



IRELAND

June 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR IRELAND

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 2018 Article IV consultation with Ireland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 22, 2018 consideration of the staff report that concluded the Article IV consultation with Ireland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 22, 2018, following discussions that ended on May 14, 2018, 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 June 8, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Ireland.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND



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June 28, 2018

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IMF Executive Board Concludes 2018 Article IV Consultation with Ireland

On June 22, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Ireland.

The Irish economy continues to grow at a rapid pace, well above the EU average. Although headline data are distorted by the volatility of multinationals' activity, the broad recovery of (modified) domestic demand (4 percent in 2017) underpins the expansion. Strong labor market performance brought the unemployment rate down to below 6 percent by April 2018. While wage pressures emerged in some sectors, inflation remained subdued, mainly reflecting the pass-through of pound sterling depreciation. Public finances continued to improve on the back of strong output growth, while the public debt burden declined slightly to 68 percent of GDP. Ireland's current account surplus widened to 12½, mainly reflecting activities of multinationals.

Banks have continued to strengthen their financial soundness and remain profitable. While still high, nonperforming loans have declined. Although loan repayments from the nonfinancial corporate sector continued to outstrip new lending, credit recovery endured, as consumer and mortgage loans picked up. Reflecting improved labor market conditions, rising incomes, and low interest rates, housing demand has recovered strongly whereas the supply response has been modest so far, thus leading to growing pressure on house prices and rents.

The outlook remains broadly positive but with externally-driven downside risks. Abstracting from the volatility of activities of multinationals, growth is projected at about 5 percent in 2018 mainly driven by domestic demand, and to gradually converge to its potential rate (around 3 percent) over the medium term. Solid employment growth would bring unemployment below 5 percent by the end of the forecasting period and underpin a rise in earnings. Hence, headline inflation is expected to gradually reach 2 percent. Public finances are projected to improve further, while the external current account surplus is estimated to taper off to around 6½ percent of GDP over the medium term.

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.

Executive Board Assessment²

Executive Directors welcomed Ireland's continued strong economic growth, leading to a rapid reduction in unemployment and strengthened public and private balance sheets. While the outlook remains positive, lingering crisis legacies, rising housing prices, and external downside risks—mainly from resurgent global protectionism, adverse effects from Brexit, and ongoing changes in the international tax landscape—pose challenges. Against this background, Directors encouraged policies focused on rebuilding fiscal buffers, guarding against re-emergence of boom-bust dynamics, and addressing structural bottlenecks to enhance resilience and foster sustainable growth.

In light of the strong cyclical momentum and the risks to the outlook, Directors encouraged the authorities to step up fiscal consolidation to alleviate demand pressures and build buffers. They stressed that growth-friendly consolidation should center around broadening the tax base; saving temporary revenue windfalls, especially from volatile corporate taxes; and maintaining moderate spending growth, while improving its efficiency and addressing social and infrastructure needs. Directors welcomed the authorities' plans to establish a Rainy-Day Fund to increase the resilience of public finances. Ireland's continuous active engagement in implementing the international tax reform agenda was also commended.

Directors encouraged the authorities to boost efforts to expand the housing supply and improve affordability. They considered that taxation could be used more actively to reduce land and property hoarding, and that measures to improve housing affordability should be well targeted. Directors also agreed that macroprudential policy should continue to be deployed as needed to ensure that bank and household balance sheets remain resilient to shocks.

Directors welcomed the improvements in domestic banks' financial soundness, but underlined the need to accelerate balance sheet repair and prepare for the challenges posed by Brexit. To foster arrears resolution, they supported measures to accelerate legal processes, encourage creditor-borrower engagement, increase provisioning requirements, and provide binding supervisory guidelines on write-offs of non-performing loans. Directors also encouraged downsizing the government's stakes in the banking system as market conditions allow.

Directors underlined the importance of addressing structural bottlenecks as key to promote high, sustainable growth. They welcomed the government's plans to reduce the sizeable infrastructure gap, and encouraged prioritizing investment to best achieve value-for-money. Directors called for further efforts to boost productivity of domestic firms, including through greater support for innovation; better align educational paths with business needs; and increase female labor force participation by providing affordable child care, and supporting removal of gender pay gaps.

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>.

Directors welcomed the publication of additional statistics that aim, inter alia, to filter out the impact of multinationals' activity, and to allow a more accurate assessment than GDP of domestic economic developments and better inform policy-making. They encouraged continued efforts to provide more granular and frequent information in this area.

Ireland: Selected Economic Indicators, 2016–23

Populations (2017, millions):	4.7	Per capita income (euros):	62,559
Quota (as of May 31, 2018, millions of SDRs):	3,449.9	At-risk-of -poverty rate 1/:	16.6

	2016	Projections						
		2017	2018	2019	2020	2021	2022	2023
(annual percentage change, constant prices, unless otherwise indicated)								
Output/Demand								
Real GDP	5.1	7.8	5.0	4.1	3.5	3.0	2.8	2.8
Domestic demand	21.2	-7.8	5.7	4.3	3.6	2.9	2.6	2.6
Public consumption	5.2	1.8	2.4	1.7	1.4	1.3	1.3	1.3
Private consumption	3.1	2.1	2.4	2.5	2.5	2.4	2.4	2.3
Gross fixed capital formation	60.0	-21.8	12.1	7.7	5.9	4.1	3.5	3.5
Exports of goods and services	4.7	6.8	4.9	4.5	4.3	4.3	4.2	4.2
Imports of goods and services	16.4	-6.2	5.4	4.8	4.6	4.6	4.5	4.6
Potential Growth	4.4	7.1	5.0	4.3	3.8	3.4	3.3	3.2
Output Gap	1.1	1.8	1.8	1.6	1.4	1.0	0.6	0.2
Contribution to growth								
Domestic demand	13.9	-5.9	3.9	2.9	2.5	2.0	1.8	1.8
Public consumption	0.5	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Private consumption	1.1	0.7	0.8	0.8	0.8	0.8	0.8	0.7
Gross fixed capital formation	12.1	-6.9	2.8	1.9	1.5	1.1	0.9	0.9
Inventories	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	-9.1	14.5	1.2	1.1	1.0	1.0	1.0	1.0
Residual	0.3	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Prices								
Inflation (HICP)	-0.2	0.3	0.9	1.3	1.7	1.9	1.9	1.9
Inflation (HICP, end of period)	-0.3	-0.1	1.8	1.4	1.8	1.9	1.9	1.9
GDP deflator	0.0	-0.3	0.5	1.0	1.4	1.5	1.6	1.7
Terms-of-trade (goods and services)	-0.2	-1.7	0.3	0.1	0.1	0.0	0.2	0.1
Employment and wages								
Employment (ILO definition)	3.7	2.9	2.0	1.7	1.3	1.1	1.0	1.0
Unemployment rate (percent)	8.4	6.7	5.5	5.2	5.0	5.0	4.9	4.9
Average nominal wage	0.8	2.3	2.4	2.5	2.7	2.9	2.9	2.9
(percent of GDP)								
Public Finance, General Government								
Revenue	26.7	25.8	25.4	25.2	24.8	24.6	24.4	24.2
Expenditure	27.2	26.1	25.6	25.3	24.5	24.4	23.9	23.6
Overall balance	-0.5	-0.3	-0.2	-0.1	0.2	0.2	0.5	0.7
Primary balance	1.7	1.6	1.5	1.5	1.7	1.6	1.8	2.1
Structural balance (percent of potential GDP)	-1.0	-0.9	-0.8	-0.6	-0.2	-0.1	0.3	0.6
General government gross debt	72.9	68.1	65.9	63.5	59.9	58.3	55.5	52.5
General government net debt	63.8	58.7	56.3	54.5	52.8	50.9	48.3	45.6
Balance of payments								
Trade balance (goods)	38.5	36.3	33.2	32.9	32.6	32.5	32.3	32.1
Current account balance	3.3	12.5	9.9	8.7	7.7	7.3	6.9	6.5
Gross external debt (excl. IFC)	287.5	256.4	234.4	215.0	197.4	181.4	166.5	152.4
Saving and investment balance								
Gross national savings	35.7	36.7	35.5	35.3	34.9	34.7	34.5	34.3
Private sector	34.6	35.3	34.2	33.8	33.1	33.1	32.5	32.2
Public sector	1.1	1.4	1.4	1.4	1.7	1.6	1.9	2.0
Gross capital formation	32.4	24.2	25.8	26.6	27.2	27.5	27.6	27.8
(percent)								
Monetary and financial indicators								
Bank credit to private sector (growth rate)	-7.6	-3.4	...	...	...	...	...	...
Deposit rates	0.7	0.5	...	...	...	...	...	...
Government 10-year bond yield	0.7	0.8	...	...	...	...	...	...
Memorandum items:								
Nominal GDP (€ billions)	275.2	295.8	312.2	328.1	344.4	360.2	376.6	393.6
Modified total domestic demand (percent)	4.8	4.0	...	...	...	...	...	...
Population growth (percent)	1.0	0.6	1.0	1.0	1.0	1.0	1.0	1.0

Sources: CSO; DoF; Eurostat; and IMF staff.

1/ Share of population with an equalised disposable income (including social transfers) below the threshold of 60 percent of the national median equalised disposable income after social transfers. Data is as of 2016.



IRELAND

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

June 7, 2018

KEY ISSUES

Context. The Irish economy continues to grow at a rapid pace, well above the EU average. Although headline data are distorted by the volatility of multinationals' activity, the broad recovery of domestic demand underpins the expansion. Improving labor market conditions have led to some wage pressures, while inflation remains subdued, mainly due to pound sterling weakness. Crisis legacies are on the mend but vulnerabilities persist.

Outlook and risks. The outlook remains positive, but the economy is rapidly approaching full capacity. External risks are on the downside, most notably from a resurgence of protectionism and a hard Brexit. Changes in the international taxation landscape may affect the operations of the multinationals in Ireland, with repercussions for the economy and public finances.

Challenges and policy priorities. Key challenge is to avoid a new boom-bust cycle while addressing remaining crisis legacies and structural bottlenecks with a view to enhancing resilience to shocks and buttressing sustainable growth. Particularly:

- **Fiscal.** Take advantage of the strong cyclical momentum to accelerate fiscal consolidation and build buffers against risks. Broaden the tax base in a growth-friendly way, maintain moderate spending growth, and avoid the use of temporary revenue gains to fund permanent measures. Continue active engagement in implementing the international tax reform agenda. Strengthen the financial soundness of the Social Insurance Fund.
- **Housing.** Further rationalize building regulations to encourage housing supply, while ensuring that measures to improve housing affordability are well targeted. Macroprudential policy should continue to be deployed proactively.
- **Financial.** Retain prudent lending policies and strengthen private sector balance sheets through a sustained reduction in nonperforming loans, including through enhancing supervisory efforts and accelerating legal proceedings.
- **Structural.** Improve infrastructure quality, based on prioritization to achieve value-for-money, and encourage domestic firms' innovation, including through greater direct public support. Continue to align educational paths and training programs to labor market needs. Address gender employment and pay gaps.

Approved By
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Haksar (SPR)

Discussions were held in Dublin during May 3–14, 2018. The mission comprised E. De Vrijer (head), A. Giustiniani, N. Klein, J. Podpiera (all EUR), R. Perrelli (SPR), T. Matheson (FAD), and E. Kleinbard (FAD external expert). A. McKiernan and N. Feerick (OED) participated in the discussions. V. Perry (FAD) attended the final meeting. The team was supported from headquarters by M. Maneely and N. Romanova (EUR). The mission met with the Minister for Finance and Public Expenditure & Reform P. Donohoe, Governor P. Lane, other officials and private sector representatives, and held a teleconference with ECB staff.

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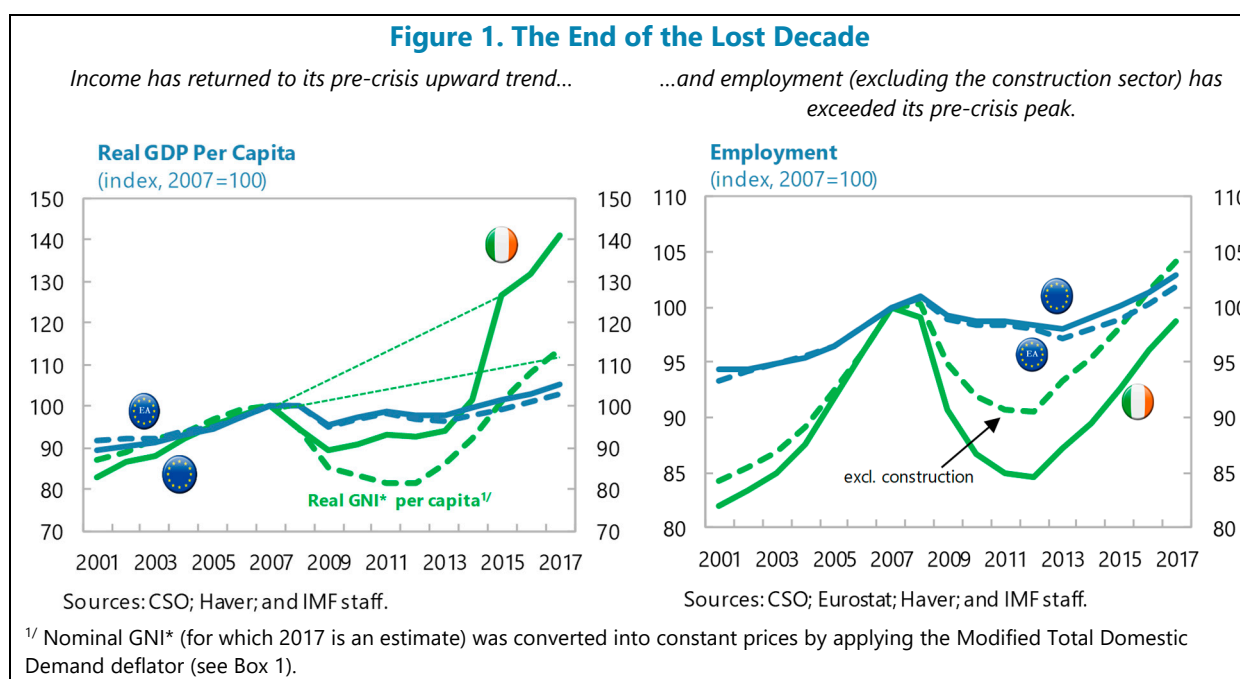
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CONTEXT: BOOM, BUST, AND BEYOND

A. Significant Strides Have Been Made Since the Crisis

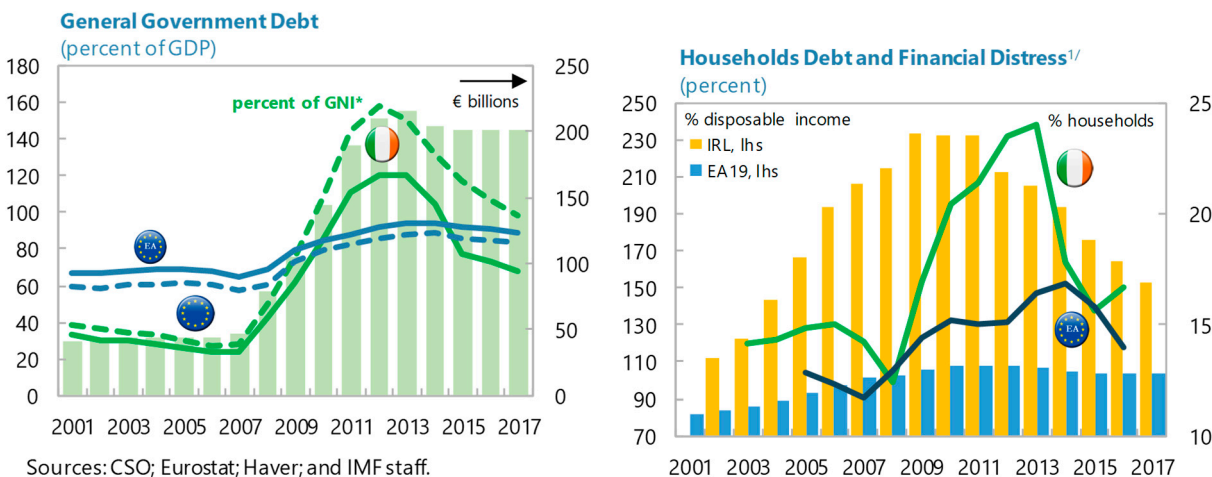
1. Ireland has made remarkable strides in recovering from the 2008 bust of the credit-driven real estate bubble. Strong ownership of its adjustment program, supported by IMF, EU, and bilateral loans, as well as a flexible and vibrant economic fabric were key to the turnaround. Public finances improved by broadening the tax base and containing expenditure, while protecting the most vulnerable. Wage cuts in the private and public sectors helped restore competitiveness. The banking sector was deeply restructured, and its financial soundness improved. As a result, economic growth resumed, initially led by exports, but, with time, more broadly based and job rich.



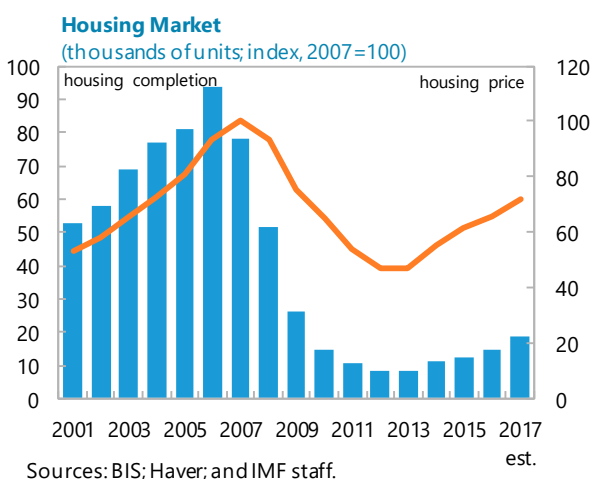
2. Crisis legacies have been on the mend but vulnerabilities remain. With the prudent fiscal policy, the strong economic recovery and the ECB's accommodative policy, the fiscal deficit and public debt have substantially declined as a share of GDP. In December 2017, Ireland fully repaid the outstanding IMF debt and bilateral loans from Sweden and Denmark ahead of schedule. Contingent liabilities have also been significantly reduced with the National Asset Management Agency (NAMA) completing the redemption of its senior debt in October 2017, three years ahead of schedule. However, alternative metrics, which provide a more accurate measure of the size of the domestic economy than nominal GDP, show that Ireland's public debt remains elevated compared to peers (Box 1 and Annex I). Households have significantly reduced their indebtedness, yet remain overleveraged compared to the euro area (EA) average, and the share of low-income families in distress is still high. Banks have strengthened their capital buffers and improved asset quality,

Figure 2. Outstanding Vulnerabilities

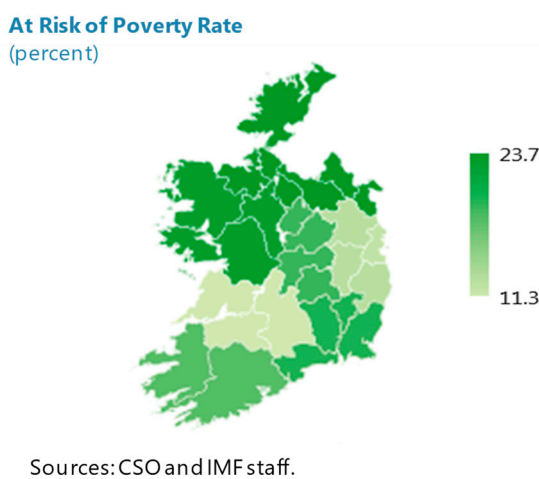
Although declining, public and households debt remain elevated compared to peers.



Undersupply affects housing market conditions.



Regional income inequality remains high.



^{1/} The indicator of financial stress is given by a simple average of the share of households, with an equivalized income below 60 percent of the median, that is unable to cope with unexpected expenses, avoid arrears, and make ends meet.

but the ratio of non-performing loans (NPLs) remains well above the EU average. The recovery of housing supply, which contracted sharply during the crisis, has been tepid, thus triggering a rapid increase in housing prices and rents. Regional disparities, albeit narrowing, persist, and many people have yet to reap the benefits of the economic upturn.

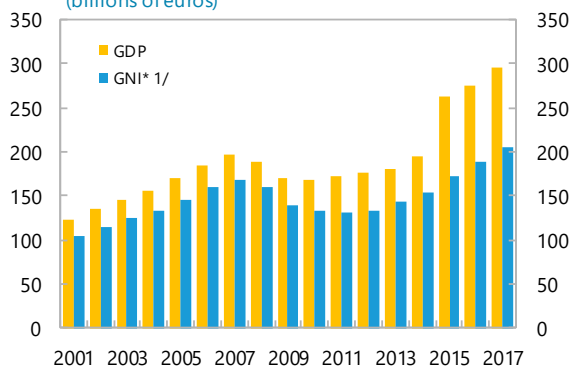
B. Strong, Broad-Based Growth Has Continued

3. Broad-based and rapid growth endured in 2017. Abstracting from GDP volatility, real modified domestic demand increased by 4 percent in 2017. Private consumption was supported by

Box 1. Filtering the Impact of Globalization on the National Accounts

Owing to the significant globalization of its economy and the large presence of foreign-owned multinational enterprise (MNEs), Ireland's headline GDP and GNP figures, although computed in line with international statistical standards, no longer provide an accurate measure of domestic economic activity.

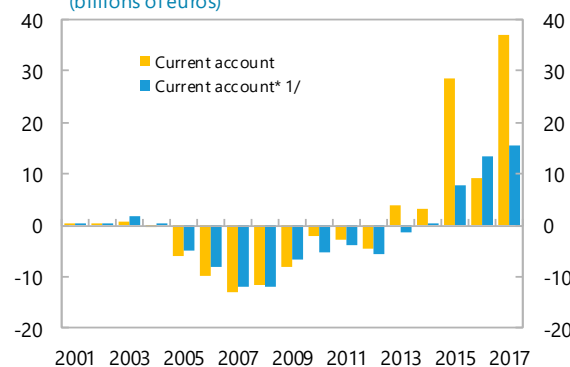
Different Measures of Domestic Output
(billions of euros)



Sources: CSO and IMF staff.

^{1/} 2017 is an estimate.

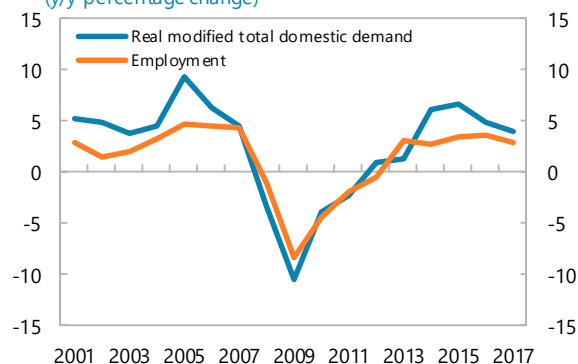
Current Account Balance
(billions of euros)



Sources: CSO and IMF staff.

Following the recommendations of the [Economic Statistics Review Group](#),^{1/} the Central Statistics Office (CSO) has produced a complementary metric—the Modified Gross National Income or GNI*—, which excludes the profits of re-domiciled companies, the depreciation of intellectual property (IP) products, and aircraft leasing. The new indicator, which is currently available only in current prices and at an annual frequency, shows that the Irish domestic economy is about 30 percent smaller than measured by GDP. Corresponding adjustments have been made also to the current account (CA*) and to domestic demand, with the latter showing a strong correlation with employment growth.

Real Modified Total Domestic Demand and Employment
(y/y percentage change)



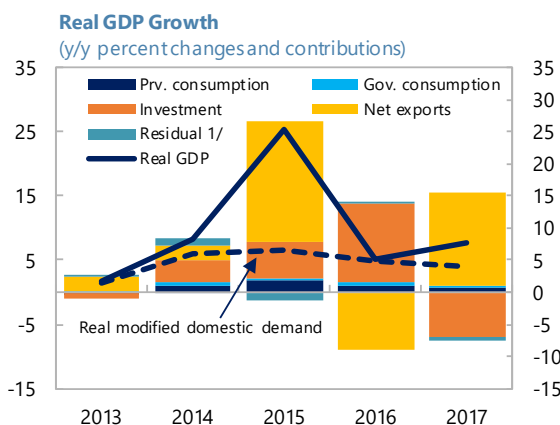
Sources: CSO and IMF staff.

^{1/} The Group was chaired by the Governor of the Central Bank of Ireland and comprised Eurostat and the IMF as international observers.

continuous employment gains, further improvements in households' balance sheets, and rising disposable incomes, reflecting wage increases and tax cuts. The expansion in construction investment was more than offset by a sharp decrease in intangibles and aircraft investment. Strong labor market performance brought the unemployment rate down to below 6 percent by April 2018, despite the resumption of net inward migration. While wage pressures emerged in some sectors, inflation remained subdued, mainly reflecting the pass-through of pound sterling depreciation. High frequency indicators suggest that the positive momentum has continued in early 2018.

Figure 3. Recent Developments

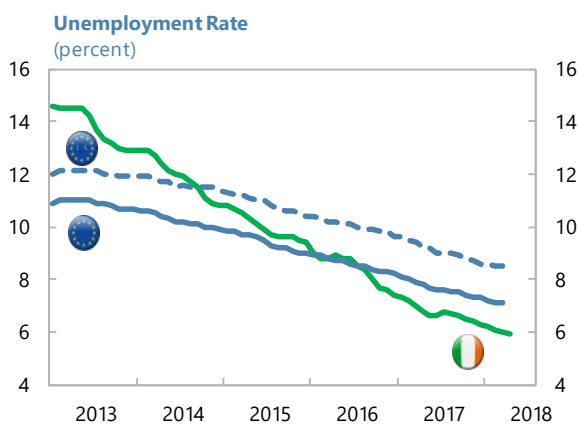
Strong domestic demand supports growth...



Sources: CSO; Haver; and IMF staff.

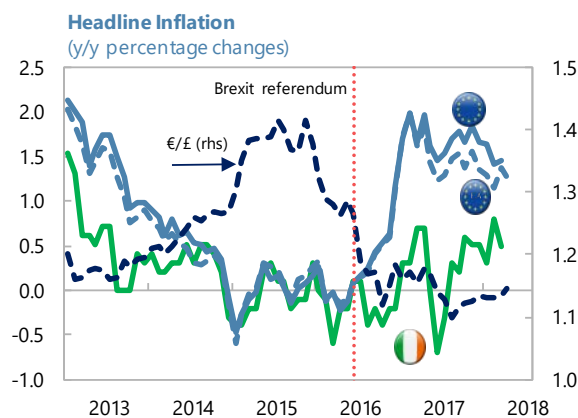
1/ Includes inventories and statistical discrepancy.

The unemployment rate has reached its lowest level in ten years.



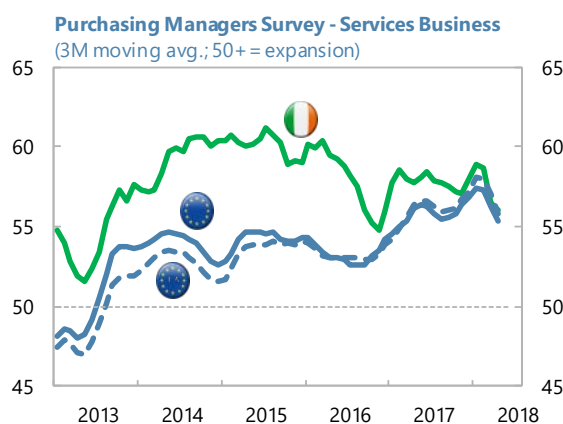
Sources: CSO; Eurostat; Haver; and IMF staff.

...nonetheless inflation remains subdued.



Sources: Eurostat; Haver; and IMF staff.

As headline indicators suggest, strong economic momentum continues in 2018.



Sources: IHS Markit; Haver; and IMF staff.

