September 2007
IMF Country Report No. 07/325

Ireland: 2007Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

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 2007 Article IV consultation with Ireland, the following documents have been released and are included in this package:

- The staff report for the 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 27, 2007, 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 August 2, 2007. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of September 11, 2007, updating information on recent economic developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 14, 2007 discussion of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

IRELAND

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives for the 2007 Consultation with Ireland

Approved by Robert Ford and Michael Hadjimichael

August 2, 2007

Executive Summary

Background and outlook: Economic performance remains impressive, though in recent years economic growth became increasingly reliant on house building. Competitiveness eroded somewhat, though it is still broadly appropriate. The rise in euro area interest rates has prompted a welcome cooling of the housing market, which will help to rebalance economic growth and reduce inflation, though there is a risk of a sharper slowdown. The key policy challenges are therefore to support adjustment to sustainable growth.

Fiscal policy: Fiscal stabilizers have ample room to operate fully, but discretionary measures that weaken the underlying fiscal position should be avoided. The authorities and staff agreed on the importance of maintaining fiscal prudence. Over the medium term, it will be important to further improve the quality of spending and review the tax base. As age-related spending will rise considerably in the long term, improving public understanding of fiscal pressures and a better approach to pension planning are needed.

Financial system: Banks have large exposures to the property market, but stress tests suggest that cushions are adequate to cover a range of shocks. Financial regulation and supervision have improved over the past year with the introduction of a new liquidity management framework for banks and the strengthening of capacity for insurance supervision. The authorities and staff shared the view that continued careful monitoring of banks' risk management practices is essential.

Labor market policies: The authorities and staff concurred that wage moderation—in both the social partnership agreement and the forthcoming public sector pay benchmarking exercise—and firm-level wage flexibility are crucial to minimizing the expected rise in unemployment and seizing new growth opportunities.

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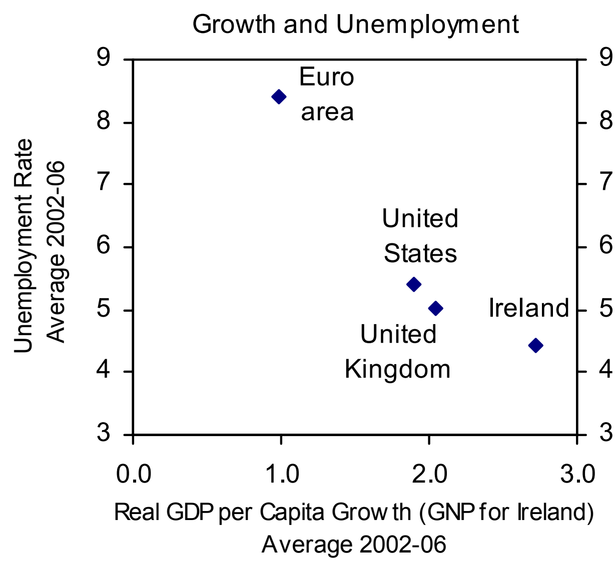
I. INTRODUCTION[1]

1. **Economic performance remains very strong, supported by sound policies**. The growth rate of real GNP per capita continues to be one of the highest among advanced economies and the unemployment rate one of the lowest. Higher value-added activities such as financial services, information technology services, and other business services are expanding. Inward foreign direct investment is boosting labor productivity, while outward FDI—and increases in foreign holdings more generally—are allowing Irish households, corporations, and financial institutions to diversify their assets. Ireland's open door for workers from new EU member states is supporting economic growth and mitigating potential labor-market bottlenecks. In addition to outward oriented policies, key pillars of Ireland's performance are prudent fiscal policy, low taxes on labor and business income, and labor market flexibility (Box 1).



Box 1. Fund Policy Recommendations and Implementation

Fiscal policy: Fiscal policy has been prudent, with a medium-term fiscal objective of close to balance or surplus, in line with Fund advice. In the past couple years, windfall property-related revenues were saved and the fiscal stance was not procyclical, in line with Fund advice.

Financial stability: The Fund supports the supervisory framework, which aims to prioritize resources across sectors based on risk profile. The regulatory and supervisory framework continues to be strengthened in line with the recommendations of the 2006 FSAP Update.

Wage policies: The present social partnership agreement contained no fiscal concessions, in line with Fund advice, though the wage increases were a little on the high side.

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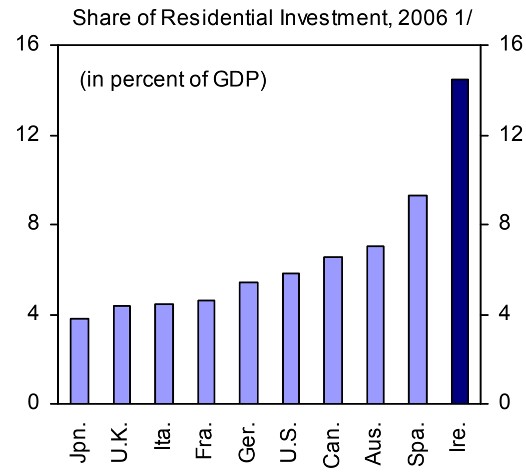
[1] Mission: Dublin, June 19–27, 2007. Staff team: Mr. Morsink (head), Mr. Kanda, Ms. Iakova, and Mr. Tang (all EUR). Country interlocutors: The Tanaiste (Deputy Prime Minister) and Minister for Finance, the Governor of the Central Bank, the Chief Executive Officer of the Financial Regulator, other senior government officials, academics, and representatives of the employers' federation, the labor unions' congress, the financial community, and the principal research institute. Mr. Fried (Executive Director) and Mr. Charleton (Alternate Executive Director) attended the meetings. Staff analytical work is listed in Appendix I. Ireland is an Article VIII member. Data provision is adequate for surveillance.

2. **However, in recent years, economic growth has become more reliant on house building and competitiveness has eroded**. The share of residential investment in economic activity rose to a higher level than in other advanced economies. House prices increased rapidly and the ratios of house prices to rents and to household disposable income rose to historical highs. The construction boom was accompanied by surging bank credit to property-related sectors, strong wage growth and inflationary pressures, and a deterioration in the external current account balance.

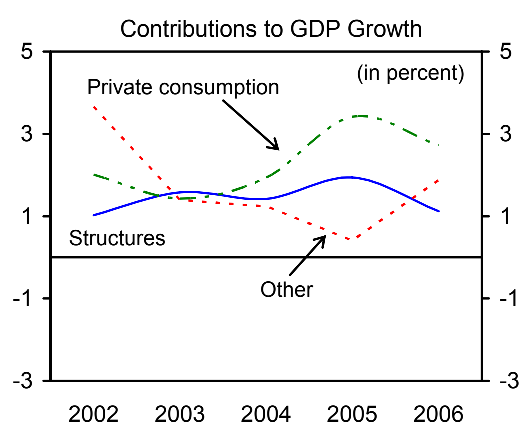


Source: AMECO.
1/ 2005 data for Australia, Canada, and France.

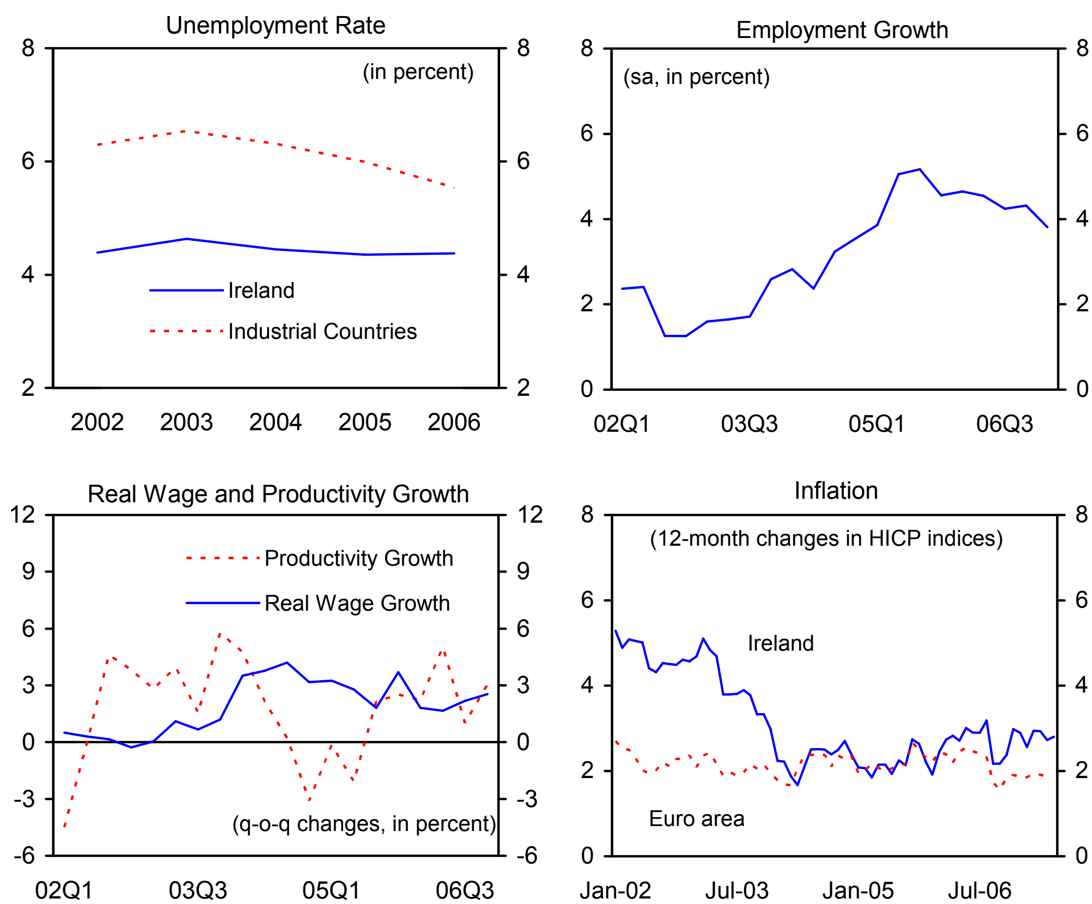
3. **A new government was formed in June following parliamentary elections, but substantial continuity in economic policies is expected**. Fianna Fail remained the largest party in parliament and Prime Minister Ahern formed a coalition government with the Green Party, the Progressive Democrats and supported by some independent members of parliament. Brian Cowen was reappointed as Finance Minister and also appointed as Tanaiste (Deputy Prime Minister). Given the comfortable majority of the ruling coalition, parliament is likely to run its full course, with the next general election in mid-2012.

II. STRONG GROWTH IN 2006, THOUGH HOUSING MARKET STARTED TO COOL

4. **Economic growth was strong in 2006, driven by robust domestic demand** (Table 1). Private consumption growth remained buoyant, as support from dynamic employment growth and steady wage growth partly offset the adverse effects of higher debt service and energy costs. Business investment growth fell sharply, reflecting the base effect of exceptionally large purchases of aircraft the previous year (and was therefore matched by a decline in import growth). Residential investment growth slowed, but this was partly offset by a pickup in nonresidential building investment. Lost competitiveness contributed to a slower growth of exports of goods and services.

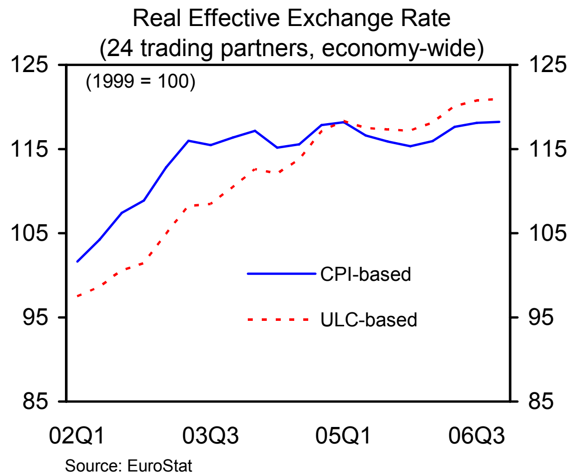


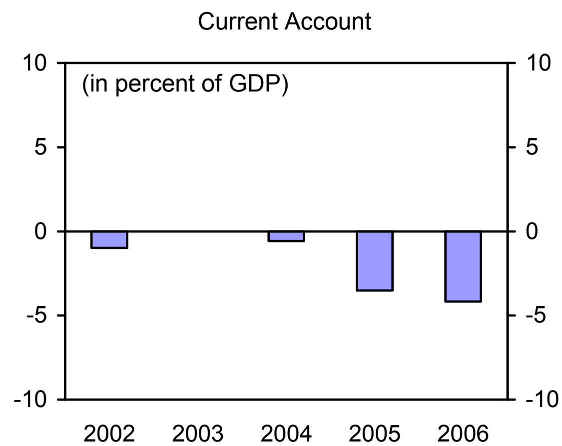
5. **Strong growth in 2006 diminished economic slack and boosted inflationary pressures**. HICP inflation rose to 2¾ percent, above the euro area average, driven by rapid increases in services prices. The unemployment rate was stable, as both employment growth and labor force growth were robust, reflecting high net immigration and increased participation rates, especially among women. For the year as a whole, wage growth was broadly in line with productivity (GDP per employee) growth, suggesting that economy-wide unit labor costs were broadly flat in 2006. In light of rising inflation and low unemployment, the authorities and staff agreed that output was at or slightly above potential in 2006, though such estimates have large margins of uncertainty.

