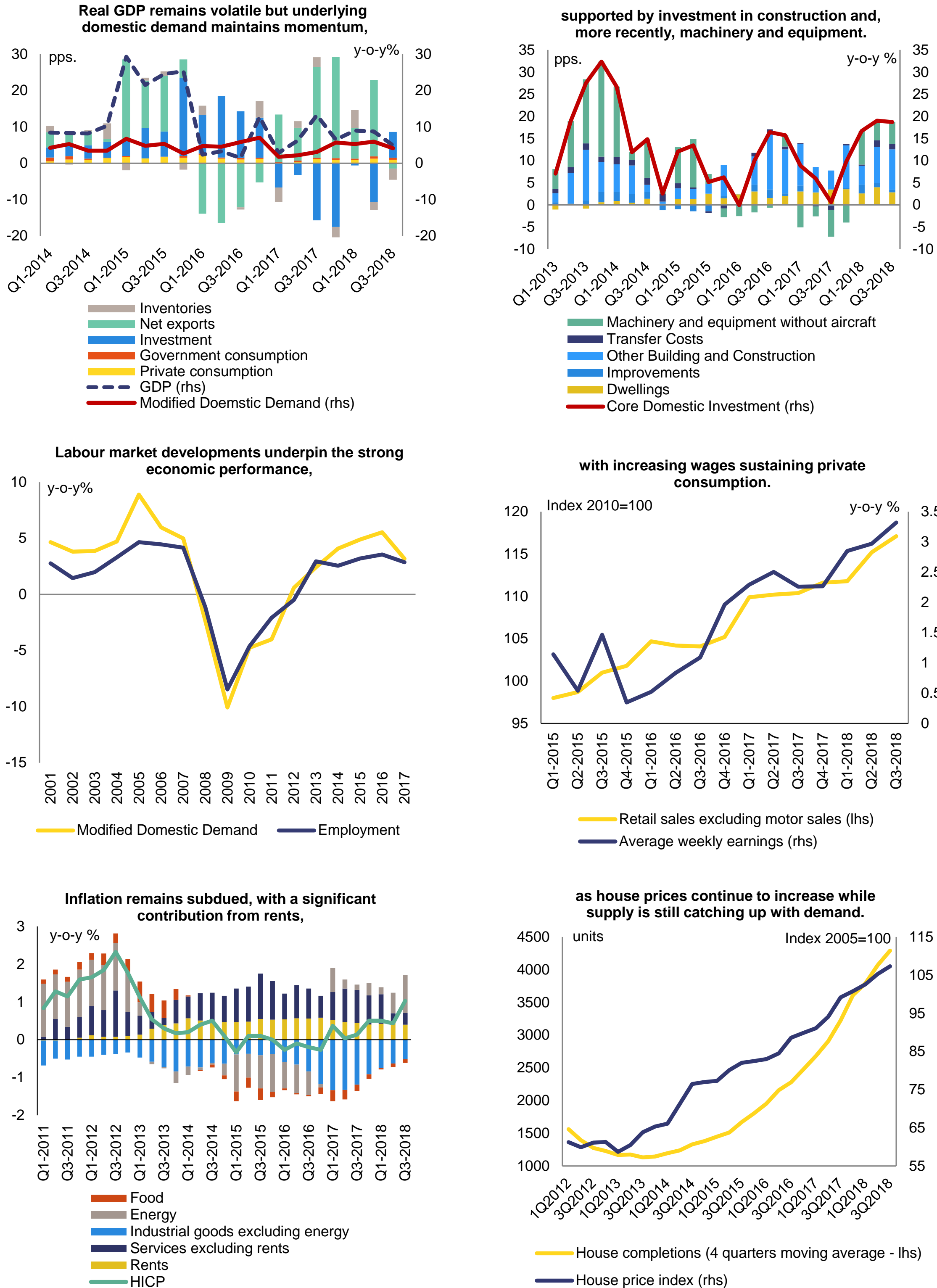
([16]) Aida Caldera Sánchez, Dan Andrews and Åsa Johansson (2011) Housing markets and structural policies in OECD countries. ECO/WKP(2011)5.

([17]) JLL (2018), Ireland Investment Market Report-Q3 2018

([18]) JLL (2018), Irish Property Index in Q2 2018

([19]) Department of Finance (2019), Fiscal Monitor, December 2018, Appendix II.

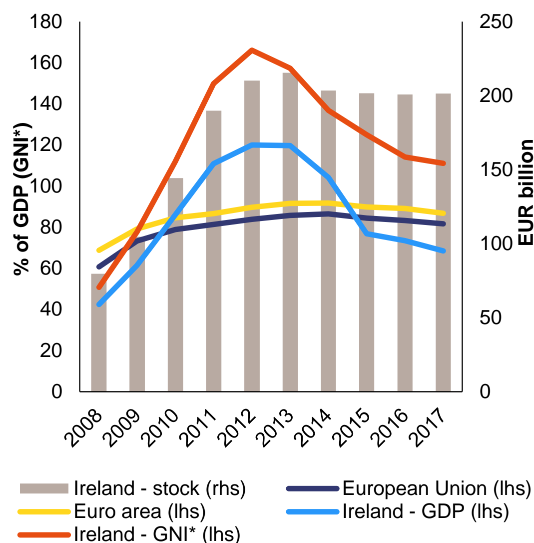
Graph 2.1: Recent economic developments



Source: European Commission, Central Statistics Office.

Public finances are projected to improve further. The general government deficit is forecast to have fallen to 0.1% of GDP in 2018, an improvement of 0.1% of GDP compared to the previous year deficit. Projections are based on the expectation of a relatively robust increase in tax revenues (5.1% y-o-y) and expenditure (4.7% y-o-y), which includes a marked rebound of public investment (28.8% y-o-y) linked to housing and other infrastructure. The 2019 Budget provides for significant growth in current spending allocations of more than 5.7%. ([20]) As a result, the general government deficit is expected to remain broadly stable at 0.1% of GDP in 2019. Based on a no-policy-change assumption, the Commission Autumn 2018 forecast projects a general government surplus of 0.2% of GDP in 2020. The structural balance is expected to deteriorate in 2019, before improving in 2020. ([21])

Graph 2.2: General government debt



Source: European Commission

The public debt-to-GDP ratio is declining. The general government debt ratio is expected to have declined from 68.4% of GDP in 2017 to 63.9% of GDP in 2018 and to fall further to 61.1% and 56.0% of GDP in 2019 and 2020 respectively.([22]) Although this represents a major achievement after the programme, significant levels of government debt remain. The stock of debt (around EUR 200 billion) and this level has remained broadly stable since 2014 (see Graph 2.2 and Annex 2).

2.3. FINANCIAL SECTOR

Banks have improved their resilience but they continue to face important challenges. The consolidated banking sector has maintained its high capital position over the year to June 2018 (CET1 ratio at around 23.0%), placing Irish banks well above the EU average. Banks maintain comfortable net interest margins, which is due to high interest rates on customers loans. Despite an increase at the beginning of 2018, aggregate provisioning remains well below the euro area average. Banks are moving ahead with sales of non-performing loans, which has helped to reduce the non-performing loans (NPL) ratio. However, the high share of mortgages in arrears for more than two years remains a challenge. The property-driven credit expansion may further increase the banks' exposure to developments in the housing market and warrants continued close attention. The elevated uncertainty in the external environment represents an additional challenge.

Credit for primary dwellings to households has picked up on the back of rising residential property prices. The pickup in lending has been associated with a change in its composition. At the end of the second quarter of 2018, 24% of the credit stock for primary dwellings had fixed rates for more than a year, up from 7% in the first quarter of 2014. Particularly loans with interest rate fixation of one to three years are gaining traction. The dynamics in loans for primary dwellings contrast with developments of credit for buy-to-let (BTL) properties which has continued to decline. The decline has offset the increase in credit for primary dwellings and as a result, the stock of credit advanced to households has been broadly stable over the past year. Following a temporary stabilisation, credit to domestic non-financial companies started declining again in March 2018. However, the decrease is modest and broad-based across most economic sectors.

Rising property prices are supporting the repair of banks' and households' balance sheets. The strong rise of property prices amid limited

([20]) Comparing to the original 2018 allocations in Budget 2018 with 2019 allocations in Budget 2019.
([21]) For more see C(2018) 8019 final, Commission Opinion on the Draft Budgetary Plan of Ireland
([22]) European Commission (2018), European Economic Forecast, Autumn 2018

housing supply has helped a number of households climb out of negative equity. In addition, increasing household disposable income strengthens the households' capacity to repay mortgages. There are, however, risks that some households may not be able to service their loans once the interest-only or temporary payment moratoria periods end on their restructured loans.

