More balanced growth is key to Ireland's continued economic success

Thanks largely to sound policies—including prudent fiscal policy, low taxes on labor and business income, and labor market flexibility—Ireland's economy is performing well, the IMF said in its recent economic review. Growth is strong, unemployment is low and labor participation is rising, and government debt has been reduced dramatically over the past two decades. Inflation is close to the euro area average, and participation in European and Economic Monetary Union has lowered interest rates in Ireland.

Executive Directors commended Ireland's continued impressive economic performance but observed that growth has become increasingly unbalanced in recent years, with heavy reliance on building investment, sharp increases in house prices, and rapid credit growth. At the same time, competitiveness has eroded, reflecting the combination of faster wage growth in Ireland than in its trading partners, declining productivity growth, and the appreciation of the euro against the U.S. dollar. Ireland's small, highly open economy is also vulnerable to external shocks.

Ireland	2003	2004	2005	2006[1]
		(percent change)		
Real GNP	5.5	3.9	5.4	6.2
Harmonized index of consumer prices	4.0	2.3	2.2	2.8
		(percent of labor force)		
Unemployment rate	4.7	4.5	4.3	4.3
		(percent of GDP)		
General government debt	31.1	29.6	27.4	25.9
Current account	0.0	–0.6	–2.6	–3.0

[1]IMF staff projections.
Data: Ireland, Central Statistics Office and Department of Finance; Datastream; and IMF, *International Financial Statistics.*

Directors expected economic growth in 2006–07 to remain strong, driven by domestic demand and accompanied by a widening current account deficit and continued rapid credit growth. While a contraction of the construction sector to a more sustainable size over the medium term is likely to be smooth, Directors noted that an abrupt correction cannot be ruled out.

Directors welcomed the Financial System Stability Assessment Update, showing generally strong financial sector soundness indicators and major lenders with adequate buffers to cover a range of shocks. Directors called for a further strengthening of the regulatory and supervisory framework, especially for insurance.

Most Directors considered that modest fiscal tightening would be desirable in 2007, given the strength of domestic demand, potential risks of a hard landing, and the need to prepare for population aging. A number of Directors, however, emphasized the need for further spending increases to achieve social goals. Directors agreed that improvements in public services remain a key priority and welcomed the authorities' plans to deepen the public debate on fiscal priorities. ■

Accelerated reforms will carry forward Macedonia's hard-won economic achievements

After a decade of sluggish growth, in part the result of external shocks, the former Yugoslav Republic of Macedonia's economic growth reached 4 percent for two years in a row in 2004–05 and is expected to stay at that rate in 2006. Inflation has also remained under control, the current account deficit has narrowed, international reserves have increased, and the fiscal position is sound, the IMF said in its recent economic review.

Despite recent progress, structural weaknesses constrain the economy's ability to increase employment and achieve more rapid growth. Recorded unemployment is one of the highest in the region, and financial intermediation and foreign direct investment remain low. In addition, Macedonia ranked low in international comparisons of the business environment because of the high costs of opening and closing businesses, hiring and laying off workers, and enforcing contracts. Property rights are also poorly defined; the tax wedge on labor is high; and telecommunications services are expensive.

FYR Macedonia	2004	Prel. 2005	Proj. 2006	Proj. 2007
Real GDP (percent change)	4.1	4.0	4.0	4.0
Consumer prices (percent change, period average)	–0.3	0.5	2.9	2.0
Unemployment rate (percent of labor force, average)	37.2	37.3	...	...
Central government balance (percent of GDP)[1]	0.4	0.3	–0.6	–0.6
Official gross reserves (million euros)	717	1,123	1,602	1,699

[1]In 2005, the central government spent an additional 0.4 percent of GDP on its recapitalization.
Data: Macedonian authorities and IMF staff projections.

IMF Executive Directors commended the Macedonian authorities for their sound macroeconomic policies, which have now started to deliver economic recovery. Considerable challenges lie ahead, however, including raising living standards closer to European levels, reducing unemployment, and keeping the current account deficit under control. The best way to meet these challenges, Directors said, would be by maintaining the country's hard-won macroeconomic stability and accelerating structural reforms. Judicial reform and improving public governance will be essential to developing a functioning market economy. Unemployment can be reduced through active labor market policies, reduction of the tax wedge, and elimination of barriers to part-time employment. Financial market development is also needed—notably to lower intermediation costs, improve the credit culture, and enhance banking supervision.

Directors cautioned that loosening the fiscal stance would be premature in view of uncertainties about the true size of the current account balance, medium-term fiscal challenges, and the limited institutional capacity to spend additional funds efficiently. Rationalization of the public sector should be undertaken before spending increases are envisaged. Directors also encouraged efforts to strengthen the fiscal revenue base and reduce nondiscretionary spending. ■