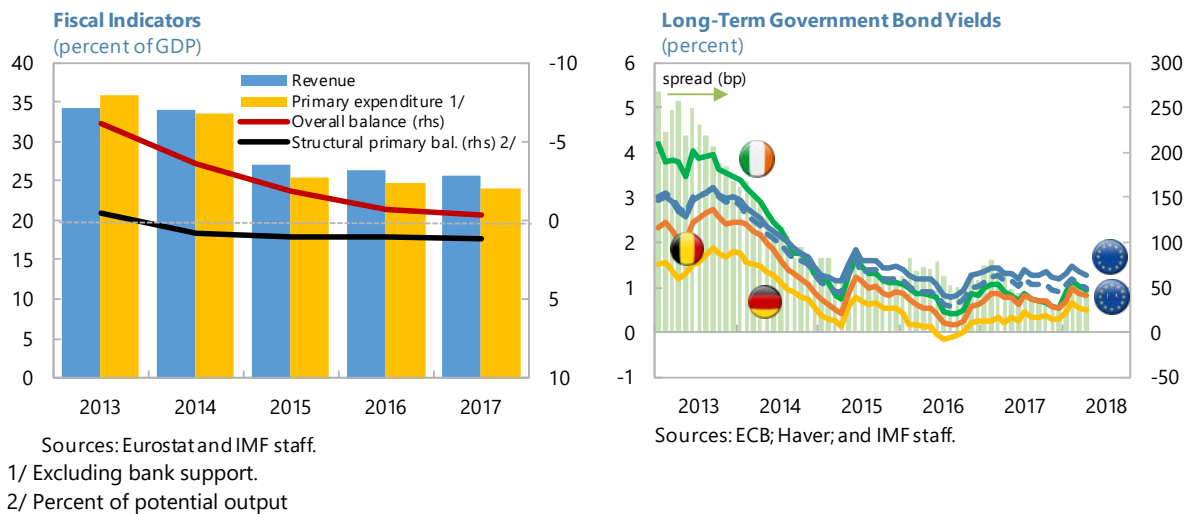
4. Public finances continued to improve on the back of strong output growth but at a slower pace than in previous years. The budget deficit came in, as expected, at 0.3 percent of GDP in 2017, despite the negative impact of a general government reclassification.¹ Better-than-budgeted corporate income tax (CIT) proceeds more than offset shortfalls in other taxes, while continuous overruns in health expenditure were compensated by reduced spending in other areas, including interest payments and the EU budget contribution. The debt burden declined slightly to 68 percent of GDP (99 percent of GNI*). Market conditions remain favorable with low spreads, reflecting also the ECB quantitative easing (QE). The positive fiscal track record has led to a one-notch uplift in Ireland's sovereign rating by Moody's (to A2) and by Fitch (to A+). In the first months of 2018, Exchequer returns have been broadly in line with budget projections.

¹ Approved Housing Bodies, non-profit entities providing affordable housing, were reclassified within the general government sector, resulting in an increase in the general government deficit of 0.15 percent of GDP and in the public debt of 0.03 percent of GDP.

Figure 4. Fiscal Developments

Fiscal consolidation endures but at a slower pace.

Favorable market conditions persist.

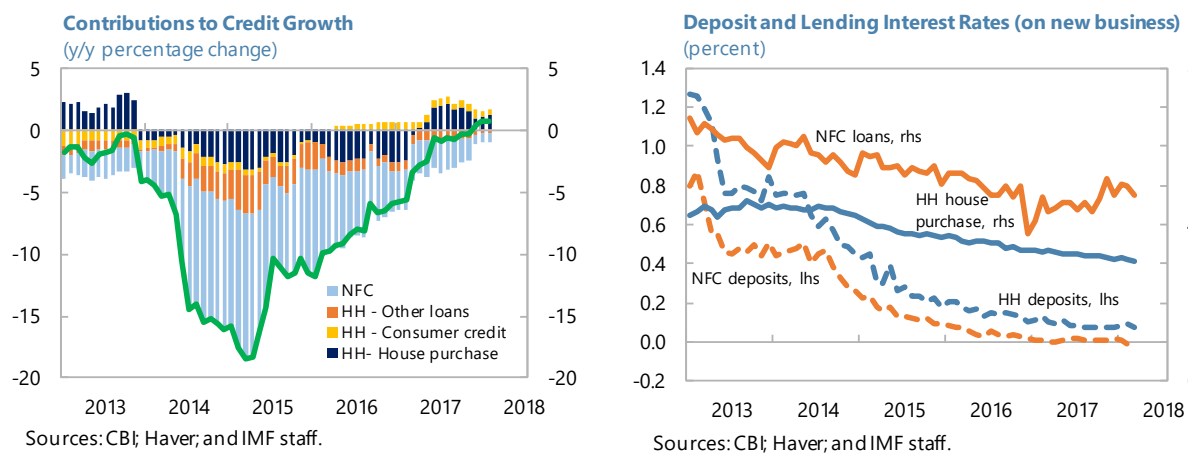


5. Credit started to recover as private sector balance sheets strengthened further. Owing to increasing disposable incomes, the household debt ratio declined to just below 140 percent, its lowest level since 2004, and the share of households with negative equity further narrowed as property prices increased. Although loan repayments from the non-financial corporate sector continued to outstrip new lending, credit recovery endured, with growth of consumer and mortgage loans moving into positive territory. Reflecting improved profitability and high reliance on internal funding, small- and medium-sized enterprises' (SMEs) borrowing remained subdued, resulting in further deleveraging. Domestic banks have continued to strengthen their financial soundness, while the NPL ratio declined.

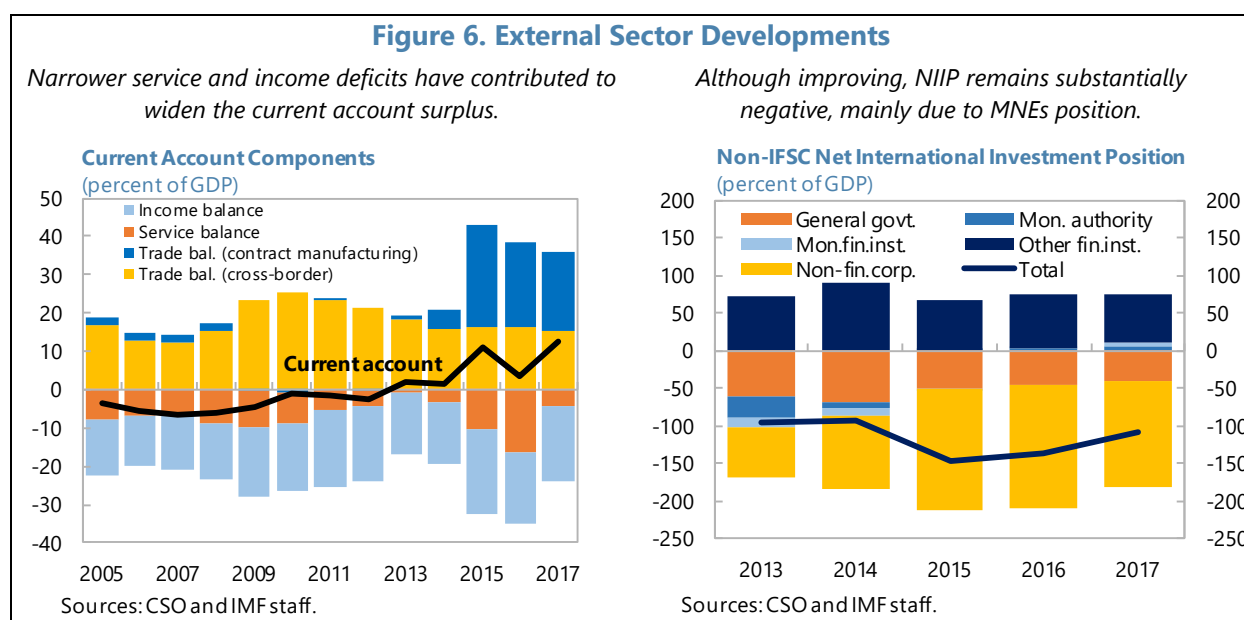
Figure 5. Credit to the Private Sector

Credit growth is recovering...

...but lending rate spreads continue to be high.



6. Ireland's current account (CA) surplus increased significantly, mainly reflecting MNE activity. Lower imports of IP and aircraft leasing services together with solid export performance contributed to widen the CA surplus to 12½ percent of GDP in 2017. The modified current account balance (CA*), which attempts to filter out the activities of MNEs with limited impact on the domestic economy (Box 1), is estimated at 5 percent of GDP. Despite some nominal appreciation vis-à-vis the U.S. dollar and the pound sterling, Ireland's real effective exchange rate remained broadly constant, reflecting productivity gains. The net international investment position (NIIP), albeit improving, continued to be substantially negative, mainly due to the position of MNEs with limited links to domestic activity. While the external balance assessment (EBA) based on the headline CA balance points to an external position substantially stronger than fundamentals, these results are distorted by MNEs' volatile operations. After attempting to control for these effects, staff assesses Ireland's external position to be moderately stronger than implied by its medium-term fundamentals and desirable policies. However, given the challenges in assessing Ireland's "underlying" CA balance, staff considers that no changes in Ireland's policy settings are required in light of such assessment at this juncture (Annex II). Staff will continue work to deepen its understanding of Ireland's underlying external position.



OUTLOOK AND RISKS

7. The baseline outlook remains broadly positive. Factoring in the spillovers from a mild Brexit and the U.S. fiscal stimulus, growth is projected at about 5 percent in 2018 and to gradually converge, over the medium term, to its estimated potential rate close to 3 percent, thus closing the positive output gap. Although projections are subject to high uncertainty due to the volatility of MNE activities, domestic demand is expected to be the main driver. Tightening labor market conditions, with unemployment declining to around 5 percent by the end of the forecasting period, would underpin a rise in earnings, thus supporting household consumption. Further recovery in

construction activity, buttressed by various government initiatives, would contribute to economic growth. Headline inflation is expected to reach 2 percent over the medium term. Abstracting from developments in contract manufacturing and IP imports, exports and imports are assumed to increase in line with global trade and domestic demand, respectively. As a result, Ireland's current account surplus is projected to taper off to around 6½ percent of GDP by 2023.

Macroeconomic Projections, 2016–23								
(Percentage Change unless indicated otherwise)								
	2016	2017	<i>Projections</i>					
			2018	2019	2020	2021	2022	2023
Real GDP	5.1	7.8	5.0	4.1	3.5	3.0	2.8	2.8
Final domestic demand	21.2	-7.8	5.7	4.3	3.6	2.9	2.7	2.6
Private consumption	3.1	2.1	2.4	2.5	2.5	2.4	2.4	2.3
Public consumption	5.2	1.8	2.4	1.7	1.4	1.3	1.3	1.3
Fixed investment	60.0	-21.8	12.1	7.7	5.9	4.1	3.5	3.5
Change in stocks (contribution to growth)	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-9.1	14.5	1.2	1.1	1.0	1.0	1.0	1.0
Exports	4.7	6.8	4.9	4.5	4.3	4.3	4.2	4.2
Imports	16.4	-6.2	5.4	4.8	4.6	4.6	4.5	4.6
Current account (percent of GDP)	3.3	12.5	9.9	8.7	7.7	7.3	6.9	6.5
Unemployment rate (percent)	8.4	6.7	5.5	5.2	5.0	5.0	4.9	4.9
Output gap	1.1	1.8	1.8	1.6	1.4	1.0	0.6	0.2
Consumer prices (HICP)	-0.2	0.3	0.9	1.3	1.7	1.9	1.9	1.9
Memorandum item:								
Modified total domestic demand	4.8	4.0	...	...	...	...	...	...

Sources: CSO; Haver; and IMF staff projections.

8. Domestically, the main vulnerabilities are related to the economy reaching full capacity (Box 2). Labor market conditions are tightening, with some pressures on wages emerging. Continued strong expansion of the economy could eventually re-ignite a boom-bust dynamics. Expectations of a “recovery dividend” and a challenging political context might complicate policy making for the minority government.

Box 2. Assessing Ireland's Cyclical Position¹

Several features of the Irish economy make it difficult to assess its cyclical position. Ireland is a small open economy whose growth model has hinged upon attracting FDI from MNEs, becoming a hub of their European and worldwide operations. The flip-side is that Ireland's headline GDP figures no longer provide a good measure of the economic activity that physically takes place in the national territory, as a significant share of the MNE activity carried out in other countries is recorded in Ireland's national accounts (Box 1). In addition, a flexible labor market together with responsive migration flows contribute to making Ireland's characteristics very similar to those of a regional economy. Considering these features, staff applies a suite of models to calculate potential output for the domestic economy, as measured by the GNI*. The results point to strong potential output growth and a rapidly widening positive output gap.

¹ See “Business Cycle in Ireland: Accounting for Open Labor Market and Multinationals”, *Selected Issues Paper*, Chapter I, International Monetary Fund, 2018.

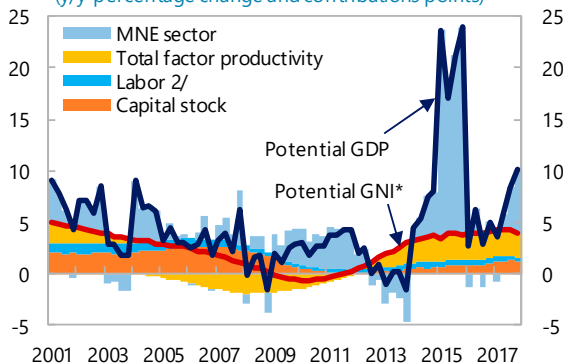
Box 2. Assessing Ireland's Cyclical Position (concluded)

Total Factor Productivity has been the main driving force of the recovery of potential growth...

...and the output gap has shifted into positive territory

Potential GDP and GNI*^{1/}

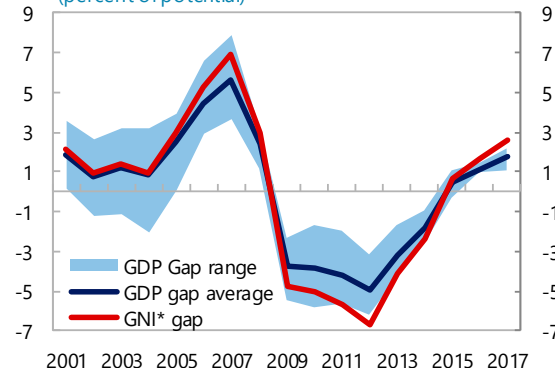
(y/y percentage change and contributions points)



Source: IMF staff.

Output Gap^{1/}

(percent of potential)



Source: IMF staff.

^{1/} Potential output and output gap are calculated for the domestic economy, as measured by the GNI*, the MNE sector is then added under the assumption that it continuously operates at its full capacity.

^{2/} Includes the contribution of human capital.

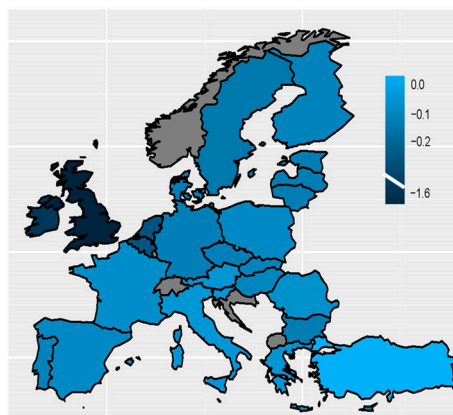
9. External risks are tilted to the downside. Despite the growth momentum in the global economy, particularly in the euro area, risks for the Irish economy are mostly external (Annex III):

- **Escalation in protectionism.** Given its deep integration into global value chains and its highly concentrated industrial base, the Irish economy is vulnerable to a retreat from cross-border integration, the impact of which might be amplified by the still high public and private sector debt.
- **Hard Brexit.** Given Ireland's deep trade, financial, and labor market links with the U.K., spillovers from Brexit are expected to be negative but their ultimate scale will depend on the future U.K.-EU relationship. Despite the recent agreements, significant difficulties in the negotiations are yet to be overcome. In particular, the thorny issue of a hard border with Northern Ireland, notwithstanding the general commitment to avoid it, elicits deep political and social divides. Important sectors such as agri-food, clothing, footwear, and tourism, are likely to be affected substantially should a WTO-type arrangement come into effect. Domestic consumption and investment decisions could be held back by the related uncertainty. It is estimated that a hard Brexit could reduce Ireland's output up to 4½–7 percent in the long run ([ESRI](#), [OECD](#), [DBEI](#)).

Figure 7. External Risks

Brexit is the main external risk.

Estimated Long-run Impact on GDP from Higher Trade Costs^{1/} (percent of GDP)



Source: IMF staff.

^{1/} Countries not included in the model are shaded in grey. The estimate assumes an average of 8 percent increase in tariff equivalent non-tariff trade costs across 31 sectors.

- **Changes in the international tax landscape.** The recent U.S. CIT reform is likely to have important implications for the investment decisions and tax planning strategies of U.S. MNEs, which play a crucial role in the Irish economy and contribute significantly to CIT revenue. The reform could make the U.S. more attractive for future investment but U.S. MNEs are unlikely to repatriate existing IP on a significant scale. In the medium-term, the implementation of reforms related to the OECD/G-20 Base Erosion and Profit Shifting (BEPS) initiative, including the EU [Anti-Tax Avoidance Directive](#) (ATAD), should lead to a better alignment between reported profits and location of productive factors. This will make profit-shifting into Ireland more difficult, but could also lead to increased real investment to take advantage of Ireland's favorable business climate, including its relatively low statutory corporate tax rate.

Authorities' Views

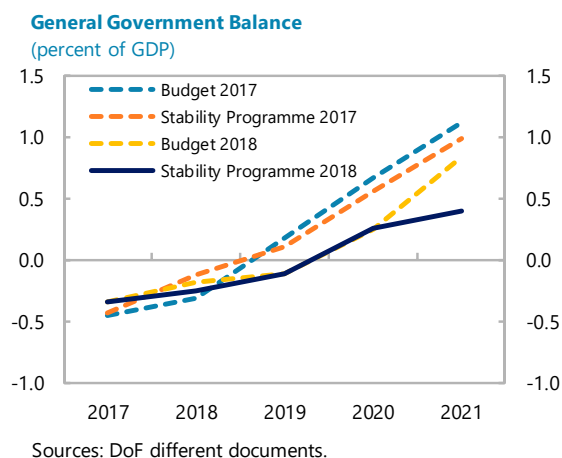
10. The authorities broadly concurred with staff's outlook and risk assessment. They shared the expectation of a continued growth momentum, driven by both domestic demand and net exports supported by the multinational sector, and agreed that growth would tend to gradually decelerate towards its potential rate over the medium term. In view of the currently advanced cyclical position, they were fully aware of the need to avoid another boom-bust cycle and stood ready to deploy policies to achieve sustainable high growth. The authorities were cognizant of risks to economic growth and fiscal revenues from the uncertainties around international trade and corporate tax changes. The need to hedge against risks is acknowledged by putting aside resources in a Rainy-Day Fund. They also saw merit in continued preparations for all possible modalities of Brexit.

FISCAL: AVOIDING THE GHOST OF FISCAL PAST

11. The government's budget strategy remains broadly prudent but the pace of fiscal consolidation has slowed. The 2018 budget targets a headline deficit of 0.2 percent of GDP, marginally lower than in 2017. Spending measures—mainly related to social protection, wages, and social housing—and some reduction of personal income taxation are expected to be almost compensated by revenue-raising measures, including an increase in the stamp duty on commercial real estate (CRE) transactions to 6 percent from 2 percent. Owing to a revision of the output gap under the EU agreed

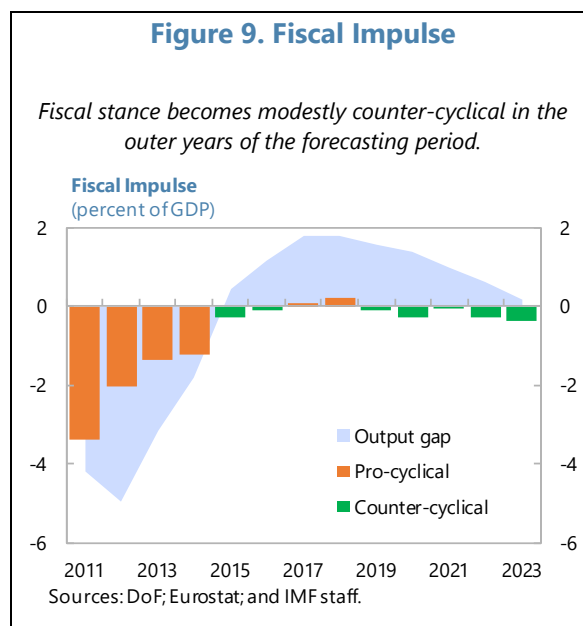
Figure 8. Different Vintages of the Authorities' Consolidation Plans

The pace of fiscal consolidation has been progressively softened.



methodology, the achievement of a structural deficit of 0.5 percent of GDP (Medium-Term Objective) has been postponed to 2019. Following a mid-term review of its [Capital Plan](#), the government intends to boost investment spending over the medium term to address key infrastructural bottlenecks, while achieving a structural surplus of 0.3 percent by 2021. The government also intends to halve (to €500 million) the annual contributions to a [Rainy-Day Fund](#) (RDF) to be established in 2019,² and push out the previously announced target of reducing public debt to 45 percent of GDP (60 percent of GNI*) beyond the next decade, after major capital projects have been completed.

12. Based on current policies, staff estimates that the fiscal stance remains broadly neutral during 2018–19. While difficulties in assessing Ireland’s cyclical position warrant caution, staff estimates a higher output gap over the medium term than the authorities. Consolidation is expected to resume in the outer years of the forecasting period with structural balance reaching a surplus of 0.6 percent of GDP by 2023.



Fiscal Projections Comparison (Percent of GDP)							
	2017	Projections 1/					
	2017	2018	2019	2020	2021	2022	2023
Staff							
Growth	7.8	5.0	4.1	3.5	3.0	2.8	2.8
Output gap	1.8	1.8	1.6	1.4	1.0	0.6	0.2
Overall balance	-0.3	-0.2	-0.1	0.2	0.2	0.5	0.7
Structural balance	-0.8	-0.8	-0.6	-0.2	-0.1	0.3	0.6
Structural effort (pp)	0.2	0.1	0.2	0.4	0.1	0.4	0.3
Public debt 2/	68.1	65.9	63.5	59.9	58.3	55.5	52.5
Department of Finance							
Growth	7.8	5.6	4.0	3.5	3.0	...	...
Output gap	0.3	1.2	0.6	0.4	0.2	...	...
Overall balance	-0.3	-0.2	-0.1	0.3	0.4	...	...
Structural balance	-0.4	-0.9	-0.4	0.1	0.3	...	...
Structural effort (pp)	...	-0.5	0.5	0.5	0.2	...	...
Public debt 2/	68.0	66.0	63.5	60.2	58.7	...	...

Sources: DoF and IMF staff.
1/ Based on current policies.
2/ Taking into account the accumulation of a Rainy Day Fund of €0.5 billion starting in 2019.

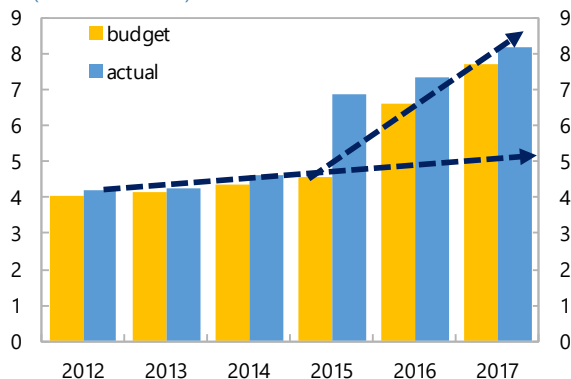
² Legislation to establish the RDF is currently being prepared. The Strategic Investment Fund will contribute €1.5 billion to the RDF.

Figure 10. Corporate Income Tax

CIT proceeds continue to surprise on the upside.

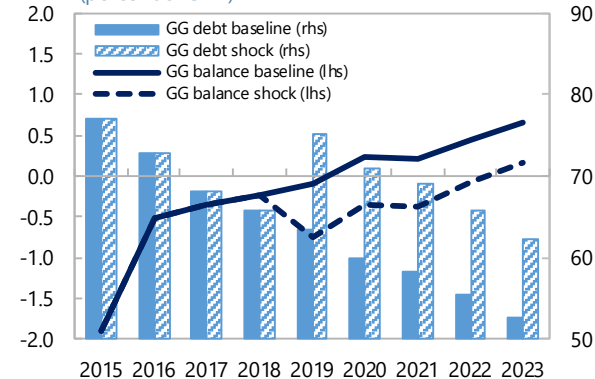
A CIT shock cum GDP level shift would drive a sharp one-off debt increase followed by a slower decline.

Corporate Income Tax Proceeds
(billions of euros)



Source: DoF.

Impact of a Shock to CIT Revenue^{1/}
(percent of GDP)



Source: IMF staff.

^{1/} See Appendix I.

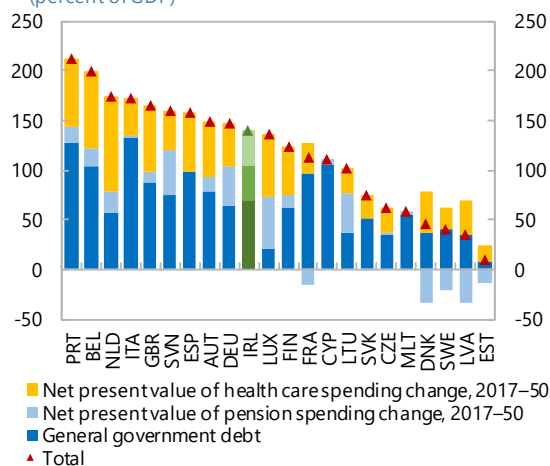
13. However, vulnerabilities are lingering. Most notably:

- Increasing reliance on volatile tax bases.** CIT proceeds, which increased from 7 to 11 percent of total revenue in 2014–17, are very concentrated, with nearly two-fifths paid by the top-10 taxpayers, many of which affiliates of U.S. MNEs. Changes in the business decisions of these companies in response to the U.S. CIT reform or BEPS-related reforms could erode Ireland’s tax base. Staff estimates that the cut in the U.S. CIT rate plus investment expensing might reduce CIT revenue by approximately 0.25 percent of GDP.³
- Still high public debt.** While debt dynamics has improved and gross financing needs are projected to be relatively contained, alternative metrics show that Ireland’s public debt remains elevated compared to EU peers and sensitive to macro-fiscal shocks (Annex I).
- Growing expenditure pressures.** Despite scope for efficiency savings (notably in healthcare), pressure is increasing to promote social housing and upgrade physical infrastructure. Rising ageing costs are highlighted by the projected deficits of the

Figure 11. Public Debt Burden

The debt burden would almost double when implicit liabilities linked to ageing are considered.

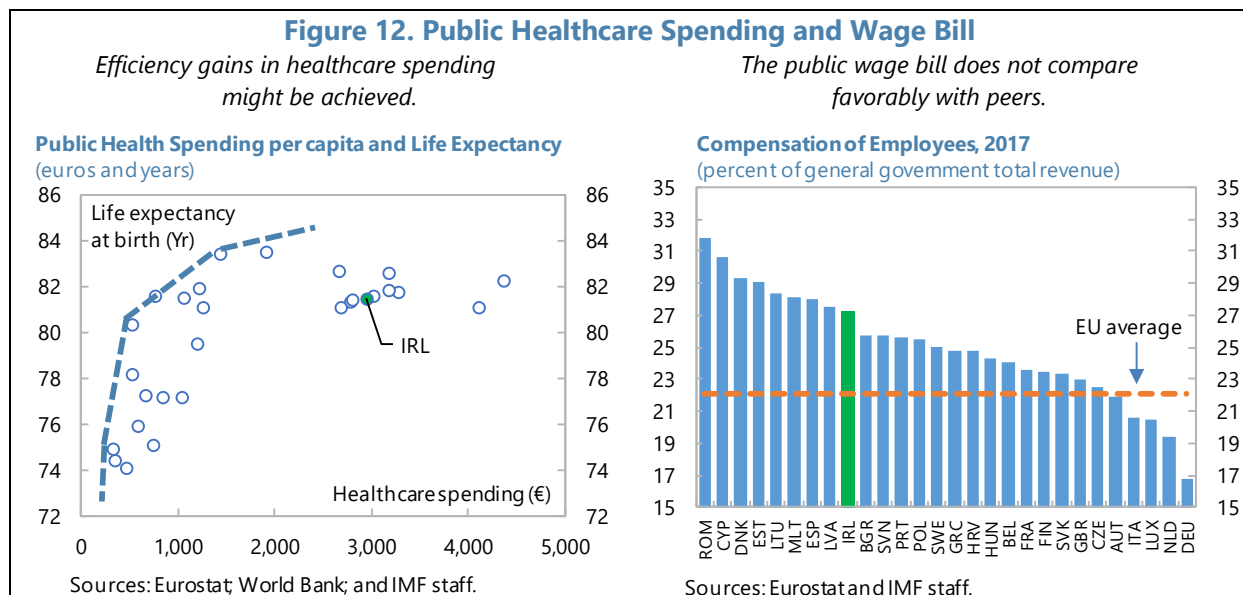
Public Debt Including Implicit Ageing-Related Liabilities
(percent of GDP)



Source: Fiscal Monitor.

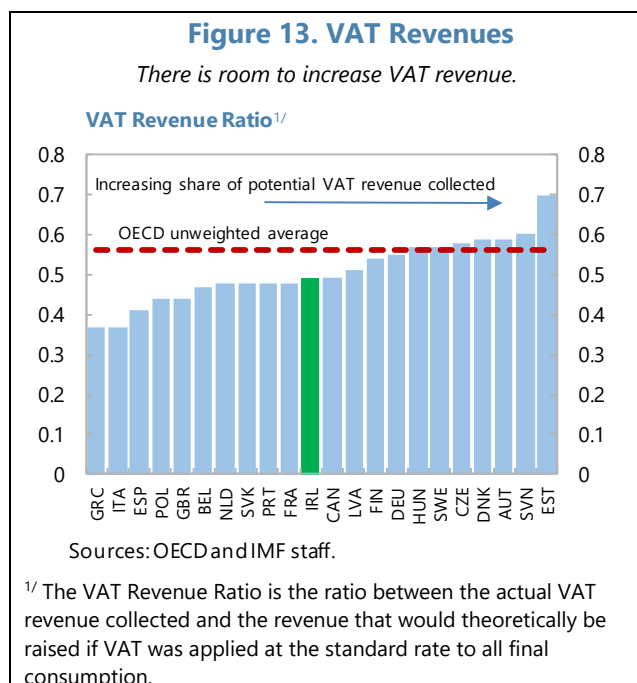
³ See “The Impact of International Tax Reforms on Ireland”, *Selected Issues Paper*, Chapter II, International Monetary Fund, 2018.