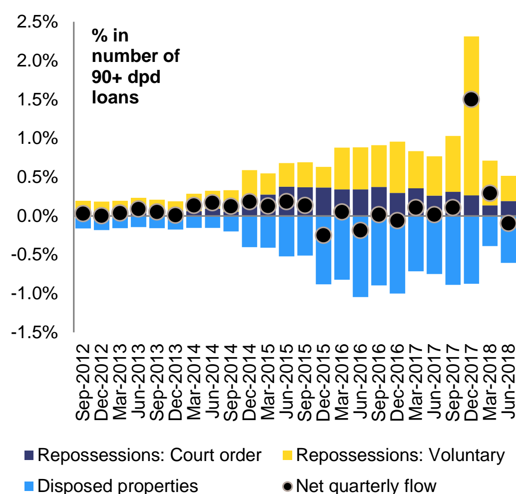
Aggregate provisioning has been broadly stable in the year up to the second quarter of 2018. The increase follows a prolonged period of a declining coverage ratio. Still, at around 30%, the coverage ratio compares low with the euro area average of 49%. Although the decline over the past years relates to improving macroeconomic conditions (e.g. rising property prices) and changes in the NPL portfolio, it remains important to retain prudent levels of loan loss reserves, also in the light of supervisory requirements of the IFRS 9 provisioning rules, which have been in place since 1 January 2018 (see section 3.2).

The stock of NPLs continues to decline, helped by sales. According to consolidated banking data published by the ECB (see Graph 2.4), the NPL ratio fell to 8.5% of gross loans in the second quarter of 2018, down from 11.6% one year earlier. The non-financial private sector NPL ratio remains elevated at 11.8% of gross loans at the end of the first quarter of 2018, down from 15.8% a year ago. The NPL ratio of non-financial corporations displayed a marked decline to 9.1% in the second quarter of 2018, down from 13.7% a year ago. The NPL reduction for households has been more modest, with an NPL ratio down from 17.1% to 13.4%. The stock of household NPLs was EUR 18.4 billion, which made up around 70% of all NPLs. While the reduction in non-performing loans from its peak in 2014 was initially driven by successful workout activity in the commercial real estate sector, it is more recently due to increased sales of non-performing loans. Reducing household NPLs, especially for primary dwelling home (PDH) borrowers, continues to be challenging.

Long-term mortgage arrear levels remain relatively high. As of September 2018, the total balance of mortgage loans that were more than 90 days past due was EUR 13.9 billion (representing 11.7% of all mortgages), down from EUR 15.9 billion (13.3%) a year ago. Of those mortgage loans, approximately two-thirds have been related to PDHs, while the remaining were related to buy-to-let properties. At the end of September 2018, the total stock of long-term mortgage arrears (i.e. more than 720 days past due) was EUR 10.1 billion, representing 8.5% of all mortgages or 72% of all mortgage loans with arrears of 90 days or more.

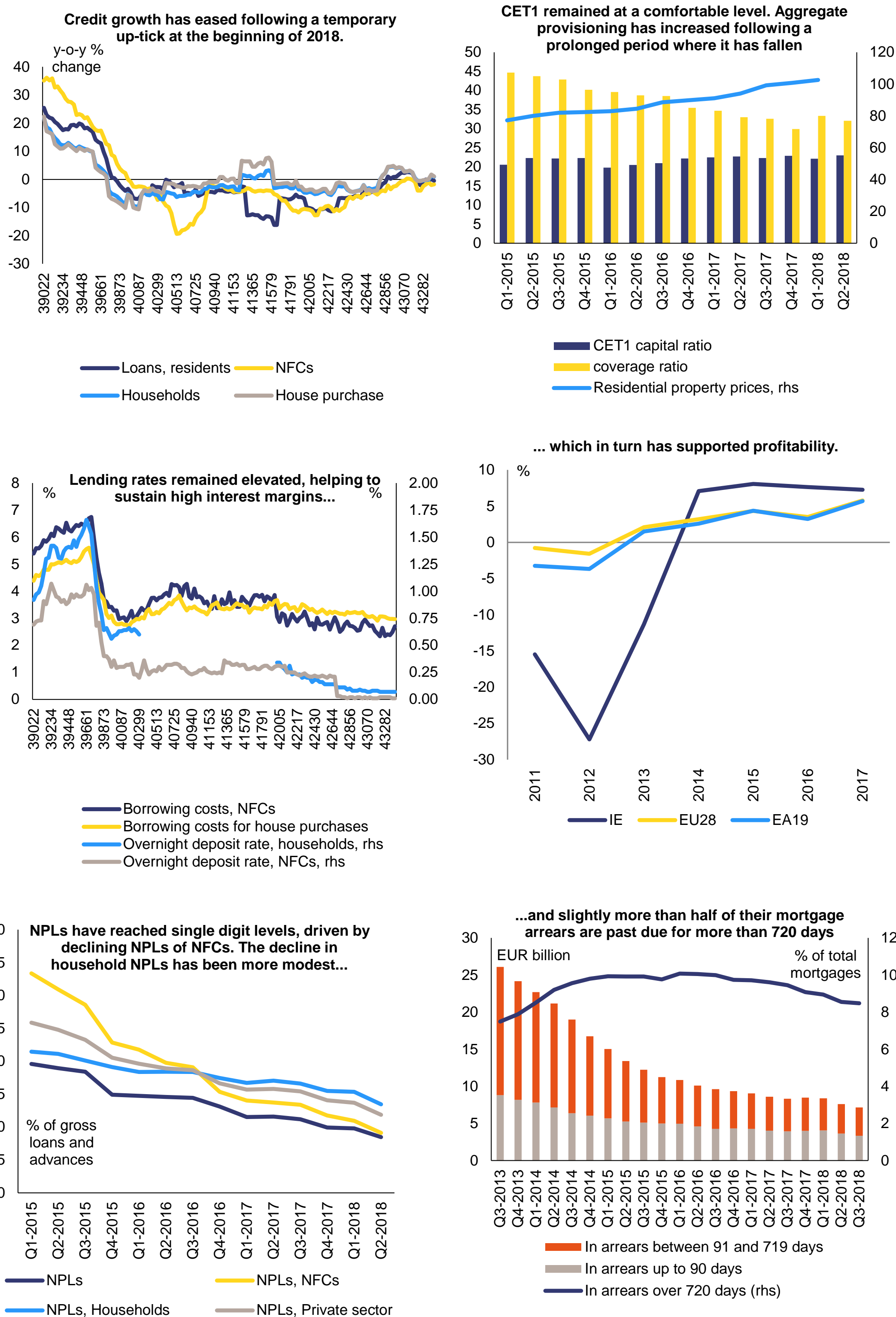
Following a temporary rise at end-2017, repossession activity has slowed down. Repossessions exhibited a temporary rise in the last quarter of 2017 due to PTSB's "voluntary surrender" programme. In the first half of 2018, repossessions appear to be on a declining trend (Graph 2.3), which could be – at least partly – due to the on-going tracker mortgage review.

Graph 2.3: Quarterly flow of residential mortgage repossessions



(1) Figures are presented as a percentage of the number of loans in arrears for more than 90 days (i.e. 90+ days past due (dpd) loans). Quarterly flow figures may differ slightly from actual flows due to reclassification of accounts between the PDH and BTL cohorts and timing issues regarding the disposal of properties.
Source: CBI, Residential Mortgage Arrears and Repossessions Statistics

Graph 2.4: **Recent financial sector developments**



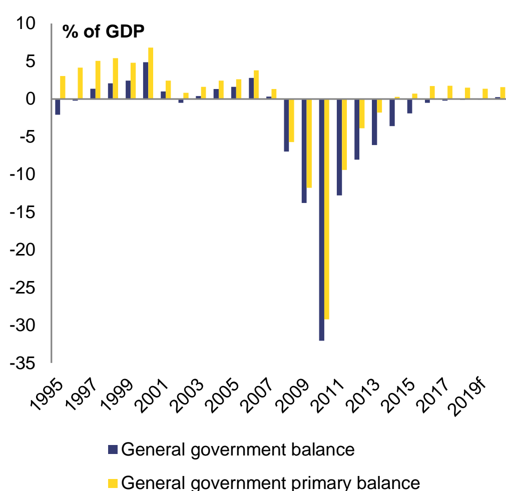
Source: European Central Bank and Central Bank of Ireland

3. POLICY ISSUES

3.1. PUBLIC FINANCES

After a slowdown in improvements, strengthening the resilience of public finances remains a major policy challenge for Ireland. With surging corporation tax receipts, the government's budget slowly returning to balance and near-term growth prospects favourable, Ireland is in a good position to make its public finances more stable. However, since 2015, there has been little improvement in the primary budget balance (Graph 3.1). There have been frequent within-year expenditure increases, contributing to limited compliance with fiscal rules. The Irish Fiscal Advisory Council has repeatedly urged against extra within-year increases in expenditure.([23])

Graph 3.1: General government balance and primary balance



Source: European Commission

The Irish healthcare system faces a crisis of cost-effectiveness. As in previous years, much of the expenditure increase in the 2019 Budget is linked to budgetary overruns in healthcare. Yet process and output measurements do not reveal an improvement in performance. Furthermore, spending on healthcare is projected to increase over the next several decades as a result of an ageing Irish population.([24]) Given this and the additional resources already allocated over the last years, it is crucial that the health allocation is managed effectively by the Department of Health and the Health Service Executive, and that it follows realistic forecasts and expenditure planning.