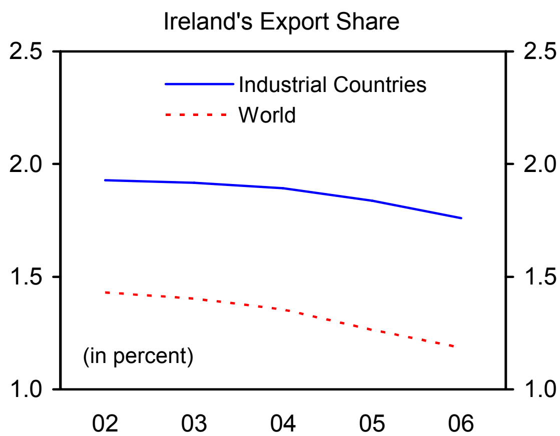


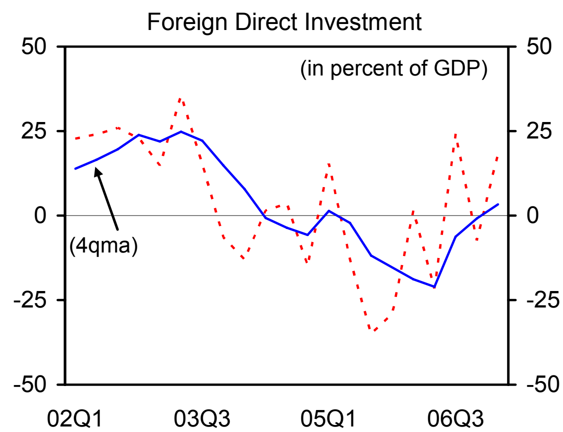
6. **Higher-than-trading-partner inflation led to a further erosion of competitiveness**. Ireland's share of industrial country exports of goods and services continued its gradual decline and the current account deficit widened to 4¼ percent of GDP (Table 2). Net FDI was negative but improved relative to 2005, mainly reflecting the passing of the impact of temporary U.S. regulatory changes. The authorities and staff agreed that, while external competitiveness has eroded, the external position is stable (Appendix II) and

that Ireland's real effective exchange rate is close to, but perhaps slightly above, its equilibrium value.[2]



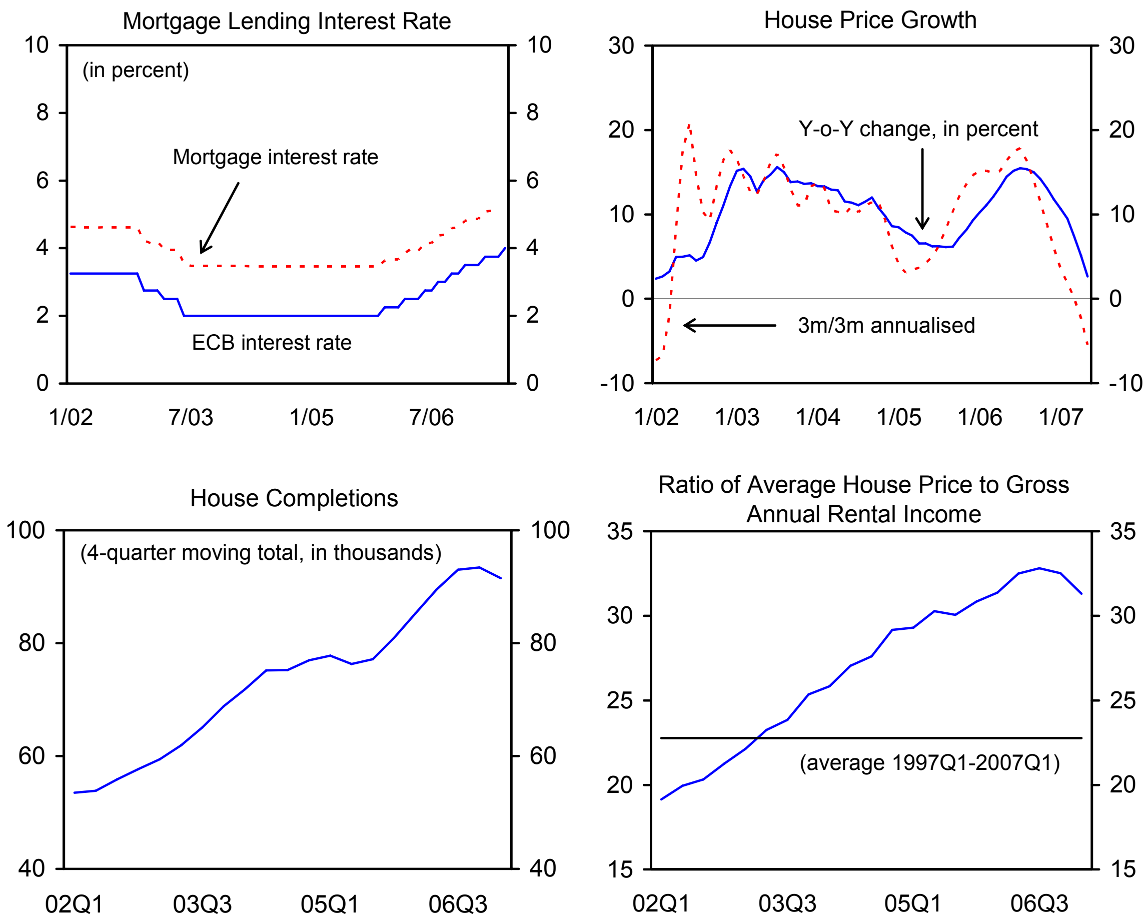






7. **The rise in euro area interest rates since late 2005 has prompted a cooling of the housing market.** The growth of residential investment declined significantly in 2006 and house prices have fallen in recent months. The share of residential investment in GDP in Ireland is higher than in other countries, partly reflecting catch-up in Ireland's housing stock. With the ratio of house prices to rental income above its historical average, house prices were seen as somewhat overvalued by Central Bank officials and staff, though in line with fundamentals by Department of Environment officials.

[2] Estimates based on the CGER methodology suggest that the real effective exchange rate is 0–10 percent above equilibrium. The standard deviation of the errors in the estimates is about 10–15 percent.



Sources: CSO; Department of Environment; Quarterly National Household Survey; and staff calculations.

III. Growth Slowdown Ahead, With Risks on the Downside

8. **Residential investment is expected to wind down as house completions return to a sustainable level**. Although rapid population growth and a relatively low number of dwellings per capita ensure strong underlying demand for housing, the staff consider the sustainable level of house completions to be about 50,000 to 70,000, well below the 88,000 dwellings finished in 2006. Thus, residential investment is projected to contract substantially during 2007–10. The authorities saw a soft landing of the housing market as likely. The shared view is that any overvaluation of house prices would likely diminish gradually over time as rental income and other fundamentals grow more quickly than house prices. The authorities and staff agreed that housing wealth effects on consumption are small.[3]

9. **The growth slowdown in 2007 will be cushioned by strong private consumption and fiscal stimulus** (Table 3). In addition to robust employment growth, steady wage

[3] Marialuz Moreno-Badia, "Who Saves in Ireland? The Micro Evidence," IMF Working Paper 06/131, 2006.

growth, and increased government transfers to households, private consumption will be supported by maturing Special Saving Investment Accounts (amounting to about 12 percent of private consumption), a small portion of which will be spent. Nonresidential structures investment is also expected to be strong, in light of continued favorable growth prospects over the medium term and Ireland's need for public infrastructure. Altogether, staff project that real GDP will grow by about 4¾ percent. Given the strength of domestic demand, the current account deficit is expected to widen further to about 4½ percent of GDP.

Macroeconomic Projections

(Percentage change, unless otherwise indicated)

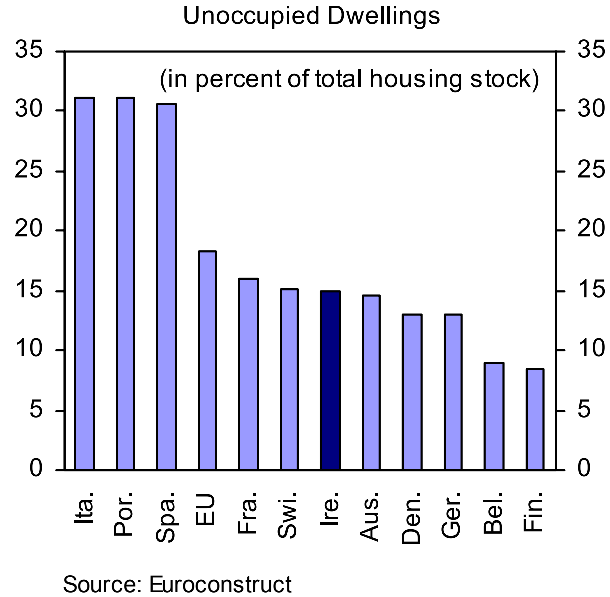
	2004	2005	2006	2007	2008
Real GNP	3.7	4.9	6.5	4.3	3.2
Real GDP	4.3	5.9	5.7	4.8	3.5
Real domestic demand	3.8	8.0	5.7	4.8	1.9
Private consumption	4.1	7.3	5.7	7.0	3.7
Public consumption	1.5	4.0	5.3	5.5	3.5
Fixed investment	6.9	11.8	3.1	1.4	-2.2
Structures	7.7	10.1	5.6	-2.3	-5.1
Residential investment	12.0	12.4	3.5	-9.0	-13.0
Non-residential investment	0.7	6.2	9.5	9.5	6.6
Equipment	5.5	17.9	-5.1	14.7	6.5
Change in stocks 1/	-0.6	-0.1	0.7	-0.2	-0.1
Net exports 1/	0.3	-1.0	0.6	0.7	1.9
Exports	7.3	5.2	4.4	5.6	4.8
Imports	8.5	7.7	4.4	5.5	2.8
Current account (in percent of GDP)	-0.6	-3.5	-4.2	-4.4	-3.3
Consumer Prices (HICP)	2.3	2.2	2.7	2.7	2.1
Unemployment rate (in percent)	4.4	4.4	4.4	4.7	5.3

1/ Contributions to growth

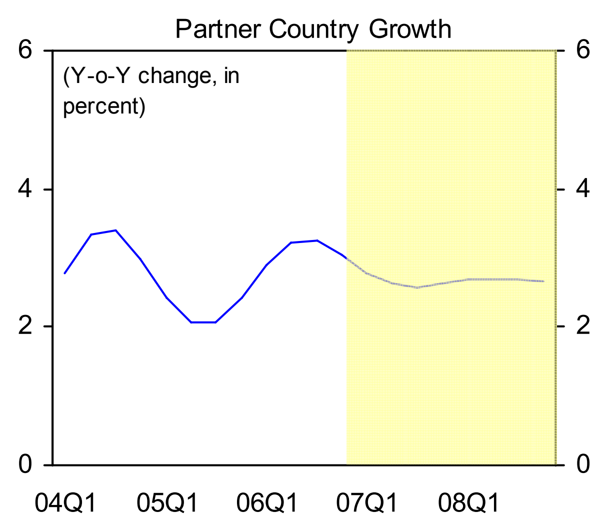
10. **Growth will rebalance further in 2008, as the easing of domestic demand relieves inflationary pressures and helps to narrow the current account deficit.** Economic growth is projected to slow further, as the temporary supports to private consumption fade, euro area interest rates continue to rise, and the downturn in residential investment gains momentum. The slowdown in domestic demand growth should increase economic slack and dampen import growth. Over the medium term, assuming the completion of the adjustment in the housing market, GDP growth will likely run at about 4 percent, reflecting employment growth of about 2 percent and labor productivity growth of about 2 percent. The authorities noted that official projections would only be updated in the autumn, but gave a broadly similar characterization of the outlook.

11. **The risks to the short-term outlook are tilted to the downside**. The housing market could cool more sharply than expected or the external environment could deteriorate (or both). If realized, these risks would further dampen economic growth, reduce government revenue, and increase financial sector stress:

- **Housing market**: The prospect of lower capital gains could scare investors in buy-to-let properties. The 2006 census shows that 15 percent of dwellings are unoccupied, though this is in line with the EU average. Another transmission channel is through private consumption, as housing market developments could undermine consumer confidence. A third transmission channel is through the financial sector. The end of rapid house price appreciation could trigger a reassessment of the risks associated with mortgage lending, possibly leading to a tightening of lending standards, which in turn could affect domestic demand. Cross-country, historical evidence presented in the April 2003 *WEO* suggests that sharp increases in house prices are followed by sharp declines about 40 percent of the time.



- **External developments**: Growth in Ireland's trading partners is projected to remain robust, but risks are skewed to the downside. In particular, a weakening of U.S. growth is an important risk (Box 2). Also, given the relatively high share of exports to the United States, a further appreciation of the euro would undermine Ireland's competitiveness to a greater extent than for other euro area countries. A reversal of still benign global financial market conditions could lead to a deterioration in investor sentiment toward Ireland.



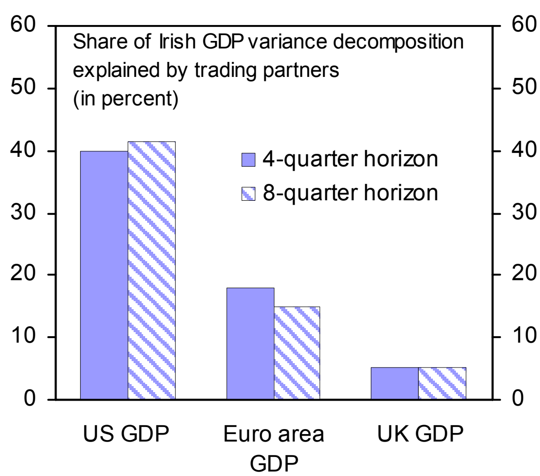
Box 2. Spillovers to Ireland

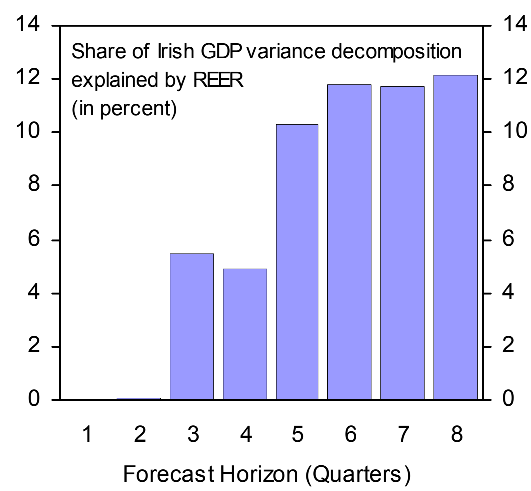
As a small, open economy, Ireland is vulnerable to spillovers from its main trading partners. Merchandise exports amount to about 50 percent of GDP, of which more than two-fifths go to the euro area and less than one-fifth each to the U.S. and the U.K. Ireland is also vulnerable to swings in its real effective exchange rate.

Staff analysis yields two main findings:[1/]

- Spillovers from the U.S. account for a much larger share of the variance of Ireland's GDP than implied by the U.S. share in Ireland's merchandise exports. This could reflect a larger U.S. share of services exports or the dominance of U.S. multinationals in inward FDI. Therefore, a further slowdown in U.S. growth could have a large effect on Ireland.

- The impact of shocks to the real effective exchange rate on Ireland's GDP increases over time, with their share of the variance decomposition rising to about 12 percent after two years and higher still at a longer horizon. This suggests that past erosion of competitiveness may yet have a more substantial impact on economic activity.





[1/] Daniel Kanda, "Spillovers to Ireland," Selected Issues Paper.

12. **With a rebalancing of economic activity in prospect, the discussions focused on the policies needed to support the adjustment to sustainable growth**. Specifically:

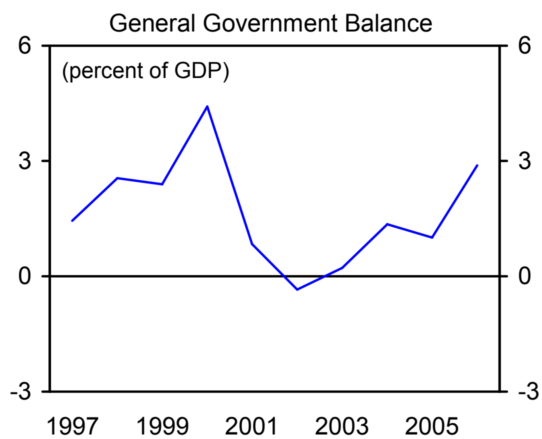
- How is fiscal policy positioned to cushion the slowdown? How will demographic change affect the public finances over the long term?

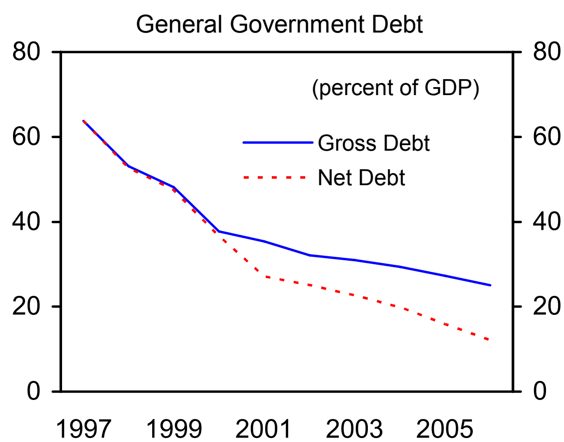
- What are the key vulnerabilities and how large are the buffers in the banking system? How will financial stability and growth be promoted over the medium term?

- How can wage-setting mechanisms help to ensure wage moderation and wage flexibility in response to changing macroeconomic conditions?