Social Insurance Fund (SIF), which, absent measures, are estimated to reach 3.1 percent of GDP in 2055 ([Actuarial Review](#)).



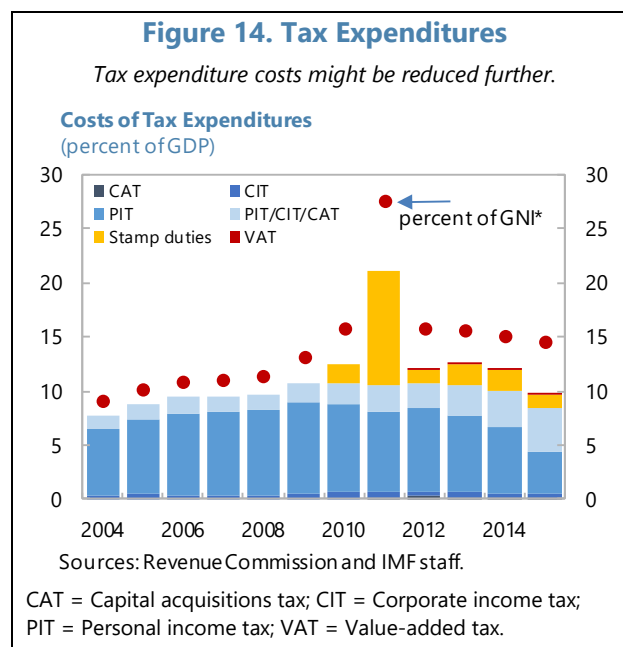
14. Against this background, fiscal policy should be tightened to alleviate demand pressures and rebuild buffers. These buffers could be used in case major external risks materialize. The fiscal strategy should aim at an overall budget surplus of 0.2 percent of GDP in 2019 and reducing the public debt ratio to close to 50 percent of GDP over the medium term. This would require an additional structural effort of at least 0.3 percent of GDP in 2019 and thereafter through raising revenue. Spending growth should remain moderate, while addressing the infrastructure gap and other growth-enhancing needs.

- **Broadening the tax base in a growth-friendly way.** A broad and stable revenue base is needed to mitigate vulnerabilities and support priority expenditures. To this end:
 - **VAT preferential rates and exemptions could be gradually eliminated.** Ireland's VAT system with five rates entails that a large share of potential VAT revenues remains uncollected. Streamlining the VAT rate structure could yield between 0.2–0.8 percent of GDP (DoF). Income distribution concerns could be mitigated by means-tested allowances for low-income households.



- **Tax expenditures could be better targeted.** The total costs of tax expenditures amounted to almost 10 percent of GDP in 2015, up from about 8 percent of GDP in 2004–05. A large share of income tax allowances is enjoyed by top income groups, with an adverse impact on income distribution ([OECD](#)).

- **Additional revenue could be raised from property and environmental taxation.** As the last self-assessed valuation dates to 2013, the government might consider a gradual adjustment to the new market values to mitigate the impact on households' finances. Although Ireland's revenues from environmental taxes are broadly in line with the EU average, the preferential excise rate charged on diesel fuel compared with petrol could be revisited.



- **Avoiding use of temporary revenue gains to fund permanent measures.** Given the difficulty in differentiating between temporary and permanent CIT revenue developments, because of the volatility of MNEs' activities, it is crucial to use tax windfall gains either to reduce public debt or to increase contributions to the forthcoming RDF.
- **Maintaining moderate spending growth, while improving its quality and effectiveness.**
 - Given the government's ambitious investment plans, it is crucial to improve the integration between strategic planning and capital budgeting, enhance evaluations of public-private partnerships, and fully factor in future costs associated with the management and maintenance of infrastructure assets ([IMF](#)). The recent [National Development Plan 2018–2027](#) builds on these recommendations, for instance by establishing an Infrastructure Projects Steering Group and by starting publication of a Capital Tracker to enhance transparency.
 - The ongoing spending review is a step in the right direction of optimizing spending allocations but its effectiveness could be enhanced by introducing specific savings objectives.

15. Ireland should continue its active engagement in implementing the international corporate tax reform agenda. Ireland has been actively engaged in the OCED BEPS initiative and complies with international standards regarding transparency and cooperation in tax matters ([OECD](#)). The government is also committed to transpose the EU's ATADs, which implement important recommendations from the OECD/G-20 BEPS action plan, according to the agreed time-table.

16. Consideration may be given to a broader review of personal income taxation to better reward work. In this regard, staff sees merit in merging the Universal Social Charge into a more comprehensive Personal Income Tax with a broader base and one or two additional income brackets to more evenly distribute the tax burden across income earners (Annex IV).

17. The financial soundness of the SIF needs to be strengthened to avoid future government subventions. Measures should be developed, including a review of social security contributions, to safeguard the SIF's long-run viability.

Authorities' Views

18. The authorities reaffirmed their commitment to maintaining sound public finances. They considered it a key priority to reduce the level of public indebtedness and build buffers so that the economy can better withstand adverse developments if, and when, they occur. Although some slack might still exist, the authorities were cognizant that the economy is rapidly approaching full employment. They concurred with staff that fiscal policy should avoid abetting a new boom-bust cycle and were determined not to repeat the pro-cyclical policies of the past. They acknowledged the importance of broadening the tax base and indicated that they will continue to review the adequacy of the current framework. In a context of substantial spending pressures, the authorities emphasized the crucial role of the three-year 'rolling' selective reviews in prioritizing expenditures and making them more efficient. They stressed the strategic importance of the [National Development Plan 2018–2027](#), which aims at enhancing Ireland's growth potential by addressing key infrastructural bottlenecks. In this regard, they will continue to build upon the recommendations of the [Fund's public investment management assessment](#). The government also recognized the importance of putting the SIF on a sound financial footing and noted that a review of social contributions is underway.

HOUSING: IS THIS TIME DIFFERENT?

19. As in the run-up to the crisis, the ongoing strong economic momentum is accompanied by a surge in house prices and rents. While house prices remain well below the pre-crisis peak, they have rebounded rapidly in Dublin and other regions, posting an average annual increase of 13 percent in March 2018. Rents have also increased at a strong pace (6 percent as of end-2017) and surpassed their pre-crisis level.

20. Unlike in the pre-crisis period, house prices are fueled by a persistent supply shortfall rather than by bank credit. Housing demand has recovered strongly, reflecting improved labor market conditions, rising incomes, and low interest rates. While mortgage drawdowns and approvals have rapidly increased, albeit from a low base, cash transactions remain relevant. In contrast, the recovery of the housing supply has been modest so far, with house completions falling well below the estimated underlying demand of about 35,000 units per year. The government has taken several measures to help boost supply (Box 3) but these will need time to have an impact. High building

Box 3. Recent Government's Measures in the Housing Market

As part of the government's overarching [strategy](#) to ramp up housing supply and tackle homelessness, the following measures, with a small budgetary impact, were introduced recently:

Increasing Supply

- A new fast-track planning process for large developments and establishment of an infrastructure fund to support new projects;
- Provision of land at low or no cost to encourage the supply of affordable homes for low-income households in exchange of the state's equity share in the property (Affordable Purchase Scheme, not launched yet);
- New apartment guidelines relaxing building restrictions;
- Establishment of Home Building Finance Ireland (HBFI) that will be financed by Ireland Strategic Investment Fund (750 million, equivalent to 0.25 percent of GDP) and provide direct funding to financially-constrained developers in the residential market;

Developing the rental market

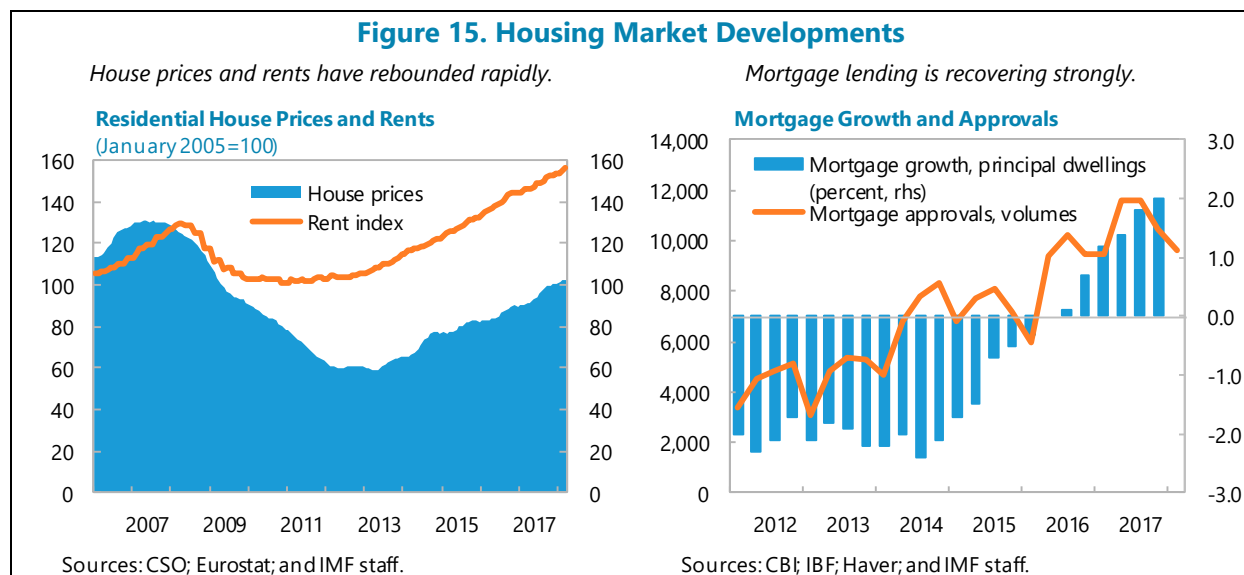
- Encouragement of development and investment projects for rental accommodation;
- Introduction of a tax deduction for pre-letting expenses of up to €5,000 per property;

Improving affordability

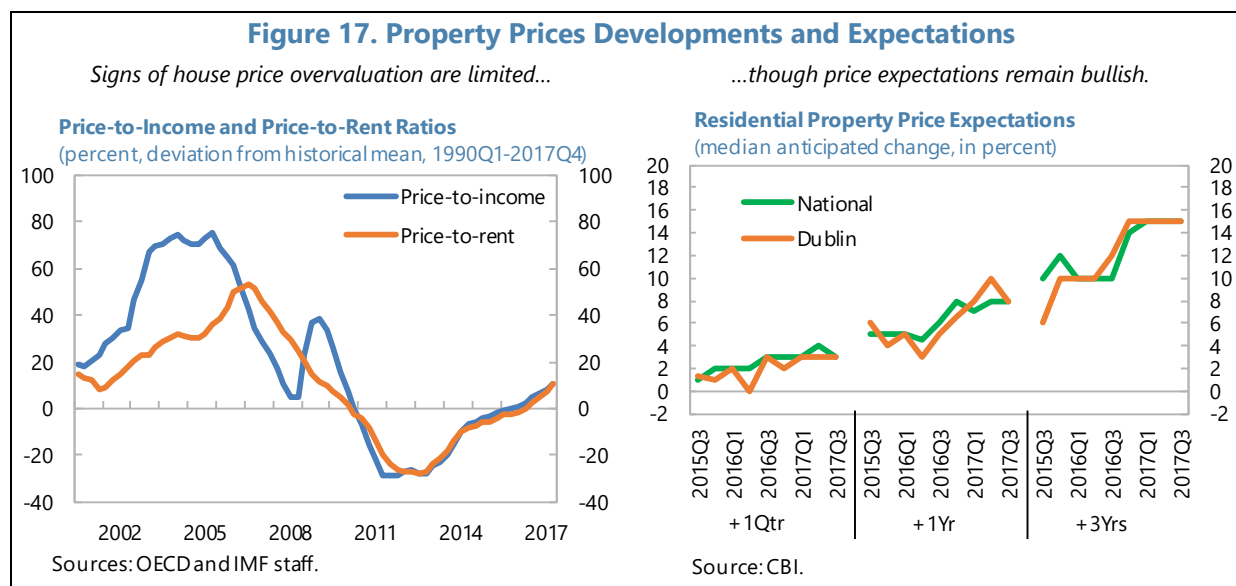
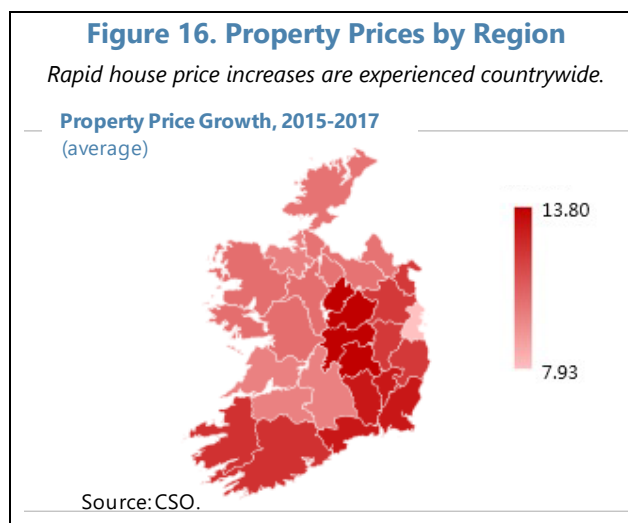
- Improvement of rent affordability by increasing Housing Assistance Payment limits;
- Introduction of administrative measures to stabilize rents in designated Rent Pressure Zones; and
- Provision of subsidized mortgages by local authorities to low-income First-Time Buyers (FTBs) that were rejected by credit institutions (Rebuilding Ireland Home Loan—RIHL).

costs, impaired balance sheets of construction firms and related funding difficulties, skill shortages, and land hoarding are the main factors holding back supply. In CRE properties, high yield attracted strong investment, largely from abroad, alleviating financing constraints and resulting in a fast supply response. Returns have moderated to levels seen in peers, after years of strong gains.

Figure 15. Housing Market Developments



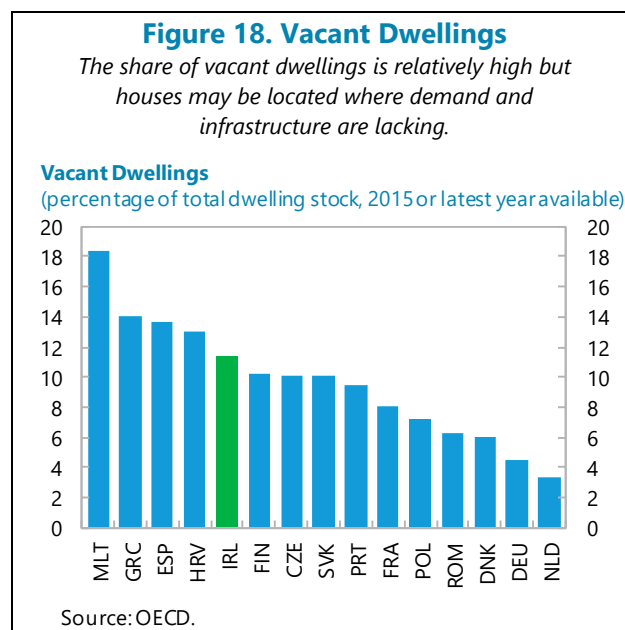
21. While house prices are not significantly misaligned, upward pressure is likely to persist. Price-to-income and price-to-rent ratios have steadily increased in recent years and at present modestly exceed their historical average. However, model-based measures of house price misalignment are inconclusive with results ranging from some undervaluation (ESRI) to a small overvaluation. While there are no immediate financial stability risks, house price pressures are likely to persist over the medium term, as demand growth is likely to continue outpacing supply.



22. Against this backdrop, priority should be given to encourage greater housing supply...

- Further rationalization of building regulations and streamlining of planning processes are warranted. Reducing skills gaps in the construction sector, advancing debt restructuring of distressed but viable construction firms, and improving their access to financing are important.
- The establishment of the HBFI could provide funding to financially-constrained developers in the residential market. However, its operations should remain limited in scope and subject to prudent risk assessment and a robust governance structure to minimize risks for public finances.

- With a view to reducing land hoarding, a vacant site levy will be introduced starting in 2019. However, its rates (3 percent for the first year and 7 percent for the second and subsequent years) should be reviewed periodically to ensure effectiveness.
- Ireland has a high level of vacant dwellings, though some of these are located in areas where demand and infrastructure are lacking. To ensure greater utilization of these properties, consideration should be given to adopting a surcharge on properties that are left vacant in urban areas.



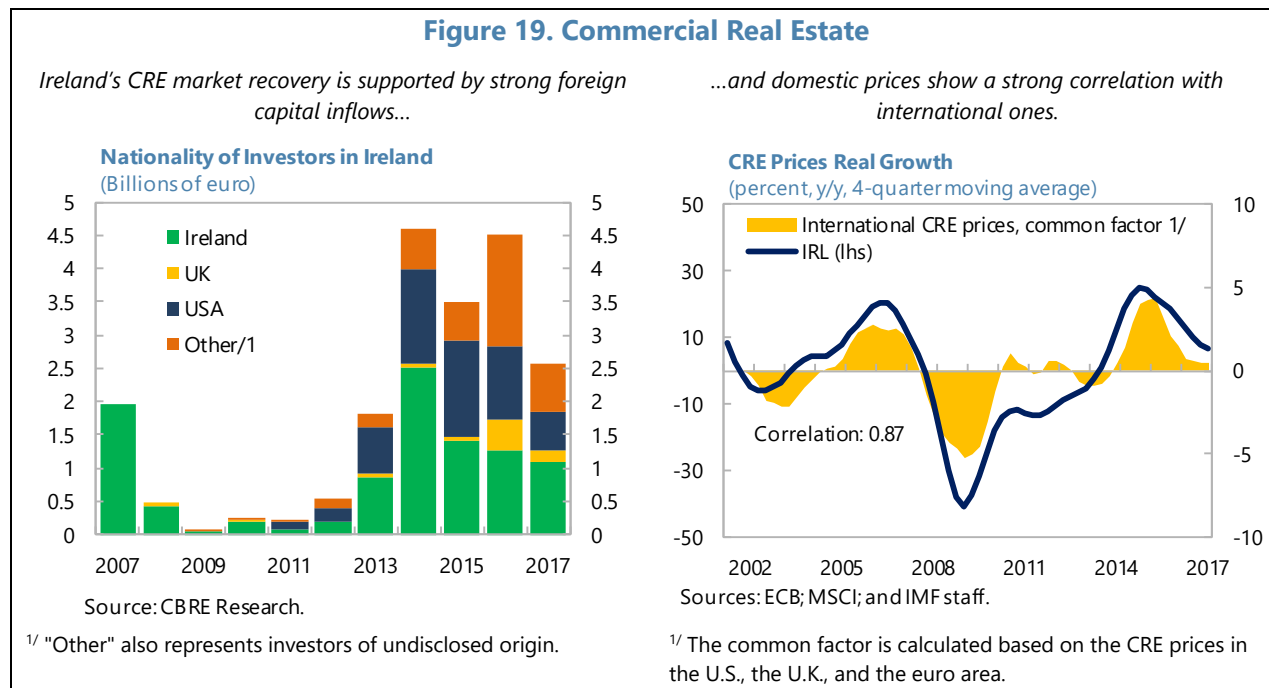
23. ...while enacted measures to improve housing affordability need to be well-targeted...

- There is scope to re-calibrate the Help-to-Buy scheme, which provides a tax rebate of up to 5 percent of the dwelling purchase price for FTBs, towards low-income households.
- Measures to stabilize rents should be reconsidered as they may deter new construction. Support for disadvantaged groups should be delivered through well-targeted housing assistance payments.
- The RIHL, which provides loans to risky borrowers outside the banking system, should remain of limited scope and subject to stringent risk assessment to safeguard financial stability, particularly because the use of the RIHL might breach the central bank's loan-to-income (LTI) limits.

24. ...and macroprudential policy should continue to be deployed proactively. Following last November's [review](#) of mortgage measures, the central bank has kept the core parameters of the macroprudential framework intact, while halving the proportion of new non-FTB loans allowed to exceed the 3.5 LTI limit to 10 percent. Although currently appropriate, it is crucial that the macroprudential limits are adjusted pre-emptively to ensure that bank and household balance sheets remain resilient to shocks. In addition, as the Central Credit Registry becomes operational in 2018, staff encourages the authorities to shift from a LTI to a debt-to-income limit, which better captures household repayment capacity, once comprehensive data on household debt are available.

25. The upswing in the CRE market requires close attention. While domestic banks' exposure to the CRE market declined considerably in recent years, non-domestic investment and funding has increased markedly, as institutional investors and investment funds searched for yield. The cyclical pattern of Irish CRE prices is highly correlated with that in other countries, with wider amplitude of

the swings also reflecting strong sensitivity to external economic conditions.⁴ This calls for enhanced monitoring of this market—including by closing data gaps—to ensure that the financial system is resilient to drops in collateral values and reversals in foreign investment flows. As bank lending recovers, it is important to maintain prudent lending practices and continue using taxation measures to dampen the strong sensitivity to international CRE prices. The authorities' intention to transpose the [EU Fourth Directive](#) on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) in the near future would strengthen their AML/CFT framework and mitigate financial integrity risk related to the property market (see also [Financial Action Task Force](#)).



Authorities' Views

26. The authorities regarded property prices as broadly in line with fundamentals, but recognized that supply shortages are likely to continue exerting pressure on housing prices. They affirmed their commitment to support a faster expansion of the housing supply, noting that the recent policy measures in this area would help in alleviating bottlenecks. They also underlined that the HBFi is designed to serve as a temporary vehicle until the property market normalizes and that its functionality will be subject to periodical evaluations. The authorities agreed that measures to improve housing affordability should be targeted at low-income households and noted their intent to keep the various schemes under review to ensure their effectiveness. They stressed their proactive approach to ensuring that the domestic financial system remains resilient in the event of a reversal in house prices, and viewed the macroprudential framework as vital in managing these risks. The

⁴ See "The Irish Commercial Real Estate Market: Synchronization and the Role of External Factors", *Selected Issues Paper*, Chapter III, International Monetary Fund, 2018.

authorities concurred with staff's assessment of risks related to the CRE market and noted that their supervisory approach remains geared to ensuring that bank balance sheets are resilient to shocks.

FINANCIAL SECTOR: BANKS ON THE MEND

27. The domestic banking system has further improved its resiliency to shocks. While deleveraging has endured, banks have strengthened their capital and liquidity buffers further. Bank profitability has remained broadly stable and above the euro area average. However, the costs associated with the tracker mortgage examination (see below), the introduction of regulatory changes (e.g., the minimum requirement for own funds and eligible liabilities), and the potential impact of Brexit are expected to add some pressure to bank profitability, although the impact of these headwinds might be felt gradually over time. NPLs have declined across all loan categories thanks to improved economic conditions, further restructuring, portfolio sales, and write offs. However, their relatively high level continues to weigh on bank balance sheets and operations.

	2012	2013	2014	2015	2016	2017
Credit growth	-7.0	-7.0	-5.4	-5.3	-9.4	-3.9
Return on assets	-2.0	-0.8	0.5	0.7	0.8	0.8
Pre-provision profits ^{2/}	-0.2	0.4	0.4	0.7	0.8	0.8
Net interest margin	0.8	1.2	1.3	1.8	2.0	2.2
Cost-to-income ratio	166.0	72.8	64.1	63.2	60.2	68.1
NPL ratio	24.8	27.1	23.2	16.1	12.9	10.7
Coverage ratio	48.4	51.4	51.7	51.6	50.3	45.6
CT1 ratio	14.7	13.3	15.5	14.9	16.8	18.3
Net loan to deposit	124.0	110.7	108.2	105.9	102.4	99.3

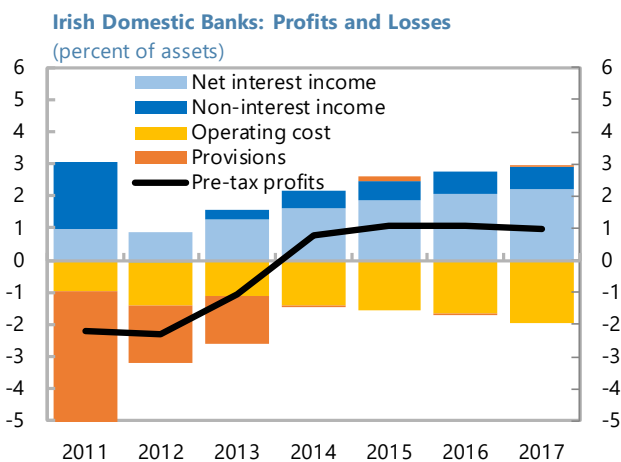
Sources: CBI and IMF staff.
^{1/} Indicators cover the three main domestic banks: Allied Irish Banks, Bank of Ireland, and Permanent TSB. Figures are based on Q4 data, unless otherwise indicated.
^{2/} Excluding nonrecurrent items, as a share of average total assets.

28. The ongoing tracker mortgage examination is unprecedented and costly for the banking sector. The [examination](#) reviews cases where banks mishandled tracker mortgages by unduly denying borrowers tracker products or charging them wrong rates. The involved institutions are bearing significant costs due to high administrative expenses to conduct the examination as well as sizeable ad-hoc provisions (about €1 billion, equivalent to about 40 percent of their 2017 pre-tax profits) for damages. Moreover, shifting costumers back to tracker mortgages may adversely impact banks' net interest margin and squeeze profitability going forward. Fast resolution of this issue is critical to support public trust and minimize uncertainty related to bank profitability.

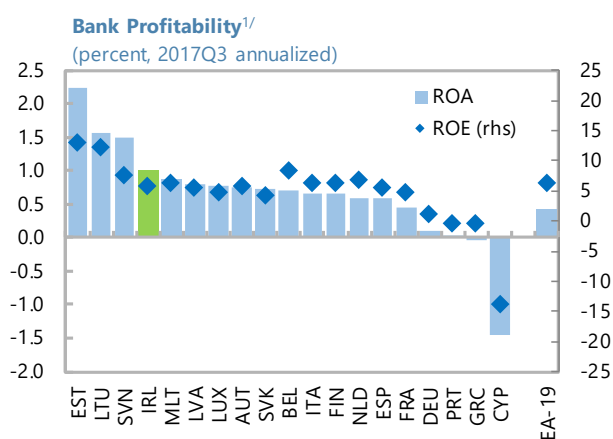
29. Improving bank asset quality should remain a key priority. Significant progress has been made with respect to distressed corporate/CRE loans. Yet, mortgage arrears declined at a reduced pace owing to limited creditor-borrower engagement and lengthy legal proceedings. Consequently, the amount of mortgages in deep arrears (over 720 days) remains elevated. Steps to further improve bank asset quality would help the banking sector to refocus on its core functions and better support growth. Priority should be given to:

Figure 20. Banks' Profitability and Asset Quality

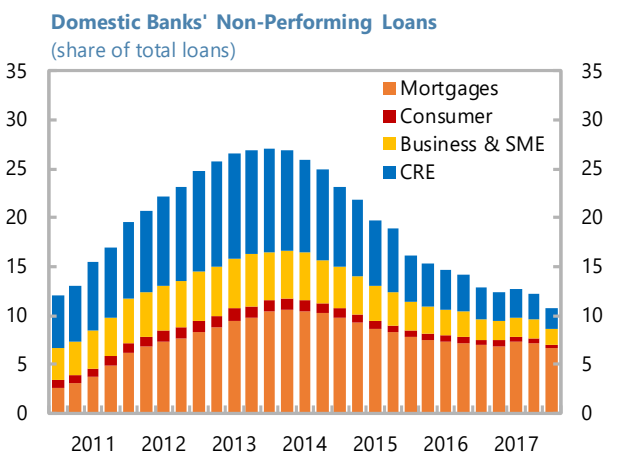
Persistent improvement in net interest margin supported bank profitability...



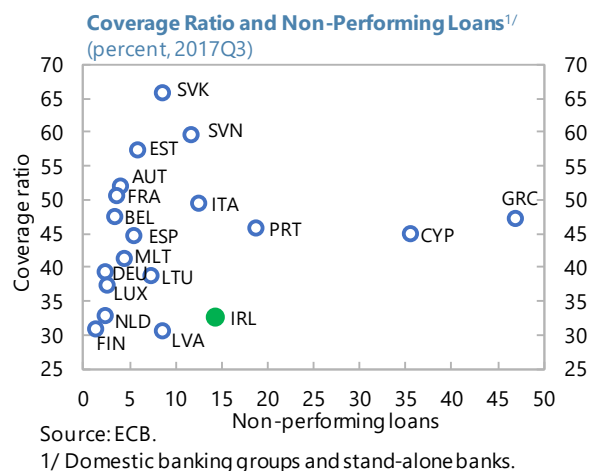
...to above the euro area average.



NPLs have moderated further....