The planned rainy day fund could contribute to prudent management of public finances. To this end, the government has approved the publication of the legislation to establish the fund in 2019, which will formally be known as the *National Surplus (Exceptional Contingencies) Reserve Fund*. The legislation is to provide for a facility to add potential windfall tax receipts or income to the fund where the Parliament so approves. However, the allocations for the fund for 2019-2021 in the 2019 Budget remain currently unchanged from the Stability Programme 2018 (at EUR 500 million per annum), despite the surge in corporation tax receipts.

Tax revenues have grown at a solid pace, but there are some vulnerabilities concerning corporate income taxes. Ireland's exposure to the concentration of corporation tax receipts among a fairly small group of companies remains a vulnerability. Together with the surge in their share in the total tax revenues, this underlines the importance of broadening the tax base. The main revenue-raising measure in the 2019 Budget was an increase in the reduced rate of value added tax (VAT) in the tourism sector from 9% to 13.5% from 2019.([25]) This reduces a tax expenditure in line with the 2018 CSRs. It is also in line with the OECD growth-oriented tax policy reform recommendations, which propose a higher share of revenue from taxes on consumption, together with recurrent taxes on residential property, and a lower share from income taxes, particularly corporate income tax. Nevertheless, in net terms, the tax measures amount to only EUR 350 million of revenue increases, a fraction of the almost EUR 1.5 billion discretionary spending increases implemented in the Budget. There were no much-anticipated changes to fuel and carbon taxes, and

([23]) Irish Fiscal Advisory Council (2018), Fiscal Assessment Report, November 2018

([24]) According to the European Commission 2018 Ageing Report, healthcare expenditure would increase by 1 % of GDP between 2016 and 2070 - above EU average expenditure growth.

([25]) Along with changes in some excise duties, vehicle registration surcharge for diesel engine passenger cars, compliance measures and an increase in the National Training Fund levy.

only a small change related to vehicle registration tax on diesel cars. The Parliamentary Budget Office has criticised this as a missed opportunity to rebalance tax revenue away from income tax and address the identified fiscal risk of missing EU climate and renewable energy targets.[26] Moreover, no changes have so far been made concerning the local property tax in view of the revaluation due before end of 2019.

A broader personal income tax base would improve revenue stability in the face of economic volatility. The 2019 Budget again includes reductions in personal income tax and universal social charges (USC). In line with previous government announcements, the USC reductions are targeted at low- to middle-income earners. Commission analysis using the EUROMOD model[27] shows that total tax revenues from personal income would be around 50% higher in a hypothetical system without tax reliefs.[28]

Despite its advantages in terms of revenue generation, a formal decision on the future of the universal social charge is awaited. The USC has provided substantial and stable revenues. Moreover, as a result of the multiple rate structure, it is a highly progressive tax. A working group was created in 2018 to examine amalgamating USC and social insurance contributions over the medium term in order to ensure that Ireland's personal tax system is competitive in the future. The publication of the results of this exercise, due to be completed by end of June 2018, is now expected in 2019. Previous PPS reports have warned that removing the USC comes with a cost.[29] A solution to a substantial part of subsequent revenue losses might lie in lowering the entry point to the tax system via a reduction of the tax credits. At the same time, an introduction of a third, intermediate income tax band would reduce the marginal tax rate for the average single employee to the EU average (39%). Data published by the Revenue Commissioners indicates that a conceptually similar introduction of a third rate of 43%, at the same time as cutting the existing top rate of 40%, is estimated to raise additional revenue (EUR 93 million)[30], , while switching the burden from middle-income to higher-income earners.

3.2. FINANCIAL SECTOR POLICIES

New policy initiatives should be carefully assessed to consider both the desired effects and any unintended consequences. The recent NPL sales improve the resilience of the banking system and help banks turn the focus on core lending and investment activities. However, several recent proposals may undermine this nascent development. First, the Private Members Mortgage Arrears Resolution ("Family Home") put forward in June 2017 proposes a new authority, the Mortgage Resolution Office, to enforce specific restructuring solutions involving debt forgiveness and rescind repossession orders for qualifying borrowers.[31] More recently, the Consumer Protection ("Regulation of Credit Servicing Firms") Act 2018 aims to expand the scope of the consumer protection framework and subject credit purchasers to regulation. It is open how these proposed bills might interact with existing or upcoming measures, including current insolvency rules as well as EU initiatives.[32],[33] More

[26] Parliamentary Budget Office (2018), Budget 2019 – Issues for Members of the Houses of the Oireachtas

[27] EUROMOD is the tax-benefit microsimulation model for the EU. It is used to simulate the benefit entitlements and tax liabilities (including social security contributions) of individuals and households according to the tax-benefit rules in place in each Member State. The simulations are based on representative survey data from the European Statistics on Income and Living Conditions (EU-SILC) and cover the main elements of direct taxation, social contributions and non-contributory benefits. It is conducted by the European Commission (Joint Research Centre).

[28] This exercise covered the period 2014-2018. It did not imply any normative approach to the benchmark Irish tax system when eliminating tax allowances and tax credits. EUROMOD inflates/deflates earnings whenever the year of the survey data does not coincide with the tax system year.

[29] Analysis based on P. McQuade, S. Riscado and S. Santacroce (2017), ECFIN Economic Brief: Personal income tax in Ireland: the future of the Universal Social Charge

[30] When applying the 43% rate to those earning over EUR 80 000 and cutting the existing top rate from 40% to 39%. Source: Revenue Commissioners (2018), Ready Reckoner – Post-Budget 2019

[31] A more recent bill, the Courts and Land and Conveyancing Law Reform Bill 2018, which is yet to be introduced to the Parliament, aims to provide repossession protections based on the proportionality and circumstances of the borrower.

[32] For similar concerns, see also the opinions of the European Central Bank of 5 March 2018 (CON/2018/13) and 5 July 2018 (CON/2018/31) on these two proposals.

generally, authorities face the challenge of balancing the twin aims of protecting consumers and supporting vulnerable households while at the same time keeping all sustainable workout options viable. Lastly, concerns remain that the Private Members bill enabling the Central Bank of Ireland (CBI) to cap interest rates on variable rate mortgages, if enacted, could have negative implications for the transmission of monetary policy, financial stability and bank competition.

Activity in personal insolvency proceedings continues to grow while new repossessions appear to be declining. Applications for the debt resolution mechanisms ([34]) introduced under the Personal Insolvency Act 2012, most notably in the applications for Personal Insolvency Arrangements, continue to grow. *Abhaile* scheme, which was introduced in October 2016 to provide free legal and financial advice to insolvent borrowers, continues to show an increasing number of applications. However, only one-third of applications lead to finalised arrangements. Creditors continue to reject cases involving write-offs. Moreover, the court reviews also often meet with procedural delays.

The *Enhanced Mortgage-to-rent* scheme ([35]) is attracting an increasing number of applications and approvals, although after some delay. In cooperation with all major banks, eleven approved housing bodies, including iCare Housing, and a private company, Homes for Life, are currently offering the scheme to vulnerable households qualifying for social housing support who meet the criteria under the Mortgage to Rent Scheme. Although the total number of approved applications remains relatively low, new approvals since introduction of the revised scheme in September 2017 have already surpassed the total number of approved cases under the original scheme introduced in 2012.

Assuming asset quality conditions continue to improve, Irish banks are expected to fulfill new regulatory requirements with relative ease. Due to the relatively high capital positions, Irish banks are not expected to face major difficulties in meeting their Minimum Requirement for own funds and Eligible Liabilities (MREL). Allied Irish Banks (AIB) and Bank of Ireland (BOI) have already engaged in issuances over the past year to fulfill their MREL under relatively favorable conditions. Although PTSB will need to raise a smaller amount, the impact of the new issuances will depend on the pricing and thereby on the bank's ability to achieve its NPL reduction strategy. Meanwhile, the IFRS 9 first-time impact has been very limited, partly due to positive impact of rising house prices on expected future losses.

All of the implementation phases of the central credit register continue as planned. Commencement of mandatory enquiries by lenders for consumer loans started in October 2018. There has been limited demand for credit reports from borrowers. Data quality issues continue to exist but are being continuously addressed. Additional legislation to incorporate car leasing and hire purchases has been enacted, putting these into the scope of the coverage of the register. The mandatory enquiries for non-consumer loans are set to start end-March 2019.

Numerous government initiatives aim at facilitating SMEs' access to credit. Certain policy initiatives that aim to provide appropriate priced, flexible non-bank funding for SMEs, including Strategic Banking Corporation of Ireland

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

([34]) The Personal Insolvency Act 2012 introduced three mechanisms for debtors who cannot afford to pay their debts. The Personal Insolvency Arrangement applies to the agreed settlement or restructuring of secured debts. The Debt Relief Notice gives debt relief to debtors with an outstanding debt of EUR 35 000 or less. The Debt Settlement Arrangement provides the possibility to settle outstanding unsecured debt over a period of five years.