IV. Ample Room for Fiscal Stabilizers, but Population Aging Ahead

13. **Already-strong fiscal performance improved further in 2006** (Table 4). Following a decade of close-to-balance-or-surplus fiscal positions, the general government surplus surged to almost 3 percent of GDP in 2006 and net debt fell to about 12 percent of GDP. The better-than-expected fiscal outturn reflected mainly the strength of property-related revenues, as stamp duties and capital gains tax benefited from rising house prices. Government expenditure as a share of GDP fell slightly, as a decline in current spending more than offset a rise in investment.





14. **The budget for 2007 implies substantial fiscal stimulus at a time when the economy may be operating at or above capacity.**[4] In staff projections, most of the 2 percentage point of GDP deterioration in the fiscal position comes from a rise in expenditure, due to increases in social welfare payments and higher education and health spending. The revenue-to-GDP ratio is projected to fall, reflecting both lower corporate income tax and some weakening of stamp duties and capital gains taxes in the second half of the year. While tax buoyancy could once again surprise on the upside (as it has done in recent years[5]), housing market turnover (the base for property-related taxes) could slow more sharply than expected. Staff noted that, given inflationary pressures, eroding competitiveness, and a widening current account deficit, substantial fiscal stimulus in 2007 is unfortunate, but the authorities pointed to the need to achieve social objectives.

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[4] After the election, the new government announced a reduction in stamp duty on house transactions, but the fiscal cost is very small (less than 0.05 percent of GDP on a full-year basis).

[5] Keiko Honjo, "Favorable Fiscal Outturns: Is it Just the Luck of the Irish?" IMF Country Report 05/370, 2005.

General Government Finances
(In percent of GDP)

	Actual			Staff Projections 1/		
	2004	2005	2006	2007	2008	2009
General government balance	1.4	1.0	2.9	0.8	0.4	0.2
Current revenue	33.2	33.6	35.5	34.9	34.3	34.2
Current expenditure	28.4	28.8	28.6	29.6	29.6	29.6
Capital balance	-3.5	-3.8	-4.0	-4.5	-4.3	-4.4
Government balance (cyclically-adjusted)	1.5	1.0	2.7	0.7	0.6	0.3
Government balance (cyclically-adjusted, excluding one-off factor)	0.6	1.4	2.6	0.5	0.6	0.3
Output Gap	-0.4	-0.1	0.4	0.2	-0.4	-0.2
General government net debt (as percent of GDP) 2/	19.9	15.9	12.2	10.3	9.1	8.1

Sources: Department of Finance and staff estimates.
1/ Staff projections are based on the 2007 budget, adjusted for staff's macroeconomic and revenue buoyancy assumptions.
2/ Net debt is defined as gross debt minus the value of the National Pensions Reserve Fund and the Social Insurance Fund.

15. **On unchanged policies, some cyclical weakening of the fiscal position in 2008 is likely, stemming from the impact of the growth slowdown on government revenue**. In staff's central scenario, the fiscal balance is projected to decline by ½ percent of GDP, with risks to this projection tilted to the downside. However, a faster-than-expected cooling of the housing market could result in a much sharper fall in the fiscal balance, reflecting lower property-related revenues, lower income tax and VAT revenues, and higher spending on unemployment benefits. If external shocks were to occur at the same time, the deterioration in the government balance could be even larger, as illustrated by the large deterioration in the fiscal balance (almost 5 percentage points of GDP) between 2000–02. The authorities agreed with the characterization of risks.

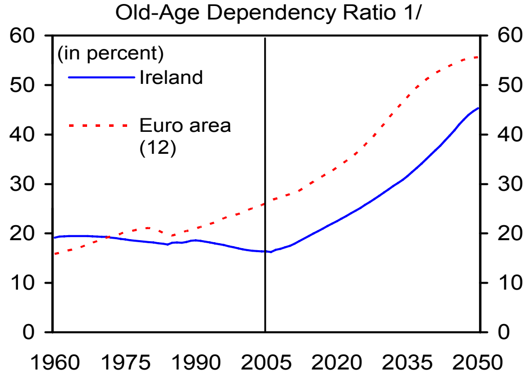
16. **Against this background, the authorities and staff shared the view that prudent fiscal policy should be maintained**. With the new government's five-year program containing some potentially costly proposals, such as a reduction in the social security contribution rate, a rise in pension benefits relative to average earnings, and a cut in personal income tax rates, staff cautioned against discretionary measures that would weaken the underlying fiscal position and suggested restraining the growth of current spending to nominal GDP growth. The authorities said that a sound fiscal position would be maintained by reducing current expenditure growth and targeting a balanced budget.

17. **Turning to the medium term, the authorities and staff agreed on the importance of further improving the quality of spending and reviewing the tax base**. Specifically, while a high level of government investment spending is appropriate given Ireland's significant infrastructure needs, robust cost-benefit analysis is needed to ensure value for money. In this regard, project sponsors need to ensure that full economic analysis is carried out: compliance with this requirement should be subject to audit by the central unit responsible for oversight and quality control of cost-benefit analysis. Turning to current spending, value for money could be enhanced by introducing multi-year envelopes and requiring efficiency gains in the delivery of public services. On the revenue side, the

authorities noted that a Commission on Taxation will be established to review the efficiency and appropriateness of the taxation system. Staff suggested that the Commission could consider, among the other issues, the nature of taxes on property, with a view to establishing whether revenue neutral adjustments might be made which would encourage mobility while ensuring a dynamic tax base and avoiding distortionary effects. Staff also suggested broadening user fees, for example by fully charging for water supply and sewage treatment and introducing a congestion charge in Dublin. The authorities pointed to the political sensitivity of property-related taxes and user fees.

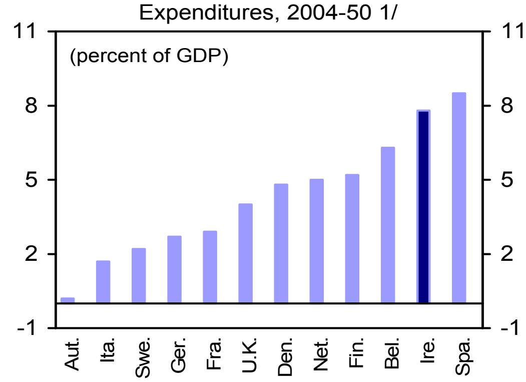
18. **Looking further ahead, population aging will put increasing pressure on public finances**. While Ireland's population actually became slightly younger over the past 50 years, the old-age dependency ratio will start to rise quite steeply very soon. As a result, the EC Aging Working Group projects a rise in age-related government spending between 2004–50 of about 8 percentage points of GDP (primarily due to increased pension spending), higher than the average for other EU countries.[6] To prepare for this spending, the government is

Old-Age Dependency Ratio 1/



Source: Eurostat.
1/ Defined as the ratio of population aged 65+ to population aged 15-64.

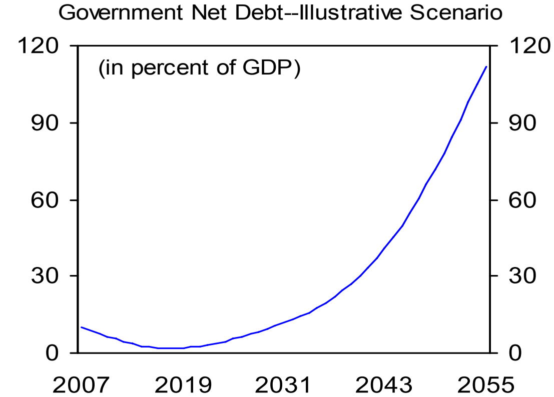
Increase in Age-related Public Expenditures, 2004-50 1/



1/ European Economy, Special Report No. 1, 2006.

setting aside every year 1 percent of GNP in a National Pensions Reserve Fund. Another partial offset will be an eventual decline in government investment spending as a share of GDP to a level more in line with the industrial country average. Nevertheless, an illustrative scenario shows that government net debt could rise substantially by mid-century. To improve public understanding of the pressures on public finances, staff suggested the regular publication of a report on long-term fiscal sustainability, as

Government Net Debt--Illustrative Scenario



[6] Unlike several EU countries, Ireland has not introduced reforms to reduce effective pension benefits.

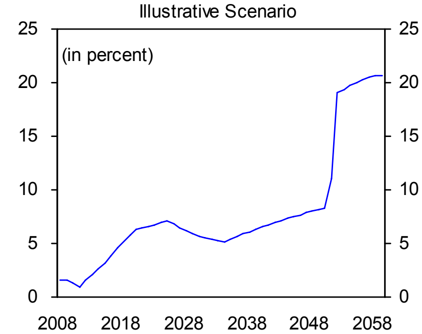
is done in some other countries. The authorities noted that the budget documents regularly cover these issues and that work on a longer report is underway.

19. **To address long-term fiscal pressures, the authorities and staff agreed that a mix of measures will be needed** (Box 3). Staff noted that the state pensionable age (currently 65) could be raised in line with rising life expectancy and that the government's annual contribution to the National Pensions Reserve Fund could be raised. Staff further observed that some other countries are addressing concerns about the adequacy of private saving for retirement by introducing a national defined-contribution scheme with automatic enrolment and low operating costs. The authorities responded that these and other options would be analyzed in a forthcoming Green Paper on Pension Policy.

Box 3. Long-Term Fiscal Sustainability

The Global Fiscal Model is used to simulate the macroeconomic effects of different options to restore debt sustainability.[1/] Funding the rise in age-related spending through a concomitant increase in social security contributions would require substantially higher contribution rates—up to 20 percentage points by 2055. This policy would have negative effects on labor supply, which would already be shrinking as the population ages. A more growth-friendly option would be a combination of raising the retirement age, broadening the tax base, and increasing less distortionary indirect taxes, the base for which is more resilient in an aging society.

Effective Social Security Contribution Rate: Illustrative Scenario

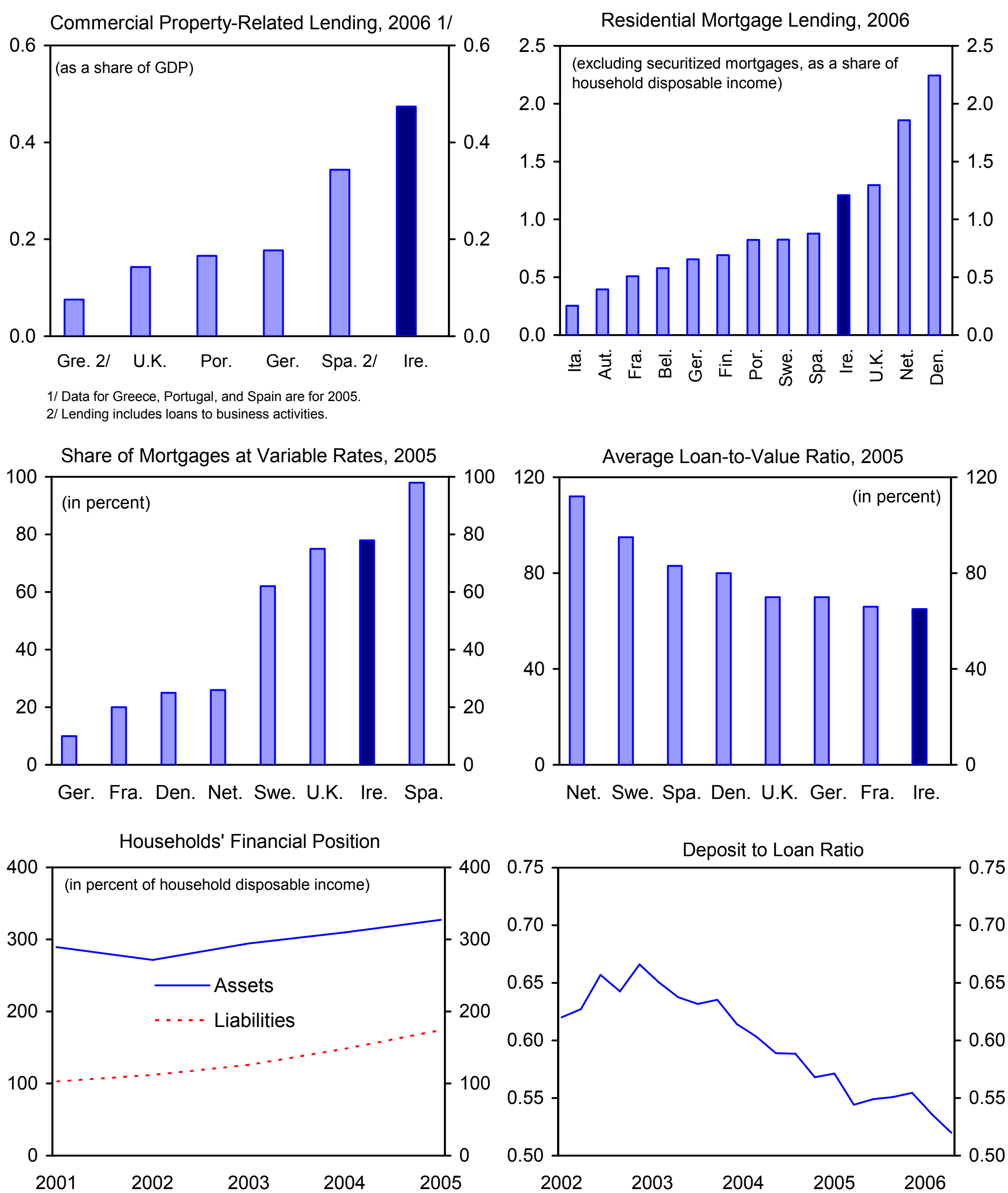


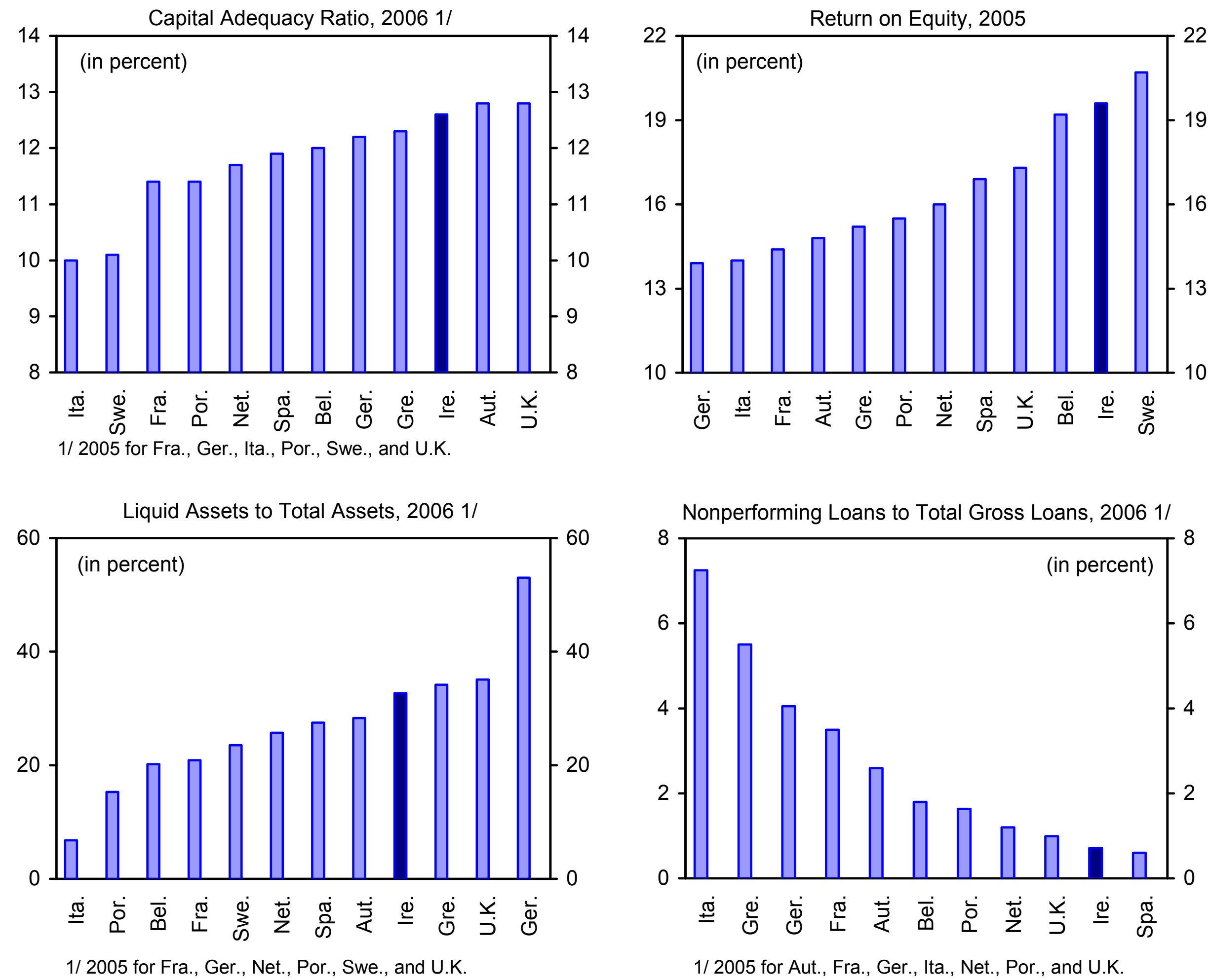
[1/] Dennis Botman and Dora Iakova, "Policy Challenges of Population Aging in Ireland," Selected Issues Paper.