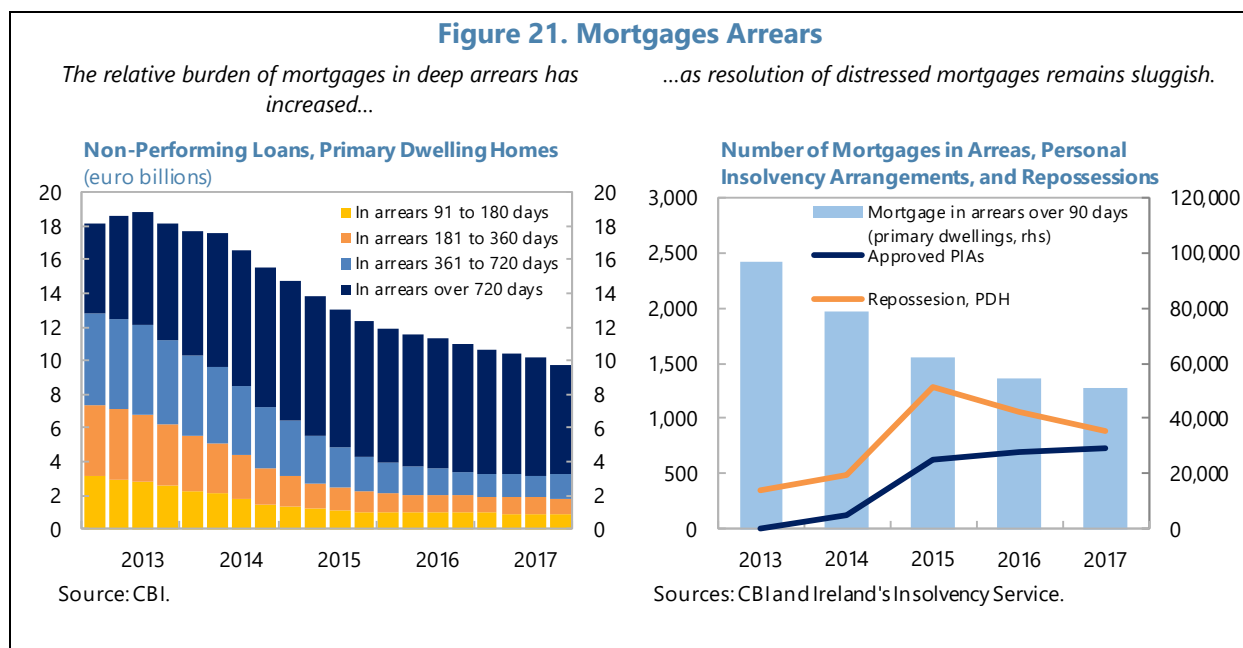


...but the coverage ratio is well below peers.



- **Enhancing supervisory efforts.** Specific and binding guidelines on NPL write offs should be adopted, including on increasing loan-loss provisions.
- **Accelerating legal proceedings.** Streamlining the legal process, including by reducing the high frequency of court adjournments, is warranted. A greater use of the enhanced mortgage-to-rent scheme should be explored as it offers distressed mortgage borrowers who qualify for social housing to stay in their homes at a subsidized rent, while the property is bought by a housing association from the original lender.
- **Strengthening borrower-creditor engagement.** The number of approved Personal Insolvency Arrangements remains low due to lengthy process and rejections by creditors (25 percent). Efforts to enhance the powers of the Insolvency Service and increase the participation to *Abhaile*

service, which provides distressed mortgage holders free legal and financial advice, should continue.



30. Further disposal of government's stakes in the banking system is needed. The government completed a successful Initial Private Offering of 28.8 percent of Allied Irish Banks' (AIB) ordinary shares (€3.4 billion) in June 2017. To date, the government has recovered about 62 percent (€18.6 billion) of its past investment in the banking sector and continues to be a key player in the market with above 70 percent shareholding in AIB and Permanent TSB, and about 14 percent in the Bank of Ireland. It is important to gradually scale down the government's ownership in the banking sector to reduce the public debt and contain potential liabilities.

31. Preparations in the financial sector for Brexit should continue. Domestic banks are highly exposed to the British economy given their direct lending to U.K. corporates and households as well as indirectly through their exposure to SMEs that export to the U.K. or use British inputs. Moreover, further Sterling weakness could adversely affect banks profitability. Banks' contingency plans should be reviewed to ensure that their business models are suitable to respond to a material change in economic conditions. A persistent reduction of NPLs accompanied with conservative collateral valuation would improve their resilience to a possible slowdown of the British economy and deterioration in Irish companies' repayment capacity. Given the strong Ireland-U.K. linkages in the insurance sector, which include sale of insurance products, cross-border reinsurance, and outsourced services providers, a close engagement with insurance companies is needed to improve their readiness to a possible change in the regulatory landscape and mitigate contract continuity risk.

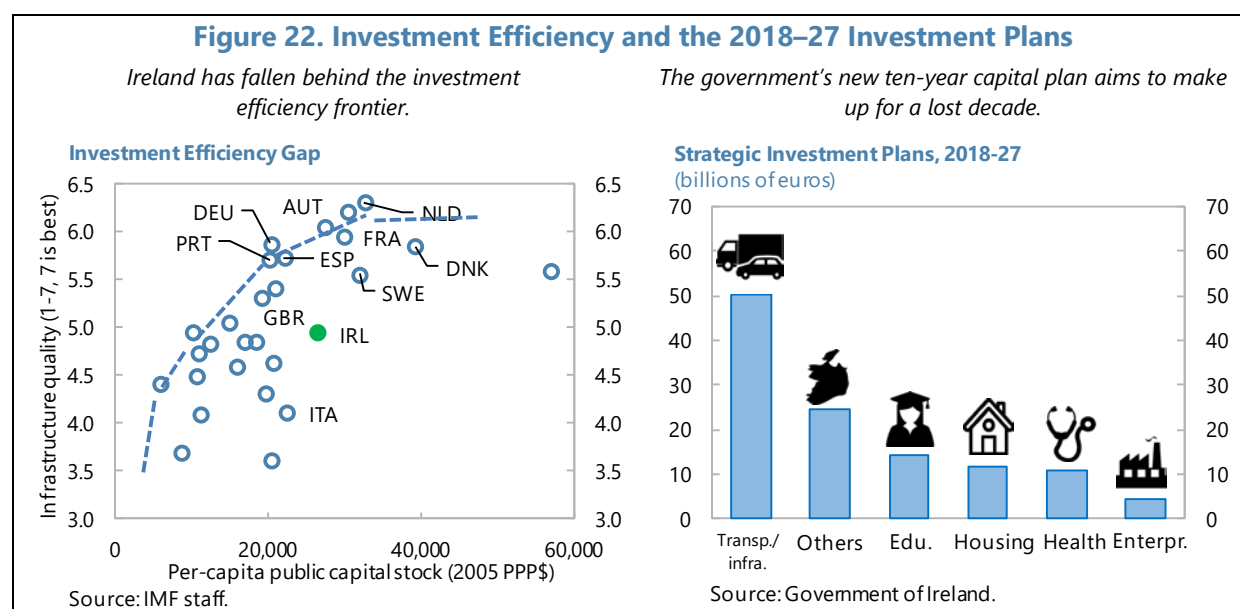
Authorities' Views

32. The authorities shared staff views on the challenges to the banking system and emphasized that NPL resolution remains a key priority. They recognized that significant work remains to be done regarding NPL resolution, including to reduce the extended timelines associated with repossession proceedings for residential properties, and highlighted their proactive approach to ensuring that lenders have appropriate arrears resolution strategies and operations in place. The national authorities affirmed their commitment to improve the conduct of lenders, including through the completion of the Tracker Mortgage Examination and adoption of reforms that will strengthen the accountability of senior personnel in regulated entities. The authorities emphasized their continued and intense engagement in assisting the financial sector in preparing for Brexit. Finally, the national authorities confirmed their intent to further reduce state shareholding in the banking system in the coming years, depending on market conditions.

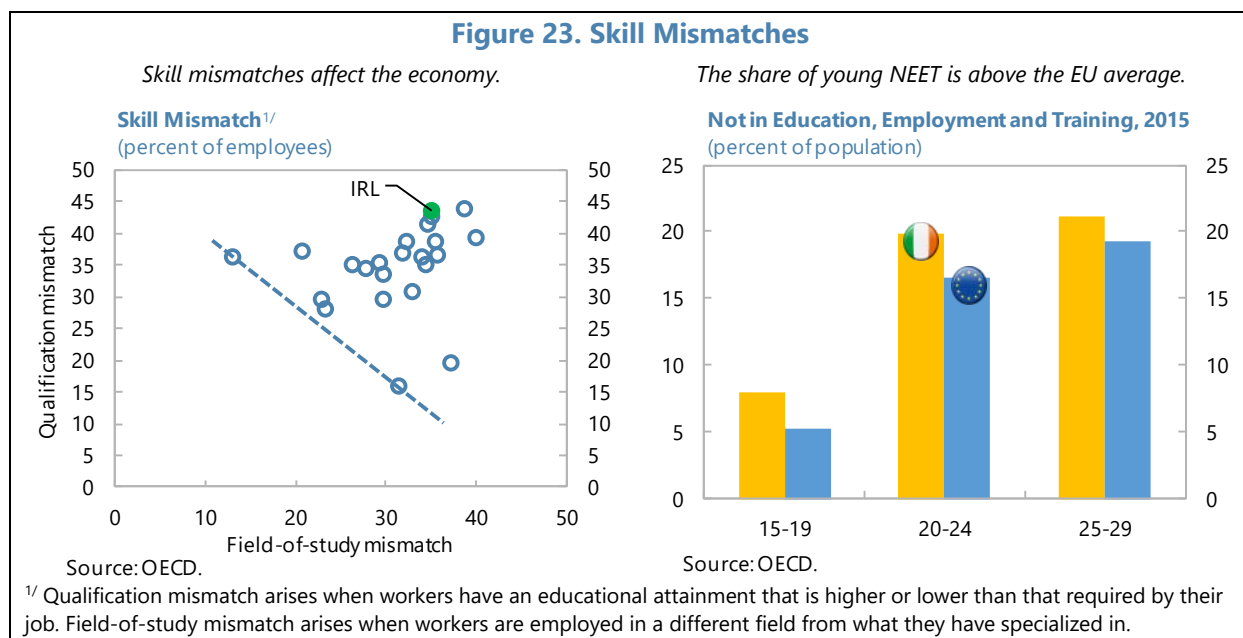
PROMOTING SUSTAINABLE GROWTH

33. To support high sustainable growth and enhance resilience to shocks, continuous efforts are needed to address Ireland's four main structural gaps:

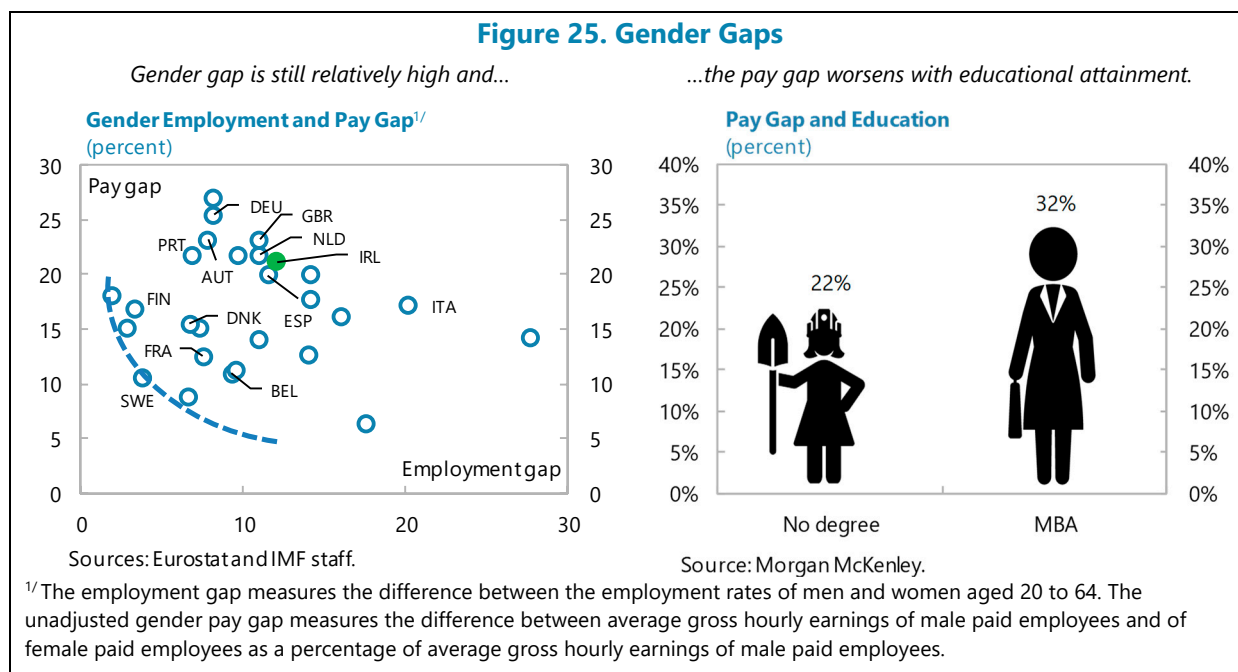
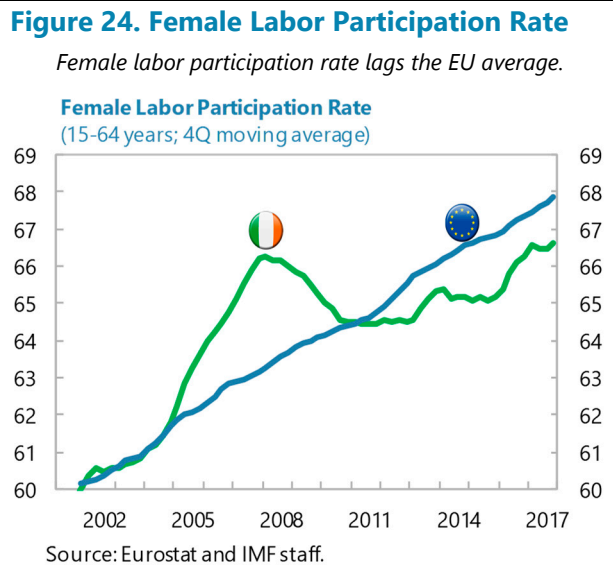
- **Infrastructure gap.** Weak effectiveness of pre-crisis investment spending and substantial cuts in public outlays in response to the crisis have resulted in a significant gap in public investment efficiency (IMF). Moreover, the uneven distribution of infrastructure across regions hampers balanced growth. To ensure Ireland's long-term economic, environmental and social progress, the government has launched its [National Development Plan for 2018–27](#). The Plan envisages an increase in public investment by one percentage point to 4 percent of GNI* by 2024 and beyond. Against this backdrop, it is crucial that investment is properly prioritized to best achieve value-for-money.



- Productivity gap.** Ireland's (relatively) high level of productivity is largely due to the performance of large MNEs, whereas local firms have been lagging. The gap between the top performers and the rest has widened over time, and spillovers between MNEs and local firms remain limited (OECD). Productivity differentials are mirrored by a wage gap, with salaries in MNEs being 60–70 percent higher than in domestic companies (EC). Public sector Research and Development spending (0.35 percent of GDP in 2016) is on a downward trend and less than half of the euro area average. Promoting sustainable productivity growth of local firms is therefore critical. To this end, further efforts are needed to encourage higher innovation activities among domestic SMEs, including through greater direct public support and by enhancing partnerships of SMEs with education and research institutions.
- Labor skills gap.** While Ireland is reported to have little difficulty in filling vacancies (Manpower Talent Shortage Survey), skill shortages are rapidly emerging, most notably in information communications technology, financial services, and engineering. In terms of qualification and field-of-study mismatch, Ireland does not compare favorably with other OECD countries. Although Ireland has a proven capability in attracting highly educated workers, the evidence shows that migrants' skills are not being fully utilized, facing both pay and occupational gaps (ESRI, 2017). In addition, the relatively high share of young people not in education, employment, and training (NEET) is at risk of becoming socially excluded. Determined efforts are needed to make educational paths and training programs more responsive to labor market needs and more accessible to young people from disadvantaged regions.



- Gender gap.** Since the crisis, female labor participation, albeit recovering, has been lagging the EU average. Women’s educational strides (43 percent of females in Ireland have a third level qualification compared to 40 percent of males) have not translated into equal job opportunities and pay. Contrary to expectations, the pay gap increases with educational attainment. Closing the employment gap would result in uplifting potential GNI* by about 10 percentage points. The recent [Pathway to Work Action Plan for Jobless Households](#) (September 2017) aims at improving incentives and removing barriers to facilitate employment. Policies should aim at addressing those hurdles that discourage women from participating in the labor force (e.g., providing affordable child care, reducing high second-earner marginal tax rates and removing gender pay gaps) and fostering women’s entrepreneurship.



Authorities' Views

34. The authorities are committed to advancing the complex structural agenda. They were determined to continue implementing the [National Planning Framework](#), which lays out key development areas to promote the sustainable and balanced growth of regions out to 2040. They also made additional room in the budget for the comprehensive [National Development Plan 2018–2027](#), the Government's new long-term capital investment plan which will underpin the National Planning Framework and drive its implementation over the next 10 years. The NDP also includes proposals to address key infrastructure gaps across multiple sectors, including transport, housing, healthcare, and education. With help of the labor activation program they aimed at increasing labor force participation, especially for women, while the [National Skill Strategy](#) continues to provide for upskilling and reskilling of the labor force, taking account of survey-based needs of SMEs. Small Business Innovation Research projects and partnerships with research centers help enhancing SMEs' innovation, while the [Strategic Banking Corporation of Ireland](#)'s risk-sharing products aimed at providing SMEs access to cheaper credit have been in high demand and could facilitate productivity growth in this sector.

STAFF APPRAISAL

35. Ireland has made great strides in recovering from the crisis and the economy is on a strong growth path, but faces several challenges. The broad-based and job-rich economic expansion has brought unemployment to its lowest level in more than a decade, and public and private balance sheets have been strengthened. However, the economy is rapidly approaching full employment and still subdued construction has resulted in severe housing shortages, fueling price hikes and stretching affordability. Moreover, alternative metrics for domestic activity, which help to correct for the large global activities of MNEs, indicate that debt ratios remain elevated. The outlook remains favorable, yet an escalation in global protectionism, a possible hard Brexit, and changes in international corporate taxation pose downside risks. Ireland's external position is moderately stronger than implied by its medium-term fundamentals and desirable policy settings. However, important issues in the measurement of Ireland's MNE activities add to the uncertainties in the overall assessment, and staff considers that no changes in Ireland's policy settings are required in light of such assessment at this juncture.

36. The policy challenge is to harness the strong economic momentum to avoid another boom-bust cycle, while addressing remaining crisis legacies to bolster the economy's resilience and strengthening the foundation for high, sustainable growth.

37. A countercyclical fiscal policy stance would help alleviating demand pressures and support building buffers for use in case of need. Staff recommends pursuing a small budget surplus in 2019, and to aim at reducing the public debt ratio to close to 50 percent of GDP over the medium term. To make room for much-needed infrastructure investments, the tax base should be broadened in a growth-friendly manner. Phasing out VAT preferential rates and exemptions, better targeting tax expenditures, and increasing property and green taxes would also help reduce the

reliance on concentrated and volatile corporate income taxes. Corporate tax windfalls should be used to further reduce the public debt or increase contributions to the forthcoming Rainy-Day Fund. Improving expenditure quality and efficiency would help containing spending growth. In view of rising population ageing costs, the financial soundness of the Social Insurance Fund needs to be strengthened, including by reviewing social contribution rates.

38. A sustainable housing supply response is needed to reduce price pressures and improve affordability. Measures to ramp up the housing supply should focus on further streamlining planning processes, reducing skills gaps in construction, and restructuring the debt of distressed but viable construction firms. Effective policies to counter land hoarding are equally important. Efforts to expand social housing are welcome but it is important to ensure that eligibility is means-tested. Measures to support housing affordability should be well-targeted to avoid exacerbating price pressures or, in the case of rent controls, stunt the supply response. The upswing in the commercial real estate market requires close attention and tax measures should continue to be used to dampen the market's volatility.

39. Further improving the resilience of the banking system is necessary and preparations for Brexit should continue. Significant progress has been made in reducing NPLs but the resolution of distressed mortgages remains difficult. Accelerating legal processes, encouraging creditor-borrower engagement, increasing provisioning requirements, and providing binding supervisory guidelines on NPL write-offs would help speeding up the cleanup of bank balance sheets. Efforts should continue to ensure that bank business models are sufficiently nimble to respond to all Brexit outcomes. Insurance companies should focus on their readiness for a possible change in the regulatory framework and to mitigate contract continuity risk.

40. Addressing structural impediments is key to promote high, sustainable growth, while strengthening the economy's resilience to shocks, including from Brexit. The National Development Plan for 2018–27 is a good step towards reducing sizable infrastructure gaps, provided the investments are well-prioritized and efficient. Boosting productivity of domestic firms, including through greater support for innovation and enhancing partnerships of SMEs with research institutions, would bolster their competitiveness. Determined efforts to better align educational paths with business needs, and increase female employment are also important.

41. Staff proposes that the next Article IV consultation with Ireland take place on the standard 12-month cycle.

Table 1. Ireland: Selected Economic Indicators, 2016–23

Populations (2017, millions):	4.7		Per capita income (euros):		62,559			
Quota (as of May 31, 2018, millions of SDRs):	3,449.9		At-risk-of -poverty rate 1/:		16.6			
			Projections					
	2016	2017	2018	2019	2020	2021	2022	2023
(annual percentage change, constant prices, unless otherwise indicated)								
Output/Demand								
Real GDP	5.1	7.8	5.0	4.1	3.5	3.0	2.8	2.8
Domestic demand	21.2	-7.8	5.7	4.3	3.6	2.9	2.6	2.6
Public consumption	5.2	1.8	2.4	1.7	1.4	1.3	1.3	1.3
Private consumption	3.1	2.1	2.4	2.5	2.5	2.4	2.4	2.3
Gross fixed capital formation	60.0	-21.8	12.1	7.7	5.9	4.1	3.5	3.5
Exports of goods and services	4.7	6.8	4.9	4.5	4.3	4.3	4.2	4.2
Imports of goods and services	16.4	-6.2	5.4	4.8	4.6	4.6	4.5	4.6
Potential Growth	4.4	7.1	5.0	4.3	3.8	3.4	3.3	3.2
Output Gap	1.1	1.8	1.8	1.6	1.4	1.0	0.6	0.2
Contribution to growth								
Domestic demand	13.9	-5.9	3.9	2.9	2.5	2.0	1.8	1.8
Public consumption	0.5	0.2	0.2	0.2	0.1	0.1	0.1	0.1
Private consumption	1.1	0.7	0.8	0.8	0.8	0.8	0.8	0.7
Gross fixed capital formation	12.1	-6.9	2.8	1.9	1.5	1.1	0.9	0.9
Inventories	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net exports	-9.1	14.5	1.2	1.1	1.0	1.0	1.0	1.0
Residual	0.3	-0.8	0.0	0.0	0.0	0.0	0.0	0.0
Prices								
Inflation (HICP)	-0.2	0.3	0.9	1.3	1.7	1.9	1.9	1.9
Inflation (HICP, end of period)	-0.3	-0.1	1.8	1.4	1.8	1.9	1.9	1.9
GDP deflator	0.0	-0.3	0.5	1.0	1.4	1.5	1.6	1.7
Terms-of-trade (goods and services)	-0.2	-1.7	0.3	0.1	0.1	0.0	0.2	0.1
Employment and wages								
Employment (ILO definition)	3.7	2.9	2.0	1.7	1.3	1.1	1.0	1.0
Unemployment rate (percent)	8.4	6.7	5.5	5.2	5.0	5.0	4.9	4.9
Average nominal wage	0.8	2.3	2.4	2.5	2.7	2.9	2.9	2.9
(percent of GDP)								
Public Finance, General Government								
Revenue	26.7	25.8	25.4	25.2	24.8	24.6	24.4	24.2
Expenditure	27.2	26.1	25.6	25.3	24.5	24.4	23.9	23.6
Overall balance	-0.5	-0.3	-0.2	-0.1	0.2	0.2	0.5	0.7
Primary balance	1.7	1.6	1.5	1.5	1.7	1.6	1.8	2.1
Structural balance (percent of potential GDP)	-1.0	-0.9	-0.8	-0.6	-0.2	-0.1	0.3	0.6
General government gross debt	72.9	68.1	65.9	63.5	59.9	58.3	55.5	52.5
General government net debt	63.8	58.7	56.3	54.5	52.8	50.9	48.3	45.6
Balance of payments								
Trade balance (goods)	38.5	36.3	33.2	32.9	32.6	32.5	32.3	32.1
Current account balance	3.3	12.5	9.9	8.7	7.7	7.3	6.9	6.5
Gross external debt (excl. IFC)	287.5	256.4	234.4	215.0	197.4	181.4	166.5	152.4
Saving and investment balance								
Gross national savings	35.7	36.7	35.5	35.3	34.9	34.7	34.5	34.3
Private sector	34.6	35.3	34.2	33.8	33.1	33.1	32.5	32.2
Public sector	1.1	1.4	1.4	1.4	1.7	1.6	1.9	2.0
Gross capital formation	32.4	24.2	25.8	26.6	27.2	27.5	27.6	27.8
(percent)								
Monetary and financial indicators								
Bank credit to private sector (growth rate)	-7.6	-3.4	...	...	...	...	...	...
Deposit rates	0.7	0.5	...	...	...	...	...	...
Government 10-year bond yield	0.7	0.8	...	...	...	...	...	...
Memorandum items:								
Nominal GDP (€ billions)	275.2	295.8	312.2	328.1	344.4	360.2	376.6	393.6
Modified total domestic demand (percent)	4.8	4.0	...	...	...	...	...	...
Population growth (percent)	1.0	0.6	1.0	1.0	1.0	1.0	1.0	1.0

Sources: CSO; DoF; Eurostat; and IMF staff.

1/ Share of population with an equalised disposable income (including social transfers) below the threshold of 60 percent of the national median equalised disposable income after social transfers. Data is as of 2016.

Table 2. Ireland: Statement of Operations of the General Government, 2016–23
(Percent of GDP, unless otherwise indicated)

	2016	2017	Projections 1/					2023
			2018	2019	2020	2021	2022	
Revenue	26.7	25.8	25.4	25.2	24.8	24.6	24.4	24.2
Taxes	19.2	18.8	18.8	18.7	18.6	18.5	18.5	18.4
Personal income tax	7.5	7.3	7.2	7.2	7.1	7.1	7.1	7.0
Corporate income tax	2.7	2.8	2.8	2.7	2.6	2.5	2.5	2.5
VAT	4.7	4.5	4.5	4.5	4.5	4.6	4.6	4.6
Excises	1.6	1.6	1.7	1.6	1.6	1.6	1.7	1.7
Other taxes	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Social contributions	4.4	4.3	4.2	4.2	4.1	4.1	4.1	4.1
Other revenue	3.1	2.7	2.4	2.3	2.1	1.9	1.8	1.7
Expenditure	27.2	26.1	25.6	25.3	24.5	24.4	23.9	23.6
Expense	25.3	24.3	23.5	22.9	22.1	21.7	21.3	21.0
Compensation of employees	7.1	7.0	6.9	6.7	6.6	6.6	6.5	6.4
Use of goods and services	3.5	3.3	3.4	3.4	3.3	3.2	3.2	3.1
Interest	2.2	2.0	1.7	1.6	1.5	1.4	1.4	1.4
Subsidies	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Social benefits	10.3	9.8	9.3	8.9	8.7	8.4	8.3	8.1
Other expense	1.6	1.6	1.6	1.7	1.6	1.6	1.5	1.4
Net acquisition of nonfinancial assets	1.9	1.8	2.2	2.4	2.4	2.6	2.6	2.6
Net lending(+)/borrowing(-) (overall balance)	-0.5	-0.3	-0.2	-0.1	0.2	0.2	0.5	0.7
Net financial transactions	-0.5	-0.3	-0.2	-0.1	0.2	0.2	0.5	0.7
Net acquisition of financial assets	-1.4	-0.5	0.5	-0.5	-1.5	0.3	0.1	0.1
Net incurrence of liabilities	-0.9	-0.2	0.7	-0.4	-1.7	0.1	-0.3	-0.5
Memorandum items:								
One-off measures	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance	-1.0	-0.8	-0.8	-0.6	-0.2	-0.1	0.3	0.6
Structural primary balance	1.2	1.1	0.9	1.0	1.3	1.3	1.6	2.0
Gross public debt 2/	72.9	68.1	65.9	63.5	59.9	58.3	55.5	52.5
in percent of GNI*	106.1	98.7	94.5	90.1	84.2	81.4	77.0	72.6
in percent of revenue	273.5	264.2	259.4	251.8	241.8	237.6	227.4	216.8
Net public debt 3/	63.8	58.7	56.3	54.5	52.8	50.9	48.3	45.6
Interest (in percent of revenue)	8.4	7.6	6.7	6.4	5.9	5.8	5.6	5.8
Currency and deposits 4/	5.2	5.7	6.4	6.0	4.6	5.0	5.0	4.9
GDP at current market prices (in billions of euros)	275.2	295.8	312.2	328.1	344.4	360.2	376.6	393.6

Sources: DoF; Eurostat; and IMF staff.