([35]) The enhanced mortgage-to-rent scheme allows borrowers in arrears to surrender its home to the lender, which is then sold to the relevant housing body and leased back to the borrower on a long-term (usually 25 to 30 year) contract. To qualify for the enhanced Mortgage-to-Rent scheme, borrowers must (i) have engaged with their banks; (ii) be eligible for social housing; (iii) be living in an appropriate property with a maximum value of EUR 215 000 to EUR 365 000 depending on location and type of housing; (iv) have a maximum net household income of EUR 25 000 to EUR 35 000 depending on location, with additional allowances for children; and (v) have no cash assets exceeding EUR 20 000. A substantial part of the rent is subsidised by the government in line with social housing support. The borrower will have the option to buy back the property at the transfer price after a period of 5 years, conditional on fully payments.

(SBCI) and Enterprise Ireland, are currently experiencing low uptake levels. The same also applies to investment tax credit for research and development. There has been a limited interest in the Brexit Loan Scheme, for which the approved applications accounted for less than 10% the funds set aside. The Scheme is intended to be available for a period of two years, until March 2020 and additionally, it is expected that SMEs may not apply for Brexit-related funding until the situation has progressed further and there is less uncertainty.

The CBI has decided not to change the residential mortgage measures in its recent review but introduced a countercyclical capital buffer of 1% from July 2019. There is evidence that the residential mortgage measures have become more binding. In particular, the share of lending at or just below the loan-to-value (LTV) and loan-to-income (LTI) limits has increased in the first half of 2018. The CBI has introduced a 1% countercyclical capital buffer requirement from July 2019 to mitigate emerging risks and increase the loss-absorbing capacity of the financial system.

CBI's Tracker Mortgage Examination is being finalised. As of August 2018, the total redress was around EUR 600 million, with 38 400 customers affected. Around 93% of all potentially impacted customers have been identified and verified as having received redress. The remaining part will be finalised during early 2019.

3.3. PROPERTY MARKET AND CONSTRUCTION

Residential construction is ramping up but it will take time to bridge the housing supply gap. Construction permissions were granted for 22 013 dwellings in the year to September 2018. This represents a 21% increase compared to the same period last year. Annual housing completions grew by 33% to 17 161. Despite the strong increase, this level is still below the required level estimated between 23 000([36]) and 50 000([37]) units per year.

The weak capacity of the construction sector may become a bottleneck to deliver the infrastructure and housing required. The construction sector has low labour productivity compared with other sectors and countries.([38]) Firms are smaller than the average firm at EU level. The productivity of the sector could be increased by a more intensive use of ICTs and pre-fabricated solutions, workforce reskilling and the market entry of larger foreign producers.([39])

Housing development in land sold by the National Asset Management Agency (NAMA) has so far been very limited. According to its 2017 Annual Report, NAMA sold sites with a potential to deliver over 55 000 housing units. However, only 6 061 units, i.e. 11% of this development capacity, had been built up by March 2018. Lack of commercial viability, infrastructure, planning permissions ([40]) or land hoarding are potential reasons for constraining their development.

The increase of the vacant site levy may further boost housing development. The increase of the vacant site levy by 4 pps. to 7% for the sites registered as vacant in 2019 may reduce land hoarding and accelerate housing supply. In addition, local vacant site registers, established in January 2017, may provide useful information on the potential existence of excessive land concentration in a limited number of landowners. Delays in populating these registers in almost two thirds of the local authorities, including some of the larger urban areas,([41]) may water down the impact of this measure.

The rapid development of publicly owned land with capacity for over 50 000 housing units could alleviate housing shortages. Master-planning and servicing land with the appropriate infrastructures before its sale to private promoters may allow increasing its value and compensate at

([36]) Duffy, D., Foley, D., McInerney, N. and McQuinn, K. (2016), '*Demographic Change, Long-Run Housing Demand and the Related Challenges for the Irish Banking Sector*'. The Economic and Social Research Institute (ESRI)
([37]) Lyons, R. (2017),'How to Build Enough Homes'
([38]) European Commission (2018), European Construction Observatory: Country Profile Ireland.
([39]) McKinsey Global Institute (2017) Reinventing construction; A route to higher productivity. February 2017.
([40]) NAMA (2017) Annual Report and Financial Statements 2017
([41]) Department of Housing, Planning and Local Government - DHPLG (2018) Circular letter PL 06/2018. 3 October 2018

least part of the infrastructure cost.(42) In addition, the sale or leasing of land could be usefully conditioned on the immediate construction of housing at affordable prices.

Housing purchase affordability in Ireland is low compared with other countries in Europe. Over 2014-2017, an average household in Ireland needed around 14 years of income to buy a 100 m^2 dwelling, the second longest period in Europe.(43) In April 2018, Ireland recorded the highest average interest rate on all new mortgages in the euro area(44), which further reduces housing affordability.

The Land Development Agency may facilitate the construction of 150 000 new homes over the next 20 years. The Agency, launched by the government on 13 September 2018, will assemble strategic land banks from a mix of public and private lands, making these available for housing in a controlled manner so as to counter the potential emergence of a boom-bust cycle in land and house prices. The compulsory purchase powers provided to this Agency may help reduce land hoarding. Providing the agency with sufficient qualified and experienced staff in the fields of land development and planning is key for its success.

The new tax measures announced by the government in Budget 2019 may incentivise investments in the rental market. The government has accelerated the restoration of the 100% tax deduction for interest expenses incurred on loans used to purchase, improve or repair property to let. This measure is expected to ease the tax burden on residential landlords.

Property taxes based on below-market valuations constitute an implicit subsidy on home ownership. (45) House price valuations serving as a base for local property taxes have not been revised since 2013 when prices were around 75% below the current level. Their regular updates, potentially combined with special arrangements for low income groups, could increase the progressivity of the tax system and dampen demand for housing purchase.(46) In addition, it would provide the local governments with additional resources to address housing and infrastructure shortages.

(42) National Economic and Social Council (2018), Urban Development Land, Housing and Infrastructure: Fixing Ireland's Broken System
(43) European Commission (2018) EU Monitor of Macroeconomic Imbalances
(44) CBI (2018) Statistical Release. Retail Interest Rates – April 2018
(45) European Commission (2012), Possible reforms of real estate taxation: Criteria for successful policies.
(46) European Commission (2012), Property taxation and enhanced administration in challenging times

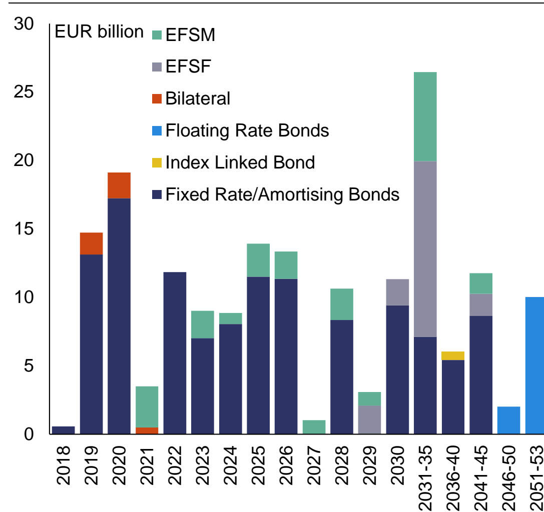
4. SOVEREIGN FINANCING ISSUES

Government refinancing needs are expected to decline in the medium term. They are expected to settle below 3% of GDP by 2022, after a hump of bonds and programme loan maturities in 2019 and 2020 of around 5% of GDP on average (Graph 4.1). At end-2018 the Exchequer had over EUR 15 billion in cash and liquid assets. The National Treasury Management Agency's (NTMA) prudence in raising cash ahead of the amortisation hump is a sensible strategy.

The issuance level in 2019 is to be similar to 2018. The NTMA raised over EUR 17 billion in 2018. This included EUR 3 billion in its first-ever sale of green bonds to diversify the agency's issuance, accessing a new category of investor and providing a new debt instrument that meets untapped investor demand.([47]) They are designed to be aligned to the Green Bond Principles, published by the International Capital Market Association. The NTMA plans to issue EUR 14-18 billion in bonds in 2019.

Sovereign bond yields remain low by historical standards. A sharp rise in Italian sovereign bond yields since spring 2018 has not had an adverse effect on the market for Irish sovereign bonds.([48]) The 10-year bond yield for Ireland stood at around 0.9% at end-2018. Aided by the low yields, total interest payments by the general government have continued to decrease as a share of GDP. Interest expenditure in Ireland is expected to fall from 2.0% of GDP in 2017 to 1.6% in 2018 and to decrease further in 2019, to 1.4% of GDP, well below the 4.2% recorded back in 2012 at the peak of the euro area sovereign debt crisis. However, when measured as a share of GNI*, interest expenditure still amounted to 3.2% in 2017.

