PROGRAMME COUNTRY EXPERIENCES

Ireland's economy continued to expand at a very healthy pace in 2016, with a solid performance of domestic growth indicators. The unemployment rate dropped to its lowest level since July 2008 and the public deficit kept falling. In the banking sector, non-performing loan (NPL) reduction lost some momentum in 2016 while profitability decreased slightly. Looking ahead, external uncertainty remains considerable, particularly around Brexit and international tax policies. In a still low interest rate environment, Irish banks, with significant UK exposures, will continue to face a challenging outlook.

Real GDP expanded by 5.2% year-on-year in 2016, making Ireland the fastest-growing economy in the European Union. Although the activities of large multinational corporations in part distort headline growth figures, a number of indicators point to a solid expansion in Ireland's underlying economic activity. In particular, employment rose by 2.9% year-on-year in 2016 and pushed the unemployment rate down to 6.9% in December, the lowest level since July 2008. Private consumption and sectors where foreign-owned multinationals are not prevalent also grew at a healthy pace in 2016.

Inflation remained subdued at -0.2% year-on-year. Meanwhile, house prices continued to rise at an average of +6.4% over the year, a trend that is expected to continue in the near term as the anticipated modest expansion in supply will be insufficient to meet growing demand. Existing macroprudential rules regarding loan-to-income and loan-to-value ratios, however, may somewhat mitigate the upward pressure on house prices.

Fiscal policy was mildly expansionary in 2016. Nonetheless, the general government deficit fell to 0.6% of GDP from 2.0% in 2015. The strong growth in general government revenue, primarily from increased tax revenues and social insurance contributions, underpinned this development. Robust performances in the corporation and capital gains tax categories mitigated below-profile VAT returns.

SVEN SESTER
Minister of Finance of the Republic of Estonia, ESM Governor

"The euro has time and again proven itself as a robust currency fostering a stable monetary climate. The euro has lowered transaction costs and allows its members an easy comparison of prices leading to increased cross-border trade, long-term investments, and economic growth. The single currency has given the euro area Member States a global voice, and together we can build a dynamic monetary union."

Mid-year adjustments to the 2016 budget targets helped absorb higher-than-expected health expenditure. The 2016 headline deficit benefited from a one-off revenue, whilst in 2015 the effect of one-offs, largely related to financial sector supporting measures, was deficit increasing. With growing uncertainties about international tax policies, the Irish authorities have identified the increasing concentration of corporate taxes as a potential fiscal risk.

The government debt-to-GDP ratio is estimated to drop again in 2016 to 75.4%, a level well below the euro area average. Nonetheless, debt measures which are not affected by the recent accounting changes in headline GDP paint a rather different picture. In particular, the debt-to-revenue ratio in Ireland is estimated at about 275% in 2016, well above the euro area average of 198%. The Irish authorities' plan to build a fiscal buffer in the medium term and to reach a 45% debt-to-GDP ratio by 2025 is, therefore, a welcome step.

Ireland maintained solid financial market access in 2016, and investors continued to perceive Irish bonds as closer to core assets than to peripheral ones. Although the ECB started purchasing fewer Irish bonds under its public-sector purchase programme (PSPP) in late 2016, yields still dropped through the year, with the Irish 10-year