V. Banks Have Large Exposures to Property, but Big Cushions Too

20. **The banking system continues to perform well, but rapid credit growth has led to vulnerabilities** (Table 5). Reflecting the strength of the economy, the banking system is well-capitalized, profitable, and liquid, and nonperforming loans are low. However, bank lending to construction and real estate firms amounts to about 47 percent of GDP (Figure 1). Household debt now amounts to about 160 percent of household disposable income and, with most debt at variables rates, rising euro area interest rates have raised households' debt burdens. While about ⅓ of the mortgages taken out by first time buyers in 2006 was at a 100 percent loan-to-value ratio, the average loan-to-value ratio is low compared to other countries and households' financial assets far exceed financial liabilities. At the same time, as loan growth has outstripped deposit growth, banks have become more reliant on wholesale funding, which is more expensive and potentially more volatile than retail funding. However,

Figure 1. Ireland: Banking System Developments





Source: IMF.

banks also hold high levels of liquid assets. Looking forward, the slowdown in credit growth associated with the cooling housing market is expected to put some pressure on profits.

21. **Stress tests by the Central Bank indicate that the major lenders have adequate buffers to cover a range of shocks**. Even in an extreme scenario, involving a sharp rise in unemployment and a sharp decline in house prices, capital remains adequate at every bank. In addition, even a very substantial withdrawal of private sector deposits would not exhaust any major lender's stock of liquid assets. However, the stress tests only incorporate first-round effects and the long period of strong economic performance limits the ability to quantify the relationship between macroeconomic variables and credit risk. The Central Bank is working on extending stress tests to banks' foreign exposures.

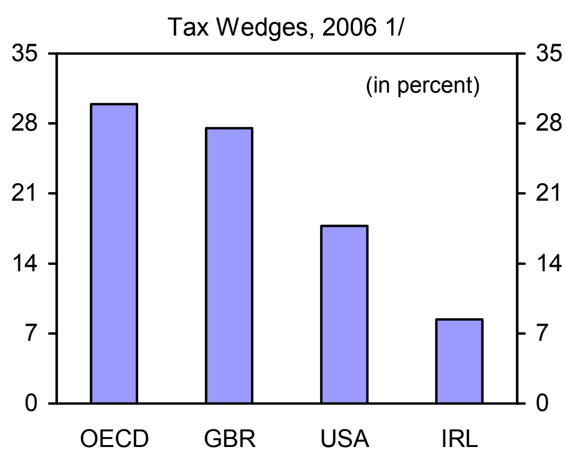
22. **The regulatory and supervisory system has been strengthened over the past year, in line with the recommendations of the 2006 FSAP Update**. New liquidity requirements for credit institutions—involving a forward-looking mismatch approach under which cash flows are assigned to relevant time bands—came into effect in July 2007. In insurance supervision, the Financial Regulator has recruited experts, trained staff, and

reorganized, with the new structure having both an on-site inspection unit and a reinsurance unit. Insurance supervisors are focusing on assessing companies' risk management frameworks and capacities, in preparation for the eventual adoption of Solvency II. The implementation of the EU Capital Requirements Directive could lead to declines in regulatory capital, though the declines would initially be limited by the capital floors imposed by the Capital Requirements Directive. As banks could use any excess capital to expand into unfamiliar activities, the authorities and staff agreed that it will be important to continue to carefully monitor banks' risk management practices, including for commercial property lending. Staff supported the Financial Regulator's prudent approach on the risk-weighting of lending to speculative commercial property and residential investment property. Although the amount of subprime mortgage loans is small (less than 2 percent of outstanding mortgage loans), staff supported the proposal to make all subprime lenders subject to the consumer protection code.

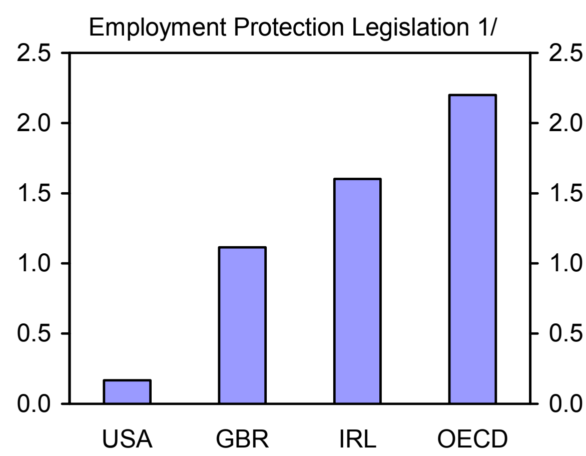
23. **Over the medium term, the financial system has an important role to play in supporting economic growth**. Staff noted that Ireland's financial system is already characterized by a relatively high degree of arm's length transactions (Box 4). In addition to maintaining high standards in areas such as bank competition, investor protection, and corporate transparency, policy measures that contribute to the further development of securities markets could be considered. For example, the relatively high stamp duty on securities transactions could be dampening market turnover.

VI. Labor Market Flexibility is Crucial to Facilitating Adjustment

24. **The reallocation of workers from residential construction to other parts of the economy will depend on the flexibility of the labor market.** Earlier reform of the tax and



Source: OECD.
1/ Percentage of total labor compensation.



Source: OECD.
1/ Restrictiveness of protection legislation on regular employment. Index scale of 0-6 from least to most restrictive.

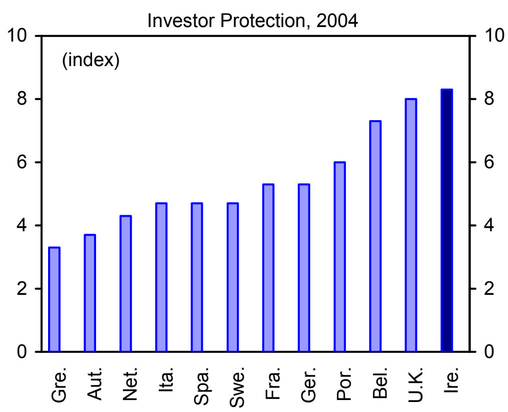
Box 4. Finance and Growth

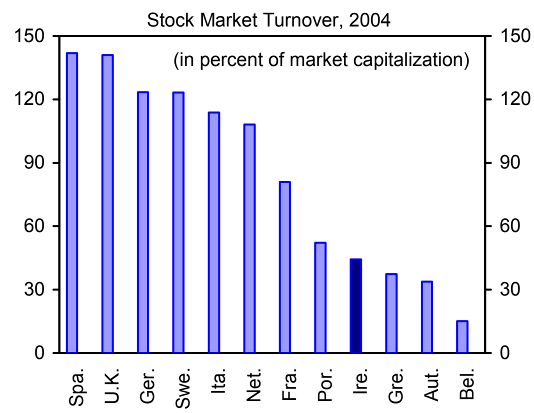
Staff analysis examines the link between types of financial systems and economic growth in advanced economies.[1] Specifically, staff finds that increased corporate borrowing has an especially favorable impact on the growth of industries more reliant on external finance in those countries with financial systems that rely more on arm's length transactions and greater labor market flexibility. An arm's length financial system is one characterized by a more competitive banking sector and more developed capital markets. Turning to the implications for Ireland:

- Ireland already ranks well in terms of banking sector competition, investor protection, and corporate transparency. Here, the challenge is to remain at the forefront of international best practice.

- At the same time, the authorities could consider whether additional policy action could contribute to the further development of capital markets, notably the stock market, the bond market, and derivatives markets.

- Maintaining the flexibility of Ireland's labor market is also important. While the tax wedge is low, Ireland needs to avoid any increases in the obstacles to workers' ability to move to their most productive jobs.





Source: World Bank, Doing Business.

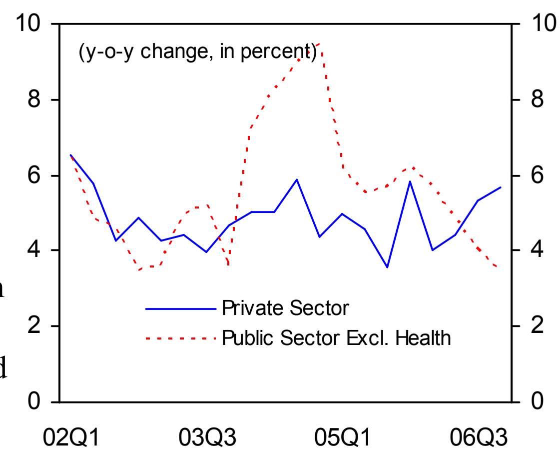
[1] Man-Keung Tang, "Efficiency Gains of Private Credit Growth in Ireland," Selected Issues Paper.

benefit system resulted in a sharp fall in the structural unemployment rate during the 1990s.[7] The tax wedge is now one of the lowest among industrial countries. Employment protection legislation in Ireland is less restrictive than the OECD average, though more restrictive than in the United Kingdom or the United States.

25. **Wage moderation and wage flexibility under the social partnership agreement will also be essential to limiting the depth of the downturn and avoiding any further loss of competitiveness.** Social partnership agreements (between employers, unions, and the government) have provided a useful vehicle for developing a common view of economic prospects, established sensible guidelines for wage increases while allowing considerable flexibility at the firm level, and preserved peaceful labor relations. With current wage growth (about 5 percent) already somewhat above the sum of projected HICP inflation (about 2 percent) and projected labor productivity growth (also about 2 percent), the staff suggested that increases in global energy prices and mortgage costs should not be allowed feed into wage growth.

26. **Similarly, wage increases under forthcoming public sector pay benchmarking exercise have the potential to affect private sector wages.** The authorities and staff agreed that any wage increases under the forthcoming exercise should be small. Staff also suggested that the exercise be appropriately transparent, increase the focus on recruitment and retention in pay determination, assess more accurately the value to employees of public sector pensions, and put more emphasis on the flexibility of work practices.

Private and Public Sector Wage Growth



VII. Staff Appraisal

27. **Economic performance remains impressive, though in recent years growth became increasingly reliant on house building and competitiveness eroded somewhat**. In 2006, real GNP growth was the fastest in the EU15 and the unemployment rate among the lowest in advanced economies. Ireland's remarkable performance continues to be underpinned by outward-oriented policies, prudent fiscal policy, low taxes on labor and business income, and labor market flexibility. However, rapid increases in house prices and a boom in residential construction have been accompanied by surging credit to property-related sectors, inflationary pressures, and a deteriorating external current account balance. While

[7] Dora Iakova, "The Evolution of Unemployment in Ireland: The Role of Labor Market Policies," IMF Country Report 05/370, 2005.

still broadly appropriate, competitiveness has eroded. Ireland's real effective exchange rate is now close to, but perhaps slightly above, its equilibrium value.

28. **Rising euro area interest rates have prompted a welcome cooling of the housing market, which will help to rebalance growth, though there is a risk of a sharper slowdown**. As residential investment winds down and house completions return to a more sustainable level, real GNP growth is projected to slow considerably by 2008. This will dampen inflationary pressures and narrow the current account deficit. However, risks to growth from the housing market and the global economy are tilted to the downside. If these risks crystallize, growth could slow more sharply, with potentially adverse effects on government revenue and the financial sector. Over the medium term, strong fundamentals are expected to drive robust growth.

29. **Fiscal stabilizers have ample room to operate fully, but discretionary measures that weaken the underlying fiscal position should be avoided**. Fiscal performance in 2006 was very strong, though the fiscal stimulus in 2007 is unfortunate, in light of inflationary pressures and the widening current account deficit. In 2008, on unchanged policies, some weakening of the fiscal position due to the cooling housing market is likely. Given the uncertainty about the size of the decline in revenue from the cooling housing market, this is the time to preserve a strong underlying fiscal position by restraining current spending increases to nominal GDP growth and avoiding tax cuts. Over the medium term, fiscal policy should focus on improving the quality of spending and modernizing property-related taxes.

30. **Looking further ahead, Ireland's current demographic sweet spot is already passing**. The authorities' coverage of long-term fiscal issues in the budget and their commitment to improve public understanding of these issues are therefore welcome. Consideration of future pension policy needs to include a review of the state pensionable age in line with rising life expectancy, the contributions to the National Pensions Reserve Fund, and the level of private saving for retirement, with a view to encouraging a better approach to long-term pension planning.

31. **The key challenge for the financial authorities is to maintain the soundness of the financial system**. Banks have large exposures to the property market, but stress tests suggest that cushions are adequate to cover a range of shocks. The Financial Regulator's general approach—which aims to prioritize supervisory resources across sectors based on risk profile—is appropriate. The introduction of a new liquidity management framework for banks and the improvement in the capacity for insurance supervision are important steps forward. Looking ahead, continued careful monitoring of banks' risk management practices, including for commercial property lending, is essential. The envisaged upgrading of the stress-testing framework and the commitment to continue to improve supervision are welcome.

32. **Wage moderation and labor market flexibility are essential to minimizing the expected rise in unemployment and seizing new growth opportunities**. Both the

implementation of the current social partnership agreement and the forthcoming public sector pay benchmarking exercise should avoid adding to wage pressures.

33. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Ireland: Selected Economic Indicators
(Annual change unless otherwise stated)

	2001	2002	2003	2004	2005	2006	Proj. 2007	2008
National accounts (constant prices)								
GNP	4.0	2.9	5.7	3.7	4.9	6.5	4.3	3.2
GDP	5.9	6.4	4.3	4.3	5.9	5.7	4.8	3.5
Domestic demand	4.1	4.5	3.9	3.8	8.0	5.7	4.8	1.9
Private consumption	5.4	4.2	3.0	4.1	7.3	5.7	7.0	3.7
Public consumption	9.9	7.0	1.2	1.5	4.0	5.3	5.5	3.5
Gross fixed investment	0.4	3.3	5.5	6.9	11.8	3.1	1.4	-2.2
Net exports (contribution to GDP growth)	2.0	2.4	1.6	0.3	-1.0	0.6	0.7	1.9
Exports of goods and services	7.1	4.4	0.5	5.9	4.3	3.6	4.5	3.9
Imports of goods and services	5.1	1.9	-1.1	5.6	5.3	3.0	3.8	2.0
Gross national saving (in percent of GDP)	22.5	21.3	23.6	23.4	22.7	23.6	22.0	21.4
Private	17.2	18.5	21.2	19.6	23.3	18.8	19.5	19.8
Public	6.5	3.9	3.2	4.7	3.2	4.8	2.5	1.6
Gross investment (in percent of GDP)	22.9	22.2	23.2	23.9	26.2	27.2	26.0	24.4
Private	18.5	18.0	19.4	20.2	22.5	23.3	22.1	20.6
Public	4.4	4.2	3.8	3.7	3.7	3.9	3.9	3.9
Prices, wages and employment								
Harmonized Index of Consumer Prices (annual average)	4.0	4.7	4.0	2.3	2.2	2.7	2.7	2.1
Average wages, all economy	8.9	5.9	5.0	5.9	5.0	4.8	4.1	3.1
Output, manufacturing 1/	10.3	7.5	4.6	0.1	3.1	5.3	...	...
Unit wage costs (manufacturing) 1/	-2.7	-7.5	-2.3	0.8	-0.3	0.0	...	...
GNP/employment	0.8	1.0	3.7	0.6	0.2	1.9	1.1	1.5
Employment	3.1	1.8	1.9	3.0	4.7	4.4	3.1	1.7
Unemployment rate (in percent)	3.9	4.4	4.6	4.4	4.4	4.4	4.7	5.3
Money and credit (end-period)								
M3 2/	17.2	9.3	-21.4	22.5	19.8	30.8	40.2	...
Private sector credit 2/ 3/	15.1	15.0	17.9	26.6	28.8	25.9	20.9	...
Financial and asset markets (end-period)								
Three-month treasury bill 2/	3.3	2.9	2.1	2.2	2.5	3.7	4.1	...
10-year government bond 4/	5.1	4.3	4.6	3.7	3.3	4.0	4.6	...
ISEQ index 4/	-5.7	-18.8	12.2	26.8	16.8	27.8	23.8	...
House prices (permanent tsb index/ESRI) 2/	14.0	6.1	14.3	11.5	7.2	13.4	2.6	...
Public finance (In percent of GDP)								
General government balance	0.8	-0.3	0.2	1.4	1.0	2.9	0.8	0.4
Primary balance	2.2	0.9	1.4	2.4	2.0	3.9	1.9	1.4
General government debt	35.4	32.1	31.0	29.4	27.3	25.0	23.6	23.2
External trade and balance of payments								
Balance of goods and services (Percent of GDP)	14.7	16.6	15.4	14.3	11.7	10.3	10.8	12.3
Current account (Percent of GDP)	-0.6	-1.0	0.0	-0.6	-3.5	-4.2	-4.4	-3.3
Official reserves (In billions of euros, end-period)	6.4	5.2	3.3	2.1	0.7	0.7	...	...
Effective exchange rates (1999q1=100, annual average)								
Nominal 2/	91.0	93.6	101.9	104.5	104.1	104.4	106.0	...
Real (CPI based) 2/	95.8	101.3	112.6	115.8	115.4	116.0	118.5	...
Memorandum items:								
Population (in million)	3.8	3.9	4.0	4.0	4.1	4.2	4.3	4.3
GDP per capita (in euros)	30,396	33,242	35,038	36,723	39,097	41,254	43,976	46,145

Sources: Department of Finance; Central Bank of Ireland; IMF, International Financial Statistics; and Fund staff calculations.

1/ Underlying productivity growth data may be overstated because of problems related to the measurement of output produced by multinational companies operating in Ireland.

2/ As of May 2007.

3/ Adjusted change, which includes the effects of transactions between credit institutions and non-bank international financial companies and valuation effects arising from exchange rate movements.

4/ As of June 2007.

Table 2. Ireland: Summary of Balance of Payments

				Proj.					
	2004	2005	2006	2007	2008	2009	2010	2011	2012
				(In billions of euro)					
Current account balance	-0.9	-5.7	-7.3	-8.3	-6.5	-6.4	-5.8	-5.9	-6.2
Balance of goods and services	21.2	18.9	18.0	20.5	24.7	26.6	28.9	30.7	32.4
Trade balance	31.4	28.2	25.4	27.8	31.6	32.9	33.9	34.9	35.8
Exports of goods	80.5	82.7	83.4	91.0	97.5	100.5	103.7	107.4	111.4
Imports of goods	-49.1	-54.5	-58.0	-63.2	-66.0	-67.6	-69.7	-72.5	-75.5
Services balance	-10.2	-9.3	-7.4	-7.3	-6.9	-6.3	-5.1	-4.2	-3.4
Credit	42.4	48.2	55.1	62.5	65.8	70.2	75.9	81.9	88.3
Debit	-52.6	-57.5	-62.5	-69.8	-72.7	-76.5	-81.0	-86.2	-91.7
Of which: Royalties									
Credit	0.3	0.6	0.8	...	...	...	...	...	...
Debit	-15.2	-15.5	-16.6	...	...	...	...	...	...
Income balance	-22.5	-24.9	-24.8	-27.6	-29.7	-31.3	-32.9	-34.7	-36.6
Credit	35.0	43.4	59.9	62.8	65.1	69.1	73.9	79.0	84.5
Debit	57.4	68.3	84.7	90.4	94.8	100.5	106.8	113.8	121.1
Current transfers (net)	0.4	0.3	-0.5	-1.1	-1.5	-1.6	-1.7	-1.8	-2.0
Capital and financial account balance	4.1	-0.2	8.7	8.3	6.5	6.4	5.8	5.9	6.2
Capital account balance	0.3	0.3	0.2	...	...	...	...	...	...
Financial account	3.8	-0.5	8.4	...	...	...	...	...	...
Direct investment	-23.1	-37.0	-12.5	...	...	...	...	...	...
Portfolio investment	14.3	52.7	-15.4	...	...	...	...	...	...
Other investment	11.4	-17.7	36.3	...	...	...	...	...	...
Change in reserve assets	1.2	1.5	0.1	...	...	...	...	...	...
Net errors and omissions	-3.2	5.9	-1.4	...	...	...	...	...	...
				(In percent of GDP)					
Current account balance	-0.6	-3.5	-4.2	-4.4	-3.3	-3.0	-2.6	-2.5	-2.4
Balance on goods and services	14.3	11.7	10.3	10.8	12.3	12.5	12.8	12.8	12.7
Trade balance	21.2	17.5	14.5	14.7	15.8	15.5	15.0	14.5	14.0
Services balance	-6.9	-5.8	-4.2	-3.9	-3.4	-3.0	-2.3	-1.8	-1.3
Income balance	-15.1	-15.4	-14.2	-14.6	-14.8	-14.8	-14.6	-14.4	-14.3
Current transfers	0.3	0.2	-0.3	-0.6	-0.7	-0.8	-0.8	-0.8	-0.8
Capital and financial account balance	2.7	-0.1	5.0	4.4	3.3	3.0	2.6	2.5	2.4
Of which:									
Direct Investment	-15.6	-22.9	-7.2	...	...	...	...	...	...
Portfolio Investment	9.6	32.6	-8.8	...	...	...	...	...	...
Other Investment	7.7	-10.9	20.8	...	...	...	...	...	...
Memorandum items (percent of GDP)									
Reserve assets	1.4	0.5	0.4	...	...	...	...	...	...
Gross External Debt	520.2	648.9	696.0	...	...	...	...	...	...
General Government	17.3	16.7	15.6	...	...	...	...	...	...
Monetary Authorities	4.6	2.9	1.5	...	...	...	...	...	...
Monetary Financial Institutions	269.0	344.6	387.3	...	...	...	...	...	...
Other Sectors	156.3	190.7	205.9	...	...	...	...	...	...
Direct Investment Debt	73.1	94.1	85.7	...	...	...	...	...	...
Net international investment position	-19.4	-27.5	...	...	...	...	...	...	...
Foreign assets	840.3	989.5	...	...	...	...	...	...	...
Foreign liabilities	859.7	1017.0	...	...	...	...	...	...	...

Sources: The Central Statistics Office; and Fund staff estimates.

Table 3. Ireland: Contributions to GDP Growth
(In percent)

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Domestic demand	3.2	6.9	5.0	4.2	1.6	2.6	2.8	3.2	3.2
Final domestic demand	3.8	6.9	4.3	4.4	1.8	2.7	2.9	3.3	3.2
Private consumption	1.9	3.4	2.7	3.3	1.8	1.8	1.9	2.0	2.0
Public consumption	0.2	0.6	0.7	0.8	0.5	0.5	0.5	0.4	0.4
Fixed investment	1.7	2.9	0.8	0.3	-0.5	0.3	0.5	0.8	0.8
Structures	1.4	1.9	1.1	-0.5	-0.9	0.0	0.1	0.5	0.5
Residential investment	1.4	1.5	0.5	-1.1	-1.4	-0.5	-0.3	0.1	0.1
Equipment	0.3	1.0	-0.3	0.8	0.4	0.3	0.3	0.4	0.4
Change in stocks	-0.6	-0.1	0.7	-0.2	-0.1	-0.1	-0.1	-0.1	0.0
Net exports	0.3	-1.0	0.6	0.7	1.9	1.2	0.9	0.8	0.8
Exports	5.9	4.3	3.6	4.5	3.9	4.0	4.2	4.4	4.5
Imports	-5.6	-5.3	-3.0	-3.8	-2.0	-2.8	-3.3	-3.6	-3.7
Statistical discrepancy	0.7	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
GDP (annual percent change)	4.3	5.9	5.7	4.8	3.5	3.8	3.7	4.0	4.0
GNP (annual percent change)	3.7	4.9	6.5	4.3	3.2	3.9	4.0	4.2	4.2

Table 4. Ireland: General Government Finances
(In percent of GDP)

	Actual			Staff Projections 1/		
	2004	2005	2006	2007	2008	2009
Current balance	4.8	4.8	6.9	5.4	4.8	4.6
Current revenue, *of which:*	33.2	33.6	35.5	34.9	34.3	34.2
Tax revenue (including taxes on capital)	25.4	25.9	27.5	27.0	26.4	26.3
Social security receipts	4.4	4.5	4.7	4.7	4.7	4.7
Miscellaneous	3.4	3.2	3.3	3.2	3.2	3.2
Current expenditure, *of which:*	28.4	28.8	28.6	29.6	29.6	29.6
Interest payments	1.1	1.0	1.0	1.0	1.0	1.0
Goods and services	5.2	4.9	5.0	5.1	5.1	5.1
Compensation of employees	9.4	9.8	9.9	9.8	9.9	9.9
Current transfers	12.0	12.2	11.9	12.8	12.8	12.8
Depreciation	0.8	0.8	0.8	0.8	0.8	0.8
Current expenditure, excluding interest	27.3	27.8	27.6	28.5	28.6	28.6
Capital balance	-3.5	-3.8	-4.0	-4.5	-4.3	-4.4
Capital receipts (excluding taxes on capital)	1.1	0.9	1.0	0.9	0.9	0.9
Gross capital formation	3.7	3.7	3.9	3.9	3.9	3.9
Capital transfers	1.0	1.1	1.0	1.5	1.4	1.4
General government balance	1.4	1.0	2.9	0.8	0.4	0.2
Primary balance	2.4	2.0	3.9	1.9	1.4	1.2
Memorandum items:						
Structural (as a percent of potential GDP)						
Government balance (including one-off factors)	1.5	1.0	2.7	0.7	0.6	0.3
Revenue	34.4	34.6	36.4	35.9	35.3	35.1
Expenditure	32.8	33.5	33.7	35.1	34.6	34.8
Government balance (excluding one-off factors)	0.6	1.4	2.6	0.5	0.6	0.3
Primary balance	2.6	2.1	3.7	1.8	1.6	1.3
General government gross debt (as percent of GDP)	29.4	27.3	25.0	23.6	23.2	22.9
General government net debt (as percent of GDP) 2/	19.9	15.9	12.2	10.3	9.1	8.1
Output Gap	-0.4	-0.1	0.4	0.2	-0.4	-0.2
Growth in nominal GDP	6.5	8.8	8.2	8.3	5.9	5.9

Sources: Department of Finance and staff estimates.

1/ Staff projections are based on the 2007 budget, adjusted for staff's macroeconomic and revenue buoyancy assumptions.

2/ Net debt is defined as gross debt minus the value of the National Pensions Reserve Fund and the Social Insurance Fund.

Table 5. Ireland: Indicators of External and Financial Vulnerability

	2000	2001	2002	2003	2004	2005	2006
External indicators							
Exports (annual percent change, value in Euros)	10.7	9.9	10.8	14.2	17.1	6.7	6.6
Imports (annual percent change, value in Euros)	13.2	7.6	7.0	13.1	19.1	10.3	8.4
Terms of trade (goods, annual percent change)	-3.6	2.4	2.1	-0.5	-1.4	-2.1	-2.4
Current account balance (in percent of GDP)	-0.4	-0.6	-1.0	0.0	-0.6	-3.5	-4.2
Capital and financial account balance (in percent of GDP)	9.2	0.3	1.2	-0.9	2.7	-0.1	5.0
Of which:							
Inward portfolio investment	80.2	84.9	57.7	75.1	100.6	107.4	114.2
Inward foreign direct investment	26.7	9.2	23.9	14.5	-5.8	-15.8	-0.4
Other investment liabilities	29.4	36.9	40.2	57.3	39.9	57.9	75.2
Total external public debt (in percent of GDP) 1/	2.0	1.8	0.6	0.0	0.0	0.0	0.0
Of which:							
External debt to exports ratio (in percent)	2.6	2.4	0.8	0.0	0.0	0.0	0.0
External interest payments to exports (in percent)	0.2	0.1	0.2	0.0	0.0	0.0	0.0
U.S. dollar per euro (period average)	0.92	0.90	0.94	1.13	1.24	1.25	1.26
U.K. £ per euro (period average)	0.61	0.62	0.63	0.69	0.68	0.68	0.68
Financial markets indicators							
General government debt (in percent of GDP)	37.7	35.4	32.1	31.0	29.4	27.3	25.0
Government bond yield (in percent, 10-year, end-period)	5.1	5.1	4.3	4.6	3.7	3.3	4.0
Spread of government bond yield with Germany (in percent, end of period)	0.2	0.4	0.0	0.3	0.1	-0.1	0.2
Real government bond yield (in percent, 10-year, period average, based on CPI)	-0.4	0.9	0.0	2.1	1.4	1.0	-1.1
Annual change in ISEQ index (in percent, end of period)	18.0	-5.7	-18.8	12.2	26.8	16.8	27.8
Personal lending interest rate (in percent)	11.8	10.6	10.4	9.9	9.9	10.1	11.2
Variable mortgage interest rate (in percent)	6.0	4.6	4.2	3.5	3.5	3.6	4.8
Financial sector risk indicators							
Annual credit growth rates (to private sector, in percent)	21.3	15.1	15.0	17.9	26.6	28.8	25.9
Annual deposit growth rates (in percent)	15.6	15.6	9.6	11.9	14.1	23.9	25.1
Personal lending as a share of total loans (in percent)	52.1	52.2	55.3	55.6	55.8	54.6	50.3
(excluding financial intermediation and government)							
Of which:							
House mortgage finance	39.0	38.8	42.4	44.4	44.9	44.6	41.5
Other housing finance	1.0	0.9	0.8	0.4	0.3	0.3	0.4
Other personal lending	12.2	12.5	12.0	10.8	10.6	9.7	8.4
Annual mortgage credit growth rates (in percent)	24.3	17.8	23.1	25.5	26.5	27.1	24.2
Commercial property lending as a percent of total loans							
(excluding financial intermediation) 2/	15.0	16.4	17.0	19.7	21.2	25.3	31.2
Foreign-currency denominated assets (in percent of total assets)	41.5	44.6	40.1	32.5	29.4	33.9	33.7
Foreign-currency denominated liabilities (in percent of total liabilities)	44.4	47.4	42.9	34.2	32.2	35.9	36.9
Contingent and off-balance sheet accounts (in percent of total assets) 3/	465	592	505	538	662	879	1132
Non-performing loans (in percent of total loans) 4/	1.03	1.03	0.97	0.93	0.82	0.68	0.71
Total provisions for loan losses (in percent of total loans)	1.1	1.1	1.1	0.9	0.7	0.5	0.4
Risk-weighted capital/asset ratios of domestic banks (in percent)	10.7	10.6	12.3	13.9	12.6	12.0	10.9
Bank return on assets (before tax, in percent)	1.2	0.9	1.0	0.9	1.1	0.8	0.8
Bank return on equity (before tax, in percent)	22.0	16.0	18.0	17.8	20.7	19.6	19.1
Liquid assets of all banks to total assets (liquid asset ratio, in percent)	32.0	30.0	30.0	33.6	33.0	34.2	32.7
Liquid assets of all banks to short-term liabilities (in percent)	44.0	37.0	34.0	41.2	40.0	40.2	38.4
Deposits to M3 ratio 5/ 6/	1.03	1.02	1.02	1.46	1.36	1.38	1.34
Loan-to-deposit ratio vis-à-vis Irish residents 2/ 7/	1.36	1.44	1.43	1.46	1.61	1.77	1.87
vis-à-vis total 2/ 7/	1.54	1.59	1.51	1.57	1.72	1.82	1.85
Concentration ratios in the banking sector							
No. of banks accounting for 25 percent of total assets	3.0	3.0	3.0	2.0	2.0	2.0	3.0
No. of banks accounting for 75 percent of total assets	23.0	21.0	19.0	18.0	17.0	16.0	17.0
Share of state-owned banks in total assets (in percent)	2.0	1.0	0.0	0.0	0.0	0.0	0.0
Share of foreign-owned banks in total assets (in percent)	39.0	42.0	29.0	31.0	34.0	32.3	36.3