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



(1) The Irish programme was the second euro area assistance programme, and the first financed by two new financial assistance instruments established in 2010, the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM). EFSF loans reflect the maturity extensions agreed in June 2013. EFSM loans are also subject to a seven year extension. It is not expected that Ireland will have to refinance any of its EFSM loans before 2027. However the revised maturity
(2) Bilateral loans were provided from the United Kingdom.
Source: National Treasury Management Agency

Risks for Ireland's capacity to service the EFSM and EFSF debt thus remain low. At the end of 2017, public debt amounted to EUR 201 billion, of which around 90% had a maturity of more than one year. Redemptions of EFSF and EFSM loans currently extend until 2042. For EFSF, there are no maturities until 2029. EFSM maturities to 2026 have been subject to a lengthening option. The maturity of EFSM loans to Ireland, including EUR 3.9 billion originally due in 2018 has been extended, within the limit of 19.5 years of average maturity established by the Council Decision on Union financial assistance to Ireland.([49]) It is therefore not expected that Ireland will have to repay any of its EFSF and EFSM loans before 2027. This Decision and the ensuing operations entail financial benefits for Ireland, linked to the EU's favourable funding conditions.

([47]) NTMA (2018), Press Points – Ireland: EUR 3.0 billion inaugural Irish Sovereign Green Bond (ISGB), due 18th March 2031
([48]) CBI (2018), Macro-Financial Review 2018: II
([49]) Council Implementing Decision 2011/77/EU

Table 4.1: Government financing plans

EUR billion	2018	2019
Funding requirement		
Exchequer borrowing requirement (EBR) (1)	-0.1	2.3
Bond maturities (2)	8.9	13.1
UK bilateral loan (3)	0.0	1.6
Other bond flows (4)	6.8	0.0
Other (5)	0.0	3.5
Total requirement	15.5	20.5
Funding sources		
Government bonds (6)	17.5	16.0
Other (7)	2.8	2.9
Use of cash & other short-term investment balances (- represents an increase)	-4.8	1.6
Total sources	15.5	20.5
Financial buffer (8)	15.3	13.7

2018 figures are provisional outturns, subject to revision. 2019 figures are estimates, as of January 2019. Rounding may affect totals.

(1) 2019 estimate as per Budget 2019.
(2) Includes Amortising Bonds.
(3) Includes the effect of currency hedging.
(4) 2018 includes bond (including floating rate notes) purchases and switching.
(5) 2019 includes general contingencies and provisions for potential bond purchases/switching.
(6) In its 2019 Funding Statement, the NTMA announced plans to issue EUR 14 – EUR 8 billion of government bonds in 2019. EUR 16billion is used as an indicative amount in this presentation.
(7) Includes net State Savings (Retail), net short-term paper funding and other medium/long-term funding.
(8) Exchequer cash and liquid assets. Excludes non-liquid Exchequer financial assets.

Source: NTMA

ANNEX 1
Debt sustainability analysis

Underlying changes in the stock of public debt are being masked when it is measured as a proportion of GDP. Supported by a favourable interest rate-growth rate differential, public debt is expected to decrease from 68.4% of GDP in 2017 to 56.0% of GDP in 2020, the lowest level since 2008. However, between end-2017 and end-2020, its stock is actually forecast to somewhat increase by EUR 2.4 billion.

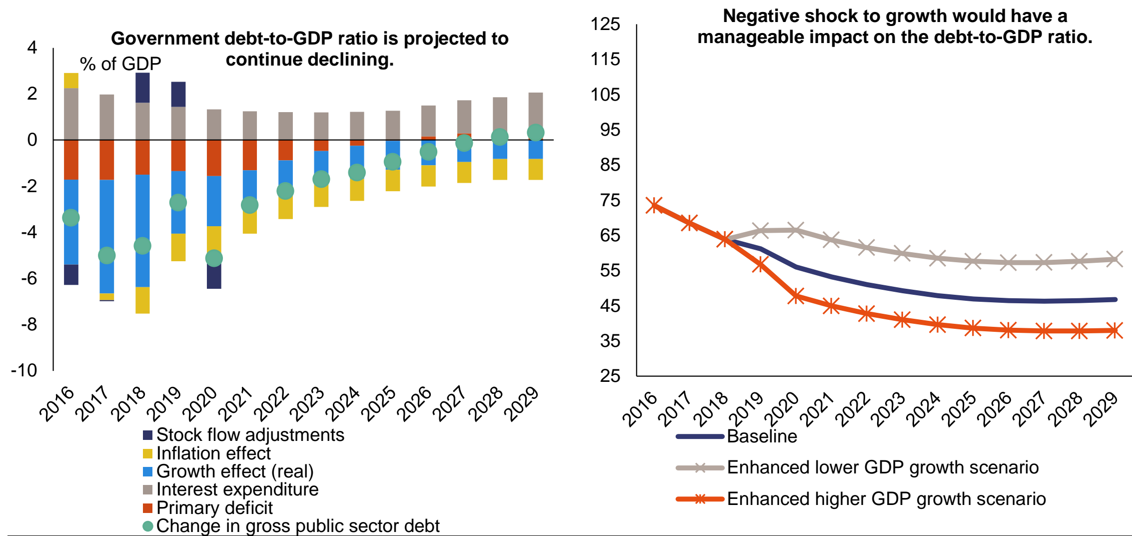
Over the medium-term, debt sustainability risks measured based on the GDP appear to be low. This assessment is driven by results from both the baseline scenario and most of the stress tests and alternative scenarios. In the baseline scenario, public debt is projected to keep steadily declining and reach 46.7% of GDP in 2029. This debt sustainability analysis uses the Commission's autumn 2018 forecast (2018-2020) as a starting point to ensure consistency across EU Member States. Adverse shocks to real GDP growth – of a magnitude reflecting Ireland's historical variability of output – would increase the public debt-to-GDP ratio by 11.5 pps by 2029 compared to the baseline scenario, to about 58.2%.([50])

When debt metrics are measured relative to GNI, the vulnerabilities are already significantly higher. With the view to providing a more accurate assessment of debt vulnerabilities, the Commission debt projections, traditionally expressed as a share of GDP, are complemented by alternative metrics based on GNI.([51]) Standard deterministic sensitivity analysis would point to higher vulnerabilities than traditionally measured on the basis of GDP (see Table A.1). This complementing analysis points to medium risks – compared to low risks when only considering ratios based on GDP.

([50]) Enhanced sensitivity tests on real GDP growth: assumes -1 standard deviation/+1 standard deviation on real GDP growth for first 2 projection years, followed by -0.5/+0.5 p.p. over remaining of projection period. The shock is symmetrically applied to actual and potential GDP growth, so that the output gap remains unchanged. The cyclical component of the balance is therefore not affected by these shocks to growth.

([51]) Although in Ireland an important discrepancy is also observed between the standard GNI and GNI*, with GNI amounting to 129% of GNI* in 2017. Hence, the assessment based on GNI still presents an overly benign assessment of the debt burden.

Graph A1.1: **Debt Sustainability Analysis**



Source: European Commission

Table A1.1: **Government debt projections, relative to GDP and GNI**

	% of GDP		% of GNI	
	2018	**2029**	**2018**	**2029**
Baseline no-policy change scenario (% of GDP)	**63.9**	**46.7**	**84.1**	**62.2**
Historical SPB scenario	63.9	62.9	84.1	83.7
Combined historical scenario	63.9	55.7	84.1	74.2
Standardized (permanent) positive shock (+1p.p.) to the short- and long-term market interest rates	63.9	49.6	84.1	66.0
Standardized (permanent) negative shock (-0.5p.p.) on GDP growth	63.9	49.3	84.1	65.7
Standardized (permanent) negative shock on the PB equal to 50% of the forecasted cumulative change over the 2 forecast years	63.9	48.4	84.1	64.4
Adverse combined scenario (+1p.p. on interest rates and -0.5p.p. on GDP growth)	63.9	52.3	84.1	69.6
Enhanced (permanent) positive shock (+2p.p./+1p.p) to the short- and long-term market interest rates	63.9	50.7	84.1	67.4
Enhanced (permanent) negative shock (-stdev(14-18)/-0.5p.p.) on GDP growth	63.9	58.2	84.1	77.5

(1) Details on the scenarios can be found in European Commission (2018), Debt Sustainability Monitor 2017, Directorate-General for Economic and Financial Affairs, European Economy, Institutional Paper 071/2018.
(2) In the table, medium risks (yellow) are associated with the level of the debt ratio at the end of the projection period (2029) when the value projected is at 60% or above, and high risks (red) when the value projected is at 90% of above. Risks are deemed low (green) otherwise.
Source: European Commission

ANNEX 2
Specific monitoring of macroeconomic imbalances

In March 2018, Ireland was found to be experiencing macroeconomic imbalances in the context of the MIP ([52]). The imbalances involve vulnerabilities from large stocks of public and private debt and net external liabilities. High stock of non-performing loans and rapidly rising house prices also warrant close monitoring.

