Ireland: 2015 Article IV Consultation-Staff Report; Press Release

INTERNATIONAL MONETARY FUND

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IRELAND

March 2015

2015 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Ireland, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 23, 2015, following discussions that ended on January 27, 2015, with the officials of Ireland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 9, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Staff Supplement** of March 19, 2015 updating information on recent developments.
- A **Press Release** summarizing the views of the Executive Board as expressed during its March 23, 2015 consideration of the staff report that concluded the Article IV consultation with Ireland.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

IRELAND

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

March 9, 2015

EXECUTIVE SUMMARY

Ireland's recovery has been robust. Growth is estimated at about 5 percent in 2014, although offshore manufacturing of exports appears to have made a significant contribution. The unemployment rate has declined to 10½ percent, down from a peak of 15 percent three years ago, with long-term unemployment falling notably though still unduly high. Private balance sheet health is improving and enterprise profitability has risen, yet distressed loans remain high and arrears are increasingly prolonged.

Property markets are bouncing back rapidly. Commercial real estate values are up 30.7 percent y/y in 2014, though they still remain about 30 percent below pre-boom levels. Values were bolstered by record transaction volumes with over one-third reflecting foreign investment inflows. At the same time, house prices rose 16.3 percent y/y, as fast as the increases during the boom period, though they are still 38 percent below peak.

The priority is to ensure that solid growth and job creation is sustained. Near-term growth prospects appear bright at about 3½ percent y/y in 2015. Solid growth needs to be maintained to further reduce unemployment. To achieve that Ireland should:

- **Balance its budget over the cycle through a phased and steady adjustment.** Fiscal balance will ensure that growth erodes Ireland's high public debt burden. An adjustment phased over three years would limit the drag on recovery.

- **Implement a policy mix to achieve steady fiscal adjustment that protects growth potential.** Both the expenditure and revenue sides can support adjustment and help create room to rebuild public investment. Rigorous assessment of the quality of capital projects is needed to ensure this investment helps to avoid growth bottlenecks.

- **Facilitate a revival of financing flows in support of investment and recovery.** Cases of prolonged loan arrears need to be tackled more vigorously. Banks should address capital quality issues early to safeguard lending capacity. Scope to further develop nonbank financing should be explored, especially risk capital for SMEs.

- **Strengthen the financial resilience of banks and borrowers to shocks while tempering Ireland's property cycles.** Recent regulations of mortgage origination are welcome. Supervision should also ensure bank exposures to commercial property risks are appropriately contained. Reforms to improve the performance of the construction sector and the depth of rental property markets would help temper property cycles.

Approved By
Jörg Decressin and Alfred Kammer

C. Beaumont (head), A. Bhatia, A. Chailloux, and J. Andritzky, (all EUR); T. Poghosyan (FAD); C. Wilson (MCM); and A. Culiuc (SPR) visited Dublin during January 20-27. The mission followed a conference on "Ireland—Lesson from its Recovery from the Sovereign-Bank Loop" on January 19. Ms. Boranova and Ms. Ilagan assisted the mission. Messrs. McGrath and Hough (OED) participated in the discussions.

CONTENTS

Acronyms

AIB	Allied Irish Banks
BEPS	Base Erosion and Profit Shifting
BoI	Bank of Ireland
BTL	Buy to let
CBI	Central Bank of Ireland
CRD IV	Capital Requirements Directive IV
CRE	Commercial real estate
EDP	Excessive Deficit Procedure
EFSM	European Financial Stability Mechanism
EFSF	European Financial Stability Facility
ESA	European System of Accounts
FDI	Foreign direct investment
FTB	First time buyer
HICP	Harmonized index of consumer prices
IBRC	Irish Bank Resolution Corporation
IFAC	Irish Fiscal Advisory Council
MART	Mortgage Arrears Resolution Targets
MNE	Multinational enterprise
NAMA	National Asset Management Agency
NFC	Nonfinancial corporation
NPL	Nonperforming loan
NTMA	National Treasury Management Agency
PDH	Primary dwelling home
PMI	Purchasing managers index
PSPP	Public Sector Purchase Program
PTSB	Permanent tsb
SGP	Stability and Growth Pact
SME	Small- or medium-sized enterprise
SSB	Second and subsequent buyer
SSM	Single Supervisory Mechanism
VAT	Value added tax
WEO	World Economic Outlook

FOCUSING ON THE MEDIUM TERM

1. **Ireland's recovery has been robust—the priority now is to ensure that solid growth and job creation is sustained**. As discussed below, Ireland's recovery is off to a good start in 2013–14, with some of the adverse legacies from the crisis beginning to heal. Near-term growth prospects appear bright and the fiscal deficit is expected to fall below 3 percent of GDP in 2015, enabling Ireland to exit the EU's Excessive Deficit Procedure (EDP). But at 10.4 percent in Q4, the rate of unemployment is still well above its pre-crisis average of 4½ percent. Strong growth and job creation is therefore needed for a number of years, entailing a significant rise in investment including construction. In that context, the Article IV focuses on:

- **Fiscal adjustment after EDP exit**. A new post-EDP medium-term fiscal framework is needed as Budget 2016 will likely be Ireland's first under the preventative arm of the SGP.

- **Macro-financial policies for durable recovery**. Rising investment requires increased lending yet vulnerabilities must be contained to protect the durability of recovery.

2. **The discussions took place against some settling in the political situation**. Elections are due no later than early April 2016. Polls in early 2015 show a rise in support for the coalition parties and the water charges issue appears to becoming less heated after the November 2014 steps to lower fees and set a cap to reduce uncertainty about future charges. Developments in Greece are being watched closely given Ireland's large outstanding debt to its European partners.

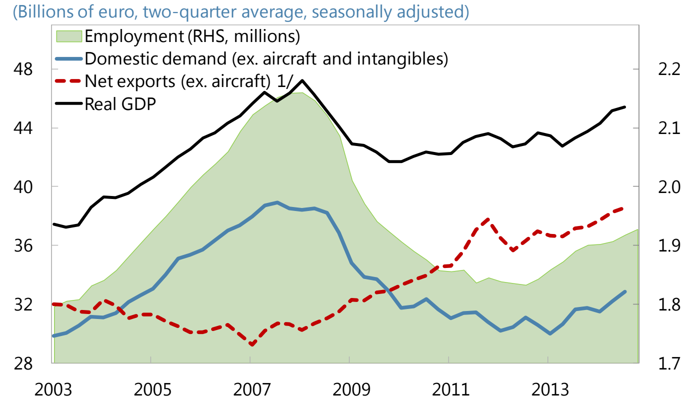
RECOVERY IS OFF TO A GOOD START

Exports and investment drove a strong recovery in 2014 and indicators suggest solid momentum into 2015. Property prices are bouncing back sharply despite low credit growth, driven in part by international investment. Some crisis legacies are beginning to heal, including unemployment, private balance sheets and bank health, yet substantial nonperforming loans remain to be resolved.

3. **Ireland's economic recovery is starting to fire on all cylinders**. Real GDP rose by 4.9 percent y/y in Q1–Q3 2014, with net exports generating two-thirds of this expansion and investment being the other main contributor. The export surge partly reflects offshore manufacturing under contract, contributing perhaps as much as 2 percentage points to growth (Box 1). Ireland's export performance was strong even excluding this factor, benefitting from U.S. and U.K. trade linkages and improved competitiveness (Annex I).

Real GDP Components and Employment

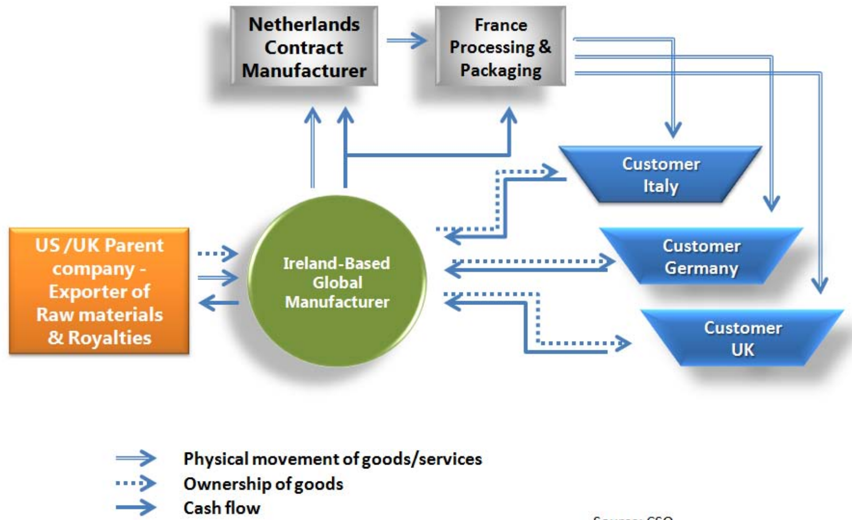
(Billions of euro, two-quarter average, seasonally adjusted)



Sources: CSO; Haver Analytics; and IMF Staff calculations.
1/Adjusted uniformly upward by €28 billion.

Box 1. Contract Manufacturing and Trade Performance in 2014

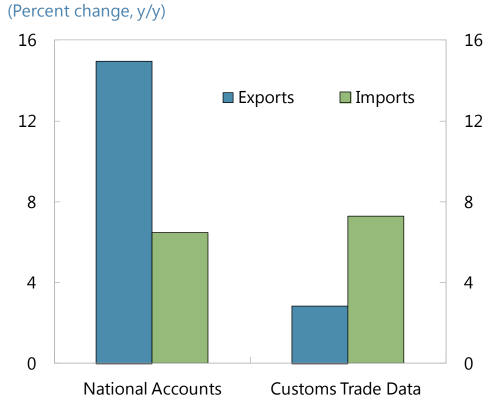
In 2014, multinational enterprises (MNEs) operating in Ireland made greater use of offshore manufacturing under contract. As a base for many of the large pharmaceutical and information technology companies operating in Europe, Ireland is highly exposed to the fragmentation of the global supply chain. As depicted in this chart, the booking of export sales in Ireland sometimes reflects a more complex process whereby products are manufactured in a country A subsidiary, packaged in country B and sold to country C customers, while generating royalty payments to country D for use of intellectual property.



Source: CSO

Goods produced through contracted manufacturing agreements are treated differently in the national accounts than in customs measures of trade. As these goods do not cross the Irish border, they are not included in customs data on exports. If, however, the goods remain under the ownership of the Irish company, they are recorded as exports in the national accounts. Payments for manufacturing services and patent and royalty payments are service imports in the national accounts, offsetting in part the positive GDP impact of contracted manufacturing.

Goods Trade, 2014Q1-Q3
(Percent change, y/y)



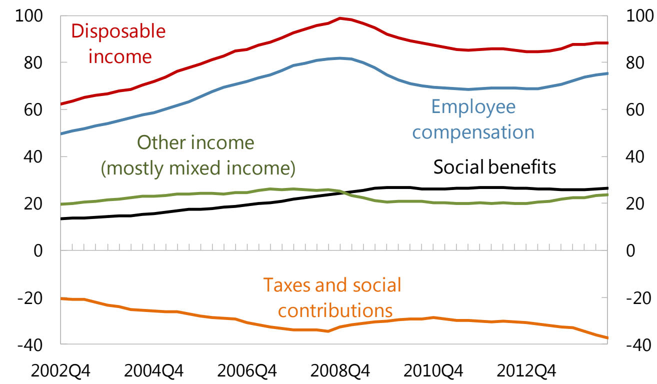
Source: Central Statistics Office of Ireland.

Contracted manufacturing appears to have had a significant impact on GDP growth in 2014 although it is difficult to make a precise estimate. Customs data on goods exports rose by 2.8 percent y/y in volume terms in the first nine months of 2014. In contrast, national accounts data on exports rose 12 percent in the same period. The gap between these two export measures can be attributed in part to contracted production, but could also reflect other factors like warehousing (goods produced in Ireland but stored and sold overseas) and valuation effects. Assuming conservatively that contract manufacturing accounted for about half of the difference between customs and national accounts data, the implied gross contribution to GDP growth in the first three quarters of 2014 from contract manufacturing is 2 percentage points. However, there is a need to take into account the likelihood that service imports were higher than otherwise, but it is not possible to identify the volume of additional service imports linked to contract manufacturing.

The pickup in investment and employment that began in H2 2012 is starting to be supported by consumption, with retail sales excluding autos up 3.6 percent y/y in 2014 (Figure 1).

4. The revival of consumption is underpinned by improving labor market conditions and low inflation. Employment is up 5.2 percent from its Q3 2012 trough, bringing the unemployment rate down to 10.4 percent in Q4 2014 from a peak of 15.1 percent. The number of long-term unemployed persons is down by 37 percent from peak, reducing the share of long-term unemployed by 7 percentage points to a still high 56 percent. Labor compensation rose by a strong 6½ percent y/y in the year ended Q3 2014, helping lift household disposable incomes by just over 3 percent. The fall in energy prices is also supporting households' purchasing power.

Household Incomes
(Billions of EUR, 4-quarters sum)

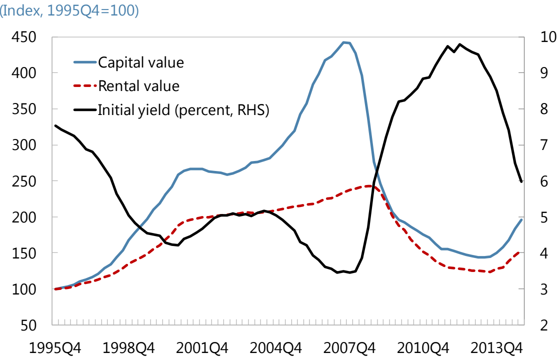


Sources: Central Statistics Office; and IMF staff calculations.

5. Property markets are bouncing back rapidly from their lows but valuations do not yet appear stretched:

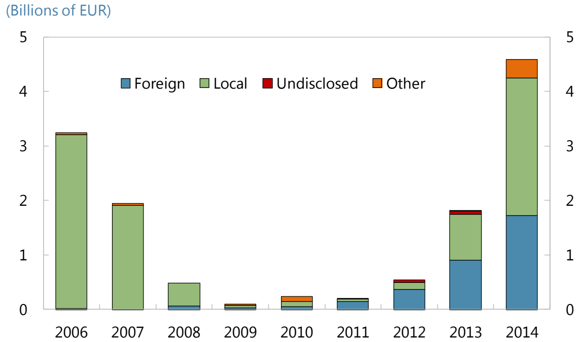
- **Commercial property values and rents are rising rapidly, in part reflecting international investments**. Capital values rose 30.7 percent y/y in Q4 2014, the fastest growth since 1999, although price levels are still 56 percent below peak and still about 30 percent below pre-boom levels. Rental growth of 19.7 percent y/y was largely driven by strong demand for Dublin office space reflected in falling vacancy rates and a 31 percent y/y increase in office rents. From almost 10 percent in early 2012, initial rental yields on commercial property have declined substantially to 6 percent in Q4 2014, yet they are still somewhat above the 5.2 percent yield in the U.K., and the premium over the 0.84 percent yield on 10-year government bonds remains sizable. The volume of turnover in Irish commercial real estate in 2014 was higher than in the mid 2000s, with 37.5 percent from offshore investors.

Commercial Real Estate Value Indices and Initial Yield
(Index, 1995Q4=100)



Source: Investment Property Databank; and Central Bank of Ireland.

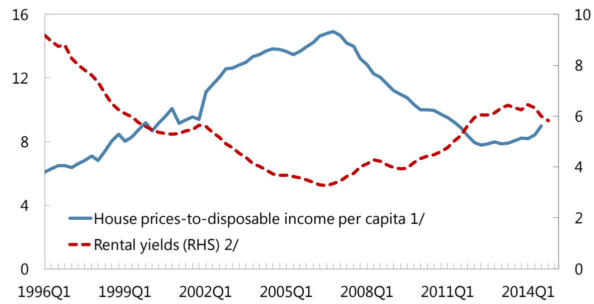
Commercial Property Transactions 1/
(Billions of EUR)



Source: CBRE Research.
1/ Relates to individual transactions worth of at least €1 mln.

- **House prices rose as fast as in the boom during 2014, with mortgage lending starting to pick up from low levels**. Nationally, prices rose by 16.3 percent y/y in 2014, bringing the rise from the trough in early 2013 to 27 percent. Yet, price levels are still some 38 percent below peak and remain in line with historical norms on standard valuation ratios. Expectations of further appreciation may be deferring sales, contributing to house shortages in Dublin. Mortgage credit has not driven the house price rebound, with about half of transactions in cash, but mortgage loan approvals have risen sharply more recently (Figure 2).

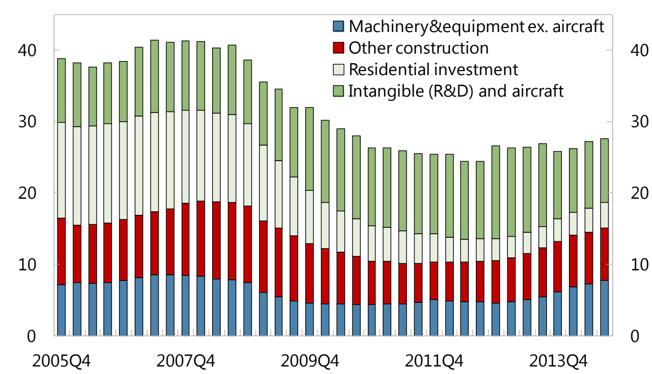
Indicators of Housing Valuation Levels



Sources: PTSB/ESRI; CSO; and Haver Analytics.
1/ Average house prices divided by moving 4-quarter adjusted GDI per capita.
2/ Census 2011 rent extrapolated by CPI rental component over CSO house prices.

6. Investment is reviving but remains low by historical standards, with residential construction recovery modest to date. Investment (excluding aircraft orders and intangibles) in the year to Q3 2014 was up almost 40 percent from two years earlier, led by a rise in machinery and equipment spending. But the ratio of investment to GDP, at 16 percent, is still well below its 22 percent pre-boom average, primarily reflecting low construction. While house completions rose by 33 percent y/y in 2014, they remain just under one-half of estimated household formation needs. Rising house prices are making new construction more profitable, yet high costs appear to be slowing the supply response together with developers' depleted equity and their slow transition to using external equity financing.

Fixed Investment Components
(EUR billions, 4-quarter rolling sum, constant prices)

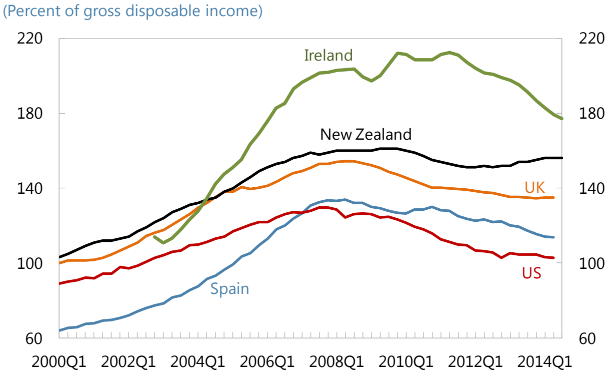


Source: Central Statistics Office of Ireland.

7. Household balance sheets are healing gradually, yet loan distress remains high and over half of arrears cases are prolonged:

- Households have cut nominal debts by 20 percent from peak through repayments primarily funded by a 4 percentage point rise in their trend savings rate. Debt ratio falls have been large by international standards but debt levels remain relatively high at 177 percent of disposable income. Household net worth has risen 25 percent from its trough (Figure 2).

Household Debt
(Percent of gross disposable income)



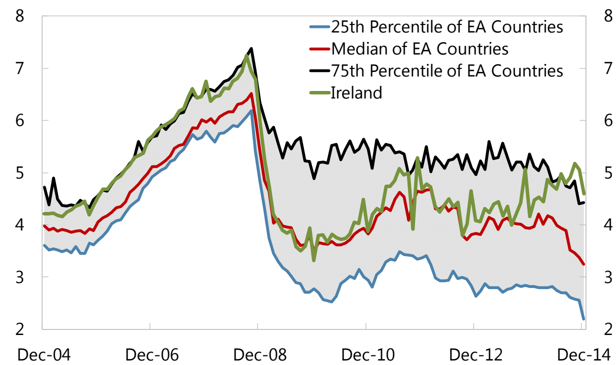
Sources: BEA;BIS; CBI; CSO; INE; ONS; RBNZ; and Haver Analytics.

- A recent survey finds household debts concentrated among families with mortgages, having 2 to 3 children, with the reference person aged 35 to 44, and in the two top income quintiles. Yet, their debt servicing burden is still similar to other groups, reflecting the high share of long-term "tracker" mortgages, with an average interest rate of 1.05 percent at end 2014.

- The share of mortgages on primary dwellings in arrears for over 90 days declined to 14.8 percent in Q4 2014, from a peak of 17.3 percent five quarters earlier (Figure 2). Staff estimates that some 4.4 percent of households have mortgages in arrears. However, prolonged arrears (over 720 days) rose to just over half of mortgages in arrears over 90 days, with arrears outstanding on these mortgages accounting for 78 percent of total arrears over 90 days. In the case of buy-to-let property, mortgages in arrears remain exceptionally high at 29.4 percent of loans. (Box 1 in the Second PPM report provides further details.)

8. **Rising earnings of Irish enterprises appear to be limiting their needs for external financing at this stage in the recovery**. In the year to Q3 2014, Irish private enterprises (excluding financial intermediaries) repaid outstanding credit at double-digit rates while building deposits at similar rates, indicating a strong cash flow position (see Box 2 in the Second PPM report), consistent with recent surveys finding that SMEs are making fewer loan requests. SMEs also see greater willingness of banks to lend and face lower loan rejection rates. Yet in the second half of 2014, lending rates for SMEs moved up from the median in the euro area to the 75th percentile—where they were pre-crisis. This could reflect a combination of reduced competition, pricing for higher risk on those SMEs that need to borrow, and a shift from financing of working capital toward lending for investment. Some 25.4 percent of SME loans are in default, but 41.2 percent by value given high default rates on larger loans.

SME Lending Rate in Euro Area Countries 1/
(Percent)



Source: MFI interest rates, ECB.
1/ Rate on new loans to nonfinancial corporations of up to €1 million for up to one year.

9. **Bank health is benefiting from favorable funding conditions and property market recovery yet challenges remain in loan resolution and the transition to Basel III:**

- **Domestic banks returned to profitability in the first half of 2014 for the first time since 2008 and reports show continued improvements**. Operating income growth reflected a fall in costs on both deposits and market funding. Provisioning expenses fell by two-thirds in 2014 H1 as impaired assets stabilized and increases in property prices also contributed. These trends continued for the full year based on financial reporting by AIB and BoI.

- **Though declining, NPLs remain very elevated at one-quarter of outstanding loans**. By Q2 2014 NPLs had fallen 12 percent from their peak in Q3 2013, largely as a result of write-offs and disposals. The authorities note that headline NPL figures overstate the scale of

distress, as even after a workout plan is in place, the portion of impaired loans expected to be serviced after a workout remains as an NPL until the remaining debt is written off.

- **Capital adequacy has risen but the transition to Basel III capital rules will require action**. CET1 ratios of domestic banks averaged a strong 13.4 percent in June 2014, although this partly reflects lower risk weighted assets due to loan repayments. However, Irish banks have significant balance sheet items—such as deferred tax assets and preference shares—that will, under CRD IV, be netted out from equity in the calculation of the capital adequacy ratio after transition periods of some years.

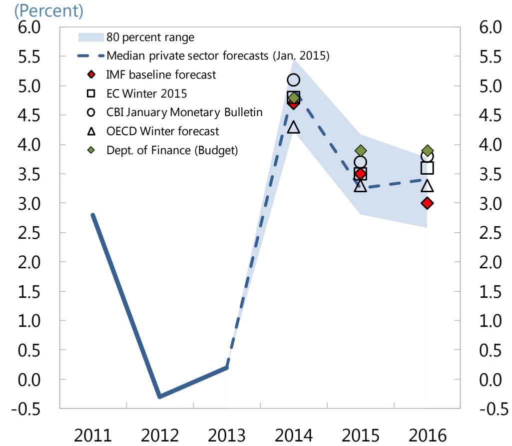
BRIGHT PROSPECTS CLOUDED BY RISKS

Prospects for a self-sustaining recovery appear favorable although euro area developments present risks in the near and medium term. The ECB's quantitative easing is of particular benefit given Ireland's strong trade outside the euro area and the ongoing need to address debt overhangs.