1/ Starting in 2019, staff assumes that the resources available for additional spending but not allocated by the Budget 2018 are distributed mainly among compensation of employees, use of goods and services, and net acquisition of nonfinancial assets.

2/ Includes the accumulation of a Rainy Day Fund of €0.5 billion starting in 2019.

3/ Gross debt minus financial assets corresponding to debt instruments (currency and deposits, debt securities, and loans).

4/ Includes the Rainy Day Fund.

Table 3. Ireland: Summary of Balance of Payments, 2016–23

	2016	2017	Projections					
			2018	2019	2020	2021	2022	2023
(percent of GDP)								
Balance of Payments								
Current account balance	3.3	12.5	9.9	8.7	7.7	7.3	6.9	6.5
Balance of goods and services	22.0	32.2	31.2	30.8	30.5	30.4	30.3	30.3
Trade balance	38.5	36.3	33.2	32.9	32.6	32.5	32.3	32.1
Exports of goods	70.5	65.7	61.0	60.6	60.2	60.2	60.1	60.0
Imports of goods	32.1	29.4	27.7	27.7	27.6	27.7	27.8	27.9
Services balance	-16.4	-4.1	-2.0	-2.1	-2.1	-2.1	-2.0	-1.8
Primary income balance	-17.3	-18.2	-19.8	-20.5	-21.1	-21.3	-21.5	-21.7
Credit	25.5	26.5	24.8	24.1	23.5	23.3	23.1	22.9
Debit	42.8	44.7	44.6	44.6	44.6	44.6	44.6	44.6
Secondary income balance	-1.4	-1.4	-1.5	-1.6	-1.7	-1.8	-1.9	-2.0
Capital account balance	-1.8	-9.1	-1.3	-1.0	-0.8	-0.5	-0.5	-0.5
Financial account balance	4.3	-0.3	8.6	7.7	6.9	6.8	6.4	6.0
Direct investment	4.9	-3.1	-3.0	-2.9	-2.8	-2.8	-2.7	-2.7
Portfolio investment	12.4	-28.4	11.8	11.3	10.7	10.3	9.8	9.4
Other investment	-13.5	31.1	-0.2	-0.7	-1.0	-0.7	-0.7	-0.7
Change in reserve assets	0.5	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	2.8	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Net International Investment Position								
Net investment position	-176.1	-155.7	-138.9	-124.5	-111.7	-100.0	-89.3	-79.4
Net direct investment	-0.3	5.4	2.2	-0.8	-3.6	-6.2	-8.7	-11.0
Net portfolio investment	-213.6	-186.0	-164.5	-145.2	-127.6	-111.7	-97.1	-83.5
Net other investment	36.6	23.7	22.2	20.4	18.5	16.9	15.5	14.1
Reserve assets	1.2	1.2	1.2	1.1	1.1	1.0	1.0	0.9
External Debt								
Total external debt	767.4	684.4	640.0	600.9	565.0	532.8	502.6	474.0
Non-IFSC external debt	287.5	256.4	234.4	215.0	197.4	181.4	166.5	152.4
IFSC external debt	479.9	428.0	405.6	385.8	367.6	351.4	336.2	321.6
Short-term debt	145.6	144.5	135.1	126.9	119.3	112.5	106.1	100.1
Medium & long term debt	621.9	539.9	504.9	474.0	445.7	420.3	396.5	373.9
Memorandum item:								
Modified current account balance (CA*) 1/	4.9	5.0	...	...	...	...	...	...

Sources: CBI; CSO; and IMF staff.

1/ 2017 is an estimate.

Table 4. Ireland: Monetary Survey, 2013–2018 1/
(Billions of Euros, unless otherwise specified, end of period)

	2013	2014	2015	2016	2017	2018 1/
Aggregate balance sheet of domestic market credit institutions						
Assets	476.6	423.4	377.6	356.2	332.7	334.6
Claims on Central Bank of Ireland	2.0	3.3	5.5	10.4	9.9	13.0
Claims on Irish resident Other MFIs	48.6	47.3	46.1	41.5	38.4	38.2
Claims on Irish resident non MFIs	280.5	236.5	205.8	190.4	183.2	180.9
General government	20.5	20.1	18.4	17.3	15.9	16.3
Private sector	260.0	216.4	187.4	173.2	167.3	164.7
Households	107.7	96.9	92.0	88.2	89.5	88.5
Non-Financial Corporations	78.0	58.0	44.2	39.5	38.2	38.2
Non-Bank Financial Intermediaries	74.3	61.5	51.2	45.5	39.6	37.9
Claims on non-residents	105.5	94.0	83.5	72.6	65.5	63.1
Other assets	40.1	42.3	36.7	41.2	35.8	39.3
Liabilities	476.6	423.4	377.6	356.2	332.7	334.6
Liabilities to Eurosystem 2/	30.5	13.6	10.0	7.0	7.4	7.4
Liabilities to Irish resident Other MFIs	52.1	49.8	46.3	39.4	35.9	35.6
Deposits of Irish resident non MFIs	175.3	163.1	166.6	169.1	175.4	176.9
General government	13.7	8.6	4.2	3.7	3.0	3.3
Private sector	161.6	154.5	162.3	165.4	172.4	173.5
Households	91.1	91.4	94.7	97.1	99.5	101.1
Non-Financial Corporations	32.4	37.5	40.1	42.5	47.6	47.7
Non-Bank Financial Intermediaries	38.1	25.6	27.5	25.8	25.3	24.8
Deposits of non-residents	72.2	63.7	42.8	38.5	23.7	23.7
Debt securities	26.9	27.4	25.2	23.1	21.2	22.5
Capital and reserves	96.6	80.2	67.2	61.3	57.4	56.1
Other liabilities (incl. Central Bank of Ireland)	22.9	25.5	19.5	17.8	11.7	12.4

Sources: CBI and IMF staff.

1/ As of April 2018.

2/ Relating to Eurosystem monetary policy operations.

Table 4. Monetary Survey, 2013–2018 1/ (Concluded)
(Billions of Euros, unless otherwise specified, end of period)

	2013	2014	2015	2016	2017	2018 1/
Aggregate balance sheet of domestic market credit institutions						
Assets	476.6	423.4	377.6	356.2	332.7	334.6
Claims on Central Bank of Ireland	2.0	3.3	5.5	10.4	9.9	13.0
Claims on Irish resident Other MFIs	48.6	47.3	46.1	41.5	38.4	38.2
Claims on Irish resident non MFIs	280.5	236.5	205.8	190.4	183.2	180.9
General government	20.5	20.1	18.4	17.3	15.9	16.3
Private sector	260.0	216.4	187.4	173.2	167.3	164.7
Households	107.7	96.9	92.0	88.2	89.5	88.5
Non-Financial Corporations	78.0	58.0	44.2	39.5	38.2	38.2
Non-Bank Financial Intermediaries	74.3	61.5	51.2	45.5	39.6	37.9
Claims on non-residents	105.5	94.0	83.5	72.6	65.5	63.1
Other assets	40.1	42.3	36.7	41.2	35.8	39.3
Liabilities	476.6	423.4	377.6	356.2	332.7	334.6
Liabilities to Eurosystem 2/	30.5	13.6	10.0	7.0	7.4	7.4
Liabilities to Irish resident Other MFIs	52.1	49.8	46.3	39.4	35.9	35.6
Deposits of Irish resident non MFIs	175.3	163.1	166.6	169.1	175.4	176.9
General government	13.7	8.6	4.2	3.7	3.0	3.3
Private sector	161.6	154.5	162.3	165.4	172.4	173.5
Households	91.1	91.4	94.7	97.1	99.5	101.1
Non-Financial Corporations	32.4	37.5	40.1	42.5	47.6	47.7
Non-Bank Financial Intermediaries	38.1	25.6	27.5	25.8	25.3	24.8
Deposits of non-residents	72.2	63.7	42.8	38.5	23.7	23.7
Debt securities	26.9	27.4	25.2	23.1	21.2	22.5
Capital and reserves	96.6	80.2	67.2	61.3	57.4	56.1
Other liabilities (incl. Central Bank of Ireland)	22.9	25.5	19.5	17.8	11.7	12.4

Sources: CBI and IMF staff.

3/ Including banks in the International Financial Service Center.

4/ Sourced from quarterly IIP statistics.

5/ Differs from the M3 (M2) Irish contribution to euro area as only liabilities vis-a-vis Irish residents are used.

6/ Refers to credit advanced by domestic market credit institutions.

7/ Includes IFSC.

8/ Growth rates adjusted for valuation, reclassification, derecognition/loan transfer to non-MFIs, and exchange rates.

9/ Excludes IFSC.

10/ Domestic market credit institutions' private sector credit to deposits.

11/ Includes resident and non-resident MFI deposits, and debt securities issued.

Table 5. Ireland: Main Domestic Banks' Aggregated Summary Financial Statements, 2016Q4–2017Q4 ^{1/}
(Billions of Euros, unless otherwise indicated)

Balance Sheet	2016Q4	2017Q4	Y/Y change		Profit and Loss Account				
	€ bn.	€ bn.	€ bn.	%	2016Q4		2017Q4		
					€ bn.	% of TAA	€ bn.	% of TAA	
Cash & due from Eurosystem	13.2	15.6	2.4	18.4	Interest income	6.5	2.7	6.0	2.7
Net loans	158.0	155.0	-3.0	-1.9	Interest expense	-1.8	-0.8	-0.3	-0.1
Due from banks	4.6	3.9	-0.7	-16.0	Net interest margin	4.6	2.0	5.6	2.5
Securities & derivatives	42.6	35.6	-6.9	-16.3	Net fee income	1.0	0.4	1.2	0.5
Other assets	8.5	9.0	0.5	5.9	Net trading gains	0.1	0.0	0.2	0.1
Total assets	226.9	219.1	-7.8	-3.4	Other nonrecurrent items	0.5	0.2	0.2	0.1
Total average assets (TAA)	236.6	222.0	-14.6	-6.2	Gross operating income	6.3	2.7	7.2	3.2
Due to Eurosystem	5.8	6.3	0.5	9.4	Operating expenses	-3.8	-1.6	-4.3	-1.9
Due to banks	11.7	6.4	-5.3	-45.5	o/w: administration & other	-2.1	-0.9	-2.5	-1.1
Deposits	154.3	155.6	1.3	0.8	o/w: staff	-1.7	-0.7	-1.8	-0.8
Debt & derivatives	25.9	20.9	-5.1	-19.5	Preprovision profits (PPP)	2.5	1.1	2.8	1.3
Other liabilities	4.5	4.5	0.0	0.9	Loan loss & NAMA provisions	0.2	0.1	0.0	0.0
Total liabilities	202.2	193.7	-8.5	-4.2	Loss on derecognized assets	-0.2	-0.1	0.1	0.1
Net equity	24.7	25.4	0.8	3.1	Net income before tax	2.5	1.0	3.0	1.4
Total liabilities & equity	226.9	219.1	-7.8	-3.4	Tax effects & other	-0.6	-0.2	-0.4	-0.2
					Net income	1.9	0.8	2.6	1.2
<i>Memorandum items:</i>									
Gross loans ^{2/}	169.0	162.4	-6.6	-3.9	PPP net of other nonrecurrent items	2.0	0.8	1.9	0.8
Loan loss provisions	11.0	7.9	-3.0	-27.7	Return on equity		7.6		10.4
Gross NPLs	21.8	17.4	-4.4	-20.2	Provisions to gross loans		0.1		0.0
Gross NPLs to gross loans (%)	12.9	10.7		-17.0	Risk weighted assets (RWA)	115.5	48.8	107.5	48.4
Provisions to gross NPLs (%)	50.3	45.6		-9.4	Core tier 1 capital (CT1) and CT1 to RWA (%)	19.4	16.8	19.7	18.3
Net NPLs to net equity (%)	44.0	37.2		-15.3	CT1 to total assets = leverage ratio (%)		8.5		9.0

Sources: CBI and IMF staff.

^{1/} Bank of Ireland, Allied Irish Banks, and Permanent tsb.

^{2/} Includes loans held for sale, classified on balance sheet as other assets.

Annex I. Public Debt Sustainability Analysis (DSA)

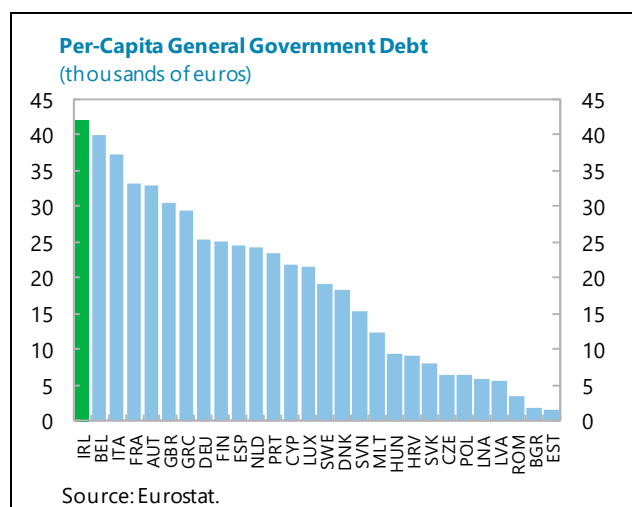
A. Summary

1. Ireland’s public debt sustainability has continued to improve. Several factors bode well for debt sustainability:

- The government’s prudent fiscal stance and the relatively long maturity of public debt are estimated to bring about moderate gross borrowing requirements over the forecasting period, with a small uptick in 2019–20.
- The early and in full repayment of the outstanding IMF loan together with the bilateral loans from Denmark and Sweden (in total about €5.5 billion) further reduces Ireland’s interest burden (estimated at about €150 million over the remaining lifetime of the loans), while smoothing and extending the debt maturity profile.
- Contingent risks have been reduced significantly as the banking sector continues to strengthen its resilience to shocks; and the NAMA completed the redemption of its senior debt in October 2017, three years ahead of schedule. It is also expected that NAMA’s winding down in 2020 might generate a profit of some €3 billion.
- Over the short-term, bond yields and CDS spreads are expected to remain low, owing to the ECB’s QE policy.¹ A prospective return of interest rates to more normal levels is estimated to have a negligible short-term impact on debt dynamics, as most public debt is at fixed rates and with medium-term maturity.
- Further disposal of government’s stakes in the banking system presents an upside risk.

2. However, the debt burden remains elevated and vulnerabilities persist.

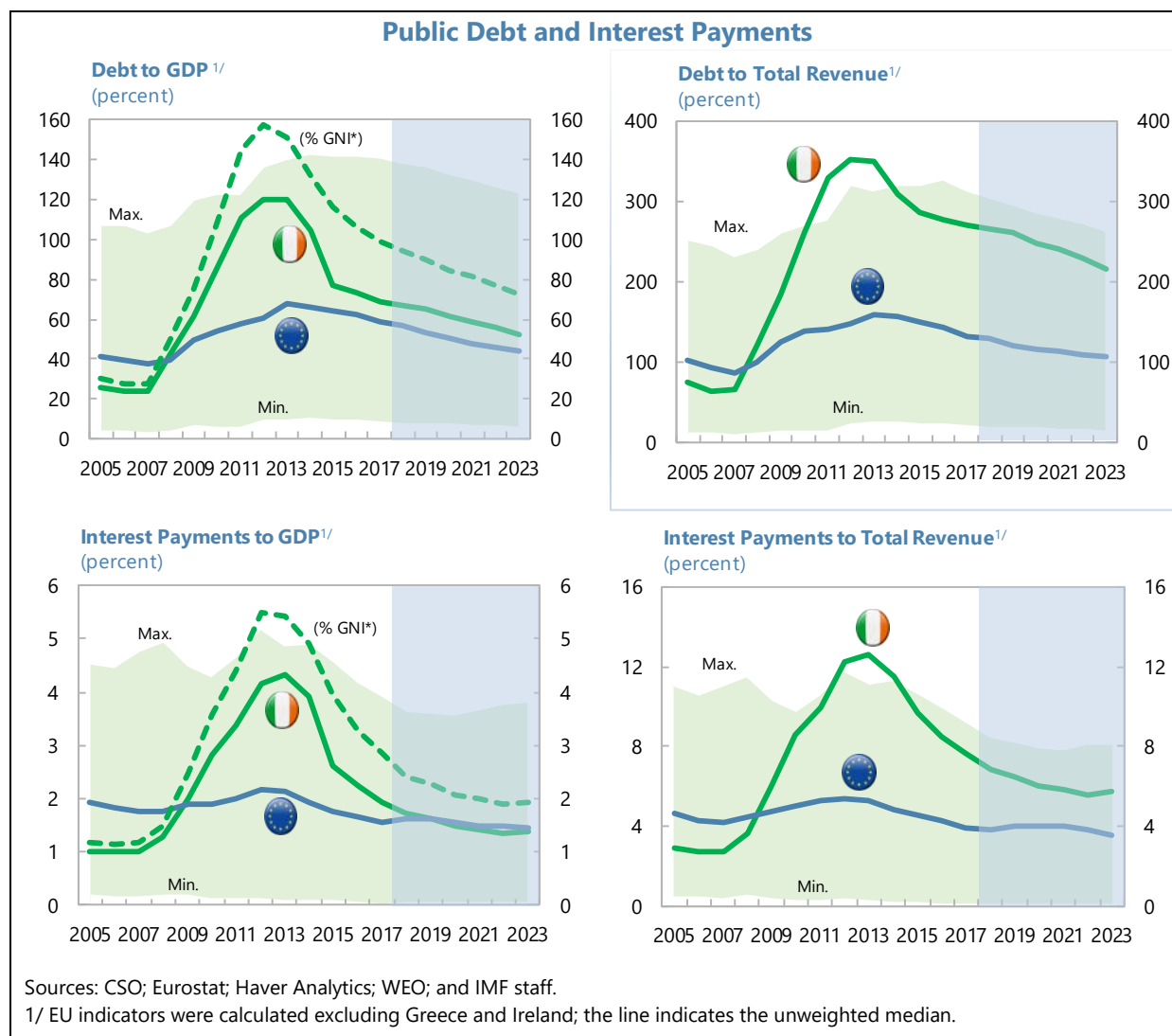
- Alternative scaling metrics such as GNI*, which provides a more accurate measure of the size of the economy than nominal GDP, government revenue, or in per-capita terms show that Ireland’s public debt burden remains high.
- Debt dynamics are vulnerable to macro-financial and contingent liability shocks. While debt metrics remain within the



¹ In 2017, the National Treasury Management Authority (NTMA) raised €17 billion from the market with an average maturity of 13.2 years and an average interest rate of 0.88 percent. In 2018, the NTMA has a funding range of €14–18

tolerance limits when expressed in terms of GDP, the heat map would turn mostly red, especially for the debt stock, when GNI* is used as yardstick.

- The relatively high share of debt held by non-residents poses potential vulnerabilities, but a sudden-stop scenario represents a tail risk since non-resident holders are mainly real-money investors with long-term investment plans.



billion. As of mid-April 2018, the NTMA has issued €10.3 billion with a weighted average maturity of 12.3 years and a weighted average yield of 1.1 percent.

B. Baseline Scenario

3. Ireland's public debt burden is projected to decline steadily over the medium term.

Sound fiscal performance, as incorporated in staff's forecast², and the positive real growth-interest rate differential would bring the gross public debt to 53 percent of GDP (46 percent of GDP in net terms) by 2023 from about 68 percent (59 percent in net terms) in 2017 and 120 percent (87 percent in net terms) in 2012. However, the well-known problems with Ireland's headline GDP figures mean that the conventional debt metrics overstate the debt improvement.

4. Expressed in terms of GNI* or general government revenue, the improvement path would be slower. These alternative metrics show that, although remaining on a downward path, the debt burden would continue to compare unfavorably with EU peers. However, privatization proceeds and any potential funds related to a settlement of the EC ruling on Apple Inc., which have not been incorporated into current projections, may provide additional resources for debt reduction.

Box. Main Working Assumptions

In carrying out the public DSA, the following working assumptions have been made:

1. Since the share of debt denominated in foreign currency (mainly, the U.K. bilateral loan granted during the crisis) is small (about 2 percent of the outstanding stock) and fully hedged, the DSA exercise has been carried out as if all the public debt was denominated in euros.
2. About 10 percent of Ireland's public debt is represented by the State Savings Scheme, including Post Office Savings bank deposits, that, although redeemable on demand, have been a stable source of medium-term funding, even during the crisis period. For the calculation of the gross financing needs, it is assumed that 20 percent of the stock of these liabilities falls due each year of the projection period and is fully rolled-over with a medium-term maturity beyond the projection period. Similar assumptions were made for another small portion of Ireland's public debt (2 percent of the total), which is due to local authorities and other general government entities. As a result, both these components of the public debt are kept constant over the projection period at their (estimated) 2017 level.
3. With the phasing out of the ECB's QE policy, the 10-year bond spread between Ireland and Germany is projected to gradually widen over the medium-term to 125 basis points from the current 30 basis points. As a result, the real interest rate on new issuances becomes closer to real output growth, although the growth-interest rate differential remains positive.

5. Gross financing needs (GFNs) are estimated to remain modest. As result of the government's prudent fiscal stance and the relatively long maturity of the public debt, Ireland's GFNs are estimated to average about 6 percent of GDP (about 8 percent of GNI*) over the 2018–23 period, with a peak at around 8 percent of GDP (11½ percent of GNI*) in 2020. However, some 20 percent of the estimated GFNs (equivalent to about one percent of GDP) is represented by stable

² Over 2007–15, there is no evidence of systematic bias in the staff projections of the main macroeconomic and fiscal variables except during the crisis period and at the time of the large revision of national accounts in 2015.

liabilities (see Box), which have historically been fully renewed, thus reducing the government's needs to tap financial markets.

6. However, vulnerabilities endure. The Irish economy is highly integrated into the world economy and is concentrated in a small number of sectors. This leaves the economy, and hence the public finances, vulnerable to a broad range of common and idiosyncratic shocks. In addition, the CIT proceeds, which account for about 11 percent of total revenue, are highly concentrated, with the top ten payers accounting for about 40 percent of the tax receipts. Furthermore, staff estimates that more than 50 percent of Ireland's total CIT revenue is paid by affiliates of U.S.-based MNEs. Therefore, the U.S. corporate tax reform might affect Ireland's public finances.³

C. Risk Assessment

7. In carrying out the stress scenarios, shocks were calibrated to consider Ireland-specific features. In particular:

- **The growth shock** is normally assumed to be one standard deviation of the historical growth rate calculated over a 10-year period (2008–17). However, the 2015 revision of national accounts had a substantial effect on both 2014 and 2015 growth rates. If applied, the standard approach would result in a recession (growth would contract, on average, by almost 5½ percent in 2019–20) more severe than that experienced during the crisis (average of -4½ percent in 2008–09). Therefore, the standard deviation for growth was calculated over the 2004–13 period. The shock remains substantial with growth contracting by an average of about 0.3 percent in 2019–20; this could represent the outcome of a very negative Brexit scenario.
- **The primary balance shock** is usually modeled as half of the historical standard deviation (2008–17) of the primary balance in percent of GDP. However, in the case of Ireland, the historical primary balance would include also the financial support granted to the banking sector during the crisis. The standard deviation was therefore recalculated excluding those expenditures to provide a more accurate picture of underlying developments. This, nonetheless, implies a significant worsening of the primary balance, which shifts from a surplus of almost 1½ percent of GDP in 2018 to an average deficit of about 0.6 percent in 2019–20.
- **The interest rate shock** is by default equal to the difference between the average effective (real) interest rate on government debt in the projection period (2018–23) and the maximum value of that variable in the previous 10 years. Given the high interest rates on government debt during the financial crisis, this standard methodology would result in an interest rate shock of over 800 basis points (bp); more than ten times the current spread for Irish government bonds. The shock was therefore scaled down to 200bp, which would imply issuing government bonds at an interest rate almost three times the current one.

³ See "The Impact of International Tax Reforms on Ireland", *Selected Issues Paper*, Chapter II, International Monetary Fund, 2018.

- **A combined macro-fiscal shock** estimates the impact of the above-described shocks together.
- **A contingent financial liability shock (CFL)** combines a growth shock, like the one described above, with a one-time increase in public expenditure equal to 10 percent of banks' assets. However, this is likely to be a tail risk as domestic banks have significantly strengthened their capital buffers.
- **A customized shock** was devised by assuming a permanent decline in CIT revenue by 20 percent, reflecting the volatility of MNEs' operations. This is equivalent to about two-thirds of the difference between actual and expected CIT revenue in 2015 (the year of the large revision of national accounts), about half of the CIT proceeds from the ten largest companies, and almost half of the estimated CIT losses, should the Irish affiliates of U.S.-based MNEs allocate their profits more in line with their activity in Ireland. In this scenario, lower MNEs' profits are accompanied by a severe one-time drop in headline GDP, calculated to be about 12 percent based on the accounting relationship between GDP, profits, wages, and taxes.⁴ Assuming the consequences for the underlying domestic economy are limited, non-CIT revenues are kept unchanged in nominal terms compared to the baseline. Similar assumption is made regarding public expenditure.

8. Based on traditional metrics, debt dynamics appears to be resilient to shocks, although vulnerable to macro-financial shocks. As shown in the heat map (Figure 5), all the debt metrics expressed in terms of GDP would remain within the risk assessment benchmarks, except for the CFL shock scenario.

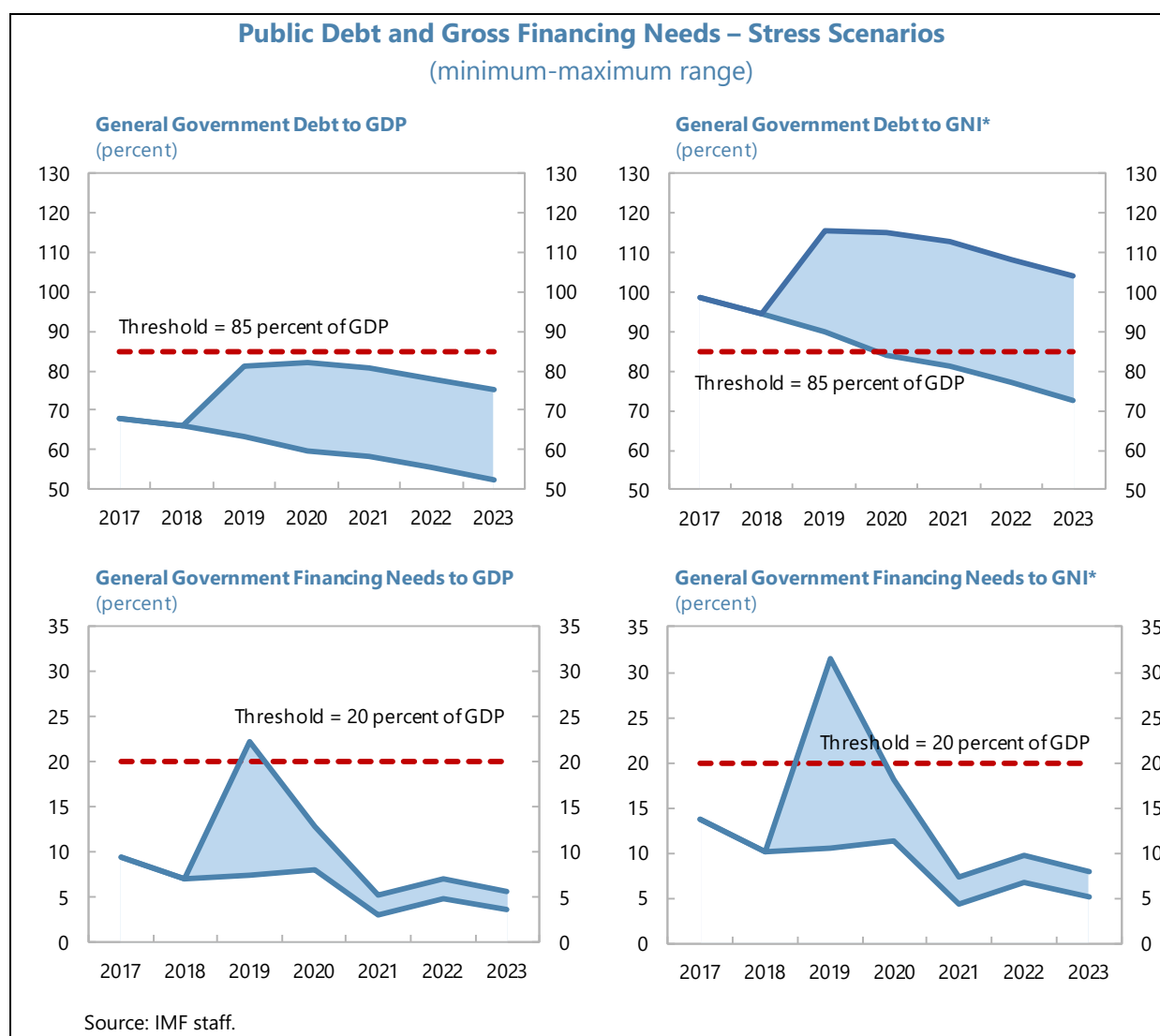
- In the CFL shock scenarios, the debt-to-GDP ratio almost reaches the 85 percent threshold, with the GFNs briefly surpassing the 20 percent of GDP vulnerability mark. Although returning on a downward path, the debt-to-GDP ratio would remain close to 75 percent in 2023; more than 20 percentage points higher than in the baseline and about 10 percentage points above the starting point.
- In the growth-shock scenario as well as in the combined macro-financial and customized scenarios, the debt burden would return approximately to the level at the beginning of the scenario analysis (around 63 percent of GDP). In these circumstances, the government's goal of bringing the debt-to-GDP ratio below 60 percent in the early part of the next decade would require additional fiscal measures.