The Country-Specific Recommendations under the European semester provided guidance for the policy follow-up. MIP relevant CSRs are, in particular: (i) the use of windfall gains to accelerate the reduction of the general debt ratio, and limiting tax expenditures and broadening the tax base; (ii) the timely and effective implementation of the National Development Plan, including in terms of transport, housing and water services; and (iii) the promotion of faster and durable reductions in long-term arrears by the use of secondary markets, building on initiatives for vulnerable households and, where necessary, using write-offs of non-recoverable exposures.

This section provides an overview of the state of play regarding progress with policy implementation to address imbalances as identified under the MIP framework. In order to avoid an overlap of surveillance processes, it does not provide an assessment of fiscal targets.

A2.1. EVOLUTION OF IMBALANCES

Macroeconomic imbalances have been further reduced in 2018 supported by the robust economic growth. Some indicators remain heavily influenced by the activities of multinational companies**.** The domestic economy is expected to remain strong in the short term, underpinned by private consumption and investment in construction. Strong employment growth, in conjunction with increasing wages, continues to support household income and private consumption. Construction investment is expanding at a solid pace, though from a low base. External risks to the economic outlook relate primarily to the uncertainties regarding the terms of the UK's withdrawal from the EU as well as changes to the international taxation and trade environment.

The public debt ratio has diminished, but the stock of debt remains elevated. Public debt as a share of GDP has significantly declined, reaching 68.4% in 2017. The improvement (of 5.0% of GDP) compared to 2016 is primarily due to the denominator effect of strong GDP growth. As a proportion of modified-GNI([53]), debt remains high, at 111% in 2017. The total debt and interest payments also remain high as a percentage of revenue. The Commission forecast projects the general government debt ratio to have declined to 63.9% of GDP in 2018 and to fall further to 61.1% and 56.0% of GDP in 2019 and 2020 respectively. This is contingent on still robust GDP growth and the realisation of positive primary budget balances.

Private sector debt continues to represent an imbalance in stock terms. The high level of private debt, at 243.6% of GDP in 2017, is pushed up by large multinational companies present in Ireland, which makes the underlying domestic trends harder to grasp based on headline numbers. However, underlying flows signal continued deleveraging, driven by the corporate sector. Household deleveraging has brought debt down from 52.2% of GDP in 2016 to 47.7% of GDP in 2017, levels consistent with economic fundamentals. New lending is however picking up, supported by the buoyant housing market. An increasing share of new mortgages is loans with interest rate fixation of one to five years. Moreover, Gaffney et al. (2018) show that recent new loans with deferred amortisation are rarely related to primary dwellings. In 2017, 15% of new mortgages were with deferred amortisation.([54]) While the composition of new mortgages is favourable, its impact on the stock of mortgages remains limited. 90% of the mortgage stock remains characterised by variable interest rates.

([52]) This annex presents developments relevant to the analysis of macroeconomic imbalances and related policy implementation, and therefore might overlap in some respect with the other chapters of the post-programme surveillance report.

([53]) The Modified Gross National Income (also known as GNI*), provided by the Irish statistical authorities, more accurately reflects the income of Irish residents than GDP. It differs from actual GNI in that it excludes inter alia the depreciation of foreign-owned, but Irish-resident, capital assets (most notably intellectual property and assets associated with aircraft leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

([54]) Gaffney, E., Kinghan, C. and Nevin, C. (2018), *An overview of interest only mortgages in Ireland*, Financial Stability Notes, no. 4. Central Bank of Ireland.

Increased portfolio sales are facilitating faster NPL reduction in the banking sector. The three main domestic banks continue to improve their asset quality. According to ECB data, which covers all Irish domestic and foreign-owned banks, the aggregate NPL ratio fell to 8.7% of gross loans in the second quarter of 2018, down from 11.5% one year earlier. The non-financial private sector NPL ratio remains nevertheless elevated, at 11.8%. Close to 70% NPL stock relates to mortgage arrears, and more than half of these arrears are over two years past due. This indicates continued challenges posed by long-term arrears. Asset quality improvements over the past year have been primarily driven by loan sales activity, which are likely to continue in the coming months assuming that the announced sales are fully implemented. The sales that have been implemented so far have led to a significant improvement in mortgage arrears. Provisioning levels remain low at 32% as of June 2018, which are driven by the high share and the low provisioning levels of restructured NPLs.

The external position has improved but figures are volatile. The current account (CA) surplus stood at 8.5% of GDP in 2017, following a deficit of 4.2% in 2016. Volatility in imports of intellectual property and contract manufacturing were contributing to the swings in the CA balance in the past years ([55]).The net international investment position (NIIP) continues to improve, but remains highly negative. In the second quarter of 2018 it stood at -140.2% of GDP compared to a peak level of -242.7% in Q1 2015. The high level of net external liabilities is to a large extent explained by the operations of some multinationals and the negative net position of the International Financial Services Centre, to which domestic sectors have only limited exposure. Overall, the NIIP is expected to strengthen further on the back of GDP growth and CA surpluses.

Residential construction is booming but housing completions are still falling short of demand. Annual housing completions amounted to 17 161 in the third quarter of 2018, i.e. 33% more than on the same period last year but still well below the level required which has been estimated in the range of 23 000 (rising to 32 000 by 2024) ([56]) to 50 000 ([57]).

Residential property inflation has recently eased due to dynamic housing supply and more binding macroprudential rules. Annual residential property price inflation peaked at 13.3% in April 2018 but declined to 8.2% in September, mainly as a result of a deceleration of property prices in Dublin ([58]). The exhaustion of the allowances to exceed 3.5 loan-to-income limits by some banks has apparently weakened housing demand. In combination with a higher housing supply, this could have curbed residential price inflation. In 2017, house prices did not seem to be overvalued yet but affordability is a concern.

A2.2. POLICY MEASURES TAKEN TO ADDRESS MACROECONOMIC IMBALANCES

To increase the resilience of public finances

Some expected receipts may be used to accelerate the reduction of public debt. Budget 2019 estimates exchequer receipts of EUR 0.8 billion in 2018 from the return of funds from the resolution of the financial crisis. However, it does not report any new measures implemented so far concerning the use of these to accelerate the reduction of the general government debt ratio. It is the stated position of the government that these and further estimated exchequer receipts of EUR 3.5 billion, spread over 2020 and 2021, arising from the winding down of the National Asset Management Agency will be directed towards lowering the debt.

While it is important to bear in mind a possible trade-off with faster debt reduction, the

([55]) Contract manufacturing is a process in which resident multinational companies issue contracts to foreign firms to produce goods on their behalf. As resident companies own these goods, their sales are recorded as exports of the resident country even though they do not enter the domestic economy.

([56]) Duffy, D., Foley, D., McInerney, N. and McQuinn, K. (2016), *'Demographic Change, Long-Run Housing Demand and the Related Challenges for the Irish Banking Sector'*. The Economic and Social Research Institute (ESRI) (https://www.esri.ie/pubs/CB201617.pdf)

([57]) Lyons, R(2017),*'How to Build Enough Homes'* (http://www.ronanlyons.com/category/blog/propertymarket)

([58]) From January to September 2018, more than 33% of the dwelling transactions in Ireland have been taking place in Dublin. Residential property inflation in Dublin dropped from 13.0% in April to 5.8% in September

planned rainy day fund could contribute to prudent management of public finances. The 2016 Summer Economic Statement outlined that, once the medium-term objective (MTO) of a structural deficit of 0.5% of GDP was achieved, a rainy day fund would be established. To this end, the government has approved the publication of the legislation to establish the fund, which will formally be known as the *National Surplus (Exceptional Contingencies) Reserve Fund*. The Fund is intended to be a reserve into which sums will be transferred from the assets of the Ireland Strategic Investment Fund and from the exchequer. The legislation is envisaged to provide for a facility to strengthen the fund, by adding potential windfall tax receipts or income to it where the parliament so approves. Exchequer returns to end-November 2018 were helped by an unexpected temporary EUR 0.7 billion influx of corporate tax linked to changes in international tax accounting rules. Nevertheless, so far, the allocations for the fund for 2019-2021 in Budget 2019 remain unchanged from the Stability Programme 2018 (at EUR 500 million per annum).

Budget 2018 includes an increase in the reduced rate of VAT on tourism activities to 13.5%, limiting the scope of this tax expenditure. Furthermore, Finance Bill 2018 includes some additional measures, which were not announced as part of Budget 2019. Amendments concerning the sugar sweetened drinks tax and vehicle registration tax reliefs for certain leased vehicles could moderately limit the tax expenditures and broaden the tax base. However, some measures do not contribute to this, such as a decrease in the VAT rate on electronically supplied publications; increases to tax credits for self-employed and home carers, the interest relief for landlords, the fiscal incentive for certain types of share-based remunerations, a capital acquisition tax threshold; exemptions for certain childcare support payments and benefits in kind; and an extension of a young trained farmers stamp duty relief.([59])

To conclude, although policy action aimed at reducing debt and broadening the tax base is ongoing, challenges remain. Areas of progress include building fiscal buffers, inter alia, with the envisaged rainy day fund, but no new measures have been implemented so far concerning the use of returned funds from the resolution of the financial crisis to accelerate the debt reduction. While some progress has been made in limiting tax expenditures, the impact of measures outlined in Budget 2019 on the overall policy goal of limiting tax volatility is mixed.