10. Growth is projected to moderate to 3½ percent in 2015 and to gradually ease to a 2½ percent pace. With the latest WEO maintaining growth of Ireland's trading partners at 2 percent, export growth is projected to revert to about 4 percent from 2015. Investment growth decelerates modestly yet remains brisk given the low base. In view of still high household debt, the baseline is for a gradual revival of private consumption supported by rising disposable income. Inflation rises only slowly as unemployment declines towards 8 percent by 2018. The Irish authorities' growth outlook is about ½ percent higher in 2015, primarily due to a quicker revival of private consumption. Their projection for growth of about 3½ percent in the medium term mostly reflects lower import growth, and on the supply side is underpinned by higher productivity growth than the 1 percent pace staff assumes (based on OECD research placing Ireland in the "close to frontier" economies) together with faster employment growth.

Real GDP Growth Projections

(Percent)



Sources: Bloomberg; and IMF staff estimates.

11. This growth and investment outlook will increasingly require credit flows in the medium term, with banks expected to play the main role. Despite the strong growth in 2014, bank credit to the private sector declined by about 5 percent y/y, similar to the declines in previous years of weak or negative growth. But rising investment is expected to increase financing needs over time, with initial signs of such a pick up seen in mortgage approvals (Figure 2). This outlook is consistent with expectations of major Irish banks for loan balances to stabilize and for credit to then grow broadly in line with GDP in the medium term. Gross lending volumes would be larger, and together with continued financing by retained earnings and FDI, would support investment while avoiding the past high reliance on wholesale funding.

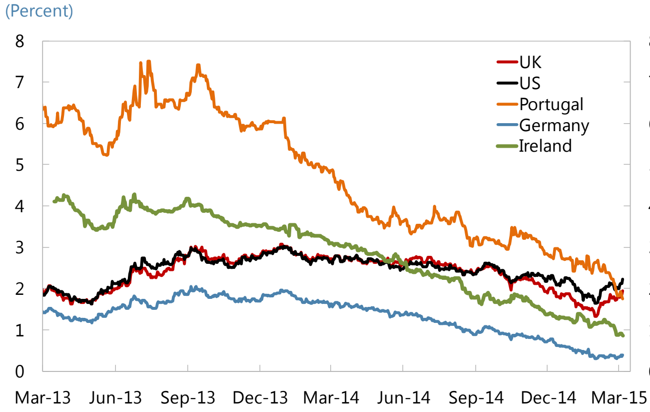
Macroeconomic Projections, 2010–18
(Percentage change unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP	-0.3	2.8	-0.3	0.2	4.8	3.5	3.0	2.7	2.5
Ex. sectors dominated by MNEs	-1.7	2.4	-1.0	3.0	3.2	3.5	3.0	2.7	2.5
Final domestic demand	-4.9	-1.7	-0.2	-0.7	3.8	2.7	2.6	2.5	2.5
Private consumption	0.9	-1.2	-1.2	-0.8	0.8	1.5	1.6	2.0	2.2
Public consumption	-7.1	-2.1	-2.1	1.4	6.7	-0.9	0.2	-0.4	-0.2
Fixed investment	-18.0	-2.9	5.0	-2.4	10.0	9.5	7.5	6.0	5.3
Change in stocks (contribution to growth)	0.5	0.8	-0.3	0.3	0.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	3.3	5.9	-0.8	0.6	1.9	1.4	1.0	0.9	0.6
Exports	6.2	5.5	4.7	1.1	8.0	4.0	4.0	4.2	4.1
Imports	3.0	-0.6	6.9	0.6	7.8	3.3	3.9	4.2	4.5
Current account (percent of GDP) 1/	-2.6	-2.5	-2.7	0.1	-0.6	-1.1	-0.3	-0.5	-0.4
Unemployment rate (percent)	13.9	14.6	14.7	13.0	11.3	10.0	9.1	8.6	8.2
Output gap	-4.0	-3.2	-4.8	-3.8	-2.7	-1.4	-0.6	-0.2	0.1
Consumer Prices (HICP)	-1.6	1.2	1.9	0.5	0.3	0.2	1.5	1.4	1.7
Credit to households and NFCs (eop)	-3.4	-2.9	-4.0	-4.9	-4.9	-2.0	0.2	1.5	3.0

Source: IMF staff projections.
1/ Excluding undistributed profits of redomiciled firms.

12. Ireland's market access is robust and on highly favorable terms, reflecting its improved economic outlook and euro area developments including quantitative easing. The NTMA has already secured over half of Ireland's 2015 financing needs. It has also made further early repayments to the IMF, equivalent to €3.5 billion in February, bringing total early repayments to 54 percent of Fund lending. The ECB's public sector purchase program (PSPP) will support continued highly favorable financing terms—staff's preliminary estimates are for the CBI to purchase in the secondary market the equivalent of over half of the bonds the NTMA is expected to issue through September 2016. Soon after the ECB announcement, the NTMA raised €4 billion from the sale of its first 30-year bond at a yield of 2.1 percent. While gross financing needs are projected to fluctuate significantly in the medium term, the authorities have in the past successfully smoothed amortization humps.

10-year Government Bond Yields
(Percent)



Source: Bloomberg.

13. Ireland's external position is sustainable and the economy remains competitive. EBA's three approaches suggest that the current account and the real exchange rate are in line with economic fundamentals and desired policy setting (Annex I). The Current Account and External Sustainability approaches suggest a small undervaluation, but this may reflect the treatment of retained earnings of redomiciled firms. The small overvaluation on an REER basis in 2014 has been unwound by the recent euro depreciation. Competitiveness is strong in the services export sector, albeit driven by industries with relatively low domestic value added.

14. Risks to Ireland's growth prospects are broadly balanced within a wide range, with key sources being (Box 2):

- **Financial market volatility could be triggered by a range of factors, yet Ireland's vulnerability appears to be contained**. Financial conditions are currently exceptionally favorable for both the sovereign and banks. A reassessment of sovereign risk in Europe or geopolitical developments could result in renewed volatility and spread widening. But market developments currently suggest contagion to Ireland would be contained by OMT and PSPP.

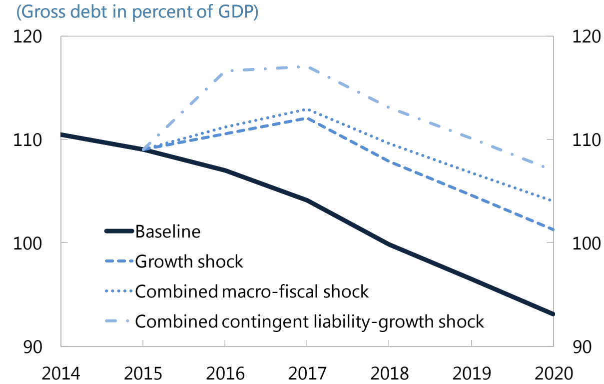
- **Yet continued easy international financial conditions could lead to vulnerabilities in the medium term**. For example, if the international search for yield drove up Irish commercial property prices, risks of an eventual slump in prices and construction would increase, weakening economic activity and potentially impacting domestic banks.

- **Euro area stagnation would impede exports**. Export projections are below the average growth in the past five years of 4¾ percent, implying some upside especially given recent euro depreciation. Yet Ireland is vulnerable to stagnation of the euro area, which accounts for 40 percent of exports. Over time, international action on corporate taxation could reduce Ireland's attractiveness for some export-oriented FDI, but the authorities see limited risks in practice given other competitive advantages and as the corporate tax rate is not affected.

- **Domestic demand could sustain its recent momentum, yet concerns remain around possible weak lending in the medium term**. Consumption growth may exceed the pace projected in coming years given improving property and labor market conditions. However, domestic demand recovery could in time be hindered by a weak lending revival if Basel III capital requirements became binding owing to insufficient bank profits, or if slow NPL resolution were to limit the redeployment of capital to profitable new loans.

15. Public debt remains high and growth shortfalls are the key risk to the debt outlook. From 123 percent in 2013, public debt fell notably in 2014 to an estimated 111 percent of GDP (Annex II accounts for this fall). Under the baseline, gross debt falls below 100 percent of GDP in 2018. A temporary shock to nominal GDP growth would hurt these dynamics: if growth were to drop 2 percentage points below the baseline in 2015–16, debt would rise to 112 percent of GDP in 2017. If compounded by a cumulative worsening of the primary balance by 3.1 percent of GDP over 2015–20 and a 2 percentage point rise in interest rates on new debt, debt would peak at 113 percent of GDP in 2017. On the upside, disposal of the state's stakes in banks in coming years could significantly lower public debt; its holdings in AIB and BoI were recently valued at about 8 percent of GDP by the NTMA.

Public Debt Paths under Various Scenarios
(Gross debt in percent of GDP)



Source: IMF staff estimates.

Box 2. Ireland: Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact	Policy response
I. A surge in financial volatility, as investors reassess underlying risk and move to safe-haven assets. Ireland's high level of private and public debt make it susceptible to financial contagion.	H	M Market developments suggest any spread widening is most likely contained by the ECB's OMT and QE. To the extent spreads did widen, the impact on deficits and debt is limited by low financing needs. The impact on growth could be more significant if there was also a reversal of inflows into commercial property.	Continue phased and steady fiscal adjustmentto ensure market confidence in access to euro area backstops.
II. Protracted period of slower growth in advanced economies, especially in the euro area. Ireland's exports were 110 percent of GDP in 2014, with the Euro Area some 40 percent of the total.	H	M The export growth impact would be significant but moderated to the extent that U.S. and U.K. markets remained robust. However protracted EA weakness could undermine domestic confidence, investment, and FDI inflows.	ECB policy actions should help revive growth and could also aid competitiveness. Strengthen growth potential through reforms in OECD *Going for Growth* 2015.
III. Bond market stress from a reassessment of sovereign risk. Sovereign stress re-emerges due to policy uncertainty and faltering of reforms, and political and social upheaval, particularly in Greece.	M	M With Irish elections due no later than early 2016, external political developments could increase challenges to expenditure control in 2015 and undermine adjustment in Budget 2016. Yet the strong trackrecord of the Irish authorities limits such risks.	Maintain steady fiscal adjustment.
IV. Financial imbalances from protracted period of low interest rates. The international search for yield appears to be a significant factor driving Irish commercial real estate markets.	M	M Low domestic credit growth limits risks. Yet further strong inflows into commercial real estate could eventually generate over-building and risks of future slump in prices.	Deploying prudential policy instruments to limit the exposure of domestic banks to potential asset price bubbles if they begin to emerge, including in commercial real estate.
V. Excessively low inflation. This would slow the decline in Ireland's high private and public debt levels.	H	L Lasting low inflation could lead to high savings and lower investment given the slower decline in private debt burdens.	ECB policy actions should contribute to mitigating imported disinflation in Ireland.

Note: The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relatively likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline (with L, M, H, denote low, medium, and high, respectively). The RAM reflects staff views on the sources of risk and overall level of concern as of the time of discussions with the authorities.

POLICIES FOR SUSTAINED RECOVERY

Ireland has an opportunity to achieve the lasting recovery needed to reverse high unemployment and other crisis legacies. Steady and phased fiscal adjustment to reach budget balance would avoid undue drag on growth while putting the high public debt burden on a downward path. A coherent set of financial and property-related policies are needed to help revive lending while protecting the resilience of banks and borrowers and moderating property cycles to some extent.

A. Fiscal Policy

16. **Strong revenues reduced the fiscal deficit to about 4 percent of GDP in 2014 despite significant primary spending overruns**. At 3.9 percent of GDP, the estimated deficit is 0.9 percentage points below the budget target. An upward revision to GDP from the transition to ESA 2010 contributed 0.3 percentage points to this outperformance. The remaining 0.6 percentage points reflect revenue gains (1.3 percent of GDP) and interest savings (0.4 percent of GDP) sufficient to outweigh higher expenditure (0.9 percent of GDP). All major taxes were ahead of projections (0.8 percent of GDP), reflecting stronger labor market conditions and higher corporate profits and consumer spending, while a range of factors boosted other revenues. However, current primary spending overruns were 0.5 percent of GDP, with healthcare accounting for three-quarters of overruns, but social protection and education also contributed. Capital spending exceeded budget owing to the extra cost of setting up Irish Water and a frontloading of some spending from 2015.

Fiscal Performance in 2014 1/

	Budget (€ bn)	Outturn (€ bn)	*Difference* (€ bn)	*Difference* *(% of GDP)*
Revenue	55.3	57.7	*2.3*	*1.3*
Tax revenue	40.0	41.3	*1.2*	*0.7*
Social contributions	11.6	11.8	*0.2*	*0.1*
Other	3.7	4.6	*0.9*	*0.5*
Expenditure	64.9	65.9	*1.0*	*0.5*
Current primary	52.3	53.2	*1.0*	*0.5*
Capital	4.5	5.2	*0.7*	*0.4*
Interest	8.2	7.5	*-0.7*	*-0.4*
Exchequer balance	-9.6	-8.2	*1.4*	*0.7*
General government balance, est.	-8.2	-7.2	*1.0*	*0.5*

Source: Exchequer report (Dec, 2014).

1/ Deficit neutral lending to the social insurance fund and a transfer of motor tax receipts to local government fund are excluded from revenue and expenditure outturns.

17. **Budget 2015 entails modest structural adjustment and firm expenditure control will be critical**. Budget 2015 targets an overall deficit of 2.7 percent of GDP, below the EDP ceiling of 3 percent of GDP, a major milestone in Ireland's fiscal consolidation efforts, which staff estimates have totaled 13 percent of GDP in structural primary adjustment from 2008 to 2015. Staff projects a decline in the overall deficit of 1.2 percentage point of GDP in 2015, aided by strong growth (0.4 percent of GDP), interest bill reductions (0.4 percent of GDP), and one-off revenues (0.1 percent of GDP), leaving 0.3 percent of GDP in primary structural adjustment. A firmer adjustment would have been preferable given high debt and strong near-term growth prospects. Avoiding a repetition of 2014 overruns, especially in healthcare, is needed to achieve this modest adjustment in 2015. In particular, revenue overperformance or a lower interest bill in 2015 should be used to reduce the deficit, rather than covering higher primary spending. The proceeds from disposals of stakes in the banks should be dedicated to debt reduction. In case Eurostat were to classify Irish Water as part of the government—with a deficit impact of 0.3 percent of GDP—any offsetting measures taken by the authorities should be high quality and durable.

Framework for Fiscal Adjustment after EDP Exit

18. As Ireland exits the EDP, it should establish a medium-term fiscal goal of balancing the budget over the cycle. Fiscal balance will ensure that growth progressively erodes Ireland's high public debt burden over time, underpinning confidence to invest and create jobs. Declining debt will also rebuild the fiscal space needed to allow Ireland to cushion future shocks to growth. Moreover, maintaining a balanced budget over the cycle will reduce the risk of the fiscal stance amplifying economic fluctuations, as was historically common in Ireland.

19. To protect recovery, the pace of fiscal adjustment after 2015 should be phased and steady. On staff estimates, GDP is still expected to be about 1½ percent below potential in 2015—although output gaps estimates are subject to significant uncertainty. Hence the deficit in structural terms is estimated at 2¼ percent of GDP in 2015. With the interest bill projected to decline by 0.3 percentage points of GDP in the medium term, primary adjustment totaling about 1.9 percent of GDP is needed to reach overall balance in structural terms. Phasing that remaining adjustment over a three year period would limit average structural primary adjustment to some 0.6 percent of GDP annually, with a modest drag on growth. Pacing this adjustment evenly, at no less than ½ percent of GDP per annum, would enhance economic stability and steady the limited room available for budgetary initiatives from year to year, making adjustment more manageable.

20. The rules of the SGP's preventative arm will in principle support such an approach to fiscal adjustment. The Expenditure Benchmark and the Structural Adjustment rules provide intermediate targets consistent with a steady fiscal adjustment toward the Medium-Term Objective of budget balance in structural terms. Importantly, stronger than budgeted revenues will no longer permit supplementary spending in the same year, as the Expenditure Benchmark will put a firm lid on spending while still allowing the automatic stabilizers to operate fully.

21. Yet, Irish-specific technical issues in applying these fiscal rules should be addressed. As discussed in Chapter 1 of the Selected Issues Paper, in Ireland's case, the current EU methodology understates cyclical swings in unemployment, with implications for estimates of output gaps and potential growth. Staff therefore welcomes ongoing work by the Irish authorities to refine some aspects of the EC methodology. Assessments of compliance with the rules by the EC and IFAC will also need to take into account Ireland's large MNE sector, which has activity swings with a sizable impact on GDP, but notably less impact on revenues and fiscal balances than other GDP shocks. Staff is therefore basing its estimates of the output gap used to calculate structural balances on a measure of GDP excluding the sectors dominated by MNEs.

22. Authorities' views. *The authorities recognized that a clear fiscal framework for the period after Ireland's forthcoming exit from the EDP is important. They agreed that balancing the budget in structural terms is a sound fiscal goal for Ireland in the medium term. They found the discussions on the pace of transition to balance helpful in developing their perspective on this issue, where they are firmly committed to a structural adjustment of at least ½ percent of GDP annually from 2016 onwards. In that respect, they are working closely with the EC to refine the potential GDP methodology for Ireland to support sound and reasonable implementation of the fiscal rules.*

Policies to Underpin Fiscal Adjustment

23. The policy mix to achieve steady fiscal adjustment should protect Ireland's growth potential. Under the authorities' current projections, further fiscal adjustment is primarily driven by expenditure restraint, as set out in the Comprehensive Expenditure Report 2015–17. Capital spending remains low in the medium term, at just under 1½ percent of GDP. Staff sees scope for both the expenditure and revenue sides to support adjustment: revenue measures would help create room to rebuild capital spending over time and they could also be needed in response to evolving international tax standards such as the BEPS project.

24. Expenditure reforms are needed to deliver core public services at manageable cost in the face of demographic pressures. Demographic pressures—from both young and old age groups—on education, health, and pension spending total about ¼ percent of GDP per annum over the medium term. A range of efforts are needed deliver the additional services required within a manageable overall spending envelope:

- ***Public wage bill***. The expiry of the Haddington Road Agreement in 2016 will lead to pressures for some reversal of past savings that were key to Ireland's consolidation to date. There are risks that these pressures impede progress to fiscal balance: any developments on future public sector wage arrangements must recognize the very tight fiscal constraints in coming years. Further cost reductions and service delivery improvements through implementation of the Public Service Reform Plan 2014–16 should also be sought.

- ***Social protection***. An expansion in social protection spending was essential in the crisis and it is important that this spending declines steadily as the economy recovers. There is also scope to generate savings while protecting those on low incomes through means-testing of benefits and taxation of universal benefits. For instance, the distribution of medical cards to persons aged over 70 could be made conditional on income and the universal component of child benefits could be progressively reduced by treating it as a taxable income.

- ***Healthcare***. Despite its relatively young population, Ireland's health spending (on a real per capita PPP-adjusted basis) exceeded the OECD average by 12 percent in 2012 while life expectancy is little above the OECD average. Cost efficiency in healthcare should be further improved by building on existing initiatives: high use of costly acute care should be reduced through expanded primary care and further pharmaceutical savings should be sought.

- ***Education***. Ireland had the third greatest annual expenditure per student in OECD countries by public educational institutions in 2011, some 14 percent above the OECD average on a PPP-adjusted basis. Higher education funding reforms are needed to control growth in public spending while protecting low income students, by better targeting college fee subsidies.

25. The amount and quality of capital spending should be reviewed carefully in order to ensure adequate maintenance and avoid growth bottlenecks. A gradual rise in public investment may be required once the fiscal position is closer to balance, while ensuring the

quality of investments through rigorous project assessment. Structural reforms that boost growth can benefit the fiscal position over time, yet may have up-front costs including investment needs. It would be appropriate to explore the scope for well specified structural reforms with credible timelines and growth benefits to qualify for the flexibility available within the EU fiscal rules.

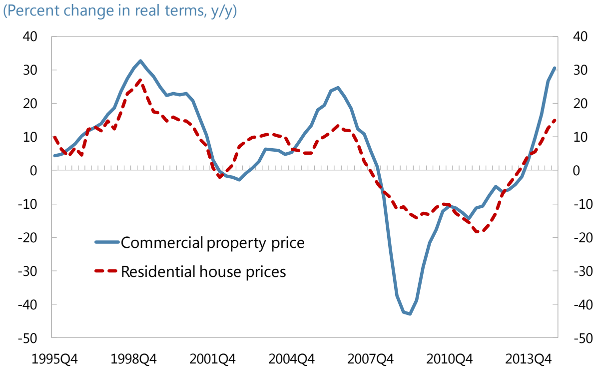
26. Revenue efforts should build on the base-broadening reforms achieved in recent years. Ireland's vulnerability to a crisis was exacerbated by its formerly high reliance on a narrow tax base, especially real estate transactions. The substantial progress since made in broadening the tax base needs to be protected going forward. Reforms to broaden the VAT base could significantly bolster revenues without raising the main VAT rate—even closing one-quarter of the "policy gap" could generate 1 percent of GDP in additional revenue (see Table 10 of the October 2013 Fiscal Monitor). Moreover, maintaining up to date housing valuations will protect the property tax base and help lean against housing market cycles. The large drop in oil prices creates an opportunity to generate revenues by raising environmentally friendly taxes. The recent report on tax expenditures should guide a review over time of the remaining tax expenditures.

27. Authorities' views. *Regarding the composition of adjustment toward fiscal balance, the authorities noted that there could be a role for further broadening of the tax base, but they also considered it important to address high marginal income tax rates. They agreed on the need to protect the gains from previous revenue and spending measures and to implement a policy mix which continues to be supportive of growth and employment. On the spending side, they noted that demographic pressures had been accounted for in developing expenditure projections, and they fully recognized the need for ongoing reforms and continued discipline across spending areas. A review of capital expenditure was in progress. The authorities are actively engaged in the BEPS project and are closely monitoring the evolution of international tax standards with a view to ensuring compliance with best international practice*.

B. Macro-financial Policies

28. Policies to revive financing need to be complemented by measures to promote the resilience of banks and borrowers. A revival of financing is needed to support investment in the medium term, including construction of commercial and residential properties. Yet, property markets are once more rising strongly, with foreign investment playing a role, and easy international financial conditions will likely persist. While ensuring the availability of sufficient financing from both banks and nonbanks, it is critical to protect the resilience of banks and borrowers to potential significant fluctuations in property prices It would also be useful to also take steps to moderate Ireland's property price cycles to some extent.

Irish Property Cycles
(Percent change in real terms, y/y)



Sources: Investment Property Databank; OECD; and IMF staff calculations.

Facilitating a Revival of Financing Flows

29. There is a risk that Irish banks will have high NPLs for a lengthy period. Although substantial mortgage restructuring was implemented during 2013–14 under the CBI's Mortgage Arrears Resolution Targets (MART) framework, by September 2014 resolution was yet to conclude in about half of mortgage arrears cases, with a further one-tenth of cases under repossession proceedings to be completed. This overall slow resolution progress is reflected in the rising share of prolonged arrears and very high buy-to-let arrears. Most SMEs with distressed loans have a workout plan that will trigger a debt restructure when the SME completes steps such as property disposals, yet this process could take some years. Although SMEs may have access to working capital in the interim, their capacity to invest and create jobs is constrained.

30. Reducing nonperforming loans remains important to address private debt overhangs and to enhance medium-term prospects for bank lending. In the immediate future Irish bank lending can pick up despite high NPLs given attractive lending margins, ready access to funding, and adequate capital and provisions. It may also be the case that NPL resolution adds little to bank profitability in the near-term, as durable restructures may not significantly increase debt service payments and proceeds from disposals of loans or collateral would initially add to low yielding liquidity. For borrowers, however, resolution would address debt overhangs that constrain their economic activity and limit their mobility, in time supporting broader economic activity. Moreover, as demand for credit grows, banks will need to be able to shift credit skills from NPL management to loan origination, especially as margins and funding conditions may not remain so favorable. In the medium-term, banks' capacity to originate loans would also benefit from the ability to redeploy capital and funding permitted by NPL resolution.

31. The authorities should therefore reinvigorate efforts to tackle entrenched NPLs. The momentum built under the MART framework should be maintained, with banking supervision continuing to monitor and guide banks' mortgage resolution efforts carefully. Maintaining a high level of transparency on the scale and quality of resolution would support progress. But the problems of prolonged arrears do not appear to be effectively addressed by the current framework. The authorities should take steps to hasten durable resolution in these cases, including through timely proceedings for repossession to secure the engagement of borrowers on lasting restructures where feasible. Further efforts to raise the utilization of the personal insolvency system, including bankruptcy proceedings, are also needed to motivate timely resolution. On the SME side, supervision should ensure that banks are proactive in advancing the completion of workouts, especially as market conditions for property disposal improve.

32. Supervision should encourage early actions to address bank capital quality issues, which would also safeguard banks' lending capacity. Deferred tax assets and preference shares are set to be phased out as eligible regulatory capital under the new EU rules. Early steps by banks to restructure their capital base and build high quality loss absorbing capital before the new capital rules become binding is preferable to relying primarily on the internal capital generation that is emerging across the sector.