⁴ It was assumed that $NGDP_t^{post-shock} = Profit_t^{post-shock} + Wage\ Bill_t^{post-shock} = (CIT_t^{post-shock} / \pi_t^{pre-shock}) + Wage\ Bill_t^{baseline}$; where $\pi_t^{pre-shock} = \frac{CIT_t^{pre-shock}}{Profit_t^{pre-shock}}$. Assuming the GDP deflator remains unaffected, the real GDP

and hence growth were derived accordingly.

- The interest rate and primary balance shocks would have a modest impact on debt dynamics. In the former case, this is due to the relatively long maturity of Ireland's public debt and limited GFNs.⁵ In the latter case, the impact would be even smaller if the increase in spending, which drives the primary balance shock, were to translate into higher growth.
- In all the scenarios, the GFN-to-GDP ratios remain well below the vulnerability threshold and decline over time.

9. When debt metrics are measured relative to GNI*, the vulnerabilities become more evident. In this case, the debt burden would fall below the 80 percent of GDP benchmark towards the end of the projection period only in the baseline scenario. However, the risks associated with the GFNs would remain relatively low, except in the CFL shock scenario, although in a few scenarios the GFN-to-GNI* ratio would be closer to the vulnerability thresholds.

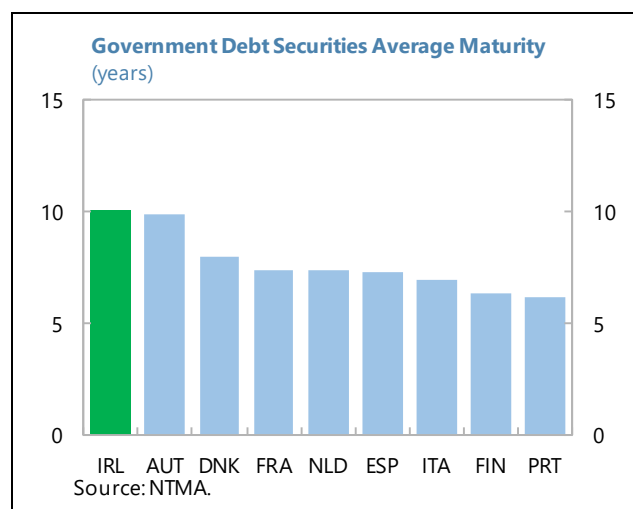


⁵ The impact of an interest rate shock on Ireland's real output is [reported](#) to be rather small.

10. A few considerations mitigate the assessment of the risks associated with the large share of public debt held by non-residents and the substantial external financing requirements. Since non-resident holders are mainly real-money investors with long-term investment plans, the likelihood of a sudden stop represents rather a tail risk. Exchequer's cash balances also provide a buffer to cover 6–10 months of GFNs.⁶ The substantial external financing requirements mostly reflect intra-company and intra-group operations of large MNEs, which also hold large financial assets.

Authorities' Views

11. The authorities were in broad agreement with staff's analysis. They agreed that headline GDP overstates underlying activity and, consequently, saw benefit in also considering metrics beyond the traditional debt-to-GDP ratio for Ireland. They highlighted the importance of considering net debt, given their well-established policy of pre-funding, and noted that the IMF repayment and Floating Rate Notes buy-backs have simplified the product mix and reduced refinancing risk. The authorities emphasized that, although public debt is still high, several factors mitigate risks: (i) debt (weighted) maturity has been extended to 10 years, one of the longest among EU countries; (ii) debt is mostly at fixed rates and consequently the benefits of ECB quantitative easing policies have been locked in; (iii) the investor base is wide and diversified; and (iv) the liquidity position is strong. Moreover, contingent liabilities have been reduced substantially as the financial soundness of the banking sector has improved, and NAMA has completed the repayment of its senior debt three years ahead of schedule and is estimated to deliver a surplus of around €3 billion at the end of its mandate in 2020. Finally, the authorities emphasized that estimates of external financing needs are heavily distorted by the activities of MNEs and do not really reflect domestic sectors' external borrowing requirements.



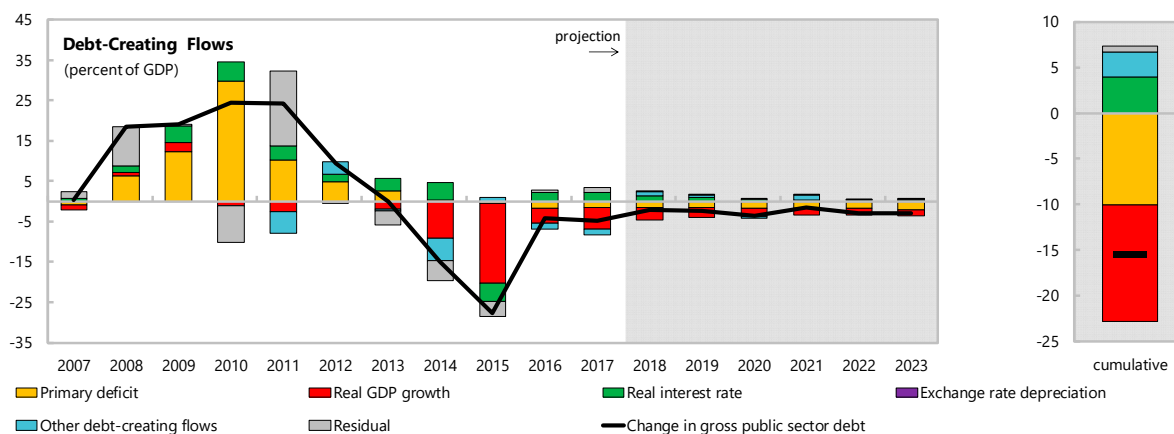
⁶ As of end-January, total Exchequer cash and other liquid short-term assets amounted to about €17 billion, equivalent to about 9 months of the average GFNs in 2018–19.

Figure 1. Ireland: Public DSA – Baseline Scenario
(Percent of GDP, unless otherwise indicated)

	Actual			Projections						As of March 23, 2018		
	2007-2015 ^{2/}	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads		
Nominal gross public debt	82.8	72.9	68.1	65.9	63.5	59.9	58.3	55.5	52.5	EMBIG (bp) 3/		43
Public gross financing needs	16.3	6.9	9.4	7.0	7.4	8.0	3.1	4.8	3.7	5Y CDS (bp)		23
Real GDP growth (in percent)	4.1	5.1	7.8	5.0	4.1	3.5	3.0	2.8	2.8	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	0.2	0.0	-0.3	0.5	1.0	1.4	1.5	1.6	1.7	Moody's	A2	A2
Nominal GDP growth (in percent)	4.5	5.2	7.5	5.5	5.1	4.9	4.6	4.5	4.5	S&P's	A+	A+
Effective interest rate (in percent) ^{4/}	4.1	3.1	2.9	2.7	2.6	2.4	2.2	2.2	2.4	Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	5.9	-4.1	-4.9	-2.2	-2.4	-3.6	-1.6	-2.9	-2.9	-15.5	
Identified debt-creating flows	5.0	-4.7	-6.2	-2.2	-2.5	-3.6	-1.7	-3.0	-3.0	-16.1	
Primary deficit	7.2	-1.6	-1.6	-1.4	-1.5	-1.7	-1.6	-1.8	-2.0	-10.1	-1.0
Primary (noninterest) revenue and grants	32.7	26.6	25.7	25.4	25.2	24.8	24.5	24.4	24.2	148.4	
Primary (noninterest) expenditure	39.9	24.9	24.1	23.9	23.7	23.1	22.9	22.6	22.2	138.4	
Automatic debt dynamics ^{5/}	-1.4	-1.6	-3.1	-1.8	-1.6	-1.6	-1.4	-1.3	-1.1	-8.8	
Interest rate/growth differential ^{6/}	-1.4	-1.6	-3.1	-1.8	-1.6	-1.6	-1.4	-1.3	-1.1	-8.8	
Of which: real interest rate	2.2	2.2	2.2	1.4	1.0	0.6	0.3	0.3	0.4	3.9	
Of which: real GDP growth	-3.6	-3.8	-5.3	-3.2	-2.6	-2.1	-1.7	-1.6	-1.5	-12.7	
Exchange rate depreciation ^{7/}	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	-0.8	-1.5	-1.5	1.0	0.6	-0.4	1.3	0.1	0.1	2.8	
Privatization/Drawdown of Deposits (+ reduces financing need)	-0.8	-1.5	-1.5	0.5	-0.5	-1.5	0.3	0.1	0.1	-0.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Stock/flow adjustment	0.0	0.0	0.0	0.5	1.1	1.1	1.0	0.0	0.0	3.6	
Residual, including asset changes ^{8/}	1.0	0.6	1.3	0.1	0.1	0.1	0.1	0.1	0.1	0.6	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gr)]$ times previous period debt ratio, with r = interest rate; π = 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).

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

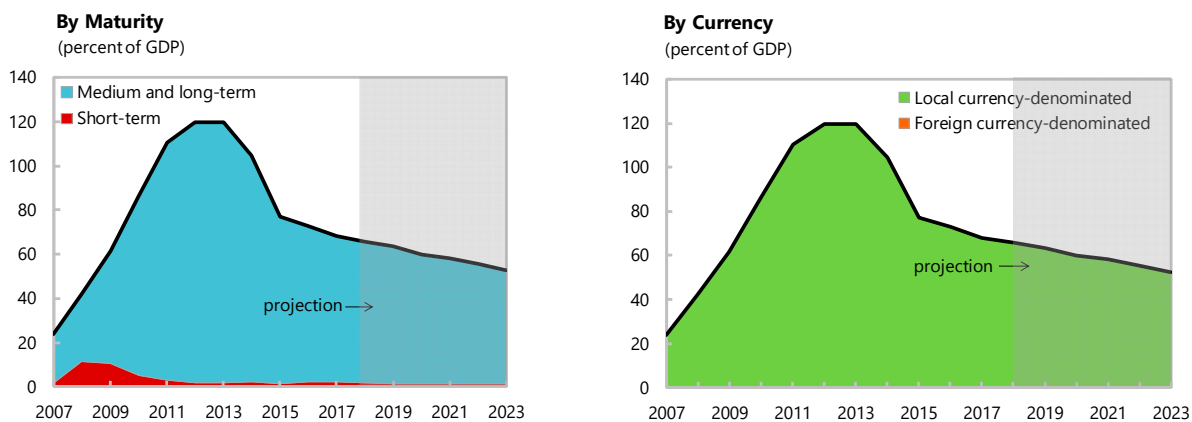
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

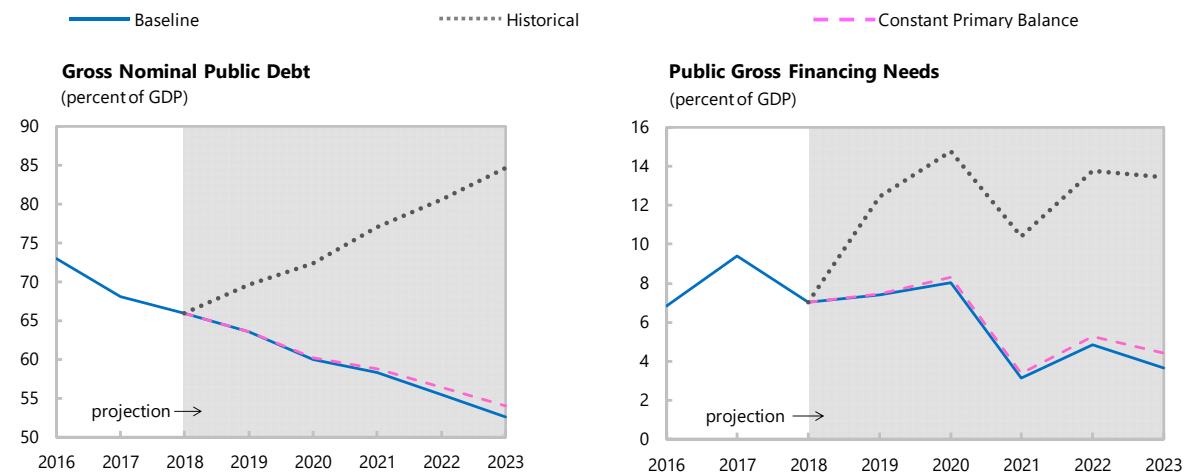
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Ireland: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(percent)

Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	4.1	3.5	3.0	2.8	2.8
Inflation	0.5	1.0	1.4	1.5	1.6	1.7
Primary Balance	1.4	1.5	1.7	1.6	1.8	2.0
Effective interest rate	2.7	2.6	2.4	2.2	2.2	2.4

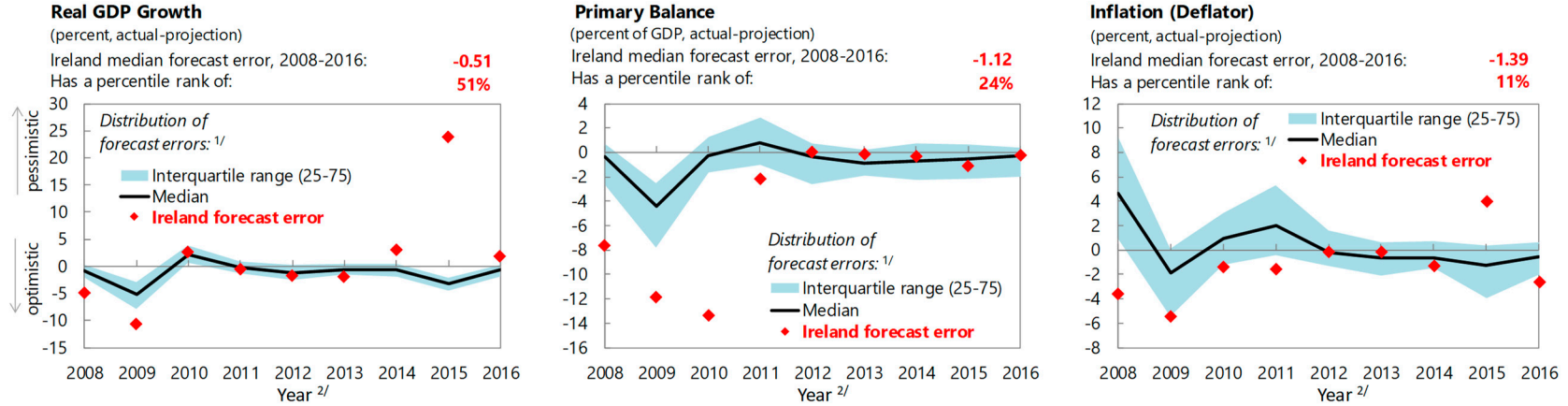
Constant Primary Balance Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	4.1	3.5	3.0	2.8	2.8
Inflation	0.5	1.0	1.4	1.5	1.6	1.7
Primary Balance	1.4	1.4	1.4	1.4	1.4	1.4
Effective interest rate	2.7	2.6	2.4	2.2	2.2	2.4

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	5.0	2.1	2.1	2.1	2.1	2.1
Inflation	0.5	1.0	1.4	1.5	1.6	1.7
Primary Balance	1.4	-3.4	-3.4	-3.4	-3.4	-3.4
Effective interest rate	2.7	2.6	2.8	3.1	3.4	4.0

Source: IMF staff.

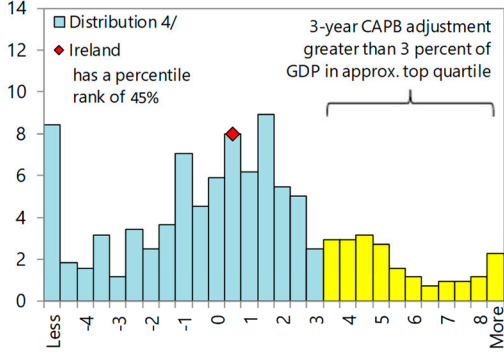
Figure 3. Ireland: Public DSA – Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

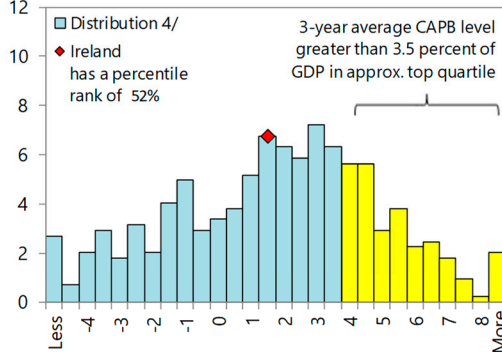


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(percent of GDP)

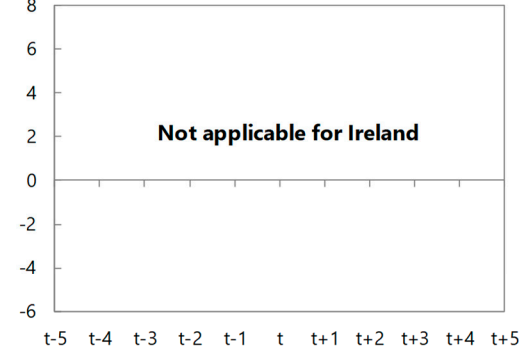


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(percent of GDP)



Boom-Bust Analysis^{3/}

Real GDP growth
(percent)



Source : IMF Staff.

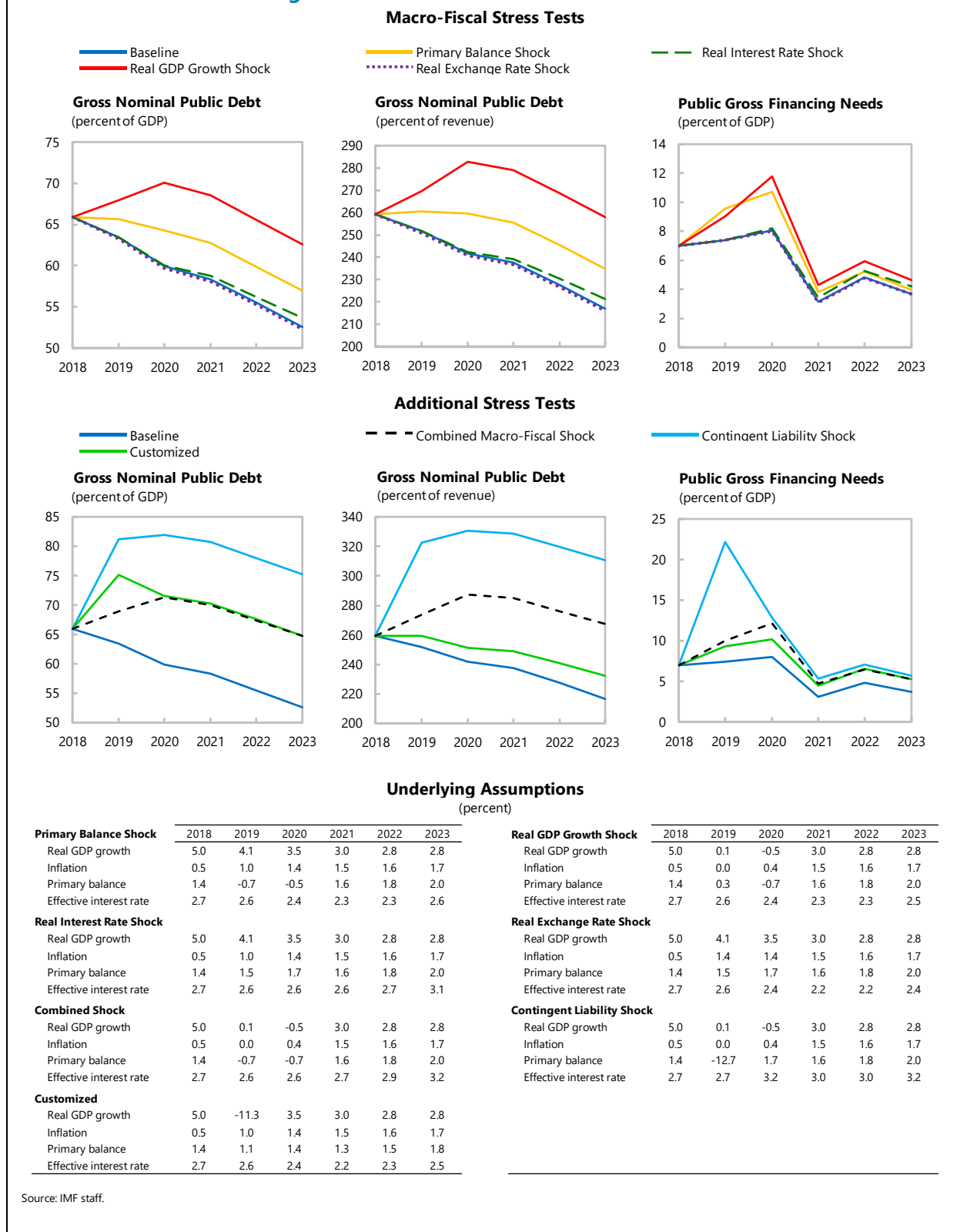
1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

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

3/ Not applicable for Ireland, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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

Figure 4. Ireland: Public DSA – Stress Tests



Source: IMF staff.

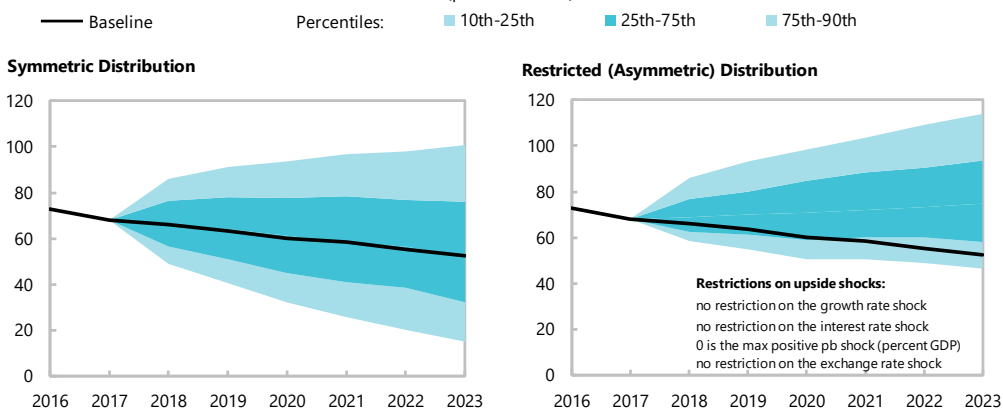
Figure 5. Ireland: Public DSA – Risk Assessment

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

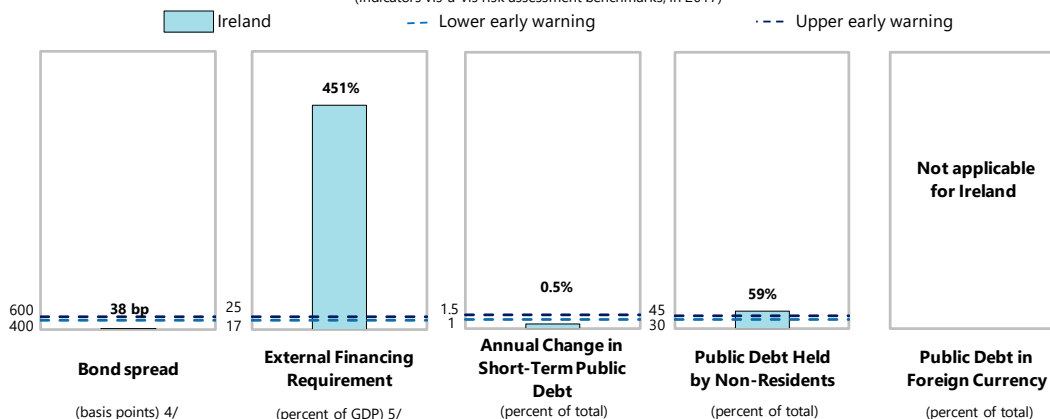
Evolution of Predictive Densities of Gross Nominal Public Debt

(percent of GDP)



Debt Profile Vulnerabilities

(indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% 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% 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/ Long-term bond spread over German bonds, an average over the last 3 months, 23-Dec-17 through 23-Mar-18.

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. External Stability Assessment

Ireland's current account (CA) recorded a strong surplus in 2017 on the back of lower imports of services and a solid export performance. Nevertheless, the headline CA is inflated by large-scale operations of MNEs, which have limited links to the domestic economy. After controlling for these effects, and considering the real effective exchange rate (REER) and external sustainability indicators, as well as the savings-investment balances by sector, staff is of the view that Ireland's external position is moderately stronger than implied by its medium-term fundamentals and desirable policies. However, given the challenges in assessing Ireland's "underlying" CA balance, staff considers that no changes in Ireland's policy settings are required in light of such assessment at the current juncture. Further work is needed to deepen our understanding of Ireland's underlying external position.

1. In 2017, Ireland's CA surplus widened by some 9 percentage points to 12.5 percent of GDP. This improvement was driven by a substantial narrowing of the services deficit to 4.1 percent of GDP in 2017 from 16.4 percent of GDP in 2016, on the back of stronger exports of royalties, financial, and computer services, and weaker imports of other business services. The large cross-border and contract-manufacturing trade surpluses contracted by about 1 percent of GDP each to 15 and 21 percent of GDP respectively, while the primary income deficit widened by broadly the same amount to 18 percent of GDP. The secondary income deficit stood at 1.4 percent of GDP.

2. However, Ireland's headline CA balance is heavily influenced by large-scale operations of MNEs with limited links to the domestic economy. Staff tried to control for that by estimating the modified current account (CA*) following the [CSO methodology](#), in which aircraft leasing and IP-related imports are deducted from the balance of goods and services but their depreciation flows, along with the redomiciled incomes, are added to the income account.¹ This resulted in a CA* surplus of 5.0 percent of GDP in 2017, close to the surplus recorded in 2016 (Table 1). This sizeable adjustment shows how difficult it is to

Table 1. Modified Current Account (CA*) Balance
(Billions of Euros)

	2015			2016			2017		
	CA	Adj.	CA*	CA	Adj.	CA*	CA	Adj.	CA*
A. Inflows	392,553		392,553	409,700		409,700	438,943		438,943
Exports	200,327		200,327	194,071		194,071	194,253		194,253
B. Outflows	363,950		384,871	400,506		396,318	401,853		424,083
B1. Current Account Goods Imports	86,933		81,765	88,219		81,082	86,922		80,315
<i>Aircraft related to leasing imports</i>		-5,168			-7,137			-6,607	
B2. Services Imports	152,947		144,681	186,179		150,548	173,331		160,214
<i>R&D related IP imports</i>		-8,266			-35,631			-13,117	
B3. Primary Income Outflows (of which)	116,743		151,098	117,817		156,397	132,228		174,182
<i>Direct Investment Income Outflows (of which)</i>									
Reinvested Earnings Outflows (of which)									
<i>IP depreciation</i>		+25,047			+27,793			+30,224	
<i>Aircraft leasing depreciation</i>		+4,642			+5,001			+5,438	
<i>Redomiciled incomes</i>		+4,666			+5,786			+6,292	
B4. Secondary Income Outflows	7,327		7,327	8,291		8,291	9,372		9,372
CA balance: A minus B	28,603		7,682	9,194		13,382	37,090		14,860
(percent of GDP)	10.9		2.9	3.3		4.9	12.5		5.0

Sources: CSO and IMF staff.

¹ In the 2017 estimates, staff computed the aircraft leasing and IP-related imports as the difference between gross domestic fixed capital formation and modified gross fixed capital formation. For lack of a better alternative, the other components were kept at roughly the same ratio to GDP as in the previous year.

identify the “underlying” current account balance for the Irish economy.

