Programme country experiences

Ireland sustained its remarkable economic recovery in 2017. Robust economic growth helped reduce both the budget deficit and public debt. Favourable market access enabled Ireland to repay its remaining loans to the IMF, Denmark, and Sweden. Irish banks maintained sufficient capital and liquidity buffers, and exhibited profitability ratios above the euro area average. The economic cycle is, however, approaching its peak. Supply-side bottlenecks could constrain growth if not addressed. NPLs remain stubbornly high. Brexit and changes to the international tax and trade environment represent sizeable external risks.

Real GDP growth of 7.8% meant Ireland was one of the fastest-growing economies in the EU in 2017. But multinational corporations' activities inflated the GDP figure. Their volatile export, import, and investment activities mean that these components are now unreliable measures of Irish domestic economic activity. Growth of close to 4% in modified domestic demand, a measure that removes the distorting activities of multinational corporations, captures Ireland's performance more realistically. Ireland's unemployment rate, at 6.1% in March 2018, is the lowest it has been since 2008 and full-time equivalent employment growth reached 4% in 2017. But labour market tightening coupled with insufficient housing availability represent supply-side constraints that could hamper future growth. External risks from Brexit are sizeable, while changes in the US corporate tax regime could weaken Ireland's attractiveness as a foreign direct investment destination.

Consumer price growth returned to positive territory during 2017, but inflation remained subdued at 0.3%. Housing rental increases, driven by urban property shortages and higher energy prices, boosted inflation. The British pound depreciation led to reduced prices for food and furniture, items heavily imported from the UK, and weighed on inflation.

Ireland recorded its fourth consecutive primary budget surplus in 2017. Bank asset sales and some dividends from a bank liquidation facilitated the transition of government finances into a surplus in cash terms for the first time since 2006, and reduced the government debt-to-GDP ratio to around 68%. Revenues from all tax categories increased, with better-than-expected corporate tax returns the main source of the fiscal outperformance. The large contribution of a small number of firms to total corporate tax returns increases the volatility of this revenue stream. Growth in income tax and value added tax receipts was slightly below projections despite robust employment and consumer spending growth. Within-year supplementary expenditure increases exploited the use of available fiscal space and exacerbated the procyclicality of the 2017 budget.

Ireland enjoyed favourable market access during 2017. Total issuance reached €16.2 billion, with a weighted average maturity of 12.4 years and weighted average yield of 0.89%. The larger-than-expected issuance was due to the early repayment of IMF and bilateral loans. These issues increased the debt stock eligible for ECB purchases, eased scarcity concerns, and facilitated an increase in purchases towards the level implied by Ireland's capital key. All credit rating agencies assign Irish debt an A rating. Fitch and Moody's upgraded Ireland's rating during 2017 to A+ and A2, respectively.

Irish banks showed further signs of recovery thanks to strong economic growth and healthy investor appetite for Irish assets. Domestic Irish banks were well capitalised, with capital well above the regulatory minimum. Reduced loan provisions and higher net interest margins increased profitability ratios to slightly above the euro area average. The government successfully sold a 28.8% stake in Allied Irish Bank (AIB) in the market at the end of June, and raised €3.4 billion. However, some vulnerabilities persist. Costs remained high and legacy issues weighed on earnings. Despite banks' efforts, the NPL ratio remained elevated at 10.4% as per the European Banking Authority (EBA) at end-December 2017. Banks face additional challenges from Brexit, regulatory changes, and monetary policy normalisation. They also need to boost digitalised banking capacity.

Under its Early Warning System, the ESM's monitoring shows limited risks for Ireland in meeting its loan service repayments. However, Ireland faces a number of internal risks as the economy approaches the peak of the economic cycle, while external risks are ever-present in such an open economy. These risks warrant the accumulation of fiscal buffers and the close monitoring of Ireland's macroeconomic and financial market dynamics.