33. Further development of nonbank financing, especially for SMEs, can complement bank lending and contain macro-financial risks. Appropriately regulated, nonbank financing can diversify sources of funding for the economy and reduce overall leverage helping to make borrowers and banks more resilient to shocks such as property cycles (see Chapter 2 of the Selected Issues Paper). Real estate investment trusts (REITs), authorized since 2013, have leverage limited to 50 percent of the market value of their assets. They are bringing in fresh equity into real estate markets, providing a significant layer of protection for lenders, and moderating macro-financial risks compared with real estate activity financed primarily with bank lending. The scope to facilitate the provision of risk capital to SMEs should also be explored, where the legal and regulatory environment for different modalities of non-bank financing should be assessed, such as closed-end mutual funds, private equity, and SME securitizations and covered bonds.

34. State sponsored financing vehicles can play a supportive role but fiscal risks should continue to be contained. Legislation for the Irish Strategic Investment Fund (ISIF) was enacted in July 2014. With some 4 percent of GDP in resources, it has the capacity to support economic activity and employment through commercial investments in Ireland. Two of the ISIF's SME Funds have demonstrated solid deal flow since incorporation while the third will not be renewed as improving conditions have limited opportunities for SME turnaround funding. This responsiveness to evolving market conditions is welcome and the ISIF should continue to be carefully managed given its recent entry into a venture capital role. The Strategic Banking Corporation of Ireland (SBCI) could enhance credit availability for SMEs and help ease lending rates, yet monitoring of loan portfolio risks is needed given state funding guarantees.

35. Authorities' views. *The authorities noted that substantial legislative, administrative, and supervisory efforts had been undertaken in recent years to facilitate resolution of distressed loans, and that the progress made is greater than evident from solely focusing on headline NPL ratios. The resolution process would need to continue for a number of years, which they considered appropriate while employment and property markets were still recovering. Building on the progress achieved through the imposition of MART in 2013–14, they would continue to monitor resolution progress and take appropriate measures as needed. On the quality of bank capital, the authorities are confident that banks' medium term capital management plans will fully meet the new regulatory requirements. Regarding SME financing, they favored further developing alternatives to bank lending, and would continue to carefully manage the risks associated with ISIF and SBCI.*

Promoting Resilience and Tempering Cycles

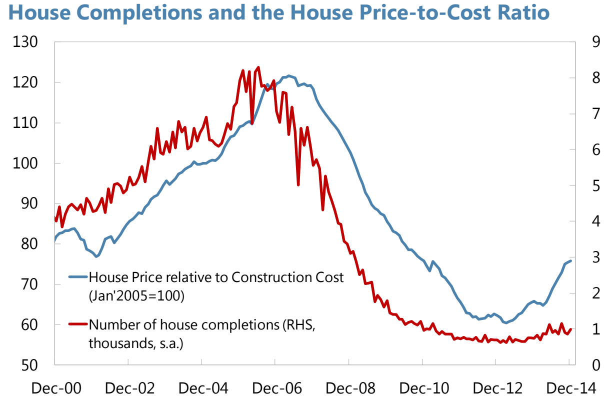
36. While financial and property cycles will continue, the durability of Ireland's recovery should be protected by policies to promote resilience and temper cycles. The CBI recently published A Macro-Prudential Policy Framework for Ireland, which sets out the range of instruments at its disposal and its decision making process for the application of those tools. This framework should be applied proactively as macro-financial risks evolve. Nonetheless, there are significant uncertainties around the appropriate timing and impact of adjustments in macro-prudential instruments, making it important to take steps ex ante to maintain financial resilience through the cycle.

37. Recent CBI steps to strengthen the regulation of residential mortgage lending are therefore very welcome. The CBI has announced that (i) no more than 15 percent of mortgage lending to owner-occupiers will be at a loan to value (LTV) ratio of greater than 80 percent, and; (ii) no more than 20 percent of mortgage lending will be at a loan to income (LTI) ratio of greater than 3.5 times. In the case of first-time buyers, the LTV limit is 90 percent up to a property value of €220,000 and 80 percent on amounts above that. Such differential treatment is warranted as first-time buyers have shown a lower default rate (Box 3), but it should be kept under review based on default experience. Together the LTV and LTI limits will increase the resilience of borrowers and banks to shocks, and may help dampen the property cycle, as the past boom was facilitated by a sharp rise in LTI ratios as well as high LTV ratios. Close supervisory monitoring of compliance with the new rules is essential. The credit register will eventually provide valuable information on borrowers' credit records and total debt, helping to limit circumvention.

38. Bank resilience to commercial real estate risks must be protected, especially given the international search for yield. Losses on commercial property accounted for over half of bank capital needs in the crisis. The current upwards pressure on commercial property prices may continue for some time given the low yields available on many assets and the ECB's quantitative easing, raising the eventual prospect of a renewed price slump. Supervision should therefore focus closely on banks' risk management, underwriting standards, and valuations in this sector. Deployment of macro-prudential tools to contain bank's commercial property exposures, such as loan-to-value limits and capital add-ons, should be biased to being ahead of the curve, especially given the availability of nonbank and international financing sources for this sector.

39. Addressing the weakness in housing construction will help dampen price increases over time. While house price rises are beginning to promote a construction supply response, it has been weaker than in past experience. High construction costs are a key factor, including local building codes that are stricter than national standards and development levies. In addition, developers have been reluctant to use external equity as required given that banks now apply more prudent LTV limits to construction loans. Incentives to complete developments should be strengthened through use-it-or-lose-it building permits and a vacant site levy. Timely implementation of other Construction 2020 actions, including a streamlining and modernization of planning procedures, would also enhance the performance of this sector.

House Completions and the House Price-to-Cost Ratio



Sources: CSO; DOEHLG; ESRI/PtsB; Haver Analytics; Thomson Reuters.

40. A more developed rental market would support labor mobility, help moderate property cycles, and reduce household exposure to house price fluctuations. Rented properties are a low share of Irish housing. Although Ireland rates favorably on indicators such as rent control, indicators related to landlord-tenant relationships suggest room for improvement.

Box 3. Mortgage Regulation and First Time Buyers

The CBI recently established a new regulation on residential mortgage lending. The primary objective of the regulation is to increase the resilience of the banking and household sectors to financial shocks and, as a secondary objective, to dampen pro-cyclical dynamics between property lending and housing prices. The regulation puts caps on loan to value (LTV) and loan to income (LTI) ratios, as summarized in the table. The caps are "proportionate" with a small share of gross lending allowed to breach the caps, as in New Zealand.

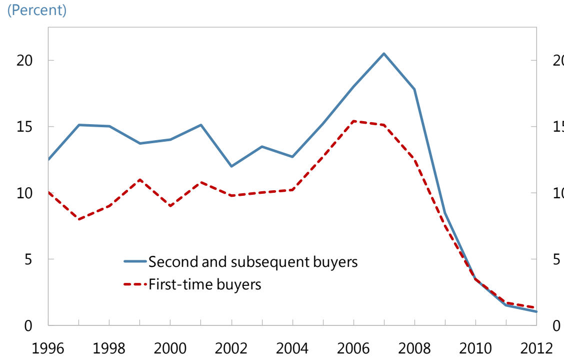
The calibration of the caps was guided by international norms and judgment, and also reflected the public consultation process. Analysis of loan level data shows a rise in loan losses at higher LTV and LTI ratios, and also supports tighter regulation of buy-to-let loans. In the near-term, the LTV cap is more likely to be binding, as LTVs exceeded 80 percent on 40 percent of primary dwelling mortgages in 2013—over the 15 percent that may exceed an 80 percent LTV—while LTIs exceeded 3.5 on 20 percent of mortgage loans. Indeed, the main issue arising from the CBI's consultation on the proposed regulation was the impact of the 80 percent LTV cap, especially on first time buyers (FTBs) who accounted for almost half of new mortgages in 2014.

Summary of CBI Mortgage Regulation Caps

	Primary Dwellings			Buy-to-let
	LTV		LTI	LTV
General buyer	80%		3.5 x	70%
First time buyer	90%	80%	3.5 x	
Property value	<€220,000	>€220,000		
Max. share over caps	20%		15%	10%

The final regulations provide differential treatment of FTBs consistent with the lower default experience of this group in Ireland. Compared with second and subsequent-time buyers (SSBs), FTBs are typically younger, have a lower average income, purchase less expensive houses but at a higher LTV. Despite these characteristics, default rates have been lower; controlling for borrower and loan characteristics, CBI research finds lower default risk for FTBs, with an average difference of 30 percent, implying that FTBs are nearly 4 percentage points less likely to default than SSBs. For the average FTB, an increase in LTV from 80 percent to 90 percent is estimated to increase the probability of default by just over 1 percentage point. This result supports a higher LTV cap for FTBs while ensuring default risk comparable to the remainder of mortgage lending. Nonetheless, the sample for the analysis is dominated by mortgages originated during a boom with weak underwriting standards, making it appropriate to periodically review FTB default experience in future and adjust the regulation if needed to protect the financial resilience of FTB borrowers.

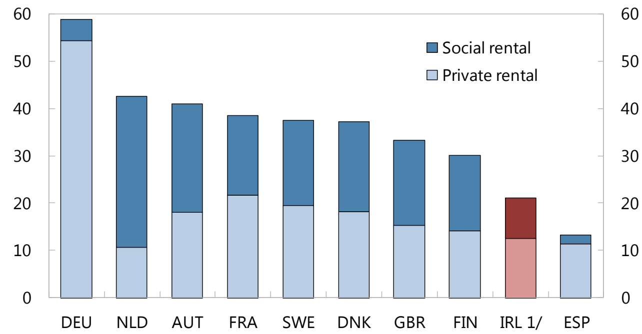
Mortgage Default Rate in 2013 by Origination Year
(Percent)



Source: Central Bank of Ireland.

For example, the large role of small scale buy-to-let investors in providing rental housing militates against security of tenure for renters, as this undermines the liquidity of the investors' property. The framework for rental property should be reviewed with the aim of attracting professional investment and management into the sector, which could in time expand the supply and quality of rental property and moderate rents.

Share of Rental Housing in Selected EU Countries
(Percent of total housing stock)



Sources: CECODHAS Housing Europe Review, 2012.
1/ Refers to 2004.

41. Authorities' views. *The authorities agreed on the need to promote the financial resilience of borrowers and banks through the cycle, while noting that the new mortgage regulations could be adjusted to moderate risks if the need arose. The authorities are monitoring commercial real estate market developments, but they did not consider a similar rules-based regulation appropriate given the scale and idiosyncratic nature of these transactions, and would instead utilize onsite and offsite examination of credit underwriting and supervisory powers such as the application of individual capital add-ons. On housing supply, the authorities emphasized that they were proactive in this area. The Construction 2020 strategy addresses key issues related to planning, sustainable development financing, and transparent and sustainable mortgage lending. Legislation on planning will be submitted to parliament before the summer recess, a conference to bring equity providers and developers together has been organized, and a public consultation has been launched on taxation measures to encourage development of zoned and serviced land. Expanded investment in Budget 2015 and the recently launched Social Housing Strategy aim to address the undersupply of affordable and good quality social housing.*

STAFF APPRAISAL

42. Ireland's recovery is off to a good start and the priority is to maintain solid growth and job creation. Export and investment driven growth is beginning to be supported by consumption. Ireland has the potential for a self-sustaining recovery to reduce high unemployment, which will entail rising investment with growing needs for financing. Yet risks to growth widen in the medium term, including from the potential for protracted slow growth in the euro area. A combination of prudent fiscal and financial policies is needed to support growth while building policy space and private sector resilience to help manage shocks.

43. Ireland should seek to balance its budget over the cycle through a phased and steady adjustment. By ensuring that growth erodes Ireland's high public debt burden over time, fiscal balance will underpin confidence to invest and create jobs, even in less favorable economic and financial conditions. Declining debt will also rebuild the fiscal space needed to allow Ireland to cushion future shocks to growth. Closing the structural deficit over a three year period, at a pace of no less than ½ percent of GDP annually, would limit the drag on growth in the near-term and support economic stability. EU fiscal rules will support such a path toward fiscal balance but Irish-specific technical issues in applying these rules should be addressed.

44. The policy mix to achieve steady fiscal adjustment should protect Ireland's growth potential and not exclude revenue measures. Public investment has been reduced to low levels and the amount and quality of spending should be reviewed carefully to ensure adequate maintenance and avoid growth bottlenecks. Both the expenditure and revenue sides can support adjustment and help create room to rebuild capital spending over time. Revenue measures could also be needed if evolving international tax standards impact the tax base in the medium term. Reforms are needed to deliver core public services within a manageable spending envelop in the face of demographic pressures, including continued wage restraint after current agreements expire, better targeting social protection spending, improving the cost efficiency of healthcare provision, and reforming higher education funding while protecting low income students.

45. A range of policy efforts are needed to facilitate a lasting revival of financing flows in support of investment and recovery. Although significant progress has been made with resolving nonperforming loans in recent years, cases of prolonged arrears are rising and buy-to-let arrears remain very high. Reinvigorated efforts are needed to hasten resolution of the most entrenched cases to address private debt overhangs and enhance medium-term prospects for bank lending. Supervision should also encourage banks to take early actions to address capital quality issues to safeguard their lending capacity. Scope to further develop nonbank financing should be explored, especially risk capital for SMEs, to complement bank lending and moderate macro-financial risks. Fiscal risks from state financing vehicles should be contained.

46. It is timely to strengthen the financial resilience of banks and borrowers to ensure recovery is more robust to future shocks including property cycles. Macro-prudential policy tools should be applied proactively as risks evolve, yet, given uncertainties around the impact of these tools, policies must also ensure financial resilience through the cycle. The CBI's recent steps to strengthen the regulation of residential mortgage lending are therefore welcome. The differential treatment of first-time borrowers should be kept under review based on default experience. With commercial property prices rising fast, in part due to international inflows in search of yield, supervision should ensure bank exposures to these risks are appropriately contained, with the deployment of macro-prudential tools biased to being ahead of the curve.

47. Construction and rental market reforms could dampen increases in prices and rents, and in time temper Ireland's property cycles and associated macroeconomic instability. The construction supply response should be strengthened through initiatives to reduce construction costs and enhance incentives to complete developments. A streamlining of planning procedures, together with the implementation of other Construction 2020 actions, would also improve the performance of this sector. The rental property framework should be reformed with the aim of attracting investment and professional management to expand the supply and quality of rental property. Over time this would moderate rents, benefitting those on low incomes in particular, while also facilitating labor mobility in support of sustained growth and low unemployment.

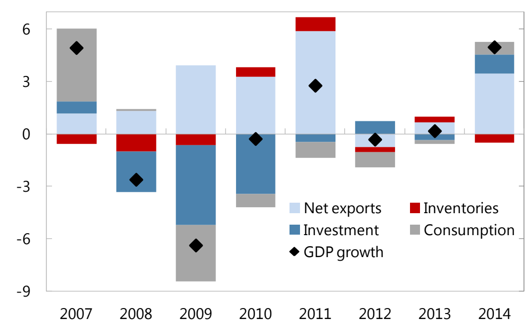
48. It is recommended to hold the next Article IV consultation with Ireland on the standard 12-month cycle.

Figure 1. Ireland: Real Sector and Inflation Indicators, 2006–15

All GDP components contributed to a 4.9 percent y/y expansion in Q1-Q3 2014…

Contributions to Real GDP Growth

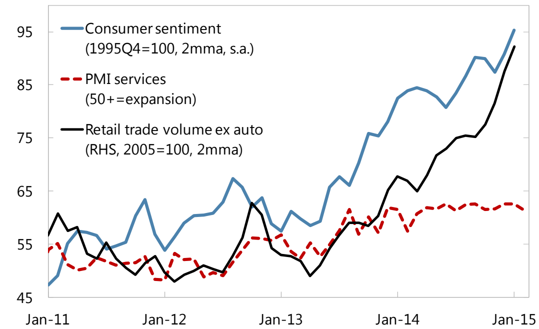
(Percent, y/y, full year GDP except for 2014)



Sources: Central Statistics Office; and IMF staff calculations.

…with strong consumer confidence evident in rising retail sales.

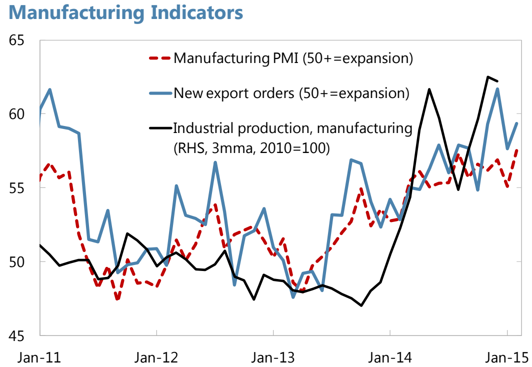
Retail Trade and Sentiment Indicators



Sources: CSO; ESRI; Haver Analytics; and NCB Stockbrokers/Markit.

Export orders and PMIs are positive for manufacturing but industrial production data has been volatile

Manufacturing Indicators

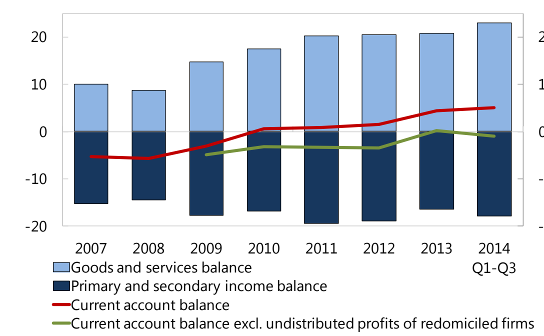


Sources: Central Statistics Office; NCB; and Haver Analytics.

The current account remained broadly balanced in Q1-Q3 excluding estimated profits of redomiciled firms.

Current Account Balance Composition

(Percent of GDP)

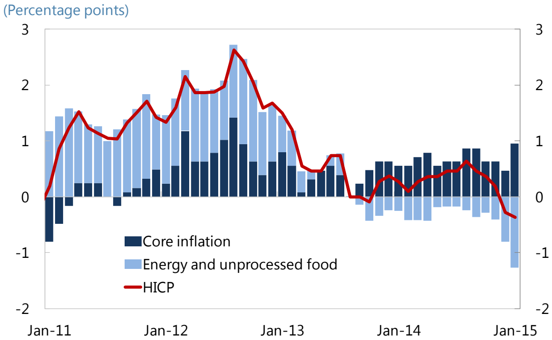


Sources: Central Statistics Office; Haver Analytics; and IMF staff estimates.

Inflation has turned negative owing to falling energy prices, but core inflation edged up to 1.1 percent as services prices rose.

Contribution to Annual HICP Inflation

(Percentage points)

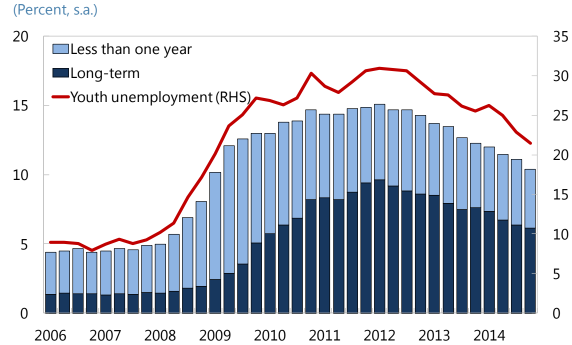


Sources: Central Statistics Office; and IMF staff calculations.

Unemployment declined to 10.4 percent in Q4, with long-term and youth unemployment also declining but remaining high.

Unemployment Rates

(Percent, s.a.)



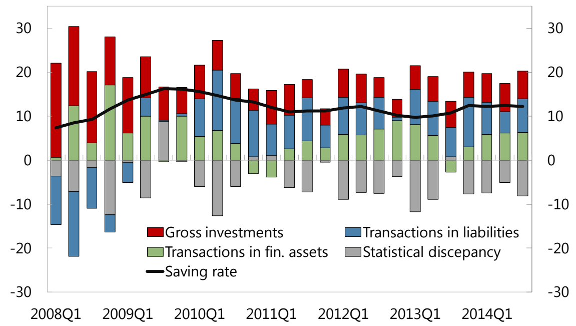
Sources: CSO; and Haver Analytics; and IMF staff calculations.

Figure 2. Ireland: Household Finance and Housing Developments, 2003–15

Household savings still remain elevated, with three-quarters of savings devoted to debt reduction since 2010…

Decomposition of Household Savings

(Percent of gross disposable income)

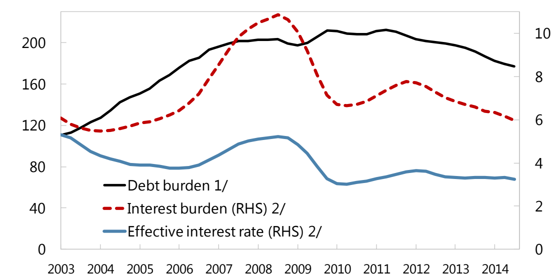


Sources: Central Bank of Ireland; Central Statistics Office; and IMF staff calculations.

…contributing to the gradual reduction in debt burdens while low interest payments also contribute.

Household Debt and Interest Payments

(Percent of gross disposable income)



Sources: Central Bank of Ireland; Haver Analytics and IMF staff calculations.

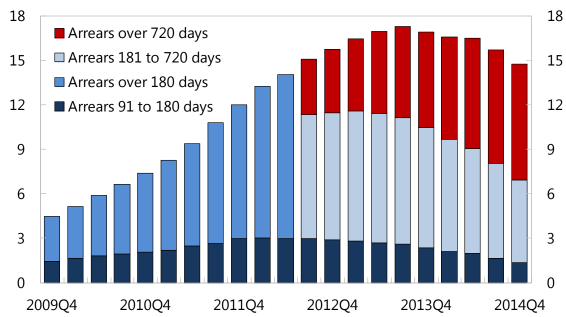
1/ Total household loans in percent of four-quarter gross disposable income.

2/ Four quarter interest payments (excluding FISIM adjustment) in percent of four-quarter gross disposable income or previous quarter's total household loans, respectively.

The share of mortgages on primary dwellings in arrears continues to decline, except for arrears over 720 days.

Mortgages in Arrears on Primary Dwellings

(Percent of total mortgage value)

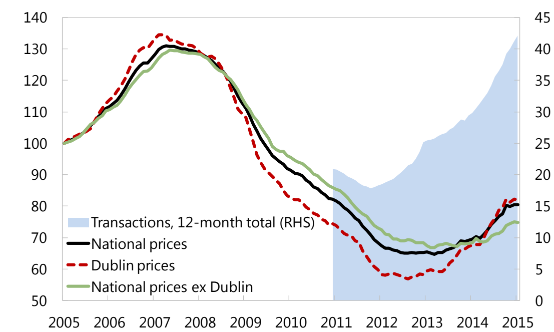


Source: Central Bank of Ireland.

The residential property market is reviving, particularly in Dublin, although prices are still well below peak levels.

Residential Property Prices and Transactions

(2005M1=100, s.a.) (Thousands)

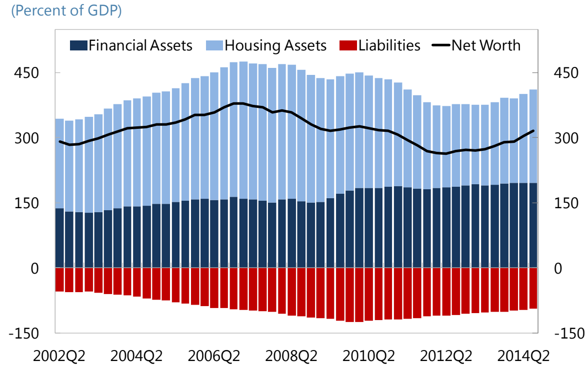


Sources: CSO; Property services regulatory authority; and IMF staff calculations.

Rising house prices together with household debt reductions have lifted net worth by 25% from trough.

Household Assets, Liabilities and Net Worth

(Percent of GDP)

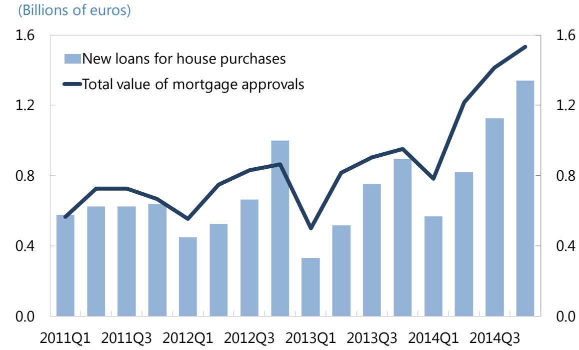


Source: Central Bank of Ireland.

New mortgage lending has rebounded strongly during the second half of 2014, albeit from low levels.