To reduce the stock of non-performing loans (NPLs)

The large banks are on track to meet their NPL reduction targets. Several banks have entered into agreements to dispose around EUR 10 billion of NPLs, or one-third of the total NPL stock at end-2017. Assuming these agreed sales go through, the Irish banks should be able to reach their goals. Importantly, some of these sales include deep mortgage arrears linked to primary dwelling homes. Despite these sales, insolvency procedures as well as court and out-of-court resolution frameworks remain under-utilised. The number of personal insolvency applications through *Abhaile* aid-and-advice scheme increases. However, creditors continue to reject some of the proposed insolvency arrangements, which transfers the cases to court procedure and results in a reduction of concluded arrangements. ([60]) The flow of approved cases under the enhanced *Mortgage-to-Rent* scheme is picking up since its introduction in September 2017. Approvals under the revised scheme have already surpassed the total approvals under the original scheme initiated in 2012. Collateral repossessions are still rare, with the exception of a one-off spike due to a bulk of voluntary repossessions offered by one bank in the last quarter of 2017. Meanwhile, the ongoing tracker mortgage examination is being finalised, with over the 90% of the total compensation readily paid by banks to affected consumers.

The credit register became fully operational for consumer loans. The long-awaited register is fully operational for consumer loans with mandatory enquiries on new loan issuances starting from October 2018. The register is also collecting data on non-consumer lending, for which mandatory

([59]) Finance Bill 2018 includes some further measures.

([60]) Court reviews confirm the creditors' rejection in approximately 75% of the cases. Anecdotal evidence suggests that, as the mortgage arrears resolution process advances, the remaining are the more difficult cases, where the arrears amounts are very large and creditors become reluctant to accept insolvency arrangements that can involve a large write-off of debt.

enquiries will be required from end-March 2019. With the latter step, the full implementation of the credit register will be finalised.

To monitor developments in the housing market

In February 2018, Ireland launched the National Development Plan which envisages EUR 116 billion of capital investments, including in the area of housing, over the period 2018-2027. The Irish construction sector is one of the least productive in the EU and the OECD. Financing conditions are stricter than for other sectors. The efficiency of public spending in this plan could therefore be relatively poor unless measures are taken to (1) ensure that the market for public construction works remains wide open to more efficient building companies; (2) coordinate projects and procurement procedures to avoid efficiency losses; (3) foster the introduction of digital and other new technologies that can increase productivity in the construction sector.

Despite the additional funding announced in Budget 2019 to support affordable housing, challenges remain. EUR 250 million of additional funding are proposed in Budget 2019 to increase the delivery of social housing through construction, acquisition and housing long term leasing from 50 000 to 54 000 over the period 2016-2021. Around 10 000 of these social houses are expected to be delivered in 2019. Additional EUR 121 million will be allocated to the Housing Assistance Payment to support the rental costs of 16 760 tenants in 2019. This will add to the EUR 134 million in support to the Rental Accommodation Scheme with 600 new tenancies joining the scheme in 2019. In total, the 2019 Budget provision will cover the housing needs of 27 360 households in 2019. This represents only 34% of the social housing demand which in July 2018 stood at 71.858. Budget 2019 has also announced an extra EUR 90 million to support the provision of emergency accommodation and the implementation of a range of sustainable housing solutions for homeless households in 2018 and 2019.

The government has stepped up its efforts to facilitate land development, including by supporting enabling infrastructure. The lack of available land, conveniently serviced with the necessary infrastructure, at the right place and the right moment, may delay housing supply. Ireland has taken important measures in 2019 to facilitate land development in the short and medium term. The National Development Agency was launched in September 2018 to facilitate the release, assembly and effective use of strategically located land banks suitable for public and private housing provision. In addition, in February a EUR 25 million Serviced Site Fund and a new EUR 3 billion Regeneration Development Fund were announced in the context of the National Development Plan. These Funds should support the delivery of infrastructure to unlock local authority-owned land as well as urban and rural regeneration interventions. Budget 2019 added further EUR 69 million to the Serviced Site Fund in 2019 and trebled its allocation to EUR 310 million over the period to 2021. As a result, this fund is expected to facilitate the delivery of over 6 000 affordable houses over the lifetime of the Fund. Budget 2019 also announced EUR 5 million of extra funding to support a new Urban Renewal Scheme and tackle dereliction and vacancy of buildings in key urban areas.

Changes in planning requirements may boost housing supply and support more sustainable compact growth. In March 2018, guidelines for planning authorities on design standards for new apartments were updated. These guidelines could contribute 3 to 15% to the reduction of apartment building costs ([61]). In addition, in August 2018, the government launched the public consultation on the draft guidelines for planning authorities on urban development and building heights. These guidelines are expected to remove blanket limitations on building height restrictions, thus increasing housing delivery through the use of a more compact urban growth.

Home Building Finance Ireland is expected to provide finance to small builders for the construction of up to 7 500 residential units in the coming years. The Home Building Finance Ireland (HBFI) bill was approved in December 2018 and is expected to start lending in early 2019. Up to EUR

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

750 million of the Ireland Strategic Investment Fund will be made available to this body for financing small developers seeking to build commercially-viable residential development projects. The loans provided by HBFI will be at commercial market equivalent rates and will not constitute cheap or subsidised funding. A robust and prudent methodology to assess project viability will be important so as to reduce risks to public finances. Credit provided by HBFI should not displace funding already in the market but target developers with limited access to bank loans. Given the sometimes limited capacity of small developers to prepare good quality business cases, the provision of complementary advisory services to help them prepare their funding applications may be beneficial.

Macroprudential policies are gaining importance amid the existing housing sector dynamics. Current pressure in the housing market resulting from housing supply shortages calls for prudent loan-to-value and loan-to-income limits. The 2017 review of mortgage-related measures, which reduced the banks' discretionary buffer above the 3.5 loan-to-income ratio to 10% for subsequent buyers, may have contributed to dampening housing demand and curbing housing price inflation in recent months (see section 2.2).

Conclusion

The government has taken measures addressing tax expenditures and housing supply shortages, but challenges remain. No new measures have been implemented so far to accelerate the reduction of the general government debt ratio. While some measures in the Finance Bill have the potential to limit the tax expenditures and to moderately broaden the tax base, some other measures are at odds with this. NPLs have been declining but long-term arrears remain a concern. The government has intervened repeatedly in the residential property market to support the recovery of supply but it will take time for the measures to generate sizeable effects.

Table A2.1: Overview Table of MIP related reforms

MIP objective: Increase the resilience of public finances			
Public finances and taxation			
Fiscal policy and fiscal governance			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Announced in October 2018: Expected estimated exchequer receipts of EUR 0.8 billion in 2018 from the return of funds from the resolution of the financial crisis, and of EUR 3.5 billion, spread over 2020 and 2021, arising from the winding down of the National Asset Management Agency to be used to reduce debt. **Proposed in October 2018**: Rainy day fund bill			CSR (1) – 2018" […] Use windfall gains to accelerate the reduction of the general government debt ratio [...]"
Broaden tax bases			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Proposed in October 2018: Increase in the reduced rate of VAT on tourism activities, as well as amendments concerning the sugar-sweetened drinks tax and vehicle registration tax reliefs for certain leased vehicles. Measures, which may **extend tax expenditures and/or narrow the tax base** include: a decrease in the VAT rate on electronically supplied publications; increases to tax credits for self-employed and home carers, the interest relief for landlords, the fiscal incentive for certain types of share-based remunerations, a capital acquisition tax threshold; exemptions for certain childcare support payments and benefits in kind; and an extension of a young trained farmers stamp duty relief.			CSR (1) – 2018" […] limit the scope and the number of tax expenditures and broaden the tax base [...]"
MIP objective: Reduce the stock of non-performing loans			
Financial Sector			
Private indebtedness			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*

(Continued on the next page)

Table (continued)

		Banks are pursuing their strategies to reduce non-performing loans to levels of European peers. Applications for the personal in-solvency scheme, *Abhaile*, have increased since the introduction of the in 2016. However, concluded arrangements remains limited, due to an increase in creditors' rejec-tions of the proposed insolvency arrangements involving partial debt forgiveness	MIP matrix and CSR (3) – 2017 "Promote faster and durable reductions in long-term arrears, building on initiatives for vulnerable households and encouraging write-offs of non-recoverable exposures."
MIP objective: Monitor developments in the housing market			
Housing Market			
Housing Supply Shortages			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
June 2018: Publication of the Home Building Finance Ireland (HBFI) bill. This bill is currently under discussion in the Houses of the Oireachtas. **August 2018:** The government launched the public consultation on the draft guidelines for planning authorities on urban development and building heights **October 2018**: Budget 2019 set aside EUR 5 million to establish an Urban Renewal Scheme funding in 2019 to tackle dereliction and vacancy of buildings in key urban areas. **October 2018**: Budget 2019 proposed to allocate EUR 41 million to the LIHAF in 2019 for the support of 30 public transport infrastructure projects. Two of them are already under construction with the remaining reaching construction stage in 2019. **October 2018**: Additional EUR 250 million were proposed in Budget 2019 to increase the delivery of social housing through build, acquisition and housing long term leasing from 50 000 to 54 000 over the period 2016-2021. Around 10 000 of these social houses will be delivered in 2019.	**February 2018**: The National Development Plan 2018-2027 (NDP) established a EUR 2 billion Urban Regeneration and Development Fund (URDF). A first call was launched in July 2018. **February 2018:** The NDP set up a Serviced Sites Fund in February 2018. Budget 2019 proposed to increase its allocation to €310 million over the period to 2021. A first call for proposal was launched in 2018. 15 proposals are currently under assessment.	**March 2018:** Updated guidelines for planning authorities on design standards for new apartments were published. **September 2018**: The Land Development Agency was launched in September. EUR 3.5 million of current expenditure were allocated to it under Budget 2019 to defray operational and start-up costs associated with its activities. **June 2018**: Since 2016, 15 723 social houses have been delivered through construction, acquisition and long-term leasing.	MIP matrix and CSR (2) – 2018 " Ensuring the timely and effective implementation of the National Development Plan, including in terms of […] transport, housing, water services [...]"