Sources: Data provided by the authorities; Central Bank of Ireland; International Financial Statistics; Bloomberg; and Fund staff estimates.

1/ Represents non-euro debt of the government sector.

2/ Includes lending for construction and real estate activities.

3/ Credit equivalent values.

4/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.

5/ Non-government deposits vis-à-vis Irish and nonresidents to M3 ratio.

6/ The methodology used to compile M3 has been amended in line with Eurosystem requirements. Therefore, there is a break in the series.

7/ Nongovernment loans/nongovernment deposits ratio.

Appendix I. Ireland: Staff Analytical Work, 2002–07

Growth, Competitiveness, and Spillovers

- *Spillovers to Ireland*, 2007 Selected Issues Paper
- *Who Saves in Ireland? The Micro Evidence*, IMF Country Report No. 05/370
- *Potential Growth after the Boom*, IMF Country Report No. 04/349
- *Adjustment in the Housing Market*, IMF Country Report No. 04/349
- *The Competitiveness of Irish Manufacturing: An Update*, IMF Country Report No. 04/349
- *How Competitive is Irish Manufacturing?* IMF Country Report No. 02/171

Fiscal Issues

- *Policy Challenges of Population Aging in Ireland*, 2007 Selected Issues Paper
- *Favorable Fiscal Outturns: Is it Just the Luck of the Irish?* IMF Country Report No. 05/370
- *Ireland Medium-Term Fiscal Scenarios*, IMF Country Report No. 02/171
- *Ireland's Tax Efforts—An International Perspective*, IMF Country Report No. 02/171

Financial Sector

- *Efficiency Gains of Private Credit Growth in Ireland*, 2007 Selected Issues Paper
- *External Linkages and Contagion Risk in Irish Banks*, IMF Working Paper No. 07/44
- *Ireland's Financial System—Structure and Performance*, IMF Country Report No. 02/171

Labor Markets

- *The Evolution of Unemployment in Ireland: The Role of Labor Market Policies*, IMF Country Report No. 05/370
- *The Role of Social partnership Agreements in Ireland: Contributing to the Boom and Facilitating Adjustment to Sustainable Growth*, IMF Country Report No. 04/349

Appendix II. Ireland: Sustainability Exercise

Fiscal Sustainability

General government net debt (defined as gross debt minus the assets of the National Pensions Reserve Fund and the Social Insurance Fund) is low. Under the baseline scenario, net debt declines from 12 percent of GDP in 2006 to 6 percent of GDP by 2012 as the primary balance is projected to remain in surplus and GDP growth is expected to exceed the average real interest rate throughout this period.

The sustainability of the fiscal position over the next five years is assessed under alternative scenarios regarding key macroeconomic and fiscal assumptions, as well as several bound tests (Table A1 and Figure A1). The medium-term fiscal position is resilient to a variety of shocks. The worst outcome—a rise in the debt ratio to 16 percent in 2012—is achieved under the assumption that there is a negative shock to real GDP growth.

However, in the long run, the projected increase in age-related spending will put pressure on public finances and substantial adjustment would be required to prevent debt from rising sharply (see Box 3).

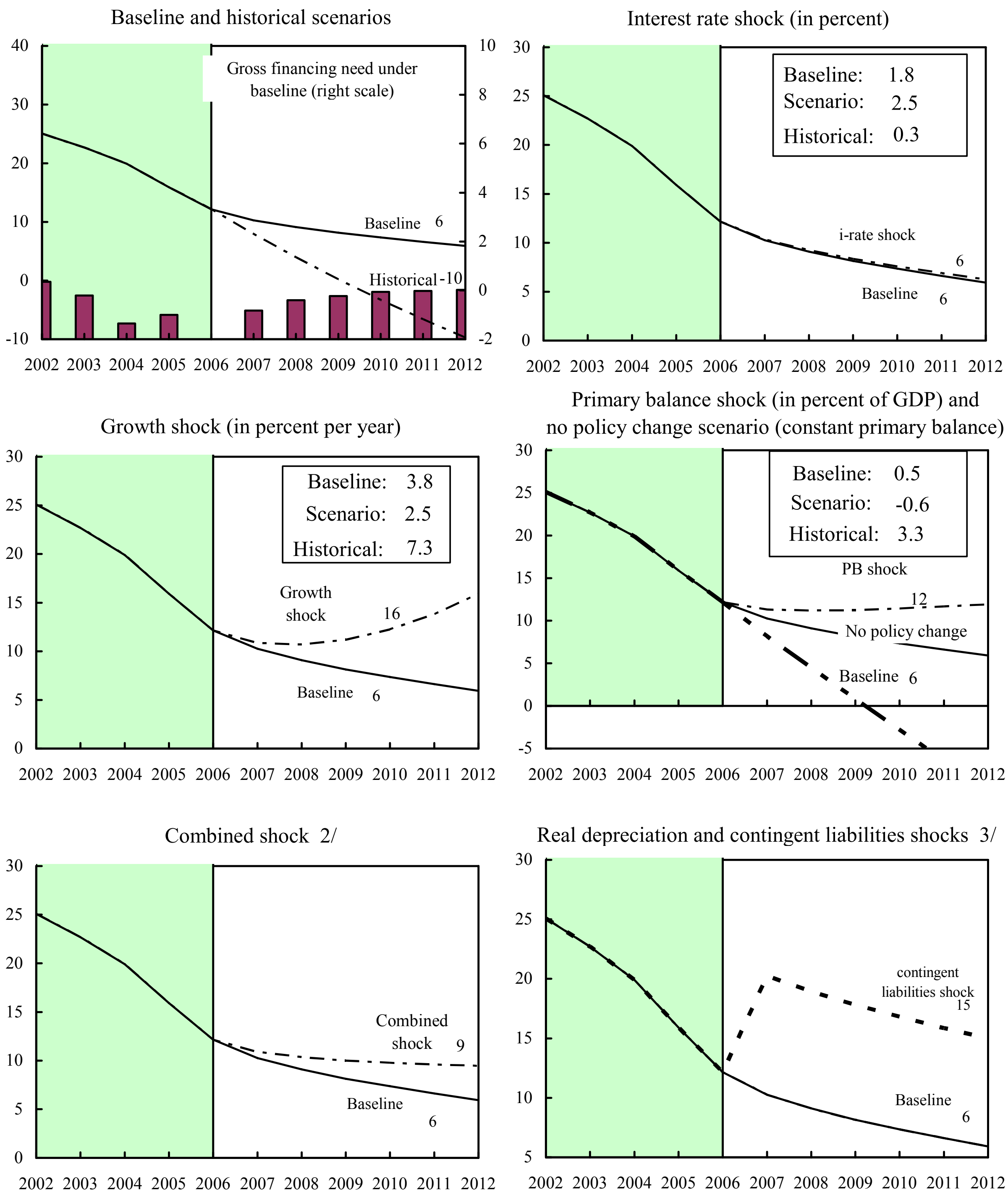
External Sustainability

External sustainability does not appear to be an issue in Ireland (Table A2). The net international investment position is in a moderate deficit against a backdrop of very large FDI flows into Ireland over the past decade. Ireland's role as an international financial center implies large gross external assets and liabilities. In 2005, gross external assets amounted to about 1,000 percent of GDP, compared to about 400 percent of GDP in the United Kingdom and 100 percent of GDP in the United States. The large gross positions generate significant volatility in the components of the net external position. Over 1998–2005, the standard deviation of the net foreign direct investment position, the net portfolio investment position, and the net other investment position were 26 percentage points of GDP, 22 percentage points of GDP, and 31 percentage points of GDP, respectively. As a result, changes in the net international investment position are dominated by factors other than the current account deficit.

The composition of the external position implies a large negative net income flow in the current account. The large stock of inward foreign direct investment, which reflects the substantial presence of multinationals, earns a high rate of return (about 20 percent on average during 2000–05).

The 2006 FSAP Update noted that the large gross assets and liabilities in portfolio and other investments associated with Ireland's role as an international financial center do not appear to pose a systemic risk to the domestic financial system.

Figure A1. Country: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data.Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time 10 percent of GDP shock to contingent liabilities.

Table A1. Country: Public Sector Debt Sustainability Framework, 2002-2012
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Baseline: Public sector debt 1/	25.1	22.7	19.9	15.9	12.2	**10.3**	**9.1**	**8.1**	**7.3**	**6.6**	**5.9**
o/w foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in public sector debt	-2.1	-2.4	-2.8	-4.0	-3.8	-1.9	-1.2	-1.0	-0.8	-0.7	-0.7
Identified debt-creating flows (4+7+12)	-2.4	-1.9	-2.7	-2.6	-4.1	-1.8	-1.0	-0.7	-0.5	-0.5	-0.4
Primary deficit	-0.6	-1.1	-2.1	-1.6	-3.4	-1.3	-0.8	-0.6	-0.4	-0.3	-0.2
Revenue and grants	32.4	32.9	34.4	34.6	36.4	35.9	35.3	35.1	34.9	34.9	34.9
Primary (noninterest) expenditure	31.7	31.8	32.3	32.9	33.0	34.6	34.5	34.5	34.6	34.6	34.6
Automatic debt dynamics 2/	-1.8	-0.8	-0.7	-1.0	-0.7	-0.5	-0.2	-0.2	-0.2	-0.2	-0.1
Contribution from interest rate/growth differential 3/	-1.8	-0.8	-0.7	-1.0	-0.7	-0.5	-0.2	-0.2	-0.2	-0.2	-0.1
Of which contribution from real interest rate	-0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.1
Of which contribution from real GDP growth	-1.6	-1.0	-0.9	-1.1	-0.8	-0.5	-0.3	-0.3	-0.3	-0.3	-0.2
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3) 5/	0.3	-0.5	-0.1	-1.4	0.3	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3
Public sector debt-to-revenue ratio 1/	77.5	69.1	57.9	46.0	33.4	28.6	25.8	23.2	21.0	18.9	17.0
Gross financing need 6/	0.3	-0.2	-1.4	-1.0	-2.9	-0.8	-0.4	-0.2	-0.1	0.0	0.0
in billions of U.S. dollars	424	-338	-2496	-2024	-6321	-2035	-1057	-656	-182	-61	72
Scenario with key variables at their historical averages 7/						**7.9**	**4.0**	**0.2**	**-3.3**	**-6.6**	**-9.7**
Scenario with no policy change (constant primary balance) in 2005-2010						**8.2**	**4.5**	**0.8**	**-2.8**	**-6.4**	**-10.0**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline											
Real GDP growth (in percent)	6.4	4.3	4.3	5.9	5.7	4.8	3.5	3.8	3.7	4.0	4.0
Average nominal interest rate on public debt (in percent) 8/	4.1	3.7	3.4	3.3	3.3	4.0	4.1	4.1	4.2	4.2	4.2
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.5	1.1	1.2	0.6	1.0	0.7	1.7	2.1	1.7	1.8	1.9
Nominal appreciation (increase in US dollar value of local currency, in percent)	5.4	19.7	9.9	0.2	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.6	2.6	2.2	2.7	2.3	3.3	2.3	2.1	2.5	2.4	2.3
Growth of real primary spending (deflated by GDP deflator, in percent)	7.3	4.6	5.9	8.1	6.0	9.8	3.1	4.0	3.8	4.1	4.1
Primary deficit	-0.6	-1.1	-2.1	-1.6	-3.4	-1.3	-0.8	-0.6	-0.4	-0.3	-0.2

1/ General government net debt is defined as gross debt minus the value of the National Pensions Reserve Fund and the Social Insurance Fund.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ 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 ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
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.

Table A2. Ireland: Net Investment Position
(In percent of GDP)

	2000	2001	2002	2003	2004	2005
Assets	651	728	713	770	846	992
Direct investment abroad	29	40	43	42	53	54
Portfolio investment abroad	351	421	421	476	533	620
Other investment abroad	265	262	245	249	258	317
Reserve assets	6	5	4	2	1	0
Liabilities	659	743	731	789	865	1,019
Direct investment to Ireland	131	130	134	127	104	87
Portfolio investment to Ireland	297	353	344	382	460	588
Other investment to Ireland	231	260	253	280	301	344
Net investment position	-8	-15	-18	-19	-20	-28
Direct investment, net	-102	-91	-91	-85	-52	-33
Portfolio investment, net	54	68	77	94	73	32
Other investment, net	34	2	-8	-31	-43	-27
Reserve assets	6	5	4	2	1	0
Memorandum items						
Net investment position (excl. FDI)	94	75	73	66	32	6
Change in net investment position	-58.4	-7.3	-2.7	-1.0	-0.5	-8.0
o/w Current account balance	-0.4	-0.6	-1.0	0.0	-0.6	-3.5
Other 1/	-58.1	-6.6	-1.7	-1.0	0.1	-4.5

Source: Central Statistics Office
1/ Includes valuation changes and errors and omissions

INTERNATIONAL MONETARY FUND

IRELAND

Staff Report for the 2007 Article IV Consultation with Ireland—Informational Annex

Prepared by the European Department

August 2, 2007

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Annex I. Ireland: Fund Relations

(As of June 30, 2007)

I. **Membership Status**: Joined 8/08/57; Article VIII

II. **General Resources Account:**	**SDR Million**	**% Quota**
Quota	838.40	100.00
Fund holdings of currency	771.31	92.00
Reserve position in Fund	67.10	8.00
Holdings Exchange Rate		

III. **SDR Department:**	**SDR Million**	**% Allocation**
Net cumulative allocation	87.26	100.00
Holdings	63.48	72.74

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Payments to the Fund**

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2007	2008	2009	2010	2011
Principal					
Charges/Interest	0.51	1.01	1.01	1.01	1.01
Total	0.51	1.01	1.01	1.01	1.01

VII. **Exchange Rate Arrangement and Exchange Restrictions**

Ireland’s currency is the euro, which floats freely and independently against other currencies.