Housing Loans and Mortgage Approvals

(Billions of euros)

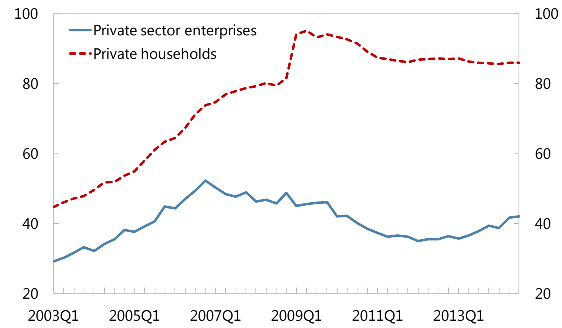


Source: Banking and Payment Federation Ireland.

Figure 3. Ireland: Credit Developments, 2003–15

Enterprise deposits are rising while household deposits remained stable…

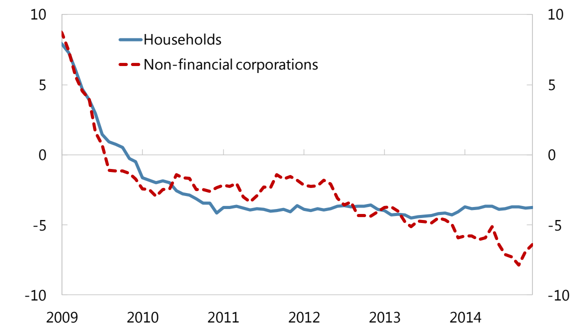
Deposits from Irish Private Residents
(Billions of EUR)



Source: Central Bank of Ireland.

…but credit continues to contract, especially as non-financial corporations repay loans.

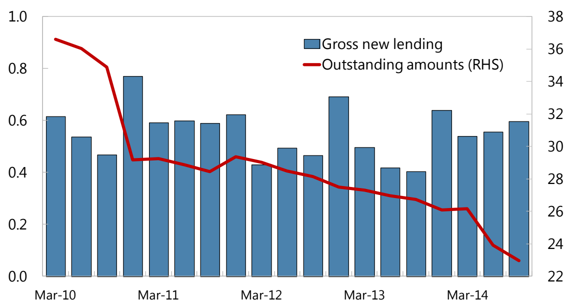
Loans Outstanding to Irish Residents
(Percent change, y/y)



Source: Central Bank of Ireland.

Deleveraging is evident in the SME sector, where redemptions continue to exceed new credit…

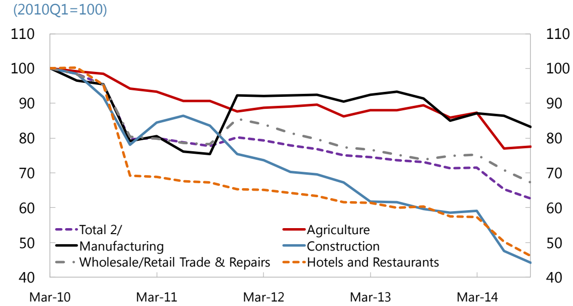
Outstanding SME Credit 1/
(Billions of euros)



Source: Central Bank of Ireland.
1/ All resident credit institutions, excluding real estate and financial intermediation.

…in all sectors.

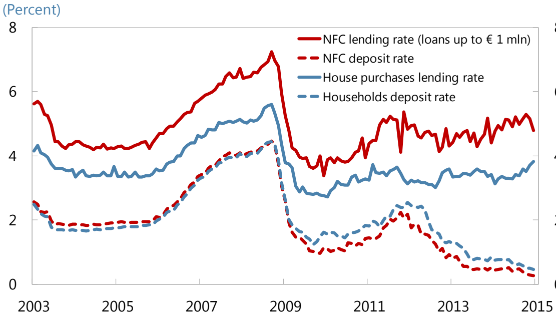
Outstanding SME Credit by Sector 1/
(2010Q1=100)



Source: Central Bank of Ireland.
1/ All resident credit institutions.
2/ Excludes real estate and financial intermediation.

Low deposit rates together with a drift up in lending rates…

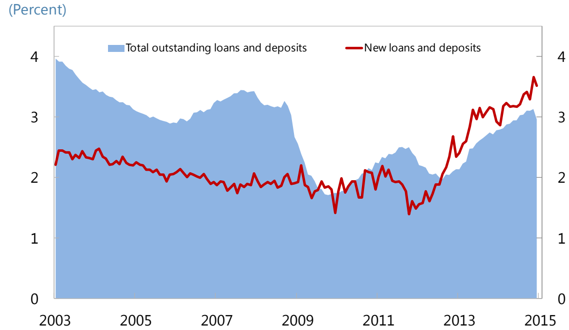
Median Lending and Deposit Rates, New Business 1/
(Percent)



Source: Central Bank of Ireland.
1/ Data relate to new business conducted through resident offices of a sample of banks and include IBRC. Last observation Aug-2014.

…continue to boost banks' interest margins, helping profitability.

Interest Rate Margins Between Loans and Deposits 1/
(Percent)



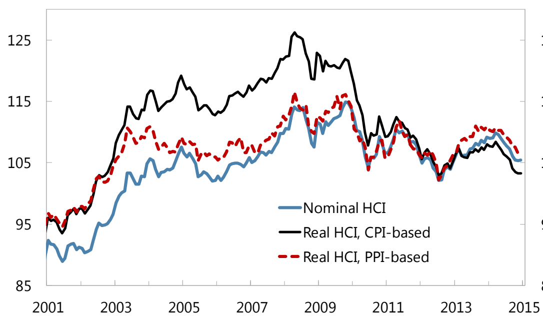
Source: Central Bank of Ireland.
1/ Weighted average loan rate minus weighted average deposit rate.

Figure 4. Ireland: Competitiveness Indicators, 1996–2015

Competitiveness indicators over the last year have moved broadly in line with the euro exchange rate.

Harmonized Competitiveness Indicators (Monthly)

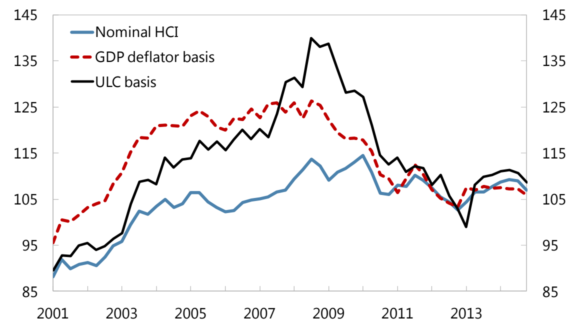
(1999Q1=100)



Sources: CBI; and Haver Analytics.

Harmonized Competitiveness Indicators (Quarterly)

(1999Q1=100)



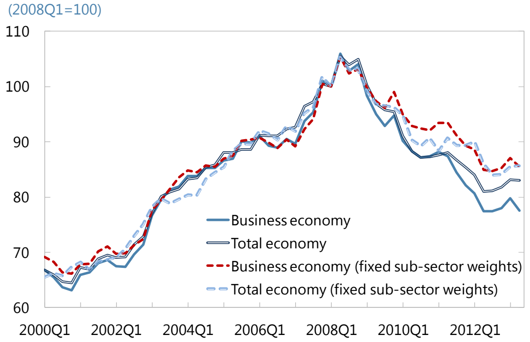
Sources: CBI; and Haver Analytics.

Though part of the earlier improvement in competitiveness reflected a shift to higher value-added sectors.

Private wages have increased at a slower pace than in the euro area, but appear to be picking up recently.

Real Effective Exchange Rates on a ULC Basis

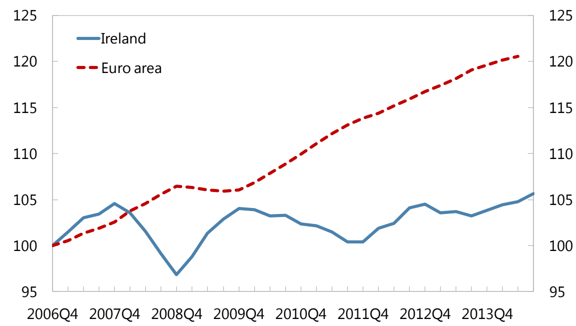
(2008Q1=100)



Source: Bruegel.

Hourly Labor Costs in Manufacturing

(2006=100; 4-quarter moving average)



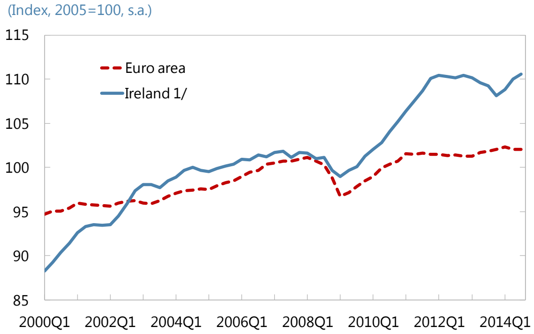
Sources: CSO; Eurostat; Haver Analytics; and IMF staff calculations.

While labor productivity outpaced the euro area in 2010–11, this gap is no longer widening.

The strong rise in the services market share is staring to lift Ireland's overall export market share.

Real Labor Productivity

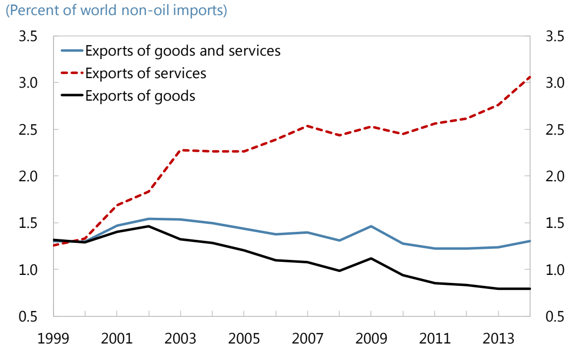
(Index, 2005=100, s.a.)



Source: CSOI; ECB; Haver Analytics; and IMF staff calculations.
1/ Calculated as real output per person employed.

Export Shares

(Percent of world non-oil imports)



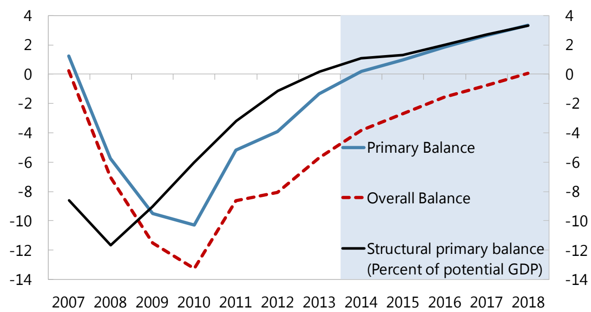
Source: IMF staff calculations.

Figure 5. Ireland: Selected Trends in General Government Finances, 2007–18

The primary deficit is estimated to have closed in 2014, down from 10¼ percent of GDP in 2010.

Headline and Structural Balances 1/

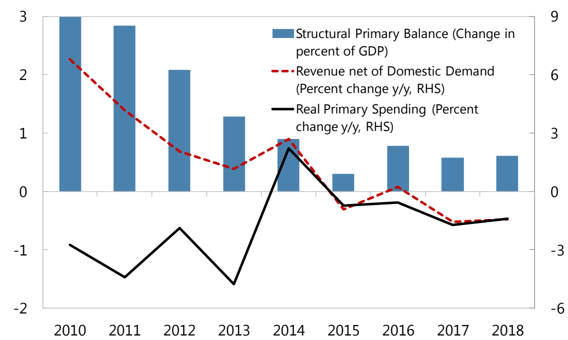
(Percent of GDP, unless otherwise indicated)



Sources: Department of Finance; and IMF staff estimates.
1/ Excluding bank support costs. Structural primary balance also excludes one-off revenue and expenditure items.

Structural fiscal adjustment was strong in 2009–14, reflecting real spending cuts and revenue growth exceeding domestic demand. More gradual adjustment in coming years relies mostly on real spending declines.

Fiscal Adjustment: Pace and Sources

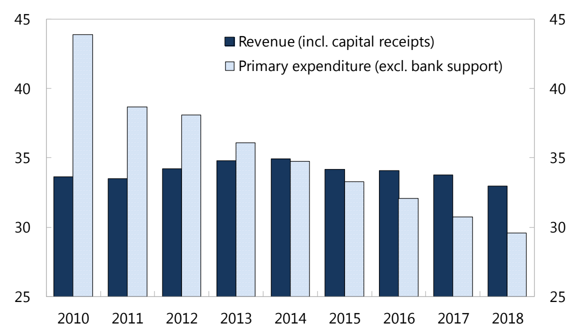


Source: Department of Finance and IMF staff estimates.

The movement into primary surplus is projected to be driven by further declines in spending to GDP.

Revenue and Primary Expenditure

(Percent of GDP)

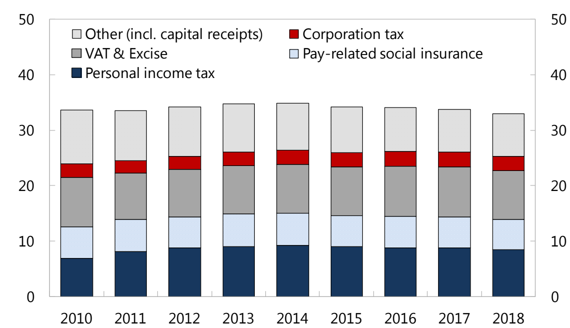


Sources: Department of Finance; and IMF staff estimates.

Given the slower rebound in domestic demand than GDP, revenues are projected to decline 2 percentage points as a share of GDP from 2014 to 2018.

Revenue Composition

(Percent of GDP)

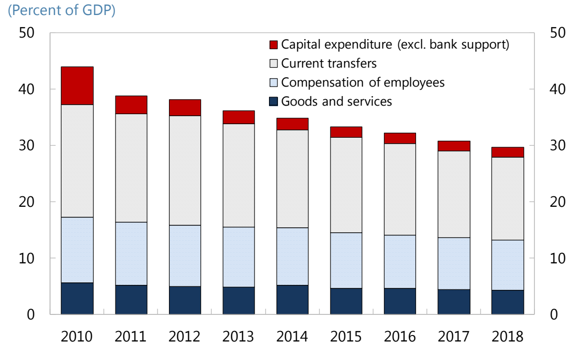


Sources: Department of Finance; and IMF staff estimates.

Primary expenditures are projected to fall by 5 percentage points of GDP form 2014 to 2018.

Primary Expenditure Components

(Percent of GDP)

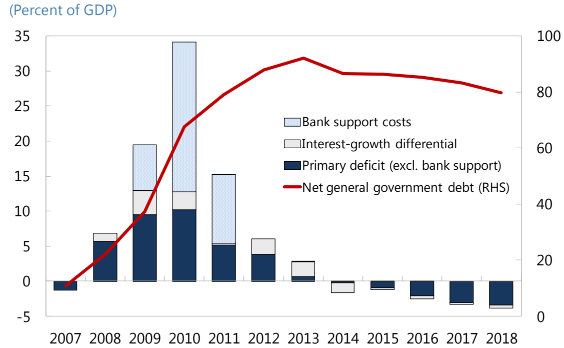


Sources: Department of Finance; and IMF staff estimates.

Half of the increase in net debt arose from bank support costs.(The fall in net debt in 2014 reflects IBRC liquidation)

Sources of Increase in Net Debt-to-GDP Ratio

(Percent of GDP)



Sources: Department of Finance; and IMF staff estimates.

Table 1. Ireland: Selected Economic Indicators, 2010–16

(Annual percentage change unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016
						Proj	
National accounts (constant prices)							
Real GDP	-0.3	2.8	-0.3	0.2	4.8	3.5	3.0
Final domestic demand	-4.9	-1.7	-0.2	-0.7	3.8	2.7	2.6
Private consumption	0.9	-1.2	-1.2	-0.8	0.8	1.5	1.6
Public consumption	-7.1	-2.1	-2.1	1.4	6.7	-0.9	0.2
Gross fixed investment	-18.0	-2.9	5.0	-2.4	10.0	9.5	7.5
Net exports 1/	3.3	5.9	-0.8	0.6	1.9	1.4	1.0
Exports of goods and services	6.2	5.5	4.7	1.1	8.0	4.0	4.0
Imports of goods and services	3.0	-0.6	6.9	0.6	7.8	3.3	3.9
Real GNP	1.4	-0.8	1.1	3.3	4.1	3.3	2.7
Gross national saving (in percent of GDP)	16.4	15.3	17.1	19.6	19.4	19.8	20.8
Private	26.3	21.6	23.3	23.5	21.6	21.1	20.9
Public 2/	-9.9	-6.3	-6.1	-4.0	-2.2	-1.2	0.0
Gross investment (in percent of GDP)	15.8	14.5	15.6	15.2	16.0	17.0	17.4
Private	12.5	12.2	13.7	13.4	14.3	15.6	16.0
Public	3.4	2.4	1.9	1.7	1.7	1.4	1.4
Prices, wages and employment (annual average)							
Harmonized index of consumer prices	-1.6	1.2	1.9	0.5	0.3	0.2	1.5
Average wage, whole economy	-1.9	-0.5	0.5	-0.7	-0.1	2.5	1.2
Employment	-4.0	-1.8	-0.6	2.4	1.7	1.9	1.9
Unemployment rate (in percent)	13.9	14.6	14.6	13.0	11.3	10.0	9.1
Money and credit (end-period)							
Irish resident private sector credit	-3.4	-2.9	-4.0	-4.9	-4.9	...	...
Financial and asset markets (end-period)							
Three-month interbank rate	1.0	1.4	0.2	0.3	0.1	...	...
Government bond yield (in percent, 10-year)	9.2	8.5	4.5	3.5	1.2	...	...
Annual change in ISEQ index (in percent)	5.1	5.2	16.3	30.3	15.1	...	...
House prices	-10.5	-16.7	-4.5	6.4	16.3	...	...
Public finance (in percent of GDP)							
Net lending/borrowing (excl. one-off items)	-11.0	-8.7	-8.0	-6.1	-4.1	-2.8	-1.5
Primary balance (excl. bank support)	-10.3	-5.2	-3.9	-1.3	0.2	1.0	2.0
General government gross debt 4/	87.4	111.1	121.7	123.3	110.5	109.0	107.0
General government net debt 4/	67.5	79.1	87.9	92.1	86.5	86.4	85.3
External trade and balance of payments (percent of GDP)							
Balance of goods and services	17.5	20.3	20.5	20.8	21.9	22.6	23.0
Balance of income and current transfers	-16.9	-19.5	-18.9	-16.4	-18.5	-19.8	-19.6
Current account	0.6	0.8	1.6	4.4	3.4	2.8	3.4
Effective exchange rates (1999:Q1=100, average)							
Nominal	107.8	108.6	105.1	109.2	104.1	...	...
Real (CPI based)	111.6	110.2	105.3	108.1	104.1	...	...
Memorandum items:							
Population (in millions)	4.6	4.6	4.6	4.6	4.6	4.6	4.7
GDP per capita (in euros)	36,210	37,387	37,675	38,055	39,847	40,983	42,201
GDP (in billions of euros)	164.9	171.0	172.8	174.8	183.7	190.5	197.8

Sources:Bloomberg; Central Bank of Ireland; Department of Finance; International Financial Statistics; IMF staff estimates.
1/ Contribution to growth.
2/ Excludes bank restructuring costs.
3/ Adjusted growth rate of credit to households and non-financial corporations.
4/ The step down in gross and net debt in 2014 reflects in part the liquidation of IBRC, equivalent to 6 percent of GDP.

Table 2. Ireland: Medium-Term Scenario, 2010–20

(Annual percentage change, unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Proj.						
Real GDP	-0.3	2.8	-0.3	0.2	4.8	3.5	3.0	2.7	2.5	2.5	2.5
Domestic demand	-4.3	-0.7	-0.6	-0.3	3.8	2.7	2.6	2.4	2.5	2.9	2.9
Final domestic demand	-4.9	-1.7	-0.2	-0.7	3.8	2.7	2.6	2.5	2.5	2.9	2.9
Private consumption	0.9	-1.2	-1.2	-0.8	0.8	1.5	1.6	2.0	2.2	2.3	2.3
Public consumption	-7.1	-2.1	-2.1	1.4	6.7	-0.9	0.2	-0.4	-0.2	1.1	1.1
Gross fixed investment	-18.0	-2.9	5.0	-2.4	10.0	9.5	7.5	6.0	5.3	5.5	5.5
Change in stocks 1/	0.5	0.8	-0.3	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports 1/	3.3	5.9	-0.8	0.6	1.9	1.4	1.0	0.9	0.6	0.3	0.3
Exports of goods and services	6.2	5.5	4.7	1.1	8.0	4.0	4.0	4.2	4.1	4.2	4.2
Imports of goods and services	3.0	-0.6	6.9	0.6	7.8	3.3	3.9	4.2	4.5	4.8	4.8
Real GNP	1.4	-0.8	1.1	3.3	4.1	3.3	2.7	2.5	2.3	2.1	2.2
Current account 2/	0.6	0.8	1.6	4.4	3.4	2.8	3.4	3.1	3.1	3.4	3.5
Gross national saving 2/	16.4	15.3	17.1	19.6	19.4	19.8	20.8	21.0	21.4	22.2	22.9
Private	26.3	21.6	23.3	23.5	21.6	21.1	20.9	20.5	20.1	20.9	21.5
Public	-9.9	-6.3	-6.1	-4.0	-2.2	-1.2	0.0	0.6	1.3	1.3	1.4
Gross investment 2/	15.8	14.5	15.6	15.2	16.0	17.0	17.4	17.9	18.4	18.9	19.4
Private	12.5	12.2	13.7	13.4	14.3	15.6	16.0	16.5	17.1	17.6	18.1
Public	3.4	2.4	1.9	1.7	1.7	1.4	1.4	1.4	1.3	1.3	1.4
Prices											
Harmonized index of consumer prices	-1.6	1.2	1.9	0.5	0.3	0.2	1.5	1.4	1.7	1.7	1.7
GDP deflator	-1.6	0.9	1.3	1.0	0.2	0.2	0.9	0.9	1.3	1.5	1.5
Average wage, whole economy	-1.9	-0.5	0.5	-0.7	-0.1	2.5	1.2	1.1	1.4	1.7	2.0
Labor market											
Employment	-4.0	-1.8	-0.6	2.4	1.7	1.9	1.9	1.5	1.5	1.5	1.5
Unemployment rate (in percent)	13.9	14.6	14.6	13.0	11.3	10.0	9.1	8.6	8.2	7.8	7.3
Public finance											
General government balance 2/ 3/	-13.3	-8.6	-8.0	-6.1	-4.1	-2.8	-1.5	-0.8	0.0	0.0	0.0
General government gross debt 2/ 4/	87.4	111.1	121.7	123.3	110.5	109.0	107.0	104.2	99.9	96.2	92.4
General government net debt 2/ 4/	67.5	79.1	87.9	92.1	86.5	86.4	85.3	83.2	79.7	76.8	73.8
Output gap	-4.0	-3.2	-4.8	-3.8	-2.7	-1.4	-0.6	-0.2	0.1	0.0	0.0
Nominal GDP (in billions of euros)	164.9	171.0	172.8	174.8	183.7	190.5	197.8	205.1	212.9	221.4	230.3

Sources: Central Statistics Office; Department of Finance; and IMF staff estimates.

1/ Contributions to growth.

2/ In percent of GDP. Public finance data excludes bank restructuring costs. For 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

3/ Excluding one-off items.

4/ The step down in gross and net debt in 2014 reflects in part the liquidation of IBRC, equivalent to 6 percent of GDP.

Table 3. Ireland: General Government Statement of Operations, 2010–20

(consistent with *GFSM* 2001; in billions of Euros)

					Projections 1/						
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	55.5	57.3	59.1	60.8	64.2	65.3	67.4	68.5	70.1	71.4	72.9
Taxes	38.1	39.0	41.1	42.5	46.0	46.9	49.0	49.8	51.2	52.4	54.0
Personal income tax	11.3	13.8	15.2	15.8	16.9	17.1	17.5	17.6	18.0	18.3	18.7
Corporate income tax	3.9	3.8	4.0	4.3	4.7	5.0	5.3	5.5	5.7	5.8	6.0
Value-added tax	10.1	9.7	10.2	10.3	11.0	11.2	11.9	12.1	12.3	12.6	13.0
Excise tax	4.7	4.7	4.7	4.9	5.3	5.5	5.9	6.0	6.3	6.6	6.8
Other 2/	8.1	7.0	7.0	7.2	8.1	8.2	8.5	8.8	8.9	9.1	9.5
Social contributions 3/	9.5	10.0	9.7	10.3	10.6	10.9	11.3	11.5	11.5	11.9	12.1
Other revenue 4/	7.9	8.3	8.4	8.0	7.6	7.5	7.2	7.1	7.3	7.1	6.8
Expenditure (excl. fin. sector support)	77.4	72.1	73.0	70.8	71.4	70.4	70.3	70.1	70.1	71.4	72.8
Expense (excl. fin. sector support)	71.8	68.0	69.6	67.8	68.3	67.7	67.5	67.3	67.2	68.5	69.7
Compensation of employees	19.3	19.2	18.9	18.7	18.7	18.8	18.8	18.8	18.8	18.9	19.2
Use of goods and services	9.1	8.7	8.4	8.3	9.4	8.8	9.0	9.0	9.1	9.4	9.6
Interest	4.9	5.9	7.2	7.7	7.5	7.0	6.8	7.1	7.1	7.1	7.0
Subsidies	1.8	1.6	1.5	1.5	1.6	1.7	1.9	1.9	1.9	1.9	1.9
Social benefits 3/	28.8	28.8	29.4	28.6	28.1	27.9	27.7	27.3	27.2	27.8	28.5
Other expense (excl. fin. sector support) 5/	8.0	3.9	4.2	3.1	3.1	3.5	3.3	3.2	3.2	3.3	3.4
Gross fixed capital formation	5.5	4.0	3.3	3.0	3.1	2.8	2.8	2.8	2.8	2.9	3.1
One-off revenue and expenditure items 6/	35.4	6.7	0.0	-0.7	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing (excl. one-off items)	-18.1	-14.8	-13.9	-10.7	-7.6	-5.4	-2.9	-1.7	0.0	0.0	0.1
Net lending/borrowing	-53.5	-21.6	-13.9	-9.97	-7.2	-5.1	-2.9	-1.7	0.0	0.0	0.1
Primary balance (excl. one-off items)	-13.2	-9.0	-6.7	-3.0	-0.1	1.6	3.9	5.4	7.1	7.1	7.1
Net financial worth, transactions	-53.5	-21.6	-13.9	-10.0	-7.2	-5.1	-2.9	-1.7	0.0	0.0	0.1
Net acquisition of financial assets	-8.1	3.2	10.3	0.0	-10.3	-1.0	-0.2	0.0	0.0	0.0	0.0
Net incurrence of liabilities	45.3	24.7	24.2	10.0	-3.1	4.2	2.7	1.7	0.0	0.0	-0.1
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items (in percent of GDP, unless indicated otherwise)											
Revenue	33.6	33.5	34.2	34.8	35.0	34.3	34.1	33.4	32.9	32.2	31.7
Taxes and social contributions 3/	28.8	28.6	29.4	30.2	30.8	30.4	30.5	29.9	29.5	29.0	28.7
Other revenue 4/	4.8	4.9	4.8	4.6	4.1	3.9	3.6	3.5	3.4	3.2	3.0
Expenditure (excl. fin. sector support)	46.9	42.1	42.2	40.5	38.9	37.0	35.5	34.2	32.9	32.2	31.6
Current primary (excl. fin. sector support) 5/	40.6	36.3	36.2	34.4	33.1	31.8	30.7	29.3	28.2	27.7	27.2
Interest	3.0	3.4	4.1	4.4	4.1	3.7	3.4	3.5	3.3	3.2	3.1
Gross fixed capital formation	3.4	2.4	1.9	1.7	1.7	1.4	1.4	1.4	1.3	1.3	1.4
Net lending/borrowing (excl. one-off items)	-11.0	-8.7	-8.0	-6.1	-4.1	-2.8	-1.5	-0.8	0.0	0.0	0.0
Net lending/borrowing	-32.4	-12.6	-8.0	-5.7	-3.9	-2.7	-1.5	-0.8	0.0	0.0	0.0
Primary balance (excl. one-off items)	-8.0	-5.2	-3.9	-1.7	-0.1	0.9	2.0	2.7	3.3	3.2	3.1
Net financial worth, transactions	-32.4	-12.6	-8.0	-5.7	-3.9	-2.7	-1.5	-0.8	0.0	0.0	0.0
Net acquisition of financial assets	-4.9	1.8	6.0	0.0	-5.6	-0.5	-0.1	0.0	0.0	0.0	0.0
Net incurrence of liabilities	27.5	14.5	14.0	5.7	-1.7	2.2	1.4	0.8	0.0	0.0	0.0
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance 7/	-8.9	-6.5	-5.1	-4.1	-2.9	-2.3	-1.3	-0.8	0.0	0.0	0.0
Structural primary balance 7/	-6.0	-3.2	-1.1	0.2	1.1	1.4	2.1	2.7	3.3	3.2	3.1
General government gross debt	87.4	111.1	121.7	123.3	110.5	109.0	107.0	104.2	99.9	96.2	92.4
General government net debt	67.5	79.1	87.9	92.1	86.5	86.4	85.3	83.2	79.7	76.8	73.8
Output gap (percent of potential GDP)	-4.0	-3.2	-4.8	-3.8	-2.7	-1.4	-0.6	-0.2	0.1	0.0	0.0
Nominal GDP (in billions of euros)	164.9	171.0	172.8	174.8	183.7	190.5	197.8	205.1	212.9	221.4	230.3

Sources: Department of Finance; and IMF staff estimates.

1/ Projections are consistent with the adjustment path set out in Budget 2015.

2/ Includes stamp duty, capital taxes, property tax and other taxes.

3/ Includes imputed social insurance contributions. The 2011 downward jump in the series reflects the integration of health levy receipts into the universal social charge (now part of income tax).

4/ Includes property income, sales of goods and services, current transfer revenue and capital transfer revenue.

5/ For 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

6/ Includes financial sector support costs, license sales, and other non-recurrent revenue and expenditure items that do not affect underlying fiscal position.

7/ In percent of nominal potential GDP. Excludes one-off items.

Table 4. Ireland: Indicators of External and Financial Vulnerability, 2010–14

	2010	2011	2012	2013	2014 6/
External indicators					
Exports (annual percent change, value in euros)	7.8	5.9	9.2	0.9	9.0
Imports (annual percent change, value in euros)	6.1	2.6	11.1	0.4	8.6
Terms of trade (goods, annual percent change)	-1.5	-2.9	0.4	0.0	0.2
Current account balance (in percent of GDP)	0.6	0.8	1.6	4.4	3.4
Capital and financial account balance (in percent of GDP)	-4.3	-5.6	0.0	6.5	3.6
Of which:					
Inward portfolio investment	45.9	17.3	40.8	31.2	30.6
Inward foreign direct investment	19.6	9.9	20.4	16.0	15.5
Other investment liabilities	-37.6	-28.5	-58.5	-14.9	-22.6
Public debt in foreign currency (in percent of GDP) 1/	0.0	0.0			
Of which:					
External debt to exports ratio (in percent)	0.0	0.0			
External interest payments to exports (in percent)	0.0	0.0			
U.S. dollar per euro (period average)	1.32	1.40	1.29	1.33	1.32
U.K. pound per euro (period average)	0.86	0.87	0.81	0.85	0.80
Financial markets indicators					
General government debt (in percent of GDP)	87.4	111.1	121.7	123.3	110.5
Government bond yield (in percent, 10-year, end-period)	9.2	8.5	4.5	3.5	1.2
Spread of government bond yield with Germany (in percent, end of period)	6.0	6.5	3.2	1.4	0.6
Real government bond yield (in percent, 10-year, period average, based on	7.6	8.4	4.1	3.3	2.0
Annual change in ISEQ index (in percent, end of period)	5.1	5.2	16.3	30.3	
Personal lending interest rate (in percent)	12.5	12.9	13.27	13.88	13.84
Standard variable mortgage interest rate (in percent)	3.3	3.1	3.6	3.4	3.4
Financial sector risk indicators					
Annual credit growth rates (to Irish resident private sector, in percent) 1/	-3.4	-2.9	-4.0	-4.9	
Annual deposit growth rates (in percent)					
Personal lending as a share of total Irish resident credit (in percent)	35.5	30.0	33.0	34.8	35.4
Of which:					
House mortgage finance	30.7	25.4	28.7	30.5	31.3
Other housing finance	0.4	0.3	0.3	0.4	0.4
Other personal lending	4.8	4.6	4.3	4.3	4.1
Irish resident household mortgage debt annual growth rates (in percent) 2/	-9.0	-19.3	5.6	-1.9	-1.1
Commercial property lending as a percent of total loans (excluding financial intermediation) 3/					
Foreign-currency denominated assets (in percent of total assets)	30.3	29.4	28.4	27.5	26.4
Foreign-currency denominated liabilities (in percent of total liabilities)	25.8	26.3	25.4	25.3	24.5
Contingent and off-balance sheet accounts (in percent of total assets) 4/	0.0	0.0	0.0	0.0	
Non-performing loans (in percent of total loans) 3/	8.6	9.1	11.3	12.5	
Total provisions for loan losses (in percent of total loans)	4.2	4.8	5.4	5.0	
Regulatory capital to risk-weighted assets of domestic banks (in percent)	10.4	17.7	16.6	15.1	
Bank return on assets (before tax, in percent)	-3.1	-0.8	-0.8	-0.7	
Bank return on equity (before tax, in percent)	-67.6	-16.9	-14.1	-13.0	
Liquid assets of all banks to total assets (liquid asset ratio, in percent)					
Liquid assets of all banks to short-term liabilities (in percent)					
Deposits to M3 ratio 4/	1.5	1.2	1.3	1.3	1.4
Loan-to-deposit ratio vis-à-vis Irish residents 5/	2.1	2.1	1.9	1.6	1.6
vis-à-vis total	2.1	2.1	1.9	1.7	1.6
Concentration ratios in the banking sector					
No. of banks accounting for 25 percent of total assets	2.0	2.0	2.0	2.0	2.0
No. of banks accounting for 75 percent of total assets	13.0	14.0	14.0	13.0	13.0
Share of state-owned banks in total assets (in percent)	8.0	18.0	19.1	17.5	
Share of foreign-owned banks in total assets (in percent)	65.0	61.6	57.6	57.9	

Sources: Bloomberg; Central Bank of Ireland; International Financial Statistics; and IMF staff estimates.
1/ Adjusted growth rate of credit to households and non-financial corporations.
2/ Including securitisations.
3/ Includes lending for construction and real estate activities.
4/ Credit equivalent values.
3/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.
4/ Deposits vis-à-vis Irish and nonresidents.The M3 compiliation methodology has been amended in line with
5/ Nongovernment credit/nongovernment deposits ratio.
6/ Staff projections for macroeconomic variables and debt Financial sector indicators cover all credit institutions licensed in Ireland except for personal lending rate, which is calculated based on a sample of retail banks, and a mortgage interest rate, which is calculated excluding IFSC.

Table 5. Ireland: Summary of Balance of Payments, 2010–20

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
					Projections						
				(In billions of euros)							
Current account balance	0.9	1.4	2.7	7.6	6.2	5.4	6.7	6.4	6.5	7.4	8.0
Balance of goods and services	28.8	34.7	35.4	36.4	40.2	43.1	45.5	47.4	49.2	50.7	52.3
Trade balance	42.9	43.3	42.4	36.2	37.2	38.6	40.7	42.8	45.1	47.6	49.6
Exports of goods	89.7	91.6	97.0	91.8	93.8	97.2	101.5	105.9	110.8	115.7	120.4
Imports of goods	-46.9	-48.3	-54.6	-55.6	-56.7	-58.5	-60.7	-63.1	-65.7	-68.1	-70.8
Services balance	-14.1	-8.6	-7.0	0.2	3.1	4.4	4.7	4.6	4.1	3.1	2.7
Credit	68.1	75.4	85.5	92.3	106.8	112.9	119.5	126.4	134.0	142.5	152.0
Debit	-82.2	-84.1	-92.5	-92.1	-103.7	-108.4	-114.7	-121.7	-129.9	-139.4	-149.3
Income balance	-26.4	-32.1	-30.3	-26.3	-31.4	-34.8	-35.8	-37.9	-39.2	-39.5	-40.1
Credit	56.2	56.6	58.4	56.3	54.9	54.7	57.2	58.5	60.8	64.5	68.1
Debit	-82.7	-88.8	-88.7	-82.5	-86.3	-89.5	-93.0	-96.4	-100.1	-104.0	-108.3
Current transfers (net)	-1.4	-1.2	-2.4	-2.5	-2.6	-2.9	-3.0	-3.1	-3.4	-3.8	-4.2
Capital and financial account balance	-7.2	24.7	21.2	22.2	6.4	5.6	6.9	6.6	6.8	7.7	8.4
Capital account balance	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2
Financial account	-7.3	24.4	21.2	22.1	6.3	5.5	6.8	6.5	6.7	7.5	8.2
Direct investment	-15.4	-17.8	-23.3	-9.8	-9.5	-9.3	-9.7	-10.2	-10.6	-11.1	-11.5
Portfolio investment	-86.0	-26.9	4.1	46.3	17.2	3.0	14.2	8.4	7.3	13.0	15.9
Other investment	94.1	69.4	40.4	-14.4	-1.4	11.8	2.4	8.4	10.0	5.6	3.8
Change in reserve assets 1/	0.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-8.3	-11.7	-2.9	3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	34.5	21.3	11.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing	0.0	34.5	21.3	11.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	12.6	6.4	3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EU	0.0	21.9	14.8	7.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP)							
Current account balance	0.6	0.8	1.6	4.4	3.4	2.8	3.4	3.1	3.1	3.3	3.5
Balance of goods and services	17.5	20.3	20.5	20.8	21.9	22.6	23.0	23.1	23.1	22.9	22.7
Trade balance	26.0	25.3	24.5	20.7	20.2	20.3	20.6	20.9	21.2	21.5	21.5
Services balance	-8.5	-5.0	-4.0	0.1	1.7	2.3	2.4	2.3	1.9	1.4	1.2
Income balance	-16.0	-18.8	-17.5	-15.0	-17.1	-18.3	-18.1	-18.5	-18.4	-17.8	-17.4
Current transfers (net)	-0.9	-0.7	-1.4	-1.4	-1.4	-1.5	-1.5	-1.5	-1.6	-1.7	-1.8
Capital and financial account balance	-4.4	14.4	12.3	12.7	3.5	2.9	3.5	3.2	3.2	3.5	3.6
Of which:											
Direct investment	-9.4	-10.4	-13.5	-5.6	-5.2	-4.9	-4.9	-5.0	-5.0	-5.0	-5.0
Portfolio investment	-52.1	-15.7	2.4	26.5	9.4	1.6	7.2	4.1	3.4	5.9	6.9
Other investment	57.1	40.6	23.4	-8.2	-0.8	6.2	1.2	4.1	4.7	2.5	1.6
Change in reserve assets 1/	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-5.0	-6.8	-1.7	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	20.2	12.3	6.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Program financing	0.0	20.2	12.3	6.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	7.4	3.7	2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EU	0.0	12.8	8.6	4.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Current account balance excluding undistributed profits 2/	-2.6	-2.5	-2.7	0.1	-0.6	-1.1	-0.3	-0.5	-0.4	0.0	0.3

Sources: Central Bank of Ireland; Central Statistics Office; and IMF staff estimates.
1/ Includes financing need to build reserves for bank support.
2/ Undistributed profits of redomiciled firms, as estimated by FitzGerald (2013).

Table 6. Ireland: Monetary Survey, 2010–14
(In billions of euros unless otherwise indicated; end of period)

	Dec-10	Dec-11	Dec-12	Dec-13	Mar-14	Jun-14	Sep-14	Nov-14
Aggregate balance sheet of domestic market credit institutions								
Assets	747	639	550	474	459	439	423	420
Claims on Central Bank of Ireland	8	4	2	2	3	5	2	2
Claims on Irish resident Other MFIs	123	92	53	49	49	47	46	47
Claims on Irish resident non MFIs	359	340	326	281	273	258	244	241
General government	43	42	47	21	20	20	20	20
Private sector	316	298	279	260	253	238	223	221
Households	130	110	111	108	107	101	100	97
Non-Financial Corporations	91	86	83	78	75	68	60	60
Non-Bank Financial Intermediaries	95	101	85	74	71	69	63	63
Claims on non-residents	209	150	122	102	95	92	91	90
Other assets	48	52	47	41	39	38	41	41
Liabilities	747	639	550	474	459	439	423	420
Liabilities to Eurosystem 1/	95	72	59	31	26	17	13	13
Liabilities to Irish resident Other MFIs	132	99	59	52	52	49	49	49
Deposits of Irish resident non MFIs	162	146	153	175	171	166	163	163
General government	3	2	6	14	13	14	13	11
Private sector	159	143	147	161	158	152	150	153
Households	94	91	92	90	91	91	91	91
Non-Financial Corporations	32	29	29	32	31	33	34	35
Non-Bank Financial Intermediaries	33	24	26	39	36	28	26	26
Deposits of non-residents	140	100	76	71	64	65	64	63
Debt securities	64	52	38	27	28	28	29	27
Capital and reserves	72	91	98	96	96	89	82	81
Other liabilities (incl. Central Bank of Ireland)	83	79	66	23	22	24	24	23
Money and credit 2/								
Net foreign assets	-480	-340	-14	2	-5	9	17	37
Central Bank of Ireland 3/	-128	-101	-62	-37	-44	-26	-21	…
Commercial banks	-352	-239	48	39	39	35	38	37
Net domestic assets	662	522	194	200	203	186	172	154
Public sector credit	43	43	48	21	20	21	21	21
Private sector credit	335	324	302	278	271	256	242	239
Other	284	156	-156	-99	-88	-91	-91	-105
Irish Resident Broad money (M3) 4/	182	182	180	201	198	195	189	191
Irish Resident Intermediate money (M2) 4/	173	167	168	183	182	178	176	180
Irish Resident Narrow money (M1)	97	90	92	114	114	110	110	115
				(Percent of GDP)				
Public sector credit 5/	27.6	27.0	29.4	12.8	12.2	12.5	12.8	12.5
Private sector credit 5/	202.4	190.1	173.5	161.9	157.5	148.3	139.2	137.4
				(Percentage change y/y)				
Broad money - Irish contribution to euro area M3 6/	-19.6	1.3	-7.3	11.2	0.2	-8.0	-6.7	3.6
Irish Public sector credit 6/ 7/	369.4	1.5	8.5	-57.8	2.2	-0.7	-0.8	-3.5
Irish Household and non-financial corporations credit 6/ /7	-3.4	-2.9	-4.0	-4.9	-4.8	-4.9	-5.4	-4.9
Memorandum items: 8/								
Credit to deposits (in percent) 9/	199.2	207.6	189.9	161.4	159.9	156.5	148.5	144.6
Deposits from Irish Private Sector (percent change y/y)	-9.4	-8.9	2.4	9.3	-1.0	-4.5	-4.2	-2.8
Wholesale funding (billions of euros)	317	235	159	135	130	129	128	126
Deposits from MFIs	253	183	120	108	102	101	99	98
Debt securities	64	52	38	27	28	28	29	27
Wholesale funding (y-o-y percent change) 10/	-21.7	-26.9	-33.0	-11.6	-12.0	-6.6	-7.0	-6.5
Wholesale funding (percent of assets) 10/	44.8	36.8	28.8	28.5	28.3	29.3	30.2	30.0

Sources: Central Bank of Ireland and staff estimates.
1/ Relating to Eurosystem monetary policy operations.
2/ Including banks in the International Financial Service Centre.
3/ Sourced from quarterly IIP statistics.
4/ Differs from the M3 (M2) Irish contribution to euro area as only liabilities vis-a-vis Irish residents are used.
5/ Refers to credit advanced by domestic market credit institutions.
6/ Includes IFSC.
7/ Growth rates adjusted for valuation, reclassification, derecognition/loan transfer to non-MFIs, and exchange rates.
8/ Excludes IFSC.
9/ Domestic market credit institutions' private sector credit to deposits.
10/ Includes resident and non-resident MFI deposits, and debt securities issued.

Table 7. Ireland. Indicators of Fund Credit, 2010–23

(In millions of SDR)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Fund credit													
Disbursement	11,050	5,493	2,922	-	-	-	-	-	-	-	-	-	-
Stock 1/	11,050	16,543	19,466	11,822	8,995	8,995	8,995	8,995	7,373	4,129	1,420	349	-
Obligations	109	332	456	8,292	3,143	251	251	251	1,865	3,387	2,747	1,083	351
Repurchase 2/	-	-	-	7,644	2,827	0	0	0	1,622	3,244	2,709	1,071	349
Charges	109	332	456	648	316	251	251	251	243	143	38	12	3
Stock of Fund credit													
In percent of quota	879	1,315	1,548	940	715	715	715	715	586	328	113	28	-
In percent of GDP	7.3	11.4	12.7	7.4	5.7	5.5	5.2	5.0	3.9	2.1	0.7	0.2	-
In percent of exports of goods and services	7.5	10.8	12.1	6.7	5.1	4.9	4.6	4.4	3.4	1.8	0.6	0.1	-
Obligations to the Fund													
In percent of quota	9	26	36	659	250	20	20	20	148	269	218	86	28
In percent of GDP	0.1	0.2	0.3	5.2	2.0	0.2	0.1	0.1	1.0	1.7	1.4	0.5	0.2
In percent of exports of goods and services	0.1	0.2	0.3	4.7	1.8	0.1	0.1	0.1	0.9	1.5	1.2	0.4	0.1

Source: IMF staff estimates.

1/ End of period.

2/ Reflects early repurchases to date

Annex I. External Balance and Competitiveness Assessment

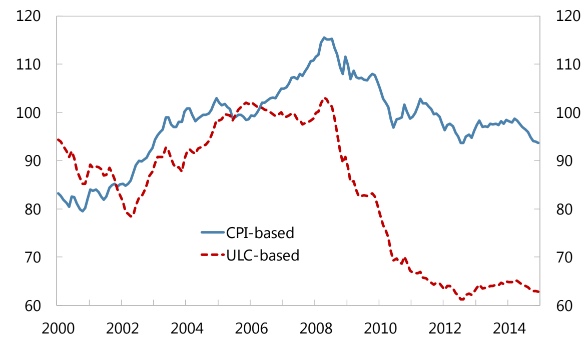
A range of External Balance Assessment methodologies suggest that the external position is broadly in line with fundamentals and desirable policy settings. Setting aside the slump associated with the pharmaceutical "patent cliff", Ireland's competitiveness has held up well in recent years. Ireland is a booming hub for service industries, non-pharmaceutical goods exports have managed to reclaim some market share since 2012, and solid FDI inflows serve as proof of investors' continued favorable assessment of the country's business-friendly environment.

A. External Balance broadly in Equilibrium

Current Account and Exchange Rates

External Balance Assessment methodologies indicate that the external position is broadly in line with fundamentals and desirable policy settings. The real exchange rate has fallen notably since the crisis—especially when measured on a unit labor cost (ULC) basis—and has remained fairly stable over the last two years. Both the Current Account (CA) and the Real Effective Exchange Rate (REER) approaches report a positive current account gap, which suggests a slight undervaluation of the currency. The equilibrium exchange rate approach suggests a small overvaluation on average for 2014, which has been largely unwound by the continued Euro depreciation over recent months – the REER was 5½ percent lower in January 2015 compared to the 2014 average. In both cases, policy gaps make a negligible contribution to the overall CA and REER gaps.

Real Effective Exchange Rate
(Index, 2005 = 100)



Source: IMF Staff calculations.

Table 1. External Balance Assessment Results for Ireland

Methodology	CA gap Percent of GDP	REER gap percent
EBA Current Account (CA) approach	5.7	-6.5
External sustainability (ES) approach	4.6	-5.2
EBA REER approach	-	6

Note: A positive CA gap indicates undervaluation, a positive REER gap indicated overvaluation. Estimates are based on data available in October 2014.

Redomiciled firms may explain the bulk of the estimated positive current account gap. The apparent contradiction between the CA- and REER-based approaches can be reconciled by the proliferation of "redomiciled firms", enterprises which only establish their headquarters in Ireland to consolidate their profits for taxation at the Irish corporate rate. FitzGerald (2013) estimates that retained earnings contributed 5.3 percent of GDP to the current account balance in 2012.

Updated CSO data put the contribution at 3.9 percent of GDP for 2013 and at least as much in 2014, which represents two-thirds of the estimated current account gap.

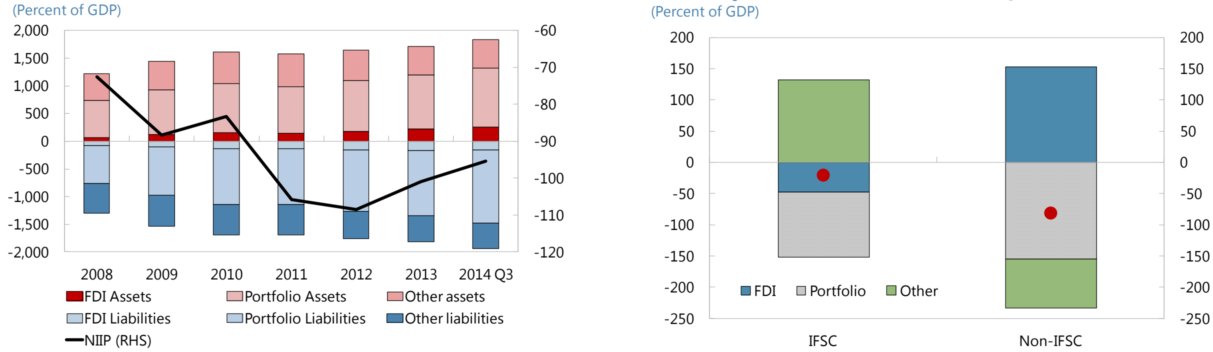
Capital Account Flows and International Investment Position

Ireland's capital account is dominated by the International Financial Services Center (IFSC). It accounts for 85 percent of overall portfolio and other investment flows and its total transactions are 33 times larger than Ireland's GDP. However, IFSC inflows and outflows are closely matched, as it serves as a hub for international financial transactions. As a result the IFSC's IIP is very close to balance, with the overall NIIP dominated by the non-IFSC sector. In this respect, it should be noted that although Ireland is a large FDI recipient, its net direct investment position is in fact positive. This is due in part to large positive valuation effects associated with redomiciled firms' foreign assets.

Figure 2. Ireland: International Investment Position

Overall IIP (IFSC and Non-IFSC), 2014Q3
(Percent of GDP)

Net IIP by financial instrument, 2014 Q3
(Percent of GDP)

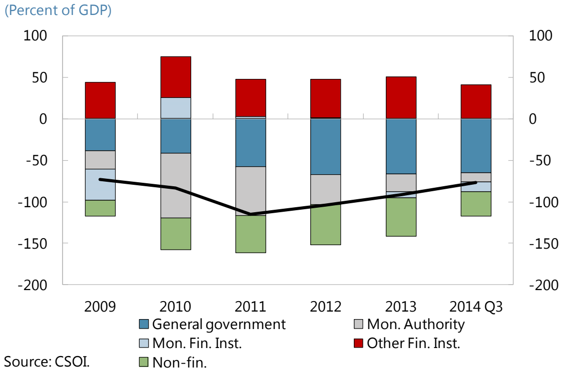


Sources: CSOI; and IMF staff calculations.

Source: CSOI.

The IIP of the Non-IFSC sector has improved rapidly over the last few years. From -115 percent of GDP in 2011, the IIP has risen to -77 percent of GDP in 2014 Q3. The primary contributor is banks' diminished reliance on Eurosystem funding, which therefore reduced the CBI's Target 2 liabilities. General government's external liabilities have also stabilized and are projected to decline gradually (see DSA). With a small current account surplus projected going forward, Ireland's NIIP-to-GDP ratio is expected to continue its gradual improvement.

Figure 3. Non-IFSC IIP by Sector
(Percent of GDP)

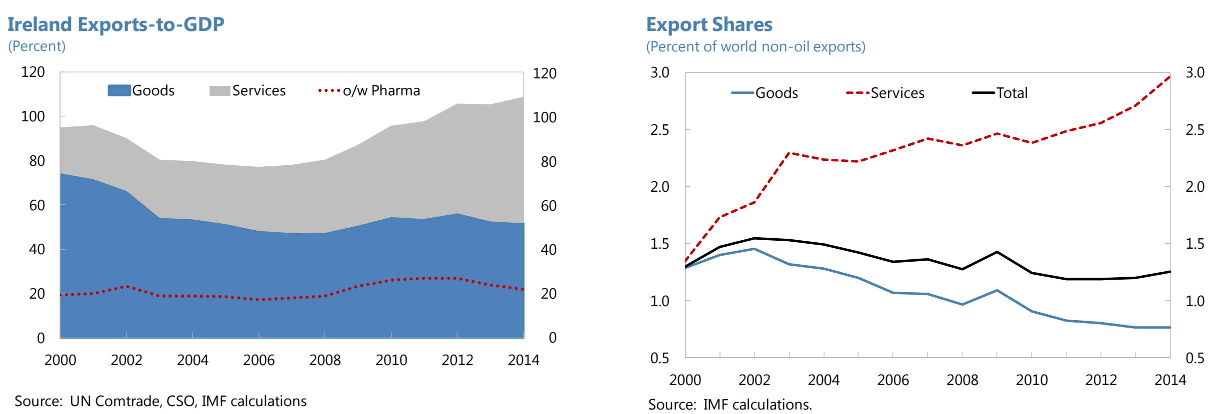


Source: CSOI.

B. Competitiveness—Services up, Pharmaceuticals down

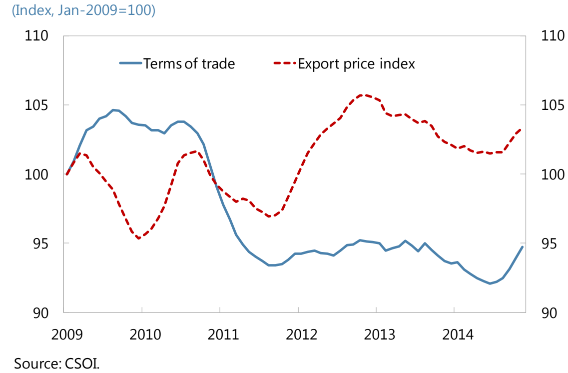
Ireland's strong export performance has been driven primarily by the services sector. Exports of goods rose relative to GDP in 2010-11, but have since receded somewhat in relative importance. On the other hand, exports of services have steadily increased, and have surpassed goods exports in 2013. This has also translated into a rapidly increasing share in world services exports, while goods exports have fallen notably in relation to international goods trade, from 1.4 percent of world exports in 2002 to under 0.7 percent by 2012–14.

Figure 4. Ireland: Export Composition and World Market Share



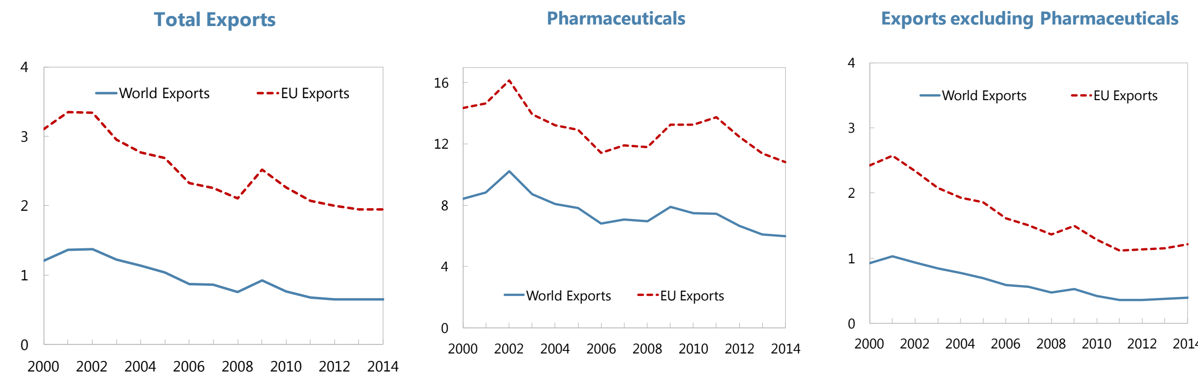
The assessment of developments in goods exports is complicated by "contract manufacturing" in the pharmaceutical sector. Goods exports as recorded at the customs increased 1.5 percent y/y in euro terms in the first ten months of 2014, even as national accounts report real goods export growth of 15 percent y/y for the first nine months of the year. This discrepancy can be traced in part to the proliferation of "contracted manufacturing" (exports of goods manufactured abroad by companies headquartered in Ireland). Such exports are part of GDP as the goods remain in the ownership of the Irish resident company. The issue is most important in the pharmaceutical sector where national accounts show that the industry's output has increased some 40 percent y/y in the first seven months of 2014, but pharmaceutical exports accounted at customs have dropped 3.6 percent over the same period.[1] The growing importance of contracted manufacturing since early 2014 may pose issues down the road in interpreting results of various methods for assessing the external balance and competitiveness.

Figure 5. Terms of Trade and Export Price Index
(Index, Jan-2009=100)



[1] To extend cross-country comparability to 2014, pharmaceutical exports are measured by adding values for Harmonized System lines 29 (Organic Chemicals) and 30 (Pharmaceutical products). This is a somewhat narrower definition than used in the Ministry of Finance study of the pharmaceutical patent cliff (SITC codes 51 and 54).

Figure 6. Ireland's Share in World and EU Non-oil Goods Exports 1/

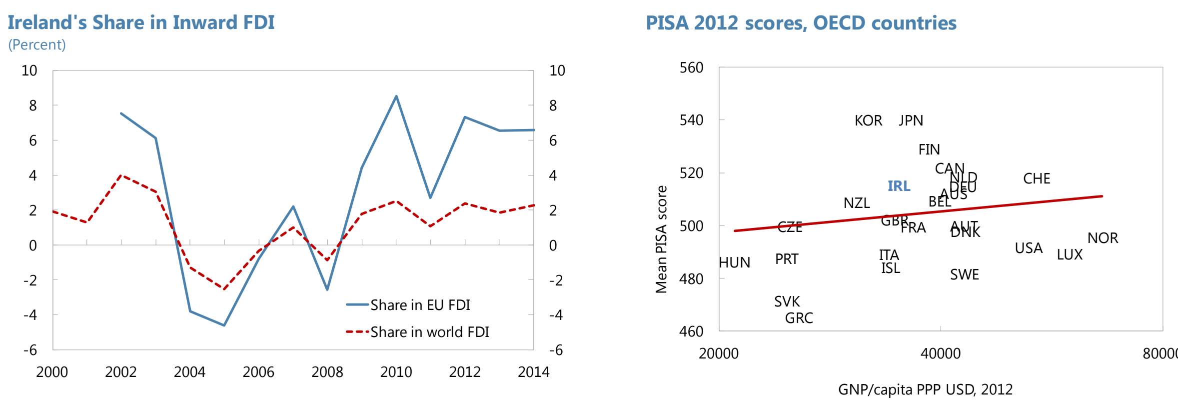


Sources: UN Comtrade; IMF WEO and staff calculations.

1/ 2014 export forecast from IMF WEO. 2014 pharmaceutical exports extrapolated based on January-June data

The impact of the pharmaceutical patent cliff conceals a possible emerging revival of goods exports in other sectors. Ireland has been steadily losing ground on world markets (figure 6, left panel). This drop cannot be attributed in full to the rise of emerging markets, as Ireland's share in EU exports has been decreasing along the same path, i.e. it lost ground *within* the EU. However, much of this decrease is due to the patent cliff in the pharmaceutical sector (middle panel), with the rest of the exports (right panel) registering a tepid recovery of market share—both in world and EU exports—2012. At the same time, there are early signs that the impact of the pharmaceutical patent cliff is gradually dissipating.

Figure 7. Ireland's Share in World and EU FDI and Educational quality 1/



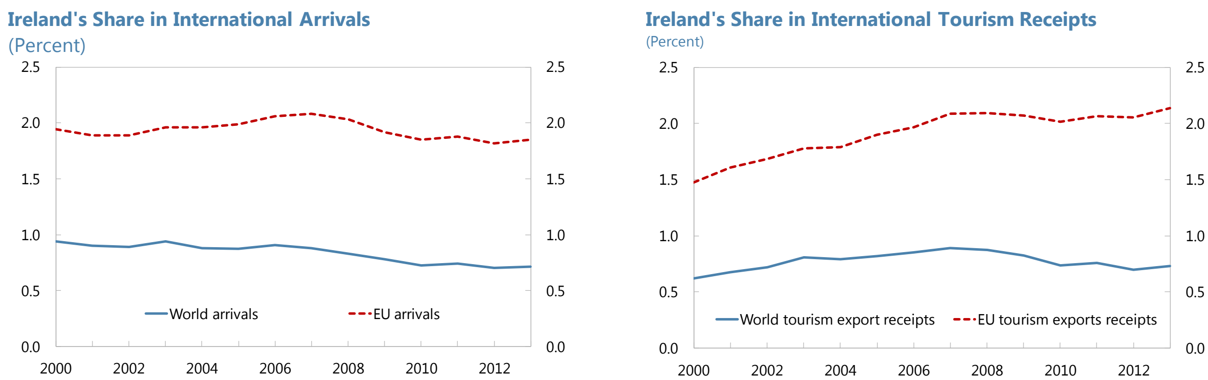
Sources: WEO, OECD PISA

1/ Ireland's incurrence of FDI liabilities is negative in some years due to reverse investment (by the affiliate into its parent company).

C. International Tourism Competitiveness

While IT and business services represents nearly two-thirds of services exports, these are in part driven by multinationals global operations, which have relatively little domestic value-added and cloud to some extent the underlying competitiveness of the Irish economy. That is why evaluating the performance of an export-oriented services industry with higher domestic value added is useful to gauge the economy's overall competitiveness in the services sector. International tourism is a fitting candidate – it accounts for sizeable shares both in GDP (2 percent) and services exports (4 percent), and cross country comparisons are possible in both nominal (tourism receipts) and real terms (arrivals or night-stays).

Figure 8. Ireland's Share in International Tourism



Sources: World Development Indicators, UNWTO, CSO, Staff estimates and calculations.

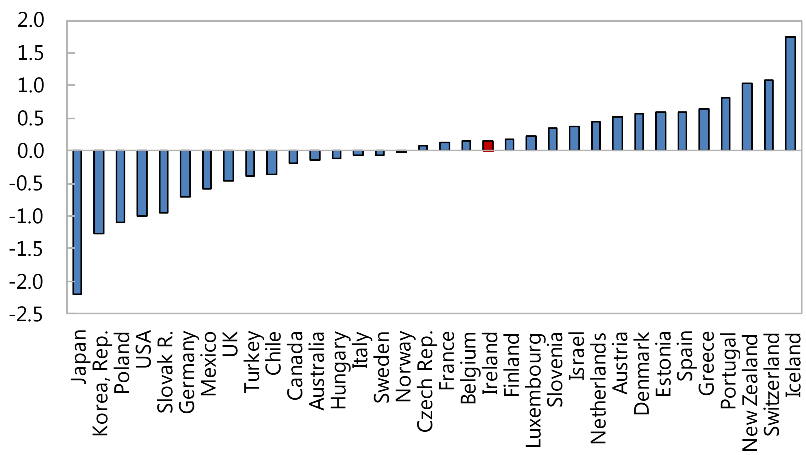
Ireland lost global market share in the aftermath of the crisis. Indirect evidence suggests that this may be in part due to the fact that tourism figures are affected by temporary migrant workers (and relatives visiting them) who have left in the wake of the economic crisis. For example, arrivals from Poland have seen the largest drop among top origin countries between 2007 and 2009: 28 percent vs. an average of 13 percent for other OECD countries. Since 2009, Ireland's share in arrivals has declined only marginally, while the share of tourism receipts have flattened (world) or even improved (compared to other EU destinations).

While looking at market share trends is useful to gauge developments in a country's competitiveness, one could also ask how attractive of a tourism destination Ireland is in absolute terms. Ideally, this should be done after accounting for a range of objective factors (size, distance to markets, historical and linguistic ties, etc.). One approach for answering this question comes from the gravity model, which has gained widespread use in the goods trade literature. Culiuc (2014) applies the gravity model to a large cross-country dataset covering the universe of bilateral tourism arrivals between 1999 and 2009, and estimates the impact on tourism of a rich set of gravity variables (economic, geographical, cultural, linguistic, etc.).[2] Estimated coefficients

[2] Culiuc, Alexander (2014) "Determinants of International Tourism", *IMF Working Paper No. 14/82*

on country dummies from country fixed effects regressions can serve as an index of tourism attractiveness *after* accounting for all these factors. When estimated for intra-OECD tourism arrivals, the model suggests that Ireland was – over the 1999-2009 period – marginally above average on this particular indicator of tourism competitiveness.

Figure 9. Revealed Tourism Attractiveness Index from Gravity Model Estimation (1999-2009)

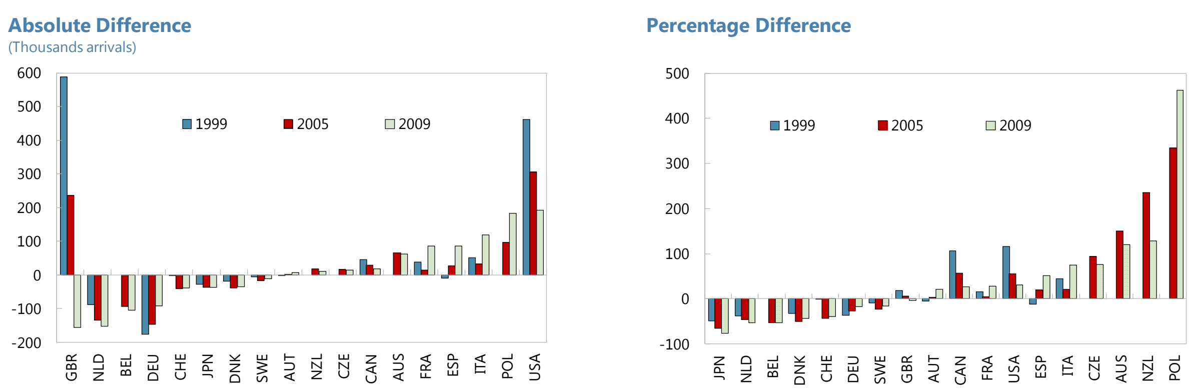


Source: UNWTO data, staff estimations.

Note: Zero corresponds to the average OECD country. Coefficients estimated using the regression specification presented in Culiuc (2014), Table A6, column (6).

Finally, the same framework can be used to estimate on which markets Ireland is doing better or worse than the model predicts, effectively measuring the relative market performance. Results for OECD markets are presented in the figure below. Ireland has been gradually losing its stronghold in traditional Anglophone markets – primarily the UK and the US, but also Canada, Australia and New Zealand – while labor migration is the likely driver behind the large over-performance for Poland.

Figure 10. Ireland's Market Over-performance (difference vs. model-predicted arrivals)



Annex II. Debt Sustainability Analysis

This Annex presents the public and external debt sustainability analysis (DSA) based on staff's medium-term macroeconomic framework and the Irish authorities' fiscal projections.

Public Debt Sustainability Analysis

1. **Statistical accounting revisions and one-off events had a significant impact on the historical debt-to-GDP data in 2014**. The key change in historical debt data arises from the consolidation of the Irish Bank Resolution Corporation (IBRC) into general government with the shift to ESA 2010, which added €12.6 billion to end-2013 public debt, a 6.2 percent increase. However, the transition to ESA 2010 also resulted in an upward revision to GDP of 6.5 percent in 2013. As a result, the revised debt-to-GDP ratio of 123.3 percent at end 2013 is very close to the 123.7 percent reported to the 1st PPM Report. However, gross public debt is estimated to have dropped 12 percentage points, to 111 percent of GDP at end-2014 on account of two main factors:

- *The liquidation of IBRC* has been mostly completed in 2014 on the back of strong investor interest, with remaining liabilities down to €1.5 billion (expected to be dealt with gradually in coming years). This liquidation lowers end-2014 debt by 6 percentage points of GDP.

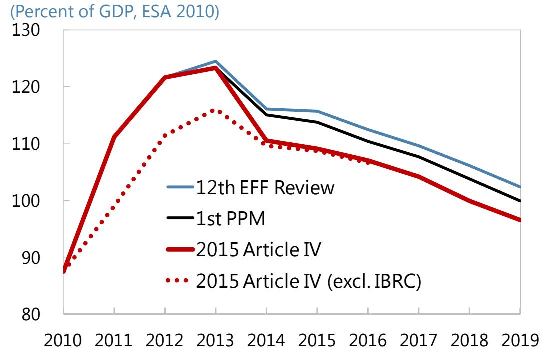
- *The draw-down of cash deposits and short-term investments* from €18.5 to €11 billion over the course of the year contributed a 4 percentage point drop in the gross debt-to-GDP ratio. This reduction in the cash buffers built ahead of exiting the EU-IMF supported program was enabled by an improved outlook and favorable financing conditions.

2. **The baseline debt outlook has improved since the DSA in the past year**. Gross public debt is 4 percentage points lower in 2014 after accounting for statistical revisions, and is forecast to remain below the medium-term debt path from the 1st PPM report owing to:

- *Better growth prospects*. Growth revisions for 2014-15 alone reduce the end-2015 debt ratio by 3.3 percentage points of GDP.

General Government Gross Debt

(Percent of GDP, ESA 2010)



Source: IMF staff projections.

- *Early repayments*. Early repayments of Fund credit—which began in mid-December 2014—improve debt sustainability by lowering the interest bill by a cumulative total of 1 percent of GDP over a number of years and is also expected to extend the debt maturity profile. Although projected gross financing needs (GFN) for 2015 are raised by financing IMF these repayments, GFN is forecast to remain below 15 percent of GDP over the medium term, mitigating the risks associated with the debt level.

- *Improved financing conditions.* The yield on 10 year Irish bonds is around 1.2 percent, with both the reference German bund rate and spreads lower than previously anticipated. The ECB's quantitative easing program lowers risks that these favorable conditions will see a sudden reversal in coming years. Nonetheless, the baseline is built on conservative projections, which do not take into account the full extent of recent declines in spreads.[3]

3. **A heat map and fan charts indicate that Ireland faces high risks to debt sustainability** (Figure 1). The debt burden benchmark for advanced economies of 85 percent of GDP is exceeded, indicating that Ireland's debt level is highly vulnerable under all scenarios regardless of the extent to which a shock increases debt. GFN exceeds 15 percent of GDP under the contingent liability shock but remains below the vulnerability threshold of 20 percent of GDP. The debt profile is also subject to high risks from external financing requirements (excluding debts of the IFSC) and public debt held by non-residents which exceed the upper risk assessment benchmarks for these indicators.[4] The fan charts illustrate the possible evolution of the debt-to-GDP ratio over the medium term, based on both a symmetric and an asymmetric distribution of risks. The asymmetric fan chart (where only negative shocks to the primary balance are considered) is more relevant given the remaining fiscal adjustment and shows that risks to the debt outlook are skewed to the upside.

4. **There is no evidence of a systematic projection bias in the baseline assumptions for key macroeconomic variables** (Figure 2). The median forecast errors for real GDP growth and the primary balance during 2005–13 are below 1 percent and in line with other countries. Individual large forecast errors for growth, primary balance, and inflation mostly arise during the crisis period, especially for the primary balance where there were very large unforeseen bank recapitalization costs.

5. **Reflecting the sizable fiscal effort, Ireland's fiscal adjustment is projected to improve its primary balance to above its debt stabilizing threshold** (Figure 2). The projected change in the cyclically-adjusted primary balance is in the top quartile of fiscal adjustments observed in advanced and emerging market countries with debt greater than 60 percent of GDP. While sizable, this projected adjustment is consistent with Ireland's track record of steadfast efforts during its EU-IMF supported program, and is further underpinned by Ireland's commitments under the EDP and fiscal rules entrenched in the Fiscal Responsibility Act.

6. **Under the baseline macroeconomic projection, Ireland's debt ratio will continue declining** (Figures 3 and 4). After a significant boost from automatic debt dynamics in 2014, when low interest rates and high growth reduced debt by 1.9 percentage points of GDP, it is projected that the interest rate-growth differential will remain close to zero in the medium term. GFN are forecasted to follow a U-shape and peak at 13 percent of GDP in 2020 before dropping in subsequent years.

[3] While incoporating easier financing conditions in the Eurozone, the projections keeps spreads on Irish bonds at 125 bps for 2015 (currently below 90 bps), gradually increasing to 200 bps by 2018.

[4] Note that Irish government bonds held by non-residents are considered to be external debt for this analysis.

7. The projected decline in public debt remains vulnerable to lower growth (Figure 5). Key risks include:

- **Growth shock**. If projected real GDP growth rates for 2015–16 are lowered by 0.5 standard deviations (implying annual growth about 2 percentage points lower at 1 percent in 2016 and 0.7 percent in 2017), the debt-to-GDP ratio peaks at 112 percent in 2017 (compared with 104 percent under the baseline) before declining.[5]

- **Interest rate shock**. In the medium term, Ireland is shielded from a rise in interest rates by its still-high share of fixed rate and official borrowing and by relatively low financing needs in coming years. For example, a 200 basis point interest rate increase on new borrowing affects the debt trajectory only marginally.[6]

- **Macro-fiscal shock.** If slower growth in 2016–17 were compounded by a primary balance shock[7] and by an increase in interest rates on new borrowing by 2 percentage points, the debt ratio rises to 113 percent of GDP in 2017 and falls to 103 percent by 2020. In this scenario, gross financing needs increase by 2.1 percentage points of GDP on average over the medium term, reaching 15 percent in 2020.

- **Contingent liability shock**. With the recent completion of the 2014 Comprehensive Assessment and expected completion of IBRC liquidation without budgetary costs, remaining sources of financial sector contingent liabilities include: (i) risks that bank provisions are inadequate to cover losses on their large NPLs, although such risks are currently contained by conservative assumptions on collateral valuation; (ii) shortfalls in the crystallized value of NAMA assets, although NAMA management is confident of at least breaking even given the improvement in market conditions; and (iii) costs related to the restructuring of the credit union sector, although these are contained by the size of the sector, with net loans being only 2½ percent of GDP. Without estimates of the potential realization of these contingencies, a scenario assuming a 10 percent of GDP shock is used.[8] Such a shock, if combined with the above growth shock, would push gross public debt to around 117 percent of GDP in 2016-17 before declining to 106 percent by 2020.

[5] A one-half standard deviation shock, instead of a default one standard deviation shock, is applied to the growth rate to adjust for the exceptionally volatile growth rates during the recent boom-bust years.

[6] A 200 basis point interest rate shock, instead of a larger shock derived from the difference between average real interest rate level over the projection period and maximum real historical level (equivalent to 541 basis points), appears more appropriate given the exceptionally high interest rates during the crisis years (2008–10).

[7] A shock equivalent to the full size of the planned fiscal adjustment over the medium term is used, which worsens primary balances by an average of 1.1 percentage points of GDP. A larger temporary shock derived from baseline primary balance minus one-half of the 10-year historical standard deviation is not yet appropriate, given the exceptionally high primary deficits (reflecting bank recap costs) during the crisis years.

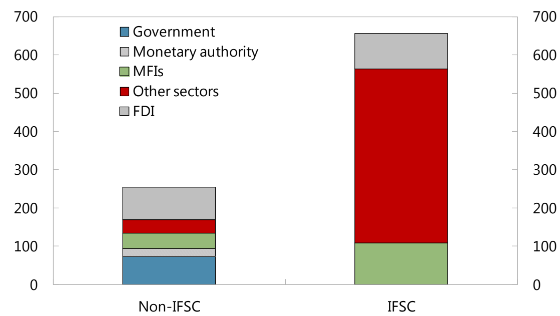
[8] A 10 percent of GDP shock is used, instead of a default shock of 10 percent of banking sector assets (equivalent to around 30 percent of GDP), taking into account the 40 percent of GDP of public support to the financial sector already incurred.

8. Debt reductions from asset sales present an upside risk. Current baseline assumptions do not incorporate proceeds from any further state asset disposals of stakes in the banks. Similarly, no allowance is made for further transactions reducing the cost incurred in supporting the banking system beyond the sales of interests in BoI and Irish Life in 2013.[9] For example, the NTMA valued state holdings in AIB at €13.3 billion (about 7 percent of GDP) at end 2014.

External debt sustainability analysis

9. The external debt of the non-IFSC sector continues to decline, though it remains very high.[10] At the end of Q3 2014, it fell to around 254 percent of GDP, from 320 percent of GDP recorded in 2010. This gross debt figure includes debt of large multinational corporations, including both intra-company and intra-group debt, which is sizable in Ireland because the Irish entity often acts as a group treasury that also has large financial assets. The debt decline in recent years mostly represented a continued fall in the Target 2 liabilities of the Central Bank of Ireland as banks reduced their reliance on Eurosystem funding. External debt of the general government has flattened in nominal terms since the last tranches of the EU-IMF program were disbursed in late 2013/early 2014. External debt is expected to continue falling, but this is subject to some risks, as all shock scenarios would suggest more gradual reductions in public debt. Including the IFSC, total external debt remains very high at 910 percent of GDP, although IFSC debt has declined considerably in recent years (down 23 percentage points of GDP since early 2012).

External Debt Composition, 2014 Q3
(Percent of projected 2014 GDP)



Sources: CSOI; and IMF staff calculations.

[9] The public sector stakes are 99.9 percent in AIB, 15.2 percent in BoI, and 99.02 for PTSB.

[10] The discussion focuses on the non-IFSC sector, as the IFSC principally serves nonresidents.

Annex II. Figure 1. Ireland Public DSA—Risk Assessment

Heat Map

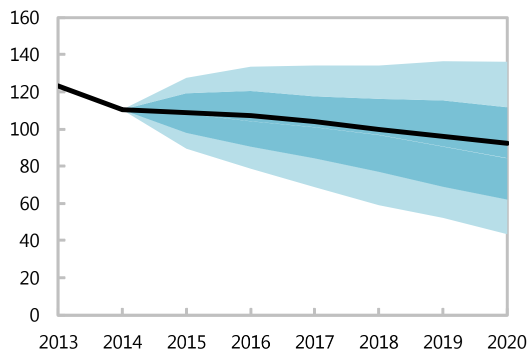
Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

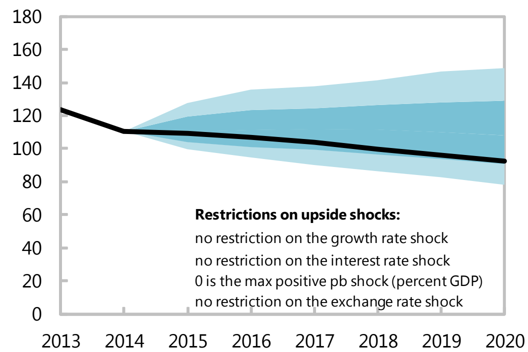
(in percent of GDP)

Baseline Percentiles: 10th-25th 25th-75th 75th-90th

Symmetric Distribution



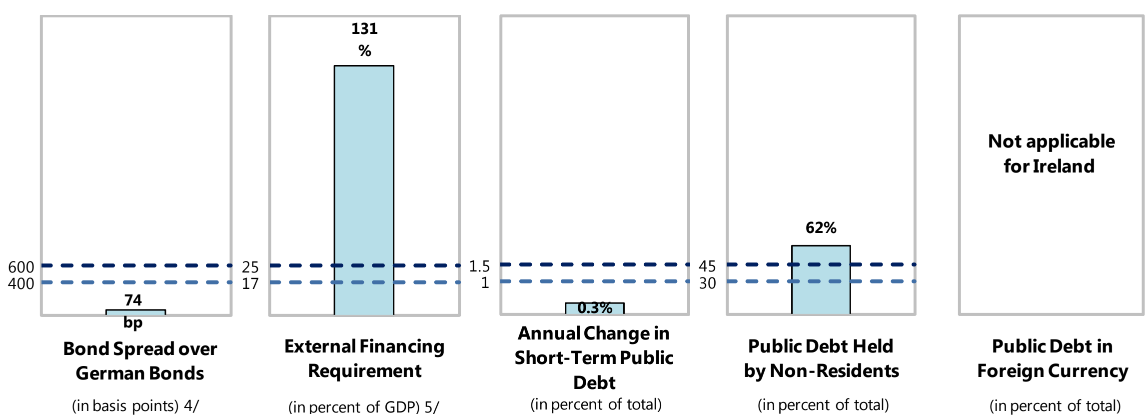
Restricted (Asymmetric) Distribution



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)

Ireland Lower early warning Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85 percent of GDP is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20 percent of GDP is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

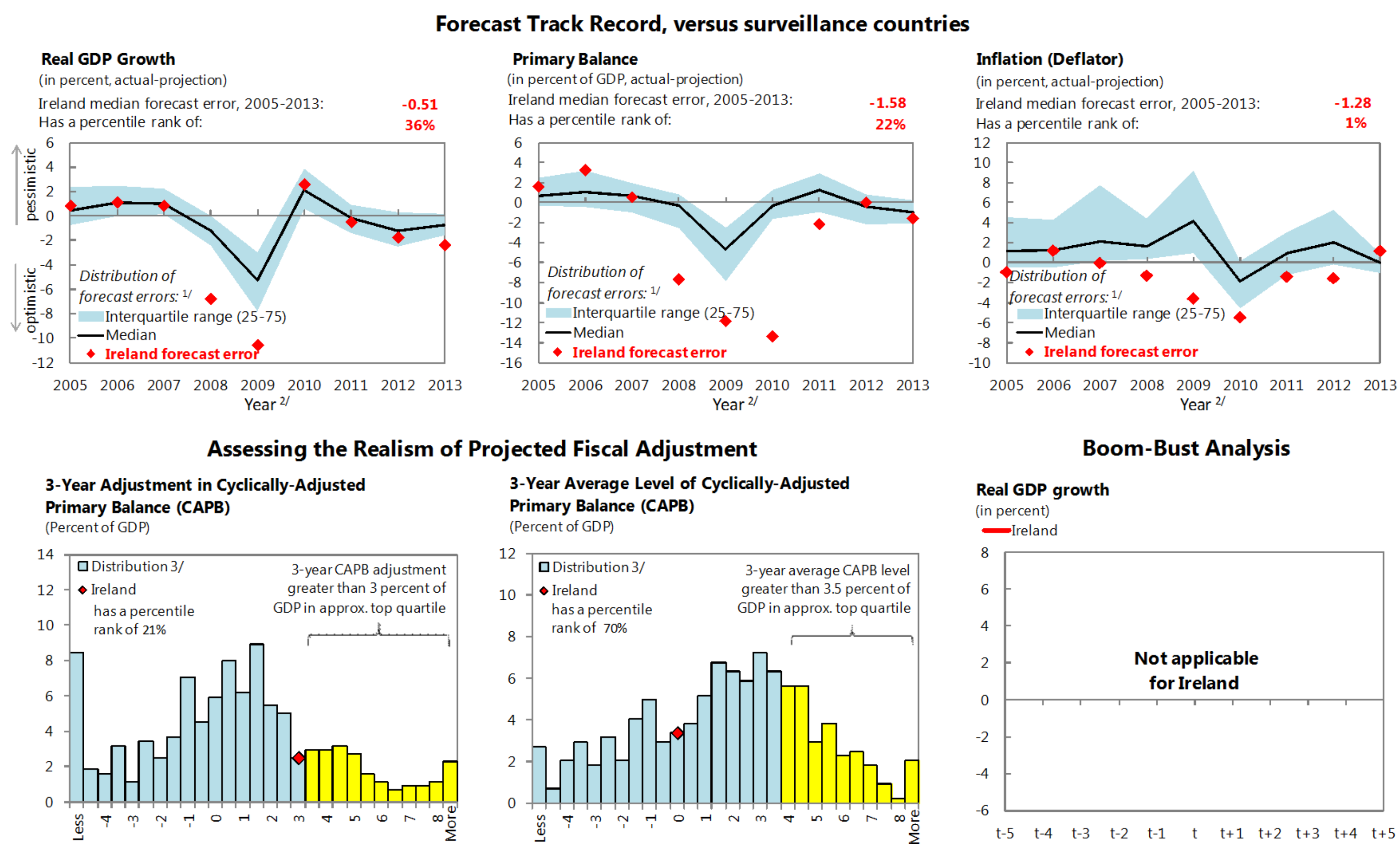
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Average over the last 3 months, 15-Nov-13 through 13-Feb-14.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II. Figure 2. Ireland Public DSA—Realism of Baseline Assumptions



Source : IMF staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex II. Figure 3. Ireland Public DSA—Baseline Scenario

(In percent of GDP unless otherwise indicated)

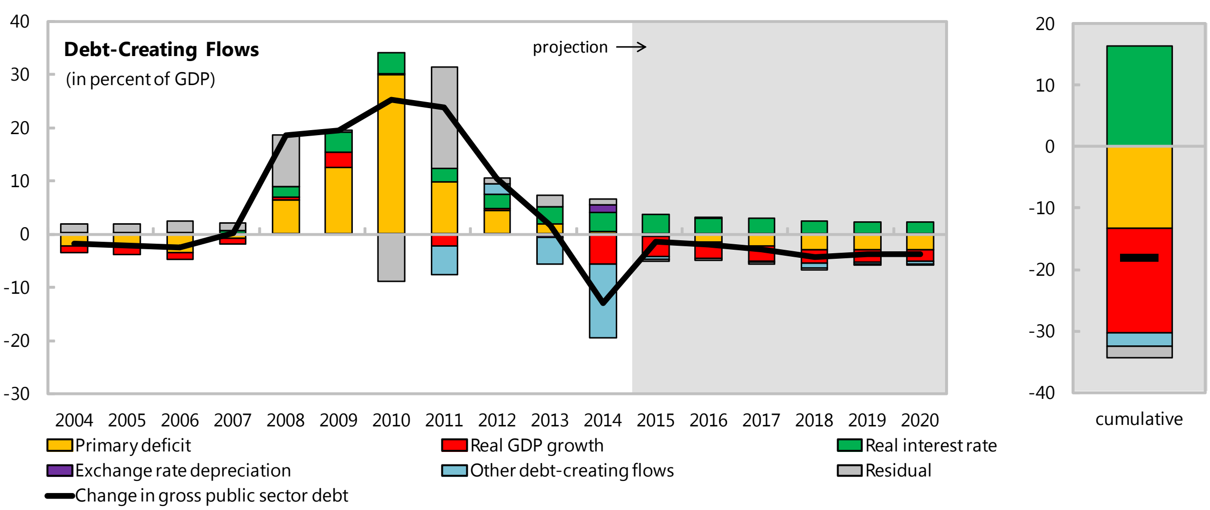
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	58.6	123.3	110.5	109.0	107.0	104.1	99.9	96.2	92.4
Public gross financing needs	...	17.9	16.9	10.5	8.5	6.8	7.4	10.2	13.0
Real GDP growth (in percent)	1.5	0.2	4.8	3.5	3.0	2.7	2.5	2.5	2.5
Inflation (GDP deflator, in percent)	0.5	1.0	0.3	0.2	0.9	0.9	1.3	1.5	1.5
Nominal GDP growth (in percent)	2.2	1.2	5.1	3.7	3.8	3.7	3.8	4.0	4.0
Effective interest rate (in percent) [3/]	4.3	3.6	3.5	3.6	3.6	3.7	3.8	3.8	3.9

As of February 13, 2014		
Sovereign Spreads		
Spread (bp) 2/		83
CDS (bp)		51
Ratings	Foreign	Local
Moody's	Baa1	Baa1
S&Ps	A	A
Fitch	A-	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing
Change in gross public sector debt	10.2	1.6	-12.9	-1.4	-2.0	-2.9	-4.3	-3.7	-3.8	-18.0	primary
Identified debt-creating flows	7.0	-0.6	-13.9	-0.9	-1.6	-2.5	-3.9	-3.5	-3.6	-16.1	balance [7/]
Primary deficit	6.0	1.9	0.4	-0.5	-1.5	-2.4	-3.0	-3.0	-2.9	-13.3	-0.7
Primary (noninterest) revenue and grants	34.4	34.2	34.4	33.8	33.7	33.1	32.6	32.1	31.5	196.9	
Primary (noninterest) expenditure	40.3	36.1	34.8	33.3	32.2	30.8	29.6	29.1	28.6	183.6	
Automatic debt dynamics [4/]	1.4	2.5	-0.5	0.1	-0.2	0.0	-0.1	-0.2	-0.2	-0.5	
Interest rate/growth differential [5/]	1.4	3.0	-1.9	-0.1	-0.2	0.1	-0.1	-0.2	-0.2	-0.6	
Of which: real interest rate	1.8	3.2	3.7	3.7	2.9	2.9	2.5	2.2	2.2	16.3	
Of which: real GDP growth	-0.4	-0.2	-5.7	-3.7	-3.1	-2.8	-2.5	-2.4	-2.3	-16.9	
Other identified debt-creating flows	-0.4	-4.9	-13.8	-0.5	0.1	-0.2	-0.8	-0.3	-0.5	-2.3	
Drawdown of deposits (negative)	-0.3	-0.5	-5.6	-0.5	-0.1	0.0	0.0	0.0	0.0	-0.6	
Other, incl. stock-flow adjustment	-0.1	-4.5	-8.2	0.0	0.2	-0.2	-0.8	-0.3	-0.5	-1.7	
Residual, incl. interest revenue [6/]	3.2	2.2	1.1	-0.3	-0.4	-0.4	-0.4	-0.2	-0.2	-1.8	



Source: IMF staff.

1/ Public sector is defined as thegeneral government (including IBRC)

2/ Bond Spread over German Bonds.

3/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the numerator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

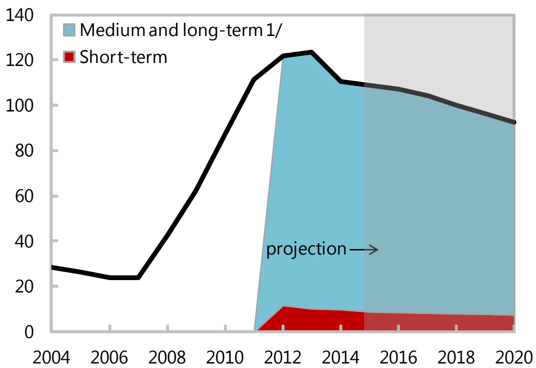
6/ Includes asset and exchange rate changes.

7/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

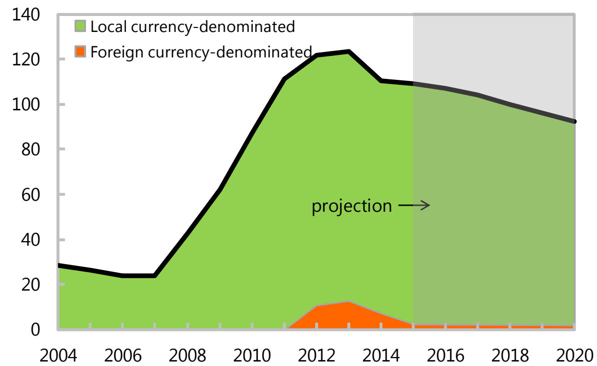
Annex II. Figure 4. Ireland Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



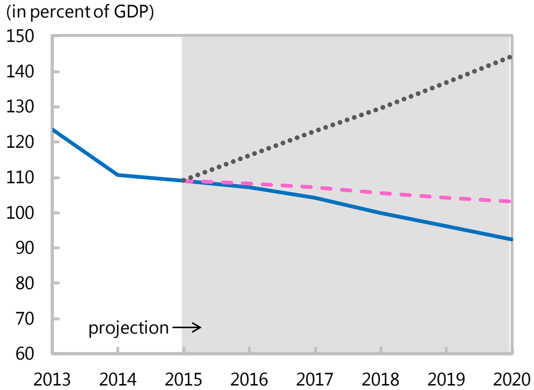
By Currency
(in percent of GDP)



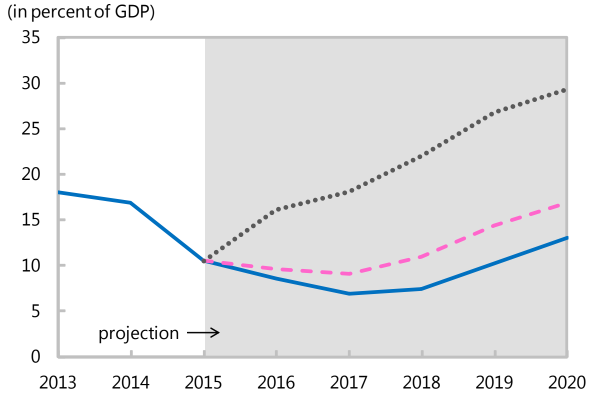
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

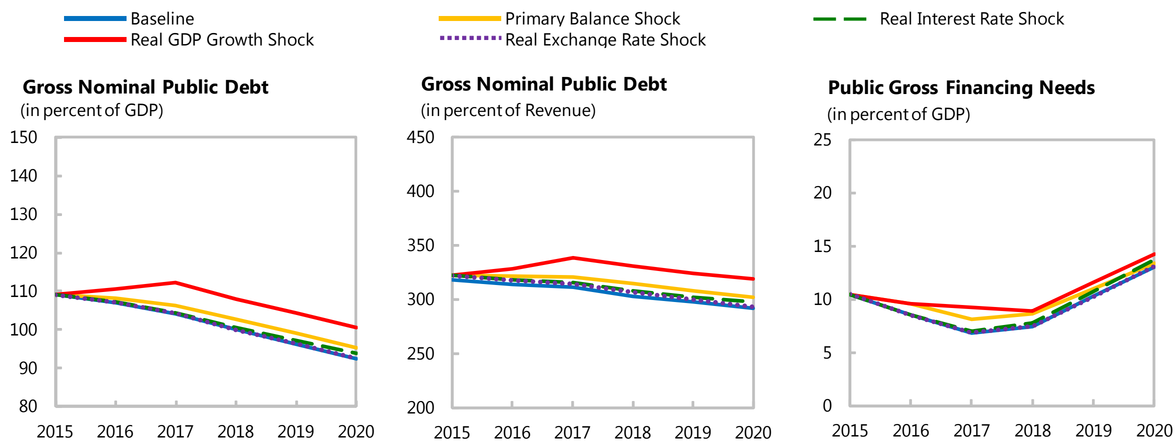
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.5	3.0	2.7	2.5	2.5	2.5
Inflation	0.2	0.9	0.9	1.3	1.5	1.5
Primary Balance	0.5	1.5	2.4	3.0	3.0	2.9
Effective interest rate	3.6	3.6	3.7	3.8	3.8	3.9
Constant Primary Balance Scenario						
Real GDP growth	3.5	3.0	2.7	2.5	2.5	2.5
Inflation	0.2	0.9	0.9	1.3	1.5	1.5
Primary Balance	0.5	0.5	0.5	0.5	0.5	0.5
Effective interest rate	3.6	3.7	3.8	3.8	3.9	4.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.5	1.4	1.4	1.4	1.4	1.4
Inflation	0.2	0.9	0.9	1.3	1.5	1.5
Primary Balance	0.5	-5.8	-5.8	-5.8	-5.8	-5.8
Effective interest rate	3.6	3.7	4.0	4.2	4.4	4.7

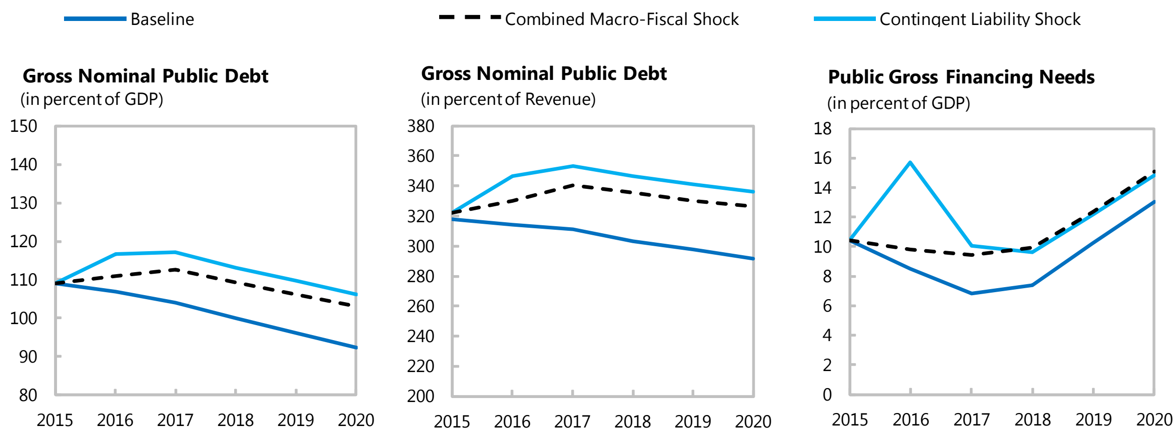
Source: IMF staff.
1/ Includes retail debt.