3. Considering these adjustments, staff assesses Ireland’s external position to be moderately stronger than implied by its medium-term fundamentals but this does not call for changes in Ireland’s policy settings at the current juncture. The EBA methodology estimates that Ireland’s cyclically adjusted CA norm stood at 3.1 percent of GDP in 2017. Nevertheless, after attempting to filter out activities of MNEs with limited impact on the domestic economy (staff analysis based on the CA* gap), a

much smaller, albeit still positive gap of 1.9 percent of GDP would be arrived at (Table 2). However, the EBA model identified medium-term policy gaps—namely fiscal and credit—are at odds with the near-term policy mix given Ireland’s cyclical position and its need to address crisis legacies, and instead point to policy distortions (too-loose fiscal policy) in the rest of the world. Considering the CA* based analysis, the high uncertainty surrounding these econometric estimates, and the challenges in assessing Ireland’s “underlying” CA balance, staff

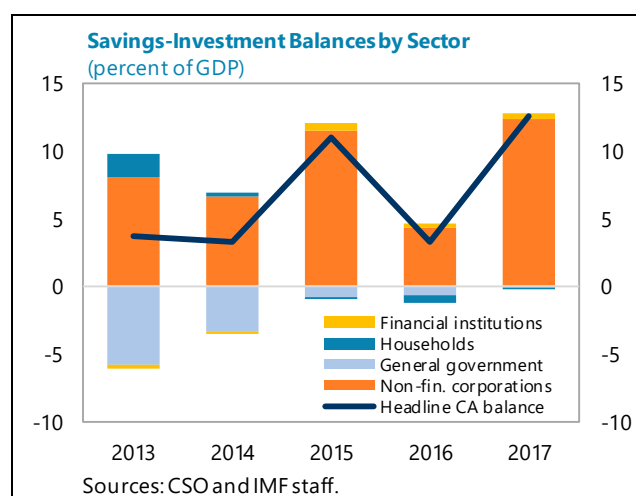
	Based on headline CA	Staff judgement based on CA*
CA actual	12.5	5.0
Cyclical contribution	-0.6	-0.6
Cyclically-adjusted CA	13.1	5.6
Cyclically-adjusted CA norm 1/	3.1	3.7
Total CA gap (cyc. adj. bal. minus norm)	10.0	1.9
Identified policy gaps 1/	2.5	2.5
o/w:		
Credit gap	2.4	2.4
Fiscal gap	0.6	0.6
Other gaps	-0.5	-0.5
Unexplained residual (excl. policy ga)	7.5	-0.6
Total CA gap range 2/	[8.5%, 11.5%]	[0.4%, 3.4%]

Sources: CSO and IMF staff calculations.
1/ Based on IMF EBA model results of end-April 2018.
2/ Total CA gap +/- 1.5 percent of GDP.

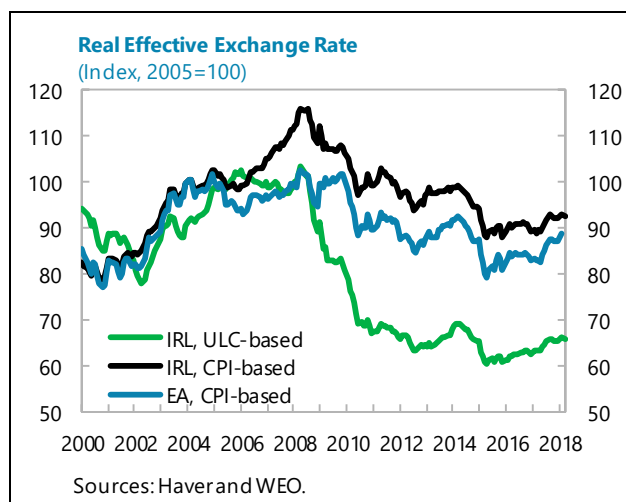
considers that no changes in Ireland’s policy settings are required at this juncture. Staff will continue work to deepen its understanding of Ireland’s underlying external position.

4. A sectoral analysis of the savings-investment balances supports staff’s assessment.

Post-crisis deleveraging led the general government, households, and financial institutions to virtually balance their savings-investment gap since 2015. Therefore, the large CA surplus reflected the considerably positive savings-investment balance of non-financial corporations (12.3 percent of GDP in 2017, on the back of a sizeable decline in corporate investment). However, this sector is heavily influenced by MNEs, the business decisions of which may be less responsive to changes in domestic tax policies, given Ireland’s broader attractiveness as an investment destination. Furthermore, a positive savings-investment balance of the non-MNE sector is consistent with the need to deleverage.



5. Ireland's REER appreciated by about 0.5 percent in 2017, reflecting the nominal appreciation of the euro vis-à-vis the U.S. dollar and the pound sterling. Despite recent appreciation, Ireland's ULC-based and CPI-based REERs remained substantially lower than their respective long-term averages, confirming the country's strong competitive position.² The EBA REER Index suggests a negative REER gap (undervaluation) of 11.2 percent, while the EBA REER Level points to a gap of 18.5 percent in the opposite direction. However, the explanatory power of policy variables is negligible in both cases, and the gaps are mostly due to unexplained residuals of these econometric models. The overvaluation is also inconsistent with the CA surplus. Consistently with the staff-assessed CA gap, the REER is estimated to be moderately undervalued (in the range of ½ to 3½ percent).

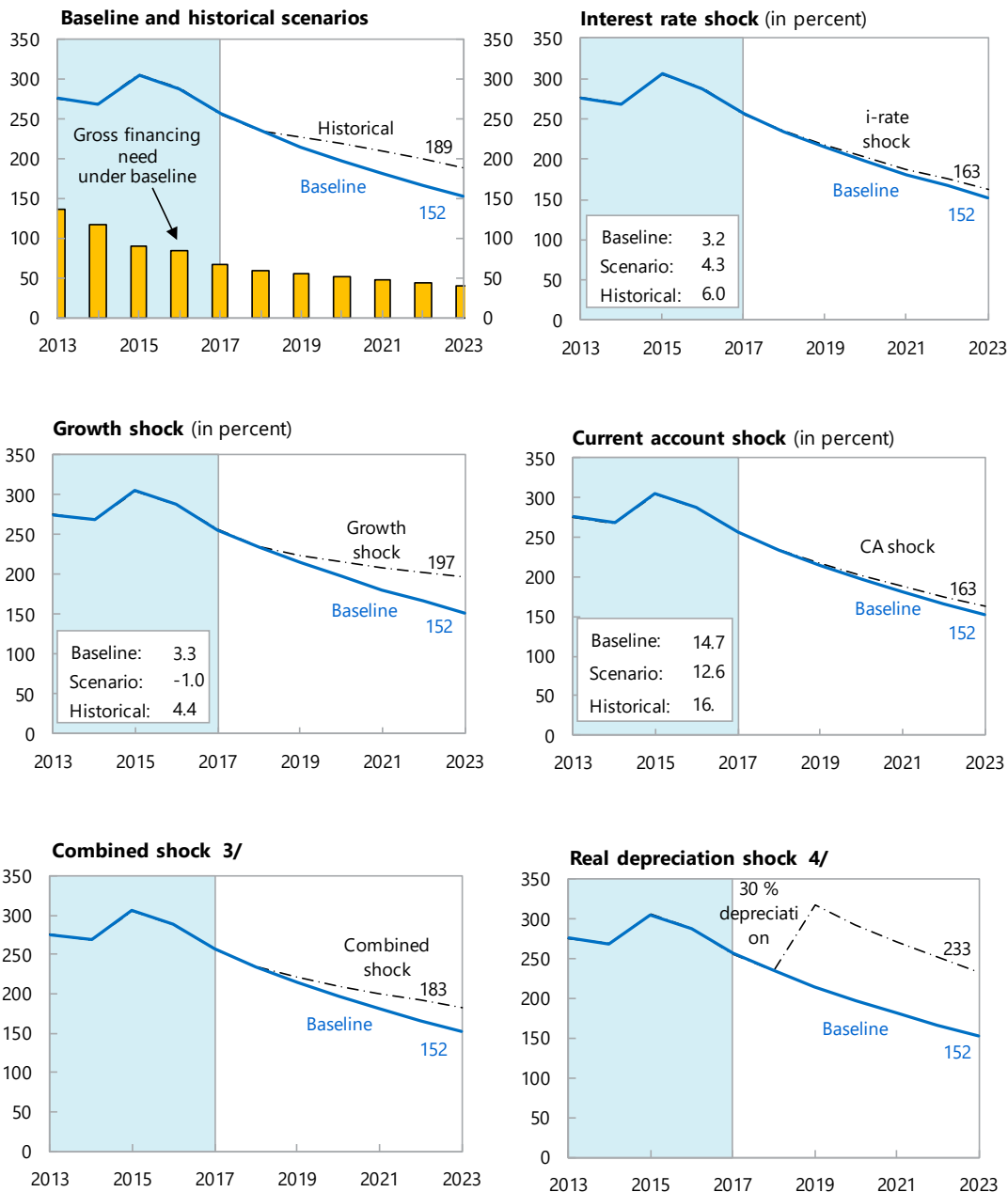


6. Ireland's negative NIIP, albeit still large, has been gradually improving, owing to lower government and non-financial corporate indebtedness. EBA's External Sustainability (ES) approach (ES) estimates that the current account norm sufficient to stabilize Ireland's NFA at the benchmark level of -98 percent of GDP (compared with the end-2016 NFA stock of -180 percent of GDP) is a deficit of 5 percent of GDP. This would imply a gap relative to the CA* balance (as defined above) in the order of 10 percent of GDP. For an elasticity of 0.92 with respect to the REER, the ES approach implies an REER undervaluation of 11 percent. Staff considers the ES approach less appropriate for Ireland because of the country's role as a hub for MNE activities and as a financial center. Current fiscal and macroprudential policies appropriately improve domestic balance sheets over the medium term (see external DSA). As such, staff does not see a case for adjusting policy settings based on the ES approach.

² It is important to bear in mind that unit labor costs are affected by the one-time upward shift in the domestic output recorded in 2015.

	Ireland	Overall Assessment
Foreign asset and liability position and trajectory	<p>Background. Ireland's net international investment position (NIIP), after worsening to -195 percent of GDP in 2015 due to MNE-related restructuring operations, recovered to -156 percent of GDP in 2017.¹ The NIIP of International Financial Services Centers (IFSC) recorded -48 percent of GDP in 2017 while non-IFSC NIIP improved to -107 percent of GDP. Non-IFSC gross external debt has continued a downward trajectory since its peak in 2015, declining to 256 percent of GDP in 2017. Staff projects it to fall to 152 percent of GDP by 2023, reflecting large current account surpluses, strong real GDP growth, and favorable interest rate environment.</p> <p>Assessment. After peaking in 2015, Ireland's NIIP continued to improve, helping core domestic sectors to achieve external sustainability. Large gross IFSC positions do not affect domestic entities; and a large stock of IFSC intra-company and intra-group debt is regularly rolled over, mitigating risks. Non-IFSC external debt shows limited sensitivity to standardized shocks that—if they materialize—would result in more gradually declining debt ratios (Figure 1).</p>	<p>Overall Assessment:</p> <p><i>Ireland's external position in 2017 was moderately stronger than implied by its medium-term fundamentals and desirable policies. However, given the challenges in assessing Ireland's "underlying" current account, staff considers that no changes in Ireland's policy settings are required in light of this assessment at this juncture.</i></p> <p>Ireland's competitiveness has further improved in recent years, as demonstrated by an increasing share of Irish exports in world exports.</p> <p>External balance sheets have strengthened with the banking sector recovery and stable external liabilities of the general government. FDI inflows continue to be strong, supported by a favorable business climate and economic performance.</p> <p>However, productivity growth varies sharply across sectors and is concentrated in large foreign-owned firms.</p> <p>Potential policy responses:</p> <p>Policies to support sustainable and inclusive medium-term growth and job creation should remain focused on continued balance sheet repair and restoration of fiscal buffers utilized during the crisis, broadening access to finance for indigenous SMEs, increasing direct public support of innovation, continuing targeted ALMPs, expanding technical and vocational training, and improving infrastructure (including transport, housing).</p>
Current account	<p>Background. The current account (CA) surplus, while volatile, has averaged around 6 percent of GDP (3.5 percent without undistributed profits) since the 2013 recovery, driven mainly by a large goods trade surplus.² Ireland's share of world exports has been increasing, driven by strong export performance in the goods (pharmaceutical) and services (business and financial services, IT) sectors. Exports of goods manufactured abroad by Irish-domiciled firms—about 60 percent of goods exports—complicates the assessment. The CA surplus widened to 12.5 percent of GDP in 2017, driven by a substantial narrowing of the service deficit on the back of strong exports of royalties, financial and computer services, and weak imports of other business services. The CA is projected to taper to around 6½ percent of GDP by 2023.</p> <p>Assessment. The 2017 cyclically-adjusted CA balance was at 13.1 percent of GDP compared to the CA norm of 3.1 percent of GDP. Nevertheless, the headline CA balance is inflated by large-scale operations of MNEs, which have limited links to the domestic economy. After adjusting for this impact, staff assesses Ireland's external position to be moderately stronger than implied by its medium-term fundamentals. Given the challenges in assessing Ireland's "underlying" current account, staff considers that no changes in Ireland's policy settings are required in light of this assessment.</p>	
Real exchange rate (REER)	<p>Background. Despite the strong appreciation in the second half of last year, the average CPI-based REER in 2017 was close to the average of 2016. In nominal terms, the exchange rate appreciated on average 2 percent vis-à-vis the U.S. dollar and 7 percent relative to the pound sterling during 2017. Meanwhile, the average ULC-based REER has shown a small appreciation in 2017 when compared to the previous year. During January-May 2018, the REER has appreciated by about 1½ percent relative to the 2017 average. From a longer-term perspective, Ireland has remained competitive, with the ULC-based REER depreciating significantly since end-2008 with increasing productivity and declining labor costs. However, productivity growth is concentrated in large foreign-owned firms and again obscures the assessment.³</p> <p>Assessment. The EBA REER Index suggests a negative REER gap (undervaluation) of 11.2 percent, while the EBA REER Level points to a gap of 18.5 percent in the opposite direction. The explanatory power of policy variables is negligible in both cases, and the gaps are mostly due to unexplained residuals of the econometric models.⁴ The staff-assessed CA gap implies a REER gap in the range of [-3½, -½] with an estimated elasticity of 0.92.</p>	
Capital and financial accounts: flows and policy measures	<p>Background. In 2017, Ireland's net direct investment position was slightly positive mainly due to lower "other capital" inflows. Large acquisition of portfolio debt instruments by the non-financial private sector also contributed to the improvement of Ireland's NIIP. On the other hand, the decline in other investment assets more than offset the fall in Ireland's other investment liabilities during last year.</p> <p>Assessment. Ireland's share in the EU and world's inward FDI—as well as foreign demand for Irish sovereign bonds—have been supported by strong economic performance and a supportive business climate, including a favorable and stable tax environment.</p>	
FX intervention and reserves	<p>Background. The euro has the status of a global reserve currency.</p> <p>Assessment. Reserves held by the euro area are typically low relative to standard metrics. The currency is free floating.</p>	
Technical Background Notes	1/ See SIP in the 2017 Article IV Consultation, "The Role of Foreign-owned Multinational Enterprises in Ireland" for more details on 2015 data revision. 2/ Retained earnings of "redomiciled firms"—that establish their headquarters in Ireland—contribute to the current account surplus (FitzGerald, 2013, 2016). 3/ IMF Country report 16/257 "Firm-level productivity and its determinants: The Irish case." 4/ EBA estimates from April 2018. EBA REER Level and Index models provide a poor fit for Ireland, and their total gap consists mostly of unexplained residuals.	

Figure 1. Ireland: External Debt Sustainability; Bound Tests ^{1/2/}
 (Non-IFSC external debt in percent of GDP, unless otherwise indicated)



Source: IMF staff.

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 2019.

Table 2. Ireland: Non-IFSC External Debt Sustainability Framework, 2013–23
(Percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing non-interest current account 6/ -3.0
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023		
Baseline: External debt	275.6	268.3	305.2	287.5	256.4	234.4	215.0	197.4	181.4	166.5	152.4		
Change in external debt	-20.2	-7.2	36.9	-17.7	-31.1	-22.0	-19.4	-17.7	-16.0	-15.0	-14.1		
Identified external debt-creating flows (4+8+9)	-13.5	-11.1	-34.9	-14.2	-45.1	-23.2	-19.9	-17.5	-15.7	-14.8	-14.1		
Current account deficit, excluding interest payments	-14.6	-23.9	-20.6	-9.7	-16.0	-16.4	-14.8	-14.8	-14.8	-14.7	-14.3		
Deficit in balance of goods and services	-13.0	-11.6	-27.5	-15.9	-26.0	-26.5	-26.2	-25.9	-25.7	-25.6	-25.5		
Exports	92.7	99.0	112.0	109.1	107.3	103.6	102.9	102.5	102.7	102.8	103.1		
Imports	79.7	87.4	84.5	93.1	81.4	77.0	76.7	76.6	77.1	77.3	77.6		
Net non-debt creating capital inflows (negative)	1.3	6.8	-0.9	-1.0	-11.7	-1.5	-1.4	-1.4	-1.4	-1.4	-1.3		
Automatic debt dynamics 1/	-0.2	6.0	-13.4	-3.5	-17.4	-5.3	-3.7	-1.4	0.5	1.3	1.6		
Contribution from nominal interest rate	16.6	26.3	16.4	10.8	8.0	5.8	5.3	5.8	6.1	6.2	6.0		
Contribution from real GDP growth	-4.5	-21.2	-60.8	-14.9	-20.5	-11.1	-9.0	-7.1	-5.7	-4.9	-4.5		
Contribution from price and exchange rate changes 2/	-12.3	0.9	31.0	0.7	-4.9	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	-6.7	3.9	71.8	-3.5	14.0	1.2	0.5	-0.1	-0.2	-0.2	0.0		
External debt-to-exports ratio (in percent)	297.4	271.1	272.5	263.5	238.9	226.4	209.1	192.7	176.6	161.8	147.8		
Gross external financing need (in billions of US dollars) 4/	244.5	227.5	234.2	231.9	198.0	186.7	181.7	176.8	171.1	165.2	159.2		
in percent of GDP	135.8	117.1	89.5	84.3	66.9	59.8	55.4	51.3	47.5	43.9	40.4		
Scenario with key variables at their historical averages 5/						234.4	226.5	218.2	208.8	199.0	188.7	3.0	
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	1.6	8.3	25.5	5.1	7.8	5.0	4.1	3.5	3.0	2.8	2.8		
GDP deflator in US dollars (change in percent)	4.3	-0.3	-10.4	-0.2	1.7	10.3	2.1	2.5	2.3	2.4	2.1		
Nominal external interest rate (in percent)	5.9	10.3	6.9	3.7	3.0	2.6	2.4	2.9	3.3	3.6	3.8		
Growth of exports (US dollar terms, in percent)	1.7	15.2	52.5	2.4	5.8	1.8	4.4	4.5	4.9	4.6	4.7		
Growth of imports (US dollar terms, in percent)	0.1	18.3	30.3	15.9	-6.1	0.0	4.6	4.8	5.2	4.8	5.0		
Current account balance, excluding interest payments	14.6	23.9	20.6	9.7	16.0	16.4	14.8	14.8	14.8	14.7	14.3		
Net non-debt creating capital inflows	-1.3	-6.8	0.9	1.0	11.7	1.5	1.4	1.4	1.4	1.4	1.3		

Source: IMF staff.

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 in US dollar terms, 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 $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

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 III. Risk Assessment Matrix¹

Source of Risk and Likelihood (G-RAM)	Impact if Realized	Policy Recommendations Mitigation/Response
<p>Medium <i>Short- to medium-term</i></p> <p>Retreat from cross-border integration: Fraying consensus about the benefits of globalization leads to protectionism and economic isolationism, resulting in reduced global and regional policy and regulatory collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.</p>	<p>High</p> <p>Ireland is highly integrated into global value chains and its production base is concentrated in a small number of sectors. This leaves the Irish economy, and hence the public finances, vulnerable to a broad range of common and idiosyncratic shocks. Depending on the nature of the shock, the role of MNEs could mitigate or exacerbate the impact on the economy.</p> <p>While populist and/or anti-EU movements have not had a major impact in Ireland to date, increased disenchantment with globalization may spur political fragmentation.</p>	<p>Participate in coordinated policy response at the European level.</p> <p>In the short run, let automatic stabilizers work. Smooth out debt issuance through use of cash buffers. Strengthening growth potential through reforms, including incentives for labor force participation, enhancing labor activation policies, better targeting benefits, improving SME access to financing, and easing impediments to productivity growth reforms.</p> <p>Accelerate NPL reduction and more broadly work to strengthen bank resiliency to negative shocks.</p>
<p>Medium <i>Short- to medium-term</i></p> <p>Policy uncertainty and divergence: Two-sided risks to the U.S. growth with uncertainties about the positive short-term impact of the tax bill on growth and the extent of potential medium-term adjustment to offset its fiscal costs; uncertainty associated with negotiating post-Brexit arrangements and NAFTA and associated market fragmentation risks; and evolving political processes weigh on the whole on global growth.</p>	<p>High</p> <p>A fiscal stimulus in the U.S. could generate positive spillovers to Ireland and its key trading partners, though the U.S. CIT reform might lead to a reduction of U.S. MNE FDI flows, with potentially adverse effects on employment, fiscal revenues, and the external position. Lower U.S. growth and increased uncertainty would create negative global spillovers, with adverse effects on consumer and investor confidence, and sovereign spreads.</p> <p>Ireland's significant trade, financial and labor market links with the U.K. makes it vulnerable to a possible slowdown in the British economy, a sustained fall in the £/€ rate or an increase in trade barriers. Irish banks would be adversely affected given their direct and indirect exposures, and the burden of impaired assets may increase further.</p> <p>Sensitivities related to the Irish border question due to Brexit also present special challenges.</p>	<p>In the short run, allow automatic stabilizers to work. In the medium term, fiscal policy, within the current envelope, should support growth. Expenditure savings could be redirected to pro-growth initiatives.</p> <p>Strengthen potential through structural reforms, as noted above.</p> <p>Continue close monitoring of Brexit related risks and update contingency plans. Facilitate SMEs' trade diversification. Rebuild fiscal buffers. On the banking side, continue close supervision and accelerate balance-sheet repair. Ensure that banks would be able to withstand negative shocks. Central bank should stand ready to provide liquidity support to banks if needed.</p>

¹The 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 relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Source of Risk and Likelihood (G-RAM)	Impact if Realized	Policy Recommendations Mitigation/Response
<p style="text-align: center;">High <i>Short- to medium-term</i></p> <p>Tighter global financial conditions: Against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes, an abrupt change in global risk appetite (e.g., due to higher-than-expected inflation in the U.S.) could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions.</p>	<p style="text-align: center;">Medium</p> <p>Ireland's public debt dynamics is resilient to interest rate shocks, given its relatively long maturity and limited gross financing needs over the medium-term.</p> <p>On the contrary, households and SMEs remain overleveraged and a sharp increase in interest rates might worsen their debt service burden.</p>	<p>Smooth out debt issuance through use of cash buffers.</p> <p>Strengthen supervision to ensure banks would withstand negative shocks and accelerate banks' balance sheet repair. Continue to improve NPLs resolution framework.</p>
<p style="text-align: center;">Medium <i>Medium-term</i></p> <p>Further pressure on traditional bank business models: Legacy problems, and potential competition from non-banks curtail banks' profitability globally.</p>	<p style="text-align: center;">Medium</p> <p>Although banks are strengthening their capital and liquidity buffers, their profitability might be affected.</p>	<p>Strengthen supervision to ensure banks would withstand negative shocks, accelerate banks' balance sheet repair, and encourage cost-savings policies.</p>
<p style="text-align: center;">High <i>Medium-term</i></p> <p>Structurally weak growth in key advanced economies: Low productivity growth (U.S., euro area and Japan), high debt, and failure to fully address crisis legacies by undertaking structural reforms amidst persistently low inflation (euro area and Japan) undermine medium-term growth.</p>	<p style="text-align: center;">Medium/High</p> <p>Structurally weak growth in key export markets (U.S., Europe) would significantly affect the Irish economy through the trade channel, thereby undermining domestic confidence, investment, and FDI inflows.</p>	<p>Strengthen growth potential through reforms, as noted above.</p> <p>Tax and spending policies should be more growth-friendly, within the existing fiscal envelope.</p> <p>ECB policy actions should contribute revive growth and could also aid competitiveness.</p>
<p style="text-align: center;">Medium <i>Medium-term</i></p> <p>Significant U.S. slowdown and its spillovers: As the current recovery ages and vulnerabilities build up, the risks of a sharper-than-expected slowdown increase. The proximate causes could be a fiscal contraction associated with the eventual planned withdrawal of the tax stimulus or market fears of overheating. A sharp adjustment necessitated by relatively limited fiscal space would create global spillovers.</p>	<p style="text-align: center;">Medium/High</p> <p>Direct and indirect spillovers through the trade channel could affect the Irish economy significantly, thereby undermining domestic confidence, investment, and FDI inflows.</p>	<p>Strengthen growth potential through reforms, as noted above.</p> <p>Tax and spending policies should be more growth-friendly, within the existing fiscal envelope.</p> <p>ECB policy actions should contribute revive growth and could also aid competitiveness.</p>

Source of Risk and Likelihood	Impact if Realized	Policy Recommendations Mitigation/Response
<p style="text-align: center;">Medium <i>Short- to medium-term</i></p> <p>Changes in corporate taxation in the U.S. and the EU. The changes in the U.S. corporate tax regime and the EU anti-tax avoidance agenda could make Ireland a less attractive location for future FDIs and adversely affect government revenues.</p>	<p style="text-align: center;">Medium</p> <p>The high concentration of its industrial base makes the Irish economy vulnerable to sectoral and firm-specific shocks. The impact of changes in operations by these corporates on gross value added and employment may vary depending on the nature of their links with the Irish economy. Budget repercussions might be substantial as 40 percent of corporate tax (equivalent to about 4 percent of total revenues) is paid by 10 MNEs.</p>	<p>Facilitate diversification through structural reforms to strengthen productivity and competitiveness; invest in education and training to create necessary skills; maintain a flexible and competitive labor market. Ensure sound public finances and durable debt reduction to rebuild fiscal buffers</p>
<p style="text-align: center;">Medium <i>Short- to medium-term</i></p> <p>Budgetary pressures coupled with a challenging political context. The minority government is facing increasing public expectations to reap the fruits of the recovery.</p>	<p style="text-align: center;">Medium</p> <p>These factors complicate domestic policy-making. While the government is committed to prudent policies, public pressure to reverse some measures implemented in recent years may slow fiscal consolidation, detract from medium-term fiscal priorities and increase the economy's vulnerabilities to adverse shocks.</p>	<p>Ensure sound public finances and a durable debt reduction to rebuild fiscal buffers and avoid procyclicality.</p> <p>Prioritize growth-friendly fiscal measures.</p> <p>Enhance communication strategy regarding policy and reform plans.</p>
<p style="text-align: center;">Low <i>Medium-term</i></p> <p>A sharp correction in housing prices. Continued strong pressures in the housing market together with a limited supply response could develop into large imbalances, with an excessive credit expansion, and potentially lead to a boom-bust cycle.</p>	<p style="text-align: center;">Medium</p> <p>Domestic banks are exposed to property market shocks. A sharp future housing price correction could weaken bank and household balance sheets, with adverse effects on financial stability and growth.</p>	<p>Monitor risks, and review macro-prudential limits periodically. Continue to expand housing supply in a sustainable manner, and ensure that the recently introduced measures to improve housing affordability are well-targeted.</p>

Annex IV. Taxation of Labor Income

This Annex provides a brief overview of labor income taxation in Ireland and qualitatively outlines some elements of potential reform.

Outline of the system

1. In Ireland, three main taxes are charged on labor income:

- **Personal Income Tax (PIT).** The PIT system comprises two tax rates: a standard rate of 20 percent and a higher rate of 40 percent. The standard rate cut-off point depends on the personal circumstances of the income earner (Table 1). Several tax credits are available to the taxpayer depending on personal circumstances (Table 2).¹ Considering the most relevant tax credits, the entry point to income tax for a single worker is €16,500, equivalent to almost 90 percent of minimum wage and about 45 percent of average total earnings in 2016.