Source: European Commission

ANNEX 3
Supplementary tables

Table A3.1: **Fiscal accounts (based on 2018 autumn forecast)**

	2014	2015	2016	2017	2018	2019	2020
			% of GDP				
Indirect taxes	8.6	8.6	8.4	7.8	7.8	7.6	0.0
Direct taxes	12.7	10.6	10.6	10.5	10.5	10.3	10.3
Social contributions	5.6	4.3	4.4	4.3	4.1	4.2	4.1
Sales	2.5	2.0	2.0	1.9	1.7	1.6	1.5
Other current revenue	1.7	1.1	0.8	0.7	0.5	0.4	0.4
Total current revenue	**31.2**	**26.8**	**26.2**	**25.1**	**24.7**	**24.1**	**16.4**
Capital transfers received	0.2	0.1	0.4	0.1	0.1	0.1	0.1
Total revenue	**31.4**	**26.9**	**26.6**	**25.3**	**24.9**	**24.3**	**16.5**
Compensation of employees	9.4	7.2	7.1	7.0	6.8	6.6	6.4
Intermediate consumption	4.6	3.5	3.5	3.4	3.5	3.7	3.7
Social transfers in kind via market producers	2.6	2.1	2.1	2.1	1.9	1.8	1.7
Social transfers other than in kind	11.8	8.8	8.3	7.8	7.1	6.8	6.6
Interest paid	3.9	2.6	2.3	2.0	1.6	1.4	1.3
Subsidies	1.0	0.7	0.7	0.6	0.6	0.6	0.5
Other current expenditure	1.4	1.0	1.1	1.1	1.0	1.0	1.0
Total current expenditure	**34.6**	**25.8**	**25.0**	**23.9**	**22.5**	**21.9**	**21.3**
Gross fixed capital formation	2.2	1.8	1.9	1.8	2.1	2.4	2.3
Other capital expenditure	0.6	1.3	0.5	0.5	0.5	0.5	0.4
Total expenditure	**37.4**	**28.9**	**27.5**	**26.3**	**25.1**	**24.7**	**24.0**
General government balance	**-3.6**	**-1.9**	**-0.5**	**-0.2**	**-0.1**	**-0.1**	**0.2**
Underlying government balance (EDP)	**-3.5**	**-1.1**	**-0.7**	**-0.2**	**-0.1**	**-0.1**	**0.2**
			EUR billion				
Indirect taxes	21.2	22.6	23.6	24.7	25.2	27.0	27.7
Direct taxes	24.9	27.9	29.1	30.8	33.9	35.4	37.6
Social contributions	11.0	11.4	12.0	12.6	13.3	14.3	14.9
Sales	4.8	5.4	5.4	5.5	5.5	5.6	5.6
Other current revenue	3.3	3.0	2.1	2.0	1.7	1.4	1.5
Total current revenue	**65.2**	**70.2**	**72.2**	**75.7**	**79.5**	**83.7**	**87.1**
Capital transfers received	0.4	0.3	1.0	0.4	0.5	0.5	0.5
Total revenue	**66.0**	**70.9**	**73.7**	**76.5**	**80.5**	**84.7**	**88.2**
Compensation of employees	18.4	19.0	19.4	20.7	21.8	22.7	23.4
Intermediate consumption	8.9	9.2	9.5	9.9	11.1	12.7	13.3
Social transfers in kind via market producers	5.1	5.4	5.7	6.1	6.1	6.2	6.3
Social transfers other than in kind	23.0	23.0	22.7	22.9	23.0	23.3	23.9
Interest paid	7.6	6.8	6.2	5.8	5.2	4.9	4.8
Subsidies	1.9	1.8	1.8	1.8	1.9	1.9	2.0
Other current expenditure	2.8	2.5	3.0	3.2	3.3	3.5	3.5
Total current expenditure	**67.6**	**67.8**	**68.4**	**70.4**	**72.4**	**75.3**	**77.3**
Gross fixed capital formation	4.3	4.7	5.3	5.4	6.9	8.1	8.4
Other capital expenditure	1.2	3.4	1.5	1.6	1.6	1.6	1.6
Total expenditure	**73.1**	**75.9**	**75.1**	**77.3**	**80.9**	**84.9**	**87.3**
General government balance	**-7.0**	**-5.0**	**-1.5**	**-0.7**	**-0.4**	**-0.3**	**0.9**
Deficit-increasing financial sector measures	0.0	-1.8	0.0	-0.2	0.0	0.0	0.0
Underlying government balance (EDP)	**-6.3**	**-2.2**	**-1.8**	**-0.7**	**-0.4**	**-0.3**	**0.8**

Source: European Commission

Table A3.2: **General Government debt projections (based on 2018 autumn forecast)**

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Government deficit (% of GDP)	**8.1**	**6.1**	**3.6**	**1.9**	**0.5**	**0.2**	**0.1**	**0.1**	**-0.2**
Government gross debt (% of GDP)	119.9	119.7	104.1	76.8	73.4	68.4	63.9	61.1	56.0
levels, EUR billion									
Government deficit	**14.1**	**11.0**	**7.0**	**5.0**	**1.5**	**0.7**	**0.4**	**0.3**	**-0.9**
Gross debt	210.0	215.3	203.4	201.6	200.7	201.3	205.9	210.0	203.7
Change in gross debt	65.8	5.3	-12.0	-1.7	-0.9	0.6	4.6	4.1	-6.3
Nominal GDP	175.2	179.9	195.3	262.5	273.2	294.1	322.5	343.5	363.7
Real GDP	174.3	176.6	192.2	240.4	252.4	270.6	291.8	305.0	316.4
Real GDP growth (% change)	**0.2**	**1.3**	**8.8**	**25.1**	**5.0**	**7.2**	**7.8**	**4.5**	**3.8**
Change in gross debt (% of GDP)	9.0	-0.2	-15.6	-27.3	-3.4	-5.0	-4.6	-2.7	-5.1
Stock-flow adjustments (% of GDP)	0.0	3.5	-3.1	-9.7	-2.6	-0.9	0.0	1.3	1.1
% of GDP									
Gross debt ratio	**119.9**	**119.7**	**104.1**	**76.8**	**73.4**	**68.4**	**63.9**	**61.1**	**56.0**
Change in gross debt ratio	33.9	-0.2	-15.6	-27.3	-3.4	-5.0	-4.6	-2.7	-5.1
Contribution to change in gross debt									
Primary balance	-6.8	-3.2	0.5	1.8	4.7	5.1	4.8	4.7	5.7
"Snow-ball" effect*	1.9	1.2	-4.9	-24.3	-1.5	-3.1	-2.4	-1.9	-1.9
of which									
Interest expenditure	*4.2*	*4.3*	*3.9*	*2.6*	*2.3*	*2.0*	*1.6*	*1.4*	*1.3*
Real growth effect	0.0	-1.9	-9.2	-19.8	-3.8	-5.3	-3.6	-2.5	-2.2
Inflation effect	-2.2	-1.2	0.5	-7.1	0.0	0.2	-0.4	-0.9	-1.0
Stock-flow adjustments	**3.5**	**-3.1**	**-9.7**	**-2.6**	**-0.9**	**0.0**	**1.3**	**1.1**	**-1.5**
Implicit interest rate	*3.8*	*3.7*	*3.5*	*3.4*	*3.1*	*2.9*	*2.6*	*2.4*	*2.3*

The projections assume no borrowing for precautionary contingencies foreseen in the programme's financing plan. Stock-flow adjustments include a reduction in cash balances from around 14% of GDP at end-2013 to around 4% by end-2016 and other and other financial transactions.
*Snow-ball" effect, Interest expenditure, Real growth effect and Inflation effect are derived from the Debt sustainability monitor update - Autumn 2018
Source: European Commission

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