Annex II. Figure 5. Ireland Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	3.5	3.0	2.7	2.5	2.5	2.5
Inflation	0.2	0.9	0.9	1.3	1.5	1.5
Primary Balance	0.5	0.5	1.5	2.4	3.0	2.9
Effective interest rate	3.6	3.7	3.8	3.8	3.9	4.0
Real Interest Rate Shock						
Real GDP growth	3.5	3.0	2.7	2.5	2.5	2.5
Inflation	0.2	0.9	0.9	1.3	1.5	1.5
Primary Balance	0.5	1.5	2.4	3.0	3.0	2.9
Effective interest rate	3.6	3.7	3.9	4.0	4.2	4.4
Combined Macro-Fiscal Shock						
Real GDP growth	3.5	1.0	0.7	2.5	2.5	2.5
Inflation	0.2	0.4	0.4	1.3	1.5	1.5
Primary Balance	0.5	0.5	0.8	2.4	3.0	2.9
Effective interest rate	3.6	3.7	3.9	4.1	4.3	4.5

	2015	2016	2017	2018	2019	2020
Real GDP Growth Shock						
Real GDP growth	3.5	1.0	0.7	2.5	2.5	2.5
Inflation	0.2	0.4	0.4	1.3	1.5	1.5
Primary Balance	0.5	0.7	0.8	3.0	3.0	2.9
Effective interest rate	3.6	3.7	3.8	3.9	3.9	4.0
Real Exchange Rate Shock						
Real GDP growth	3.5	3.0	2.7	2.5	2.5	2.5
Inflation	0.2	1.2	0.9	1.3	1.5	1.5
Primary Balance	0.5	1.5	2.4	3.0	3.0	2.9
Effective interest rate	3.6	3.7	3.8	3.8	3.8	3.9
Contingent Liability Shock						
Real GDP growth	3.5	1.0	0.7	2.5	2.5	2.5
Inflation	0.2	0.4	0.4	1.3	1.5	1.5
Primary Balance	0.5	-5.4	2.4	3.0	3.0	2.9
Effective interest rate	3.6	3.7	4.1	4.0	4.1	4.2

Source: IMF Staff.

Annex II. Table 1. Ireland: External Debt Sustainability Framework, 2010-2020

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	320.1	306.8	284.0	267.3	247.8			**232.6**	**217.6**	**203.5**	**189.8**	**176.3**	**163.5**	**-4.8**
Change in external debt	7.8	-13.4	-22.8	-16.7	-19.4			-15.2	-15.0	-14.0	-13.8	-13.4	-12.8	
Identified external debt-creating flows (4+8+9)	7.1	-7.2	-8.1	-17.0	-19.4			-14.8	-13.0	-12.1	-11.2	-10.7	-10.2	
Current account deficit, excluding interest payments	-15.3	-18.5	-19.1	-25.2	-15.7			-13.5	-11.9	-10.5	-9.3	-9.2	-7.8	
Deficit in balance of goods and services	-155.9	-157.3	-168.6	-167.9	-173.6			-174.7	-176.8	-179.3	-182.1	-185.0	-187.8	
Exports	86.7	88.5	94.7	93.8	96.5			97.4	98.5	99.8	101.2	102.6	103.9	
Imports	-69.3	-68.8	-73.8	-74.1	-77.1			-77.4	-78.2	-79.4	-80.8	-82.4	-83.9	
Net non-debt creating capital inflows (negative)	-0.8	2.5	-4.6	-14.7	-2.3			-2.2	-2.2	-2.2	-2.2	-2.3	-2.2	
Automatic debt dynamics 1/	23.2	8.9	15.6	22.9	-1.4			0.9	1.1	0.6	0.4	0.7	-0.2	
Contribution from nominal interest rate	17.2	20.3	18.6	26.2	11.7			9.3	7.7	6.4	5.3	5.3	4.1	
Contribution from real GDP growth	0.9	-8.6	1.0	-0.5	-12.3			-8.4	-6.6	-5.8	-4.9	-4.5	-4.3	
Contribution from price and exchange rate changes 2/	5.2	-2.9	-4.0	-2.8	-0.7			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	0.6	-6.2	-14.7	0.3	0.0			-0.4	-2.0	-1.9	-2.6	-2.7	-2.6	
External debt-to-exports ratio (in percent)	369.3	346.5	299.8	284.9	256.8			238.9	220.8	203.8	187.5	171.9	157.4	
Gross external financing need (in billions of euro) 4/	108.7	108.1	50.9	288.3	240.9			237.9	235.1	232.4	229.6	226.8	224.1	
in percent of GDP	65.9	63.2	29.4	164.9	131.1	10-Year	10-Year	124.9	118.8	113.3	107.8	102.4	97.3	
Scenario with key variables at their historical averages 5/								**232.6**	**223.7**	**214.4**	**204.6**	**194.4**	**183.7**	**5.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-0.3	2.8	-0.3	0.2	4.8	1.4	4.0	3.5	3.0	2.7	2.5	2.5	2.5	
GDP deflator (change in percent)	-1.6	0.9	1.3	1.0	0.3	0.3	2.3	0.2	0.9	0.9	1.3	1.5	1.5	
Nominal external interest rate (in percent)	5.4	6.6	6.1	9.3	4.6	6.7	1.9	3.9	3.4	3.0	2.7	2.9	2.4	
Growth of exports (in percent)	7.4	5.9	8.1	0.2	8.2	4.6	4.1	4.6	5.1	5.1	5.3	5.4	5.4	
Growth of imports (in percent)	6.0	3.0	8.4	1.6	9.3	2.6	6.6	4.1	5.0	5.3	5.6	5.9	6.0	
Current account balance, excluding interest payments	15.3	18.5	19.1	25.2	15.7	16.5	4.6	13.5	11.9	10.5	9.3	9.2	7.8	
Net non-debt creating capital inflows	0.8	-2.5	4.6	14.7	2.3	3.6	5.1	2.2	2.2	2.2	2.2	2.3	2.2	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflat

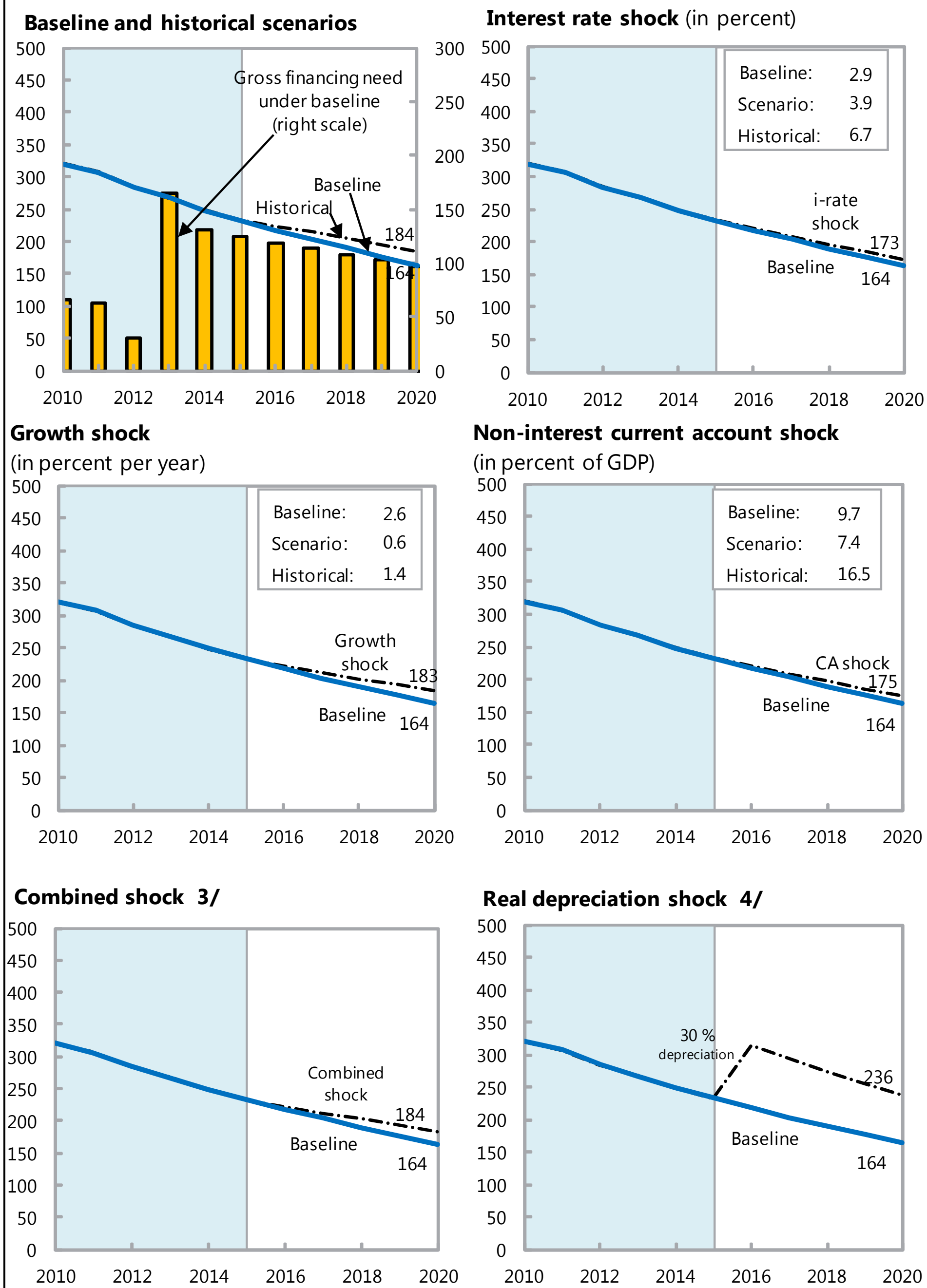
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex II. Figure 6. Ireland: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

INTERNATIONAL MONETARY FUND

IRELAND

March 9, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	European Department

CONTENTS

FUND RELATIONS

(As of January 31, 2015)

Membership Status: Joined August 8, 1957; Article VIII

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	1,257.60	100.00
Fund holdings of currency	12,820.91	1,019.47
Reserve position in Fund	258.70	20.57

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	775.42	100.00
Holdings	651.18	83.98

Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
Extended Arrangement	11,821.85	940.03

Financial Arrangements:

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
EFF	12/16/10	12/18/13	19,465.80	19,465.80

Projected Payments to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	2015	2016	2017	2018	2019
Principal				1,204.45	3,244.30
Charges/Interest	400.34	365.84	365.50	362.67	274.14
Total	400.34	365.84	365.50	1567.12	3,518.44

Exchange Rate Arrangement and Exchange Restrictions:

Ireland's currency is the euro, which floats freely and independently against other currencies. Ireland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

Article IV Consultations:

The last Article IV consultation was concluded on September 5, 2012 (IMF Country Report No. (12/264). Article IV consultations with Ireland were on the 24-month cycle during the Extended Arrangement.

Resident Representative:

The resident representative office in Ireland closed in June 2014.

STATISTICAL ISSUES

A. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance.
National accounts and real sector data. Quarterly national accounts are currently published within three months of its reference period. Other real sector data are relatively timely, with industrial production and retail sales data published within six weeks and employment data within 3 months of the reference period, but some non-SDDS series are published one and a half years later (e.g., household disposable income). Employment and unit labor costs, and national income and expenditure data are usually available with a three-month lag.
Wages and earnings statistics. The quarterly Earnings, Hours and Employment Costs Survey has replaced the four-yearly Labor Cost Survey, and also replaces all other existing short-term earnings surveys. The results are comparable across sectors and include more detail on components of earnings and labor costs than was available before. However, data are only available with more than six months lag.
Government finance statistics. The authorities publish Exchequer returns on a monthly and quarterly basis, but only annual data are available for general government finances. The authorities are working to strengthen the analytical content of exchequer reporting and enhancing reporting and forecasting for the general government. However, annual and quarterly general government statistics on an accrual basis are available as derived from the national accounts statistics. Ireland reports these data to STA through a conversion of the datasets reported to Eurostat under the "ESA Transmission Programme".
Monetary and financial statistics: The ECB reporting framework is used for monetary statistics and data are reported to the IMF through a "gateway" arrangement with the ECB. The arrangement provides an efficient transmission of monetary statistics to the IMF and for publication in the IMF's *International Financial Statistics (IFS)*.
Financial sector surveillance: Ireland reports FSIs for deposit takers, other financial corporations, and real estate markets on a regular basis for posting on the IMF's FSI website.
External sector statistics. Quarterly balance of payments (BOP) and international investment position (IIP) data are compiled by the Central Statistics Office. The authorities implemented the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* beginning with the data for Q1 2014, although those data have not been reported to STA as of February 2015. The most recent BOP and IIP data reported to STA and disseminated in the *IFS* are for Q4/2013. Ireland reports data for the Coordinated Portfolio Investment Survey (CPIS), the Coordinated Direct Investment Survey (CDIS), and the Data Template on International Reserves and Foreign Currency Liquidity.

B. Data Standards and Quality	
Ireland is subject to the statistical requirements and timeliness and reporting standards of Eurostat and the European Central Bank (ECB). Ireland subscribes to the Fund's Special Data Dissemination Standard and uses SDDS flexibility options on the timeliness of wages and earnings, and central government debt data.	No data ROSC is available.

Ireland: Table of Common Indicators Required for Surveillance

(as of March 9, 2015)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	3/9/2015	3/9/2015	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jan. 2015	3/3/2015	M	M	M
Reserve/Base Money	Jan. 2015	2/27/2015	M	M	M
Broad Money	Jan. 2015	2/27/2015	M	M	M
Central Bank Balance Sheet	Jan. 2015	2/13/2015	M	M	M
Consolidated Balance Sheet of the Banking System	Jan. 2015	2/27/2015	M	M	M
Interest Rates[2]	Jan. 2015	3/4/2015	D	D	D
Consumer Price Index	Jan. 2015	2/19/2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2014:Q3	2/3/2015	Q	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Feb. 2015	3/3/2015	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2014:Q4	3/3/2015	Q	Q	Q
External Current Account Balance	2014:Q3	12/11/2014	Q	Q	Q
Exports and Imports of Goods and Services	2014:Q4	2/13/2015	Q	Q	Q
GDP/GNP	2014:Q3	12/11/2014	Q	Q	Q
Gross External Debt	2014:Q3	12/19/2014	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

IRELAND

2015 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

March 19, 2015

Prepared By European Department

This supplement provides information that has become available since the issuance of the staff report on March 10, 2015. The information does not alter the thrust of the staff appraisal.

National accounts data for Q4 confirm the strong growth in 2014. Preliminary data for GDP in 2014 indicate growth of 4.8 percent y/y, consistent with staff projections. Final domestic demand and net exports made similar contributions to growth, of just over 2 percentage points. With net factor income payments to nonresidents rising by 2.7 percent, Gross National Product recorded a 5.2 percent increase on the year.

Real GDP growth in 2014
(Percentage change unless indicated otherwise)

	Staff Proj.	*Actual Prel.*
Real GDP	4.8	4.8
Final domestic demand	3.8	2.9
Private consumption	0.8	1.1
Public consumption	6.7	0.1
Fixed investment	10.0	11.3
Change in stocks (contribution to growth)	0.1	0.5
Net exports (contribution to growth)	1.9	2.2
Exports	8.0	12.6
Imports	7.8	13.2

Source: IMF staff projections.

The Central Statistical Office (CSO) also released a notice in relation to contract manufacturing, a topic discussed in Box 1 of the staff report. The CSO concludes that additional products made under contract manufacturing arrangements for Irish companies were not particularly significant in explaining Irish GDP growth in 2014. The information released does not permit a precise calculation of the contribution to growth in 2014 from contract manufacturing, but suggests that the upper estimate provided in the staff report, of a contribution of perhaps as much as 2 percentage points, is likely too high.

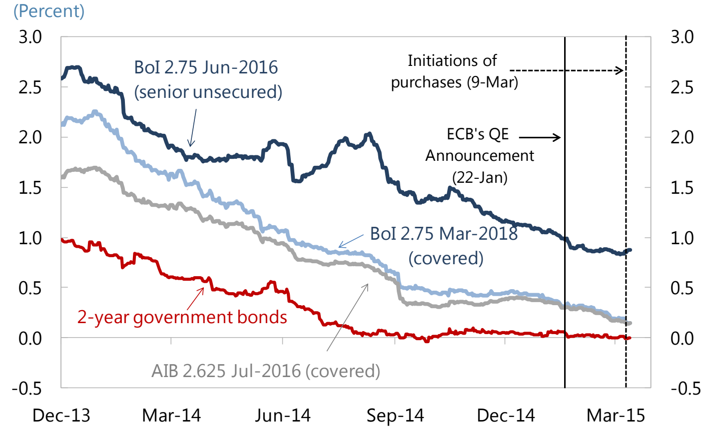
Strong tax revenues narrowed the budget deficit in early 2015. Tax revenues rose by 16 percent y/y in the first two months of 2015, exceeding the monthly profile by 5.4 percent. Revenue gains were broad-based, with strong increases in VAT and excises supported by buoyant post-Christmas retail trading, while solid rises in personal income taxes and social contributions back up signs of ongoing recovery in the labor

market. Spending trends are encouraging, with voted current spending being 1 percent below profile. Excluding a postponement of capital spending (€0.2 billion on Irish Water) the general government deficit was 0.3 percent of GDP smaller than profiled, with revenues contributing two-thirds of the improvement.

Financial market conditions have benefited from the ECB's quantitative easing. Since early March sovereign yields have fallen across the maturity spectrum. With short-term yields already close to zero, long-term yields have recorded the largest declines. The new 30-year benchmark bond issued at 2.1 percent in early February was re-opened on March 12, with €1 billion issued at the substantially lower yield of only 1.3 percent. Bank bond yields continued to decline in the wake of government benchmarks.

Bank Bond Yields

(Percent)



Source: Bloomberg.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 15/136
FOR IMMEDIATE RELEASE
March 25, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Ireland

On March 23, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the 2015 Article IV consultation with Ireland.[1]

Ireland enjoyed strong growth in 2014, at about 5 percent y/y, led by exports and investment. Solid job creation has brought the unemployment rate down to 10½ percent, from a peak of 15 percent three years ago. These positive economic developments drove higher than expected growth in revenues, helping bring the fiscal deficit down to an estimated 3.9 percent of GDP in 2014 despite some spending overruns.

Property markets are bouncing back rapidly, with commercial real estate values up 30.7 percent y/y in 2014, boosted in part by international investment. House prices rose 16.3 percent y/y, as fast as in the boom, helping to improve private balance sheet health. Yet some 14.8 percent of primary dwelling mortgages remain in arrears, with the majority having been in arrears for over two years. Overall nonperforming loans still amount to about one-quarter of total bank loans.

Looking to 2015, Ireland's growth is expected to remain robust, at about 3½ percent, bolstered by the ECB's quantitative easing. Consumption is beginning to support activity, aided by the impact of falling energy prices on real incomes. Bank credit has declined for a number of years, yet rising mortgage approvals, together with banks' improving profitability and ready access to low cost funding, suggest the decline will slow in 2015. The budget is on track for a deficit of 2.7 percent of GDP in 2015, which would enable Ireland to exit the EU's Excessive Deficit Procedure.

Executive Board Assessment[2]

Executive Directors welcomed Ireland's strong economic recovery, the further decline in unemployment, and the strengthened fiscal balances. They noted that medium-term growth

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

prospects appear favorable, though facing headwinds from risks of protracted slow growth in advanced economies, especially the euro area. Directors agreed that the priority is to maintain solid growth, which would require continued prudence in fiscal and financial policies to build policy space, while addressing legacy issues in the banking and housing sectors.

Directors commended the authorities for their steadfast consolidation efforts to reduce the fiscal deficit and public debt ratios. Going forward, they endorsed the goal of balancing the structural budget over the cycle through a phased and steady adjustment, allowing a continued build-up of the fiscal space while supporting the recovery in the near term. This calls for a careful calibration of revenue and expenditure measures. Given the need to create room for essential capital expenditure, Directors encouraged efforts to further broaden the tax base, contain the public wage bill, and improve the targeting of social programs. They also saw merit in saving windfall revenue for debt reduction and in reviewing public investment to ensure its adequacy and high quality in support of potential growth. Directors supported expenditure reforms to deliver public services within a manageable envelope in light of demographic pressures.

Directors recognized the significant progress made in reducing nonperforming loans in recent years. They recommended that the authorities take further decisive steps to resolve cases of prolonged arrears in order to address private debt overhangs and promote credit flows to the economy. Greater utilization of insolvency procedures would be helpful in this regard. Directors also considered it important that banks take early actions to address capital quality issues ahead of new rules on eligible regulatory capital becoming effective, thereby safeguarding their lending capacity. Directors supported exploring nonbank financing options, with appropriate supervision and regulation put in place, while remaining vigilant to fiscal risks from state-sponsored financing vehicles.

Directors stressed that sustaining a robust recovery calls for measures to further enhance the resilience of banks and borrowers to shocks, including property cycles. They welcomed recent steps to strengthen the regulation of residential mortgage lending. Noting the rapid rise in commercial property prices, Directors encouraged close supervision, supported by proactive use of macro-prudential tools, to ensure that bank risk exposures are appropriately contained.

Directors highlighted the medium-term benefits of reforms of the construction sector and residential rental markets in moderating Ireland’s property cycles. They looked forward to the timely implementation of the initiatives set out in Construction 2020, particularly a modernization and streamlining of planning procedures. Directors also supported reforms of the rental property framework to attract investment and professional management to the sector, which, by enhancing the supply and quality of rental property, would facilitate labor mobility and lower unemployment.

Ireland: Selected Economic Indicators, 2010–16

(Annual percentage change unless indicated otherwise)

	2010	2011	2012	2013	2014	2015	2016
						Proj.	
National accounts (constant prices)							
Real GDP	-0.3	2.8	-0.3	0.2	4.8	3.5	3.0
Final domestic demand	-4.9	-1.7	-0.2	-0.7	3.8	2.7	2.6
Private consumption	0.9	-1.2	-1.2	-0.8	0.8	1.5	1.6
Public consumption	-7.1	-2.1	-2.1	1.4	6.7	-0.9	0.2
Gross fixed investment	-18.0	-2.9	5.0	-2.4	10.0	9.5	7.5
Net exports 1/	3.3	5.9	-0.8	0.6	1.9	1.4	1.0
Exports of goods and services	6.2	5.5	4.7	1.1	8.0	4.0	4.0
Imports of goods and services	3.0	-0.6	6.9	0.6	7.8	3.3	3.9
Real GNP	1.4	-0.8	1.1	3.3	4.1	3.3	2.7
Gross national saving (in percent of GDP)	16.4	15.3	17.1	19.6	19.4	19.8	20.8
Private	26.3	21.6	23.3	23.5	21.6	21.1	20.9
Public 2/	-9.9	-6.3	-6.1	-4.0	-2.2	-1.2	0.0
Gross investment (in percent of GDP)	15.8	14.5	15.6	15.2	16.0	17.0	17.4
Private	12.5	12.2	13.7	13.4	14.3	15.6	16.0
Public	3.4	2.4	1.9	1.7	1.7	1.4	1.4
Prices, wages and employment (annual average)							
Harmonized index of consumer prices	-1.6	1.2	1.9	0.5	0.3	0.2	1.5
Average wage, whole economy	-1.9	-0.5	0.5	-0.7	-0.1	2.5	1.2
Employment	-4.0	-1.8	-0.6	2.4	1.7	1.9	1.9
Unemployment rate (in percent)	13.9	14.6	14.6	13.0	11.3	10.0	9.1
Money and credit (end-period)							
Irish resident private sector credit	-3.4	-2.9	-4.0	-4.9	-4.9	...	...
Financial and asset markets (end-period)							
Three-month interbank rate	1.0	1.4	0.2	0.3	0.1	...	...
Government bond yield (in percent, 10-year)	9.2	8.5	4.5	3.5	1.2	...	...
Annual change in ISEQ index (in percent)	5.1	5.2	16.3	30.3	15.1	...	...
House prices	-10.5	-16.7	-4.5	6.4	16.3	...	...
Public finance (in percent of GDP)							
Net lending/borrowing (excl. one-off items)	-11.0	-8.7	-8.0	-6.1	-4.1	-2.8	-1.5
Primary balance (excl. bank support)	-10.3	-5.2	-3.9	-1.3	0.2	1.0	2.0
General government gross debt 4/	87.4	111.1	121.7	123.3	110.5	109.0	107.0
General government net debt 4/	67.5	79.1	87.9	92.1	86.5	86.4	85.3
External trade and balance of payments (percent of GDP)							
Balance of goods and services	17.5	20.3	20.5	20.8	21.9	22.6	23.0
Balance of income and current transfers	-16.9	-19.5	-18.9	-16.4	-18.5	-19.8	-19.6
Current account	0.6	0.8	1.6	4.4	3.4	2.8	3.4
Effective exchange rates (1999:Q1=100, average)							
Nominal	107.8	108.6	105.1	109.2	104.1	...	...
Real (CPI based)	111.6	110.2	105.3	108.1	104.1	...	...
Memorandum items:							
Population (in millions)	4.6	4.6	4.6	4.6	4.6	4.6	4.7
GDP per capita (in euros)	36,210	37,387	37,675	38,055	39,847	40,983	42,201
GDP (in billions of euros)	164.9	171.0	172.8	174.8	183.7	190.5	197.8

Sources:Bloomberg; Central Bank of Ireland; Department of Finance; International Financial Statistics; IMF staff estimates.

1/ Contribution to growth.

2/ Excludes bank restructuring costs.

3/ Adjusted growth rate of credit to households and non-financial corporations.

4/ The step down in gross and net debt in 2014 reflects in part the liquidation of IBRC, equivalent to 6 percent of GDP.