Ireland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

VIII. **Article IV Consultations**

The discussions for the last Article IV consultation were conducted in Dublin during May 10–17, 2006. The staff report (Country Report No. 06/293) was considered by the Executive Board on July 26, 2006 (EBM/06/69). Article IV consultations with Ireland are on the standard 12–month cycle.

IX. **Technical Assistance:** None

X. **Resident Representative:** None

Annex II. Ireland: Statistical Issues

Data provision is overall adequate for surveillance purposes. Ireland is subject to the statistical requirements and timeliness and reporting standards of Eurostat and the European Central Bank (ECB). It has also subscribed to the Fund's Special Data Dissemination Standard (SDDS).

1. The consumer price index is published monthly. The weights were updated in 2006, and are to be updated every 5 years. Quarterly national accounts are currently published within 3 months of its reference period. Real sector data are sometimes published with a lag of 3–6 months, but some non-SDDS series even one and a half years later (e.g., household disposable income). Employment, earnings, unit wage costs, and national income and expenditure data are usually available with a 3 month lag. Ireland does not have an overall earnings index or comprehensive sectoral balance sheet data.

2. While the authorities publish Exchequer returns on a monthly and quarterly basis, only annual data on the general government balance are currently available.

3. Quarterly balance of payments data are compiled by the Central Statistics Office and are based on statistical surveys combined with administrative data. These data are closely integrated with the compilation of national accounts and are in line with the *Balance of Payments Manual*, 5th edition (*BPM5*). However, the historical data cover only years starting from 1998, because of improvements in coverage of the International Financial Service Center and other methodological changes that were introduced for that year. Exports and imports data from the national accounts and the balance of payments differ due to different treatments of financial services in the *European System of Accounts 1995* and *BPM5*, but can be reconciled.

Ireland: Table of Common Indicators Required for Surveillance
(as of July 12, 2007)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	7/11/07	7/11/07	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 2007	6/29/07	M	M	M
Reserve/Base Money	May 2007	6/29/07	M	M	M
Broad Money	May 2007	6/29/07	M	M	M
Central Bank Balance Sheet	May 2007	6/29/07	M	M	M
Consolidated Balance Sheet of the Banking System	May 2007	6/29/07	M	M	M
Interest Rates[2]	7/11/07	7/11/07	D	D	D
Consumer Price Index	June 2007	7/12/07	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2006	4/10/2007	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	June 2007	7/3/2007	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2006 Q4	4/10/2007	Q	Q	Q
External Current Account Balance	Q1, 2007	7/2/07	Q	Q	Q
Exports and Imports of Goods and Services	Q1, 2007	7/2/07	Q	Q	Q
GDP/GNP	Q1, 2007	7/2/07	Q	Q	Q
Gross External Debt	Q1, 2007	7/2/07	Q	Q	Q

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

INTERNATIONAL MONETARY FUND

IRELAND

Staff Report for the 2007 Article IV Consultation

Supplementary Information

Prepared by European Department

Approved by Alessandro Leipold and Michael Hadjimichael

September 11, 2007

1. This supplement provides an update on developments since the staff report was issued. These developments do not alter the thrust of the staff appraisal.

2. While recent economic developments in Ireland have been consistent with the staff report, the global outlook has weakened. As discussed in the staff report and a Selected Issues Paper, Ireland is vulnerable to spillovers from the United States. This likely reflects not just the impact on merchandise exports, but also the impact on exports of business and financial services and substantial U.S. foreign direct investment in Ireland. In light of the changes to the partner-country growth forecasts, notably those of the United States and the euro area, the projection for Ireland's real GDP growth in 2008 has been marked down from 3½ percent to 3 percent. A full set of revised tables is attached. Risks to the forecast from the Irish housing market and the global economy remain on the downside.

3. Nonetheless, assuming that global financial market conditions stabilize in the coming months, the adverse effect of the recent turbulence on Ireland's economic prospects should be modest. Irish financial institutions have zero to moderate exposure to U.S. subprime mortgages. Where the exposure is moderate, it is small compared to capital or operating profit. The fall in Irish banks' stock prices and the widening of their credit spreads have been of about the same magnitudes as those of other major European banks.

Table 1. Ireland: Selected Economic Indicators
(Annual change unless otherwise stated)

	2001	2002	2003	2004	2005	2006	Proj. 2007	2008
National accounts (constant prices)								
GNP	4.0	2.9	5.7	3.7	4.9	6.5	4.2	2.7
GDP	5.9	6.4	4.3	4.3	5.9	5.7	4.7	3.0
Domestic demand	4.1	4.5	3.9	3.8	8.0	5.7	4.6	1.4
Private consumption	5.4	4.2	3.0	4.1	7.3	5.7	6.9	3.5
Public consumption	9.9	7.0	1.2	1.5	4.0	5.3	5.5	3.5
Gross fixed investment	0.4	3.3	5.5	6.9	11.8	3.1	0.9	-3.3
Net exports (contribution to GDP growth)	2.0	2.4	1.6	0.3	-1.0	0.6	0.8	1.7
Exports of goods and services	7.1	4.4	0.5	5.9	4.3	3.6	4.5	3.6
Imports of goods and services	5.1	1.9	-1.1	5.6	5.3	3.0	3.7	1.8
Gross national saving (in percent of GDP)	22.5	21.3	23.6	23.4	22.7	23.6	21.9	21.1
Private	16.2	17.5	20.6	18.9	18.9	16.6	19.0	19.5
Public	6.2	3.8	3.0	4.5	3.8	7.0	2.9	1.6
Gross investment (in percent of GDP)	22.9	22.2	23.2	23.9	26.2	27.2	25.9	24.2
Private	18.6	17.9	19.5	20.3	22.8	23.3	22.0	20.3
Public	4.3	4.3	3.7	3.5	3.4	3.9	3.9	3.9
Prices, wages and employment								
Harmonized Index of Consumer Prices (annual average)	4.0	4.7	4.0	2.3	2.2	2.7	2.7	2.1
Average wages, all economy	8.9	5.9	5.0	5.9	5.0	4.7	3.9	3.1
Output, manufacturing 1/	10.3	7.5	4.6	0.1	3.1	5.3	...	...
Unit wage costs (manufacturing) 1/	-2.7	-7.5	-2.3	0.8	-0.3	0.0	...	...
GNP/employment	0.8	1.0	3.7	0.6	0.2	1.9	1.1	1.6
Employment	3.1	1.8	1.9	3.0	4.7	4.4	3.1	1.1
Unemployment rate (in percent)	3.9	4.4	4.6	4.4	4.4	4.4	4.7	5.5
Money and credit (end-period)								
M3 2/	17.2	9.3	-21.4	22.5	19.8	30.8	40.2	...
Private sector credit 2/ 3/	15.1	15.0	17.9	26.6	28.8	25.9	20.9	...
Financial and asset markets (end-period)								
Three-month treasury bill 2/	3.3	2.9	2.1	2.2	2.5	3.7	4.1	...
10-year government bond 4/	5.1	4.3	4.6	3.7	3.3	4.0	4.6	...
ISEQ index 4/	-5.7	-18.8	12.2	26.8	16.8	27.8	23.8	...
House prices (permanent tsb index/ESRI) 2/	14.0	6.1	14.3	11.5	7.2	13.4	2.6	...
Public finance (In percent of GDP)								
General government balance	0.8	-0.3	0.2	1.4	1.0	2.9	0.8	0.2
Primary balance	2.2	0.9	1.4	2.4	2.0	3.9	1.8	1.2
General government debt	35.4	32.1	31.0	29.4	27.3	25.0	23.7	23.6
External trade and balance of payments								
Balance of goods and services (Percent of GDP)	14.7	16.6	15.4	14.3	11.7	10.3	10.8	12.2
Current account (Percent of GDP)	-0.6	-1.0	0.0	-0.6	-3.5	-4.2	-4.4	-3.3
Official reserves (In billions of euros, end-period)	6.4	5.2	3.3	2.1	0.7	0.7	...	...
Effective exchange rates (1999q1=100, annual average)								
Nominal 2/	91.0	93.6	101.9	104.5	104.1	104.4	106.0	...
Real (CPI based) 2/	95.8	101.3	112.6	115.8	115.4	116.0	118.5	...
Memorandum items:								
Population (in million)	3.8	3.9	4.0	4.0	4.1	4.2	4.3	4.3
GDP per capita (in euros)	30,396	33,242	35,038	36,723	39,097	41,254	43,921	45,816

Sources: Department of Finance; Central Bank of Ireland; IMF, International Financial Statistics; and Fund staff calculations.

1/ Underlying productivity growth data may be overstated because of problems related to the measurement of output produced by multinational companies operating in Ireland.

2/ As of May 2007.

3/ Adjusted change, which includes the effects of transactions between credit institutions and non-bank international financial companies and valuation effects arising from exchange rate movements.

4/ As of June 2007.

Table 2. Ireland: Summary of Balance of Payments

	2004	2005	2006	Proj. 2007	2008	2009	2010	2011	2012
				(In billions of euro)					
Current account balance	-0.9	-5.7	-7.3	-8.3	-6.6	-6.4	-5.9	-5.8	-6.1
Balance of goods and services	21.2	18.9	18.0	20.4	24.3	26.4	28.5	30.3	32.0
Trade balance	31.4	28.2	25.4	27.7	30.7	32.0	33.1	34.0	34.9
Exports of goods	80.5	82.7	83.4	90.4	96.0	98.9	102.1	105.7	109.6
Imports of goods	-49.1	-54.5	-58.0	-62.7	-65.3	-66.9	-69.0	-71.7	-74.7
Services balance	-10.2	-9.3	-7.4	-7.3	-6.4	-5.6	-4.6	-3.7	-2.9
Credit	42.4	48.2	55.1	63.2	67.3	71.9	77.5	83.6	89.9
Debit	-52.6	-57.5	-62.5	-70.5	-73.8	-77.6	-82.1	-87.3	-92.8
Of which: Royalties									
Credit	0.3	0.6	0.8	...	...	...	...	...	...
Debit	-15.2	-15.5	-16.6	...	...	...	...	...	...
Income balance	-22.5	-24.9	-24.8	-27.6	-29.5	-31.2	-32.7	-34.3	-36.2
Credit	35.0	43.4	59.9	67.7	73.7	78.0	83.4	89.3	95.3
Debit	57.4	68.3	84.7	95.3	103.1	109.2	116.1	123.6	131.5
Current transfers (net)	0.4	0.3	-0.5	-1.1	-1.4	-1.6	-1.7	-1.8	-1.9
Capital and financial account balance	4.1	-0.2	8.7	8.3	6.6	6.4	5.9	5.8	6.1
Capital account balance	0.3	0.3	0.2	...	...	...	...	...	...
Financial account	3.8	-0.5	8.4	...	...	...	...	...	...
Direct investment	-23.1	-37.0	-12.5	...	...	...	...	...	...
Portfolio investment	14.3	52.7	-15.4	...	...	...	...	...	...
Other investment	11.4	-17.7	36.3	...	...	...	...	...	...
Change in reserve assets	1.2	1.5	0.1	...	...	...	...	...	...
Net errors and omissions	-3.2	5.9	-1.4	...	...	...	...	...	...
				(In percent of GDP)					
Current account balance	-0.6	-3.5	-4.2	-4.4	-3.3	-3.0	-2.6	-2.4	-2.4
Balance on goods and services	14.3	11.7	10.3	10.8	12.2	12.5	12.7	12.7	12.6
Trade balance	21.2	17.5	14.5	14.6	15.4	15.2	14.8	14.3	13.8
Services balance	-6.9	-5.8	-4.2	-3.8	-3.2	-2.7	-2.1	-1.5	-1.1
Income balance	-15.1	-15.4	-14.2	-14.6	-14.8	-14.8	-14.6	-14.4	-14.3
Current transfers	0.3	0.2	-0.3	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8
Capital and financial account balance	2.7	-0.1	5.0	4.4	3.3	3.0	2.6	2.4	2.4
Of which:									
Direct Investment	-15.6	-22.9	-7.2	...	...	...	...	...	...
Portfolio Investment	9.6	32.6	-8.8	...	...	...	...	...	...
Other Investment	7.7	-10.9	20.8	...	...	...	...	...	...
Memorandum items (percent of GDP)									
Reserve assets	1.4	0.5	0.4	...	...	...	...	...	...
Gross External Debt	520.2	648.9	696.0	...	...	...	...	...	...
General Government	17.3	16.7	15.6	...	...	...	...	...	...
Monetary Authorities	4.6	2.9	1.5	...	...	...	...	...	...
Monetary Financial Institutions	269.0	344.6	387.3	...	...	...	...	...	...
Other Sectors	156.3	190.7	205.9	...	...	...	...	...	...
Direct Investment Debt	73.1	94.1	85.7	...	...	...	...	...	...
Net international investment position	-19.4	-27.5	...	...	...	...	...	...	...
Foreign assets	840.3	989.5	...	...	...	...	...	...	...
Foreign liabilities	859.7	1017.0	...	...	...	...	...	...	...

Sources: The Central Statistics Office; and Fund staff estimates.