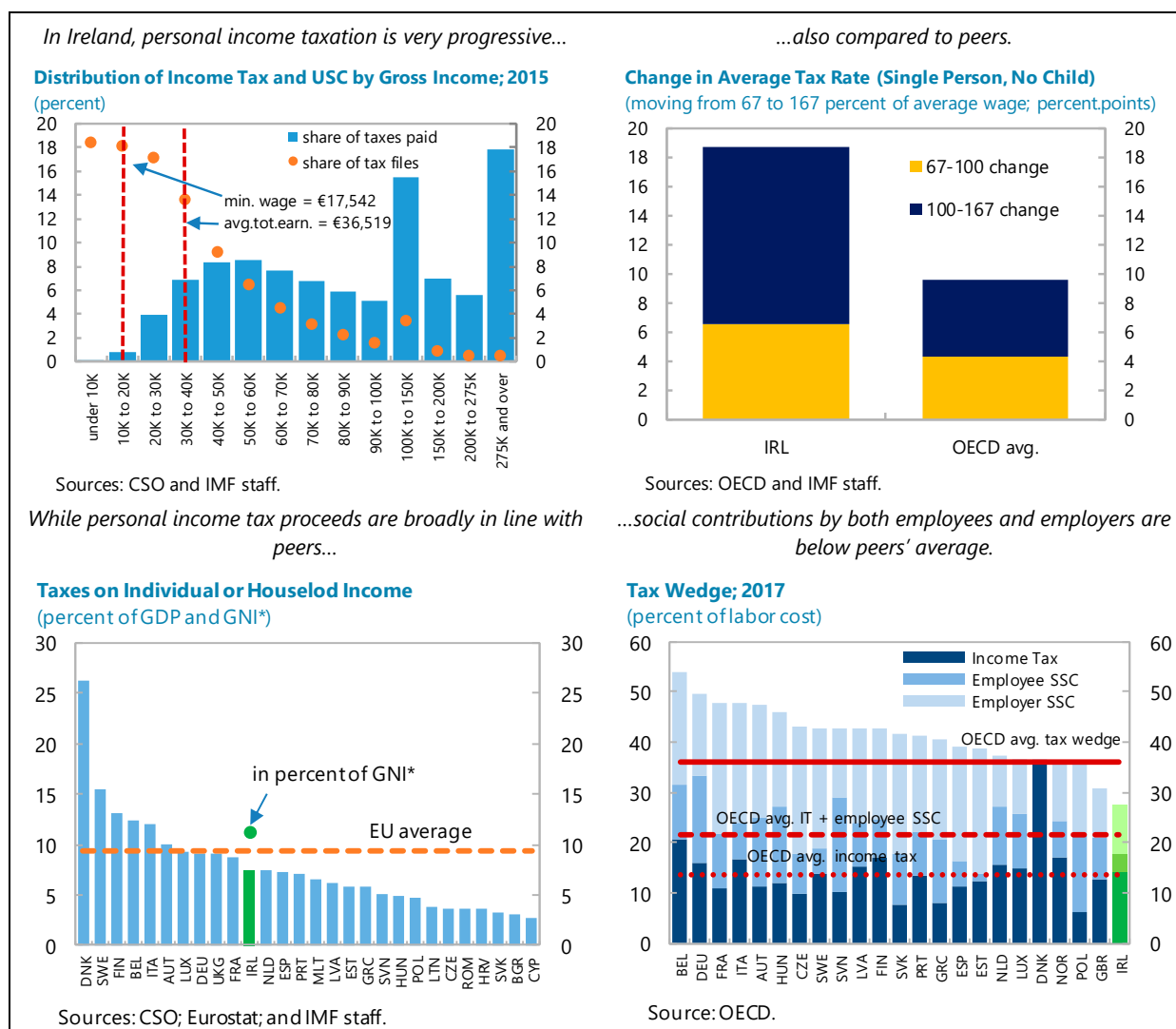
Table 1. PIT Standard Rate Cut-off Points					Table 2. Main Tax Credits	
Tax bracket	Single person	One parent family	Couple with one income	Couple with two incomes	Personal circumstances	Amount
20 percent	€34,550	€38,550	€43,550	€43,550 & €25,550 for second earner	Personal tax credit (single)	€1,650
40 percent	balance	balance	balance	balance	Personal tax credit (married)	€3,300
					Personal tax credit (widowed person)	€2,190
					Single person child carer credit	€1,650
					Home carer credit	€1,200
					Pay As You Earn credit	€1,650
					Earned income credit	€1,150
Source: Revenue Commissioners.					Source: Revenue Commissioners.	

- **Universal Social Charge (USC).** The USC was introduced in 2011, replacing two existing levies (the Income Levy and the Healthy Levy) and applied on a broad base, with few reliefs (mainly for income received from the Department of Social Protection) and no credits. Incomes below €13,000 are fully exempted. For incomes above that threshold, the USC applies according to four brackets reported in Table 3.

Table 3. USC Thresholds and Rates	
Income	Rates
First €12,012	0.50%
Next €7,360	2.00%
Next €50,672	4.75%
Balance	8.00%
over €100,000 (self-employed)	11.00%
Source: Revenue Commissioners.	

¹ The income tax system also contains two tax credits which operate by means of tax relief at source (TRS) – mortgage interest relief and medical insurance relief. TRS reduces the immediate cost to the taxpayer of their mortgage payment or insurance premium, and allows individuals who do not have an income tax liability to benefit from the relief. Both reliefs incorporate caps on the maximum value of the interest or premium which qualifies for tax relief. The mortgage interest relief applies only to mortgages taken out before 31 December 2012 and it was due to be abolished at end-2017 but with the 2018 budget it has been extended to 2020 on a tapered basis. However, these two tax credits are not considered in the present analysis.

- Pay Related Social Insurance (PRSI).** Although PRSI rates vary according to the category of employment, for the majority of employees, the PRSI is levied at a single rate of 4 percent on gross wage income with a tapered credit for low income earners.² The proceeds finance the Social Insurance Fund (SIF), which disburses pensions and a variety of other benefit payments, including for unemployment, disability, maternity, and illness.



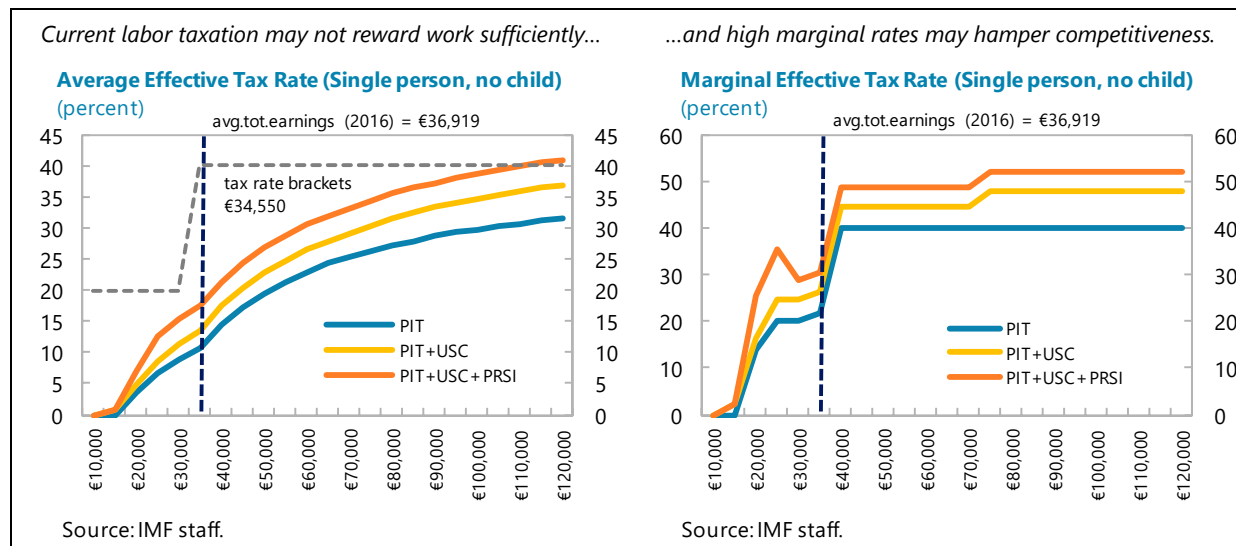
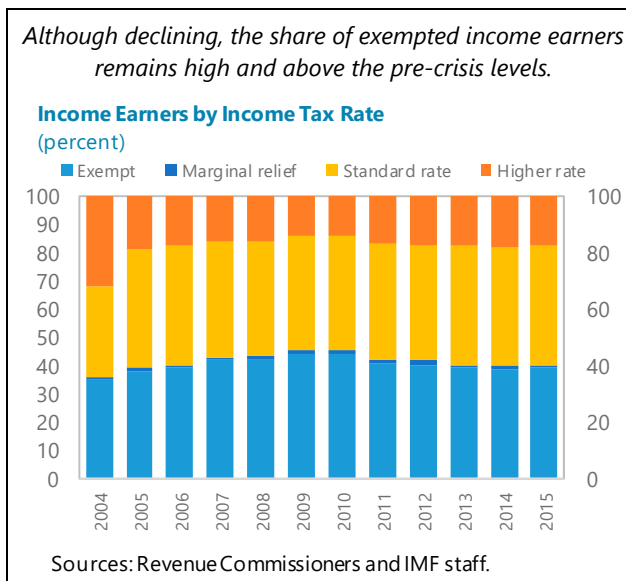
2. Among advanced economies, Ireland has one of the most progressive personal income tax systems, which plays a crucial role in the process of income redistribution. In Ireland, income earners at the top decile pay about 59 percent of total income tax, although their share of market income is about 37 percent ([Kennedy and others](#)). Although the tax wedge in Ireland is one of the lowest among the OECD countries, the difference in the average tax rate between individuals

² The contribution paid by the employer amounts to 8.6 percent on weekly earnings up to €376 and 10.85 percent on weekly earnings over €376.

earning 67 percent of the average wage and those earning 167 percent of the average wage is the one of the highest (OECD). A complete phasing out of the USC would have a regressive impact on the income distribution resulting in a significant increase of the GINI coefficient (McQuade and others).

3. In Ireland, the current system of labor taxation attracts two main criticisms:

- Relatively large share of exempted income earners.** Notwithstanding the measures introduced since the inception of the crisis to broaden the tax basis (including reductions in tax credits and bands, the restriction or abolitions of many reliefs), thus reverting the pre-crisis trend, the income tax base remains relatively narrow. In 2017, the share of income earners exempted from the personal income tax is estimated at about 37 percent (down from 45 percent in 2010).
- Insufficient work incentives.** The current system is viewed as unable to reward work sufficiently since individuals earning an average wage are charged at the higher tax rate. Also, the relatively high marginal tax rate faced by high income earners is viewed as an impediment to international competitiveness and a disincentive to attract skilled labor from abroad.



Government's measures

4. The 2018 Budget envisaged modest measures in favor of low- and middle-income earners.³ The entry point for the higher rate of the PIT was raised by €750 per annum and the two middle rates of the USC were trimmed by half of a percentage point to 2 percent and one-quarter of a percentage point to 4.75 percent.⁴

5. The government also expressed its intention to reform the system.⁵ To this end, an [inter-Departmental working group](#) has been established to examine and report on options for the amalgamation of the USC and the PRSI. While preserving the tax base remains the overarching objective, the aim of the working group is also to address current and future challenges facing the SIF.⁶ However, amalgamating the USC with the PRSI would increase the funding needs of the Exchequer and would make the financial sustainability of the SIF less transparent (de facto institutionalizing Exchequer subventions).

Main Technical Pros and Cons of USC-PRSI Amalgamation	
Pros	Cons
<ul style="list-style-type: none"> • Both the USC and the PRSI are individualized taxes (whereas the PIT allows for joint assessment). • The tax bases are very similar. 	<ul style="list-style-type: none"> • The USC accrues to the Exchequer whereas the PRSI to the SIF. • Individuals aged 66 and over are not liable to the PRSI but they pay the USC. • The PRSI operates on a weekly basis whereas the USC is a cumulative annual tax.

Considerations

6. In reforming labor income taxation, the government needs to find a balance among several objectives:

- **Broadening the tax base.** A lower threshold at which income starts being taxed (entry point) than the current one can be achieved by further streamlining tax credits and allowances, while protecting low-income households (possibly through means-tested cash transfers).
- **Mitigating progressivity.** This could be achieved, for example, by introducing one or two intermediate income brackets like in the USC structure. There is no clear-cut indication on the

³ The reduction in personal taxes, and particularly the continued phasing out of the USC, is one of the main cornerstones of "[A Programme for a Partnership Government](#)", which was agreed between the Fine Gael Party, the Independent Alliance and Independent Members of the lower house of the Irish Parliament.

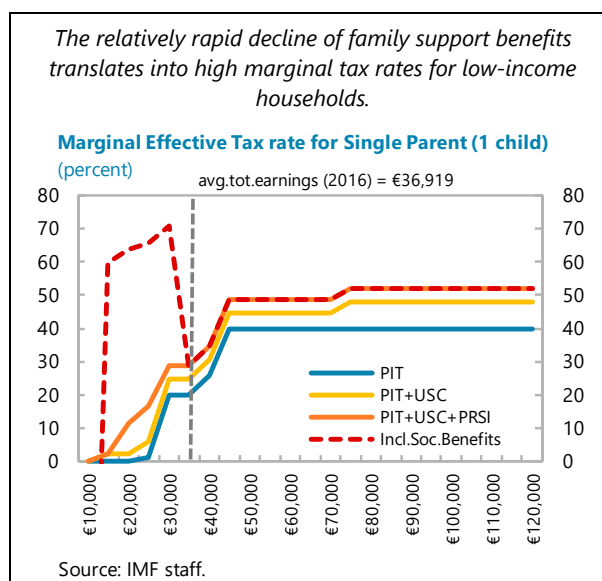
⁴ Since 2015, the rates and the income thresholds of the USC have been revised in each budget year; for more information, see <https://www.revenue.ie/en/jobs-and-pensions/usc/standard-rates-and-thresholds-of-usc.aspx>.

⁵ No change is planned regarding employers' PRSI contributions.

⁶ Under unchanged policies, the SIF's balance shifting is estimated to shift from a modest surplus of [0.2] percent of GDP in 2016 to a deficit of almost 1 percent of GDP in 2030 and 3 percent of GDP by 2055, reflecting the significant increase in pension-related expenditure due to Ireland's rapidly ageing population ([Actuarial Review](#)).

optimal number of income brackets. For example, in Austria, the 2016 reform comprises an increase in the number of income brackets from four to seven resulting in a slower and more gradual progression ([Ivaškaitė-Tamošiūnė and others](#)).

- **Preserving revenue.** Crafting at least a revenue neutral labor-income tax reform would be the first best. Potential revenue losses should be compensated by increases in other tax heads (for example, real estate taxation).
- **Enhancing incentives to work.** In this regard, the government could consider to:
 - taper off Working Family Payment (WFP) transfers⁷ more gradually, thus better rewarding households that move up the pay scale ([OECD](#)); and
 - reduce the high marginal tax rate for second income earners with a view to moving to full individualization in income tax filing, which would improve equality and promote female labor participation.
- **Strengthening the financial soundness of the SIF.** In absence of a reform of social benefits, the projected deterioration in the SIF's balance calls for an increase in social security contributions, including by making those payments more progressive with the pay scale. To address the long term sustainability of the pension system, the government has published a [Roadmap for Pensions Reform 2018–2023](#) with a view to moving from the “yearly average” contributions to a “total contributions” approach to calculate the level of pension payments.



⁷ The WFP (formerly known as Family Income Supplement) is a weekly tax-free payment available to employees with children equivalent to 60 percent of the difference between a family's weekly income and a specified income limit that depends on family size.

Annex V. Progress Against IMF Recommendations

Several policy recommendations in the [2017 Article IV consultation](#) have been taken on board.

Key recommendations

Continue growth-friendly consolidation to further reduce the debt-to-GDP ratio. Broaden the tax base. Save temporary revenue windfalls. Maintain sufficient room for social expenditures and growth-enhancing capital spending within the envisaged deficit-reduction strategy.

Accelerate the NPLs resolution, including through intensified supervisory oversight, support greater creditor-borrower engagement, and improve the efficiency of legal proceedings.

Closely monitor the strong momentum in the housing market to avoid the emergence of imbalances.

Adopt measures aimed at reducing building costs, freeing up land for development, and accelerating loan restructuring for distressed, but viable firms in the construction sector.

Continue efforts to upgrade labor force skills and raise female labor force participation. Enhance competitiveness through greater support for the SME innovation and improved infrastructure.

Publish indicators of underlying economic activity which suitably account for the operations of the foreign-owned MNEs to allow a more accurate assessment of economic developments and policy-making.

Implemented policies

Public debt ratio declined further in 2017 due to nominal GDP growth. The [2018 Budget](#) measures have a mixed impact on the tax base. In addition, direct taxes on low-medium income earners were reduced. The government plans to [amalgamate the USC with the PRSI](#) with a view to simplifying the personal tax and social insurance system and is undertaking comprehensive expenditure review to improve spending efficiency in key areas. The new [National Development Plan](#) envisages a substantial increase in public investment over the medium term.

NPLs continued to moderate supported by intensified supervisory efforts and measures to enhance borrower-creditor engagement. Repossessions remain low and the legal proceedings continue to be lengthy.

In November 2017, the [Central Bank of Ireland](#) concluded its annual review of residential mortgage lending requirement and decided to keep core parameters of the macroprudential framework unchanged, while it halved to 10 percent the proportion of non-FTB loans allowed to exceed the 3.5 LTI limit.

The 2018 Budget comprises several measures to encourage greater home supply. In March 2018, the Department of Housing has issued new regulations about apartment building, which move away from rigidly applied blanket planning standards, including for building height and separation.

In September 2017, the government introduced the Pathways to [Work Action Plan for jobless Households](#), which focus on both employment activation and identifying and removing barriers that prevent people from getting a fair chance, including by further expanding access to free and subsidized child-care and reforming the welfare schemes to support working families. Additional technology centers, which provide innovation infrastructures to SMEs, were established.

In July 2017, the Central Statistics Office published the Modified Gross National Income (GNI*) and Modified Current Account (CA*). It has also started publishing the modified domestic demand, on a quarterly basis.



IRELAND

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 7, 2018

Prepared By

European Department

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FUND RELATIONS

(As of May 31, 2018)

Membership Status: Joined August 8, 1957; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	3,449.90	100.00
Fund holdings of currency	2,643.16	76.62
Reserve position in Fund	806.78	23.39

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	775.42	100.00
Holdings	652.39	84.13

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	12/16/10	12/15/13	19,465.80	19,465.80

Projected Payments to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs, as of May 31, 2018):

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
Principal					
Charges/Interest	0.80	1.07	1.07	1.07	1.07
Total	0.80	1.07	1.07	1.07	1.07

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, and has not notified the Fund of any restrictions under Decision No. 144 (52/51).

Article IV Consultation:

The last Article IV consultation was concluded on June 23, 2017. The associated Executive Board assessment is available at <http://www.imf.org/en/News/Articles/2017/06/26/pr17245-imf-executive-board-concludes-2017-article-iv-consultation-with-ireland> and the staff report (IMF Country Report No. 17/171) at <http://www.imf.org/en/Publications/CR/Issues/2017/06/26/Ireland-2017-Article-IV-Consultation-Press-Release-and-Staff-Report-45006>. Ireland is on the standard 12-month consultation cycle.

Financial Sector Assessment Program (FSAP) Participation and ROSC:

The Financial System Stability Assessment (FSSA) for the last mandatory FSA was discussed by the Board on July 27, 2016. The FSSA and accompanying Reports on the Observation of Standards and Codes (ROSCs) are available at <http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Ireland-Financial-System-Stability-Assessment-44142>.

STATISTICAL ISSUES

I. 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 a six-month lag.

Government finance statistics: The authorities publish Exchequer returns and indicative estimates of the general government balance on a monthly basis. The definitive general government balance is reported quarterly and annually. 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)*. The most recent BOP and IIP data reported to STA and disseminated in the *IFS* are for Q4/2017. 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.

II. 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 May 25, 2018)

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	May 25, 2018	5/25/2018	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	April 2018	5/16/2018	M	M	M
Reserve/Base Money	April 2018	4/30/2018	M	M	M
Broad Money	April 2018	4/30/2018	M	M	M
Central Bank Balance Sheet	March 2018	5/3/2018	M	M	M
Consolidated Balance Sheet of the Banking System	March 2018	4/27/2018	M	M	M
Interest Rates ²	March 2018	5/8/2018	M	M	M
Consumer Price Index	April 2018	5/10/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2017:Q4	4/11/2018	Q	A	A
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	April 2018	5/3/2018	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	2017:Q4	4/11/2018	Q	Q	Q
External Current Account Balance	2017:Q4	3/15/2018	Q	Q	Q
Exports and Imports of Goods and Services	2017:Q4	3/15/2018	Q	Q	Q
GDP/GNP	2017:Q4	3/15/2018	Q	Q	Q
Gross External Debt	2017:Q4	3/15/2018	Q	Q	Q
International Investment Position ⁶	2017:Q4	3/15/2018	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 Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).

**Statement by Ms. Anne Marie McKiernan, Alternate Executive Director for Ireland
and Mr. Niall Feerick, Advisor to Executive Director
June 22, 2018**

Context

We thank staff for their continued constructive engagement with our authorities, their insightful Report and constructive Selected Issues Papers. Together, these provide for fruitful discussions when the Managing Director visits Ireland next week. The Irish economy is at an important juncture. A decade after the start of the GFC, and almost eight years after the start of the Program, the economy and financial sector have been transformed, with painful structural reforms undertaken in crisis setting the foundations of the broad-based economic upturn. Crisis legacy issues remain, however, and are now combined with very different challenges in the current environment, including Brexit and threats to international trade. Over the course of the recent mission, it was heartening to note that both Fund staff and the authorities share many of the same concerns and risks pertaining to the Irish economy, albeit with some difference in nuance.

As a small, highly regionally and globally interconnected country, Ireland has more at stake than most others in ensuring the stability of the multilateral trading system. Globalization has long been a key pillar in Ireland's economic strategy, in both directions. US FDI into Ireland – which first started in 1917 with Ford Motors – remains the most important single source of inward investment, and accounts for 150,000 employees in Ireland, while Irish companies employ over 100,000 people in the US.

With the focus of FDI having shifted to “modern” technologies and industries, Ireland has continued to build up its reputation as a technology hub, realizing agglomeration economies across cycles of different types of FDI and through the creation of a significant number of indigenous spin-offs, fulfilling a key objective of attracting FDI. Despite the increasing focus and scale of technology graduates from Irish third level institutions, employment demand is sufficient to sustain enhanced immigration -which has returned to levels last seen in the mid-2000's - another key benefit of globalization. This reflects Ireland's favorable view of immigration – amongst the most positive of European countries – and sustained by the authorities' perspective of immigration as enhancing the productive capacity of the economy and fostering multiculturalism.

Economic Outlook

As can be observed from the staff paper, the economic outlook of staff and of the authorities are very closely aligned. Both see growth continuing to be broad-based and driven by domestic demand over the short term, aided by a relatively buoyant global outlook. Over the medium term, growth will return to potential of around 3 per cent. The renewed strength in domestic demand can be attributed to a variety of factors – most notably rising household incomes, muted inflation and a rebound in confidence – and is manifest in rising retail sales, services data flow and tax receipts.

As has been made clear in recent years, the impact of more globalized activities on the Irish economy has presented measurement issues with regard to GDP, and its relevance as a primary policy variable. In 2016, a group of Irish experts, with the Fund as an observer, developed GNI*¹, which the Irish authorities consider a more appropriate metric for policy decision making and assessing fiscal and external balance positions. The Irish authorities appreciate the focus that the IMF brings to challenges presented by globalization, on, inter alia, the measurement and interpretation of developments in digitalization and internationalization of activity.

Fiscal Policy

Today (19 June), the Irish Government published its Summer Economic Statement (SES), which sets out the broad policy parameters for the forthcoming October Budget. The central message is that careful management of the public finances is needed to avoid the mistakes of the past and to chart Ireland's way forward through uncertain economic times. Compliance with the European fiscal rules has anchored fiscal policy in the post-program period, with Ireland continually achieving its target. However, at the present juncture, full use of the leeway afforded by the fiscal rules could lead to the adoption of pro-cyclical policies not appropriate to Ireland's position in the economic cycle. Accordingly, our authorities are aware that they will have to 'lean against the wind' and will anchor budgetary policy in reducing the deficit next year (notwithstanding that there is space for a larger deficit under the fiscal rules).

On the medium-term strategy, in the SES, our authorities have adopted the Managing Director's message, to 'fix the roof while the sun shines'. The Irish authorities consider, that at nearly full employment, the sun is certainly shining. The SES underscores the need to rebuild fiscal buffers and to run budgetary surpluses for a number of years in order to alleviate pressures on the domestic economy and to prepare for future challenges. Given this macroeconomic backdrop, it is imperative that taxpayers get value for money and a series of reforms have already been implemented to the budgetary framework such as the Spending Review process. This process supports an evidence based approach to policy and ensures the consistent evaluation of existing expenditure commitments through systematic reviews of expenditure programs across all sectors of Government. Our authorities would also like to reiterate their thanks to the Fund for the useful PIMA exercise which has assisted in policy formulation.

Reflecting the above, a key Government priority is to reduce the level of public indebtedness and significant progress is being made in this respect. For instance, Ireland retains significant investments in the domestic pillar banks, a legacy of the crisis. It is the firm intention of Government to extinguish its shareholdings in these banks, when conditions are appropriate, and use the proceeds to reduce debt. Additionally, in recent days, the National Asset Management Agency has revised up their estimated surplus to €3.5bn, all of which will also

¹ GNI* excludes the profits of re-domiciled companies, the depreciation of intellectual property and aircraft leasing companies.

be used to reduce debt. Our authorities acknowledge that the debt-to-GDP ratio presents an overly benign view of overall public indebtedness. As such, their preferred metric for assessing our debt outlook is GNI*, which although declining, remains high. Notwithstanding that the stock is high, the National Treasury Management Agency (NTMA) has been very proactive in liquidity management, locking in long dated maturities at very low rates, while yield spreads on Irish sovereign bonds remained largely unchanged in 2018.

As outlined in the staff report, work is progressing on the setting up of a Rainy Day Fund. The Government has approved the general scheme of the Bill providing for its establishment and the draft legislation is now proceeding to pre-legislative scrutiny. In recent days, the Finance Minister has stated that there will be a ‘triple lock’ on the proposed funds to prevent future governments from using the proceeds for any purpose other than specifically outlined in the legislation. Contributions to the Rainy Day Fund will begin next year by providing an upfront contribution of €1.5bn from the Strategic Investment Fund and subsequently setting aside €500m per year of the historically high levels of corporation tax. The appropriate size of the Fund is calibrated at some €3bn, something which reflects the cost of carry, potential demand for the monies, etc.

The staff report highlights developments in the international tax landscape as a potential downside risk to the Irish economy, albeit limited in its overall impact. This echoes the assessment of the Irish authorities as outlined in the RAM of the recent Irish Stability Program Update submitted to the European Commission as part of the fiscal surveillance process of the EU Semester. Staff note positively that Ireland has been at the forefront of reforms through the OECD BEPS process and that, last year, Ireland achieved the highest standard possible for tax transparency.

Financial Sector

The outlook for the Irish banking sector has shown a marked improvement over recent years. Profitability remains solid while capital and liquidity ratios remain well in excess of regulatory minima. The staff report highlights, and the Irish authorities concur, that NPL reduction is a key policy issue. Concerted policy action in establishing a dedicated insolvency court to expedite cases and the setting up of insolvency practitioners to arbitrate between banks and borrowers, have and will continue to pay dividends. Moreover, Irish banks have been actively selling their NPL loan books, including significant disposals in the past month. However, it is acknowledged that, as the stock of legacy NPLs has reduced, the residual comprises more complex cases. On NPLs, it is important to emphasize that the net position (after provisions)– which is important from a financial stability perspective - of Irish banks compares relatively well to EU peers.

The introduction of Macroprudential Policies in 2014 represented a key structural improvement in the Irish policy framework. By limiting high LTV and LTI lending in the market, the Central Bank seeks to promote financial stability from the damaging impact of systemic risks related to unsustainable credit growth as happened during the last crisis. Late last year, the Central Bank completed its annual review with the assessment concluding that the rules, as calibrated, remain appropriate. The analysis conducted as part of the 2017

Review suggests that house price and mortgage lending developments in aggregate are not indicative of unsustainable developments at present. The Central Bank also recently publicly indicated that the case to raise the Countercyclical Capital Buffer (CCB) was now becoming compelling.

Housing

The housing market is a key concern of the Irish authorities. Specifically, lack of supply, a legacy of the construction bust, has manifested itself in significant house price and rental inflation, which has led to some affordability and competitiveness concerns. Policymakers agree that as chronic undersupply is the core issue, their interventions have focused on supply side initiatives rather than demand, which would ultimately lead to a vicious circle of higher prices. Box 3 outlines some of the measures recently undertaken by the Irish authorities. Given the lag between when planning permissions are being sought and houses being delivered to the market, it is not surprising that it will take time to return output to long run sustainable levels. Saying that, there are positive indications emerging. Figures released last week on housing completions for Q1 2018 showed a 27 percent year-on-year increase, indicating that the strategy is beginning to bear fruit.

Brexit

Brexit is the most important policy issue for the Irish government at present, given that Ireland is the only European country to share a land border with the UK. Bilateral trade between Ireland and the UK, represents 13 percent of total exports and 12 percent of total imports, while the UK land bridge to the continent is a key factor in the supply chain for Irish exports.

While the authorities share the staff view that the economic impact, while difficult to assess and ultimately dependent upon the outcome of the negotiations of the future framework with the UK, the impact would be asymmetric for Ireland compared to other countries. Additionally, the sectoral and geographic concentration of most impacted sectors presents additional risks. Therefore, a “whole of Government” approach has been adopted entailing, inter alia, contingency plans across an extensive range of areas. Tangible measures taken to date include funding to help SMEs diversify their export market and financial market contingency planning for a hard Brexit. Ireland will continue to advocate its staunch opposition to a hard border and engage constructively with our European and UK colleagues to this end.

Conclusion

While Ireland has transformed relatively rapidly from a deep recession, the authorities are not complacent regarding the risks arising from potential overheating, globalization, and Brexit.

The continued need to address prevailing legacies from the crisis, while avoiding overheating, presents the main policy challenges for the Irish authorities. Staff call for achieving a fiscal surplus while at the same time facilitating increased investment in

infrastructure and meeting legitimate social needs of the citizens. The authorities appreciate this useful policy advice to consider in the context of some difficult trade-offs. In closing, we would just emphasize that our authorities, as echoed by our Prime Minister last week, will continue to be guided by the need to avoid 'ghosts of fiscal past'.