Table 3. Ireland: Contributions to GDP Growth
(In percent)

	2004	2005	2006	2007	2008	2009	2010	2011	2012
Domestic demand	3.2	6.9	5.0	4.1	1.3	2.6	2.8	3.2	3.2
Final domestic demand	3.8	6.9	4.3	4.3	1.4	2.7	2.9	3.3	3.2
Private consumption	1.9	3.4	2.7	3.3	1.7	1.8	1.9	2.0	2.0
Public consumption	0.2	0.6	0.7	0.8	0.5	0.5	0.5	0.4	0.4
Fixed investment	1.7	2.9	0.8	0.2	-0.8	0.3	0.5	0.8	0.8
Structures	1.4	1.9	1.1	-0.6	-1.2	0.1	0.1	0.5	0.5
Residential investment	1.4	1.5	0.5	-1.3	-1.6	-0.4	-0.3	0.1	0.1
Equipment	0.3	1.0	-0.3	0.8	0.4	0.2	0.3	0.4	0.3
Change in stocks	-0.6	-0.1	0.7	-0.2	-0.1	-0.1	-0.1	-0.1	0.0
Net exports	0.3	-1.0	0.6	0.8	1.7	1.2	0.9	0.8	0.8
Exports	5.9	4.3	3.6	4.5	3.6	4.0	4.2	4.4	4.5
Imports	-5.6	-5.3	-3.0	-3.7	-1.8	-2.8	-3.3	-3.6	-3.7
Statistical discrepancy	0.7	0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0
GDP (annual percent change)	4.3	5.9	5.7	4.7	3.0	3.8	3.7	4.0	4.0
GNP (annual percent change)	3.7	4.9	6.5	4.2	2.7	3.9	4.0	4.2	4.2

Table 4. Ireland: General Government Finances
(In percent of GDP)

	Actual			Staff Projections 1/		
	2004	2005	2006	2007	2008	2009
Current balance	4.8	4.8	6.9	5.3	4.6	4.5
Current revenue, *of which:*	33.2	33.6	35.5	35.0	34.2	34.2
Tax revenue (including taxes on capital)	25.4	25.9	27.5	27.0	26.3	26.3
Social security receipts	4.4	4.5	4.7	4.7	4.7	4.7
Miscellaneous	3.4	3.2	3.3	3.2	3.2	3.2
Current expenditure, *of which:*	28.4	28.8	28.6	29.6	29.7	29.7
Interest payments	1.1	1.0	1.0	1.0	1.0	1.0
Goods and services	5.2	4.9	5.0	5.1	5.1	5.2
Compensation of employees	9.4	9.8	9.9	9.9	9.9	9.9
Current transfers	12.0	12.2	11.9	12.8	12.8	12.8
Depreciation	0.8	0.8	0.8	0.8	0.8	0.8
Current expenditure, excluding interest	27.3	27.8	27.6	28.6	28.7	28.7
Capital balance	-3.5	-3.8	-4.0	-4.5	-4.4	-4.4
Capital receipts (excluding taxes on capital)	1.1	0.9	1.0	0.9	0.9	0.9
Gross capital formation	3.7	3.7	3.9	3.9	3.9	3.9
Capital transfers	1.0	1.1	1.0	1.5	1.4	1.4
General government balance	1.4	1.0	2.9	0.8	0.2	0.1
Primary balance	2.4	2.0	3.9	1.8	1.2	1.1
Memorandum items:						
Structural (as a percent of potential GDP)						
Government balance (including one-off factors)	1.5	1.0	2.7	0.7	0.5	0.2
Revenue	34.4	34.6	36.4	35.9	35.2	35.1
Expenditure	32.8	33.5	33.7	35.2	34.7	34.9
Government balance (excluding one-off factors)	0.6	1.4	2.6	0.5	0.5	0.2
Primary balance	2.6	2.1	3.7	1.8	1.5	1.2
General government gross debt (as percent of GDP)	29.4	27.3	25.0	23.7	23.6	23.4
General government net debt (as percent of GDP) 2/	19.9	15.9	12.2	10.3	9.4	8.5
Output Gap	-0.4	-0.1	0.4	0.2	-0.6	-0.2
Growth in nominal GDP	6.5	8.8	8.2	8.2	5.3	5.9

Sources: Department of Finance and staff estimates.

1/ Staff projections are based on the 2007 budget, adjusted for staff's macroeconomic and revenue buoyancy assumptions.
2/ Net debt is defined as gross debt minus the value of the National Pensions Reserve Fund and the Social Insurance Fund.

Table 5. Ireland: Indicators of External and Financial Vulnerability

	2000	2001	2002	2003	2004	2005	2006
External indicators							
Exports (annual percent change, value in Euros)	10.7	9.9	10.8	14.2	17.1	6.7	6.6
Imports (annual percent change, value in Euros)	13.2	7.6	7.0	13.1	19.1	10.3	8.4
Terms of trade (goods, annual percent change)	-3.6	2.4	2.1	-0.5	-1.4	-2.1	-2.4
Current account balance (in percent of GDP)	-0.4	-0.6	-1.0	0.0	-0.6	-3.5	-4.2
Capital and financial account balance (in percent of GDP)	9.2	0.3	1.2	-0.9	2.7	-0.1	5.0
Of which:							
Inward portfolio investment	80.2	84.9	57.7	75.1	100.6	107.4	114.2
Inward foreign direct investment	26.7	9.2	23.9	14.5	-5.8	-15.8	-0.4
Other investment liabilities	29.4	36.9	40.2	57.3	39.9	57.9	75.2
Total external public debt (in percent of GDP) 1/	2.0	1.8	0.6	0.0	0.0	0.0	0.0
Of which:							
External debt to exports ratio (in percent)	2.6	2.4	0.8	0.0	0.0	0.0	0.0
External interest payments to exports (in percent)	0.2	0.1	0.2	0.0	0.0	0.0	0.0
U.S. dollar per euro (period average)	0.92	0.90	0.94	1.13	1.24	1.25	1.26
U.K. £ per euro (period average)	0.61	0.62	0.63	0.69	0.68	0.68	0.68
Financial markets indicators							
General government debt (in percent of GDP)	37.7	35.4	32.1	31.0	29.4	27.3	25.0
Government bond yield (in percent, 10-year, end-period)	5.1	5.1	4.3	4.6	3.7	3.3	4.0
Spread of government bond yield with Germany (in percent, end of period)	0.2	0.4	0.0	0.3	0.1	-0.1	0.2
Real government bond yield (in percent, 10-year, period average, based on CPI)	-0.4	0.9	0.0	2.1	1.4	1.0	-1.1
Annual change in ISEQ index (in percent, end of period)	18.0	-5.7	-18.8	12.2	26.8	16.8	27.8
Personal lending interest rate (in percent)	11.8	10.6	10.4	9.9	9.9	10.1	11.2
Variable mortgage interest rate (in percent)	6.0	4.6	4.2	3.5	3.5	3.6	4.8
Financial sector risk indicators							
Annual credit growth rates (to private sector, in percent)	21.3	15.1	15.0	17.9	26.6	28.8	25.9
Annual deposit growth rates (in percent)	15.6	15.6	9.6	11.9	14.1	23.9	25.1
Personal lending as a share of total loans (in percent)	52.1	52.2	55.3	55.6	55.8	54.6	50.3
(excluding financial intermediation and government)							
Of which:							
House mortgage finance	39.0	38.8	42.4	44.4	44.9	44.6	41.5
Other housing finance	1.0	0.9	0.8	0.4	0.3	0.3	0.4
Other personal lending	12.2	12.5	12.0	10.8	10.6	9.7	8.4
Annual mortgage credit growth rates (in percent)	24.3	17.8	23.1	25.5	26.5	27.1	24.2
Commercial property lending as a percent of total loans							
(excluding financial intermediation) 2/	15.0	16.4	17.0	19.7	21.2	25.3	31.2
Foreign-currency denominated assets (in percent of total assets)	41.5	44.6	40.1	32.5	29.4	33.9	33.7
Foreign-currency denominated liabilities (in percent of total liabilities)	44.4	47.4	42.9	34.2	32.2	35.9	36.9
Contingent and off-balance sheet accounts (in percent of total assets) 3/	465	592	505	538	662	879	1132
Non-performing loans (in percent of total loans) 4/	1.03	1.03	0.97	0.93	0.82	0.68	0.71
Total provisions for loan losses (in percent of total loans)	1.1	1.1	1.1	0.9	0.7	0.5	0.4
Risk-weighted capital/asset ratios of domestic banks (in percent)	10.7	10.6	12.3	13.9	12.6	12.0	10.9
Bank return on assets (before tax, in percent)	1.2	0.9	1.0	0.9	1.1	0.8	0.8
Bank return on equity (before tax, in percent)	22.0	16.0	18.0	17.8	20.7	19.6	19.1
Liquid assets of all banks to total assets (liquid asset ratio, in percent)	32.0	30.0	30.0	33.6	33.0	34.2	32.7
Liquid assets of all banks to short-term liabilities (in percent)	44.0	37.0	34.0	41.2	40.0	40.2	38.4
Deposits to M3 ratio 5/ 6/	1.03	1.02	1.02	1.46	1.36	1.38	1.34
Loan-to-deposit ratio vis-à-vis Irish residents 2/ 7/	1.36	1.44	1.43	1.46	1.61	1.77	1.87
vis-à-vis total 2/ 7/	1.54	1.59	1.51	1.57	1.72	1.82	1.85
Concentration ratios in the banking sector							
No. of banks accounting for 25 percent of total assets	3.0	3.0	3.0	2.0	2.0	2.0	3.0
No. of banks accounting for 75 percent of total assets	23.0	21.0	19.0	18.0	17.0	16.0	17.0
Share of state-owned banks in total assets (in percent)	2.0	1.0	0.0	0.0	0.0	0.0	0.0
Share of foreign-owned banks in total assets (in percent)	39.0	42.0	29.0	31.0	34.0	32.3	36.3

Sources: Data provided by the authorities; Central Bank of Ireland; International Financial Statistics; Bloomberg; and Fund staff estimates.
1/ Represents non-euro debt of the government sector.
2/ Includes lending for construction and real estate activities.
3/ Credit equivalent values.
4/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.
5/ Non-government deposits vis-à-vis Irish and nonresidents to M3 ratio.
6/ The methodology used to compile M3 has been amended in line with Eurosystem requirements. Therefore, there is a break in the series.
7/ Nongovernment loans/nongovernment deposits ratio.

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700 19th Street, NW
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IMF Executive Board Concludes Article IV Consultation with Ireland

On September 14, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Ireland.[1]

Background

Economic performance remains very strong, supported by sound policies. The growth rate of real GNP per capita continues to be one of the highest among advanced economies and the unemployment rate one of the lowest. However, in recent years, economic growth became more reliant on house building and competitiveness eroded. Rapidly rising house prices were accompanied by surging bank credit to property-related sectors, strong wage growth and inflation measured by the Harmonized Index of Consumer Prices (HICP) above the euro area average, and a deterioration in the current account balance. The rise in euro area interest rates since late 2005 has prompted a significant fall in the growth of residential investment and declines in house prices in recent months.

Following a decade of close-to-balance-or-surplus fiscal positions, the general government surplus rose to almost 3 percent of GDP in 2006 and net debt fell to 12 percent of GDP. The better-than-expected fiscal outturn reflected mainly the strength of property-related revenues, as well as a small decline in government expenditure relative to GDP. To prepare for the projected rise in age-related spending over the long term, the government is setting aside every year 1 percent of GNP in a National Pensions Reserve Fund.

[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. 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.

The banking system continues to perform well, but rapid credit growth has led to vulnerabilities. The banking system is well-capitalized, profitable, and liquid, and nonperforming loans are low. However, bank lending to construction and real estate firms amounts to 47 percent of GDP. Most lending to households is at variable rates and household debt amounts to 160 percent of household disposable income. At the same time, loan growth has outstripped deposit growth, so banks have become more reliant on wholesale funding.

Executive Board Assessment

The Executive Directors commended Ireland's continued impressive economic performance, characterized by one of the highest growth rates of GNP per capita among advanced countries and one of the lowest unemployment rates. This performance has been underpinned by outward-oriented policies, prudent fiscal policy, low taxes, and labor market flexibility.

Given the Irish economy's strong fundamentals and the authorities' commitment to sound policies, Directors expected economic growth to remain robust over the medium term. At the same time, however, a number of downside risks will need careful attention in the period ahead. Directors pointed to inflationary pressures in the context of an economy that is operating at or above full capacity, declining competitiveness and a widening current account deficit, a deterioration in global financial market conditions and the growth outlook of the United States, and the adjustment to a cooling of the housing market. Directors underscored that rapid house price increases and a boom in residential construction have been an important driver of growth and bank lending. While the slowdown of the housing sector has been gradual so far, and will help to rebalance growth and contain inflationary pressures, a sharper correction in house prices could significantly slow economic growth.

Directors commended Ireland's sustained strong fiscal performance, and the authorities' firm commitment to fiscal discipline over the medium term. Many Directors, however, saw the planned reduction in the fiscal surplus in 2007 as an undesirable pro-cyclical fiscal stimulus, while acknowledging Ireland's pressing need to increase infrastructure and social spending, and the leeway to do so provided by the strong fiscal position. Looking ahead to 2008, Directors cautioned against discretionary measures that would weaken the underlying fiscal position. They encouraged the authorities to restrain current expenditure growth and to continue to focus on improving the quality of public spending through cost-benefit analysis. They also welcomed the decision to establish a Commission to review the tax system.

Over the long term, Directors considered the projected increase in age-related spending to be the most important fiscal challenge. They concurred that Ireland is well-placed to meet this challenge, noting that the authorities have been preparing for it, and welcomed the forthcoming Green Paper on Pension Policy. They agreed that a combination of measures is preferable to a policy based solely on increasing social security contribution rates. In this regard, Directors saw merit in reviewing the state pensionable age and the level of contributions to the National Pensions Reserve Fund, and strengthening incentives for private savings. They also supported the authorities' commitment to improve public understanding of fiscal challenges.

Directors welcomed the indicators confirming the soundness of the Irish banking system, including the stress tests suggesting that cushions are adequate to cover a range of shocks even in the face of large exposures to the property market. Nevertheless, financial sector vulnerabilities, including those arising from high household indebtedness and rising interest rates, require continued supervisory vigilance. In this context, Directors commended the progress in implementing the recommendations of the 2006 Financial Sector Assessment Program update. They called for continued careful monitoring of banks' risk management practices, including those pertaining to commercial property lending. Directors supported the envisaged upgrading of the stress-testing framework and the commitment to continue to improve supervision.

Directors stressed that preserving and enhancing Ireland's external competitiveness will be key to underpinning future growth prospects. To this end, wages should continue to grow in line with productivity, and increases in global energy prices and mortgage costs should not be allowed to feed into wage growth. Directors recommended that both the implementation of the current social partnership agreement and the forthcoming public sector pay benchmarking exercise avoid adding to wage pressures. Directors underlined the importance of labor market flexibility in facilitating adjustment to the cooling housing market.

Ireland: Selected Economic Indicators

	2002	2003	2004	2005	2006	2007 1/
Real Economy (change in percent)						
Real GDP	6.4	4.3	4.3	5.9	5.7	4.7
Real GNP	2.9	5.7	3.7	4.9	6.5	4.2
Domestic demand	4.5	3.9	3.8	8.0	5.7	4.6
Exports of goods and services	5.2	0.6	7.3	5.2	4.4	5.6
Imports of goods and services	2.6	-1.6	8.5	7.7	4.4	5.4
HICP	4.7	4.0	2.3	2.2	2.7	2.7
Unemployment rate (in percent)	4.4	4.6	4.4	4.4	4.4	4.7
Public Finances (percent of GDP)						
General government balance	-0.3	0.2	1.4	1.0	2.9	0.8
Structural balance 2/	-0.6	0.2	1.5	1.0	2.7	0.7
General government debt	32.1	31.0	29.4	27.3	25.0	23.7
Money and Credit (end-period, percent change)						
M3 3/	9.3	-21.4	22.5	19.8	30.8	40.2 5/
Private sector credit 4/	15.0	17.9	26.6	28.8	25.9	20.9 5/
Interest rates (end-period)						
Three-month	2.9	2.1	2.2	2.5	3.7	4.1 5/
10-year government bond yield	4.3	4.6	3.7	3.3	4.0	4.6 6/
Balance of Payments (percent of GDP)						
Trade balance (goods and services)	16.6	15.4	14.3	11.7	10.3	10.8
Current account	-1.0	0.0	-0.6	-3.5	-4.2	-4.4
Reserves (in billions of Euros)	5.2	3.3	2.1	0.7	0.7	...
Exchange Rate						
Exchange rate regime	Member of euro area					
Euros per US dollar	1.1	0.9	0.8	0.8	0.8	...
Nominal effective rate (1999Q1=100)	93.6	101.9	104.5	104.1	104.4	...
Real effective rate (1999Q1=100, CPI based)	101.3	112.6	115.8	115.4	116.0	...

Sources: Central Statistics Office; Department of Finance, Datastream and IMF International Financial Statistics.
1/ Staff projections, except where noted.
2/ In percent of potential GDP.
3/ The methodology used to compile M3 has been amended in line with Eurosystem requirements. Therefore, there is a break in the series.
4/ Adjusted change, which includes the effects of transactions between credit institutions and non-bank international financial companies and valuation effects arising from exchange rate movements.
5/ As of May 2007.
6/ As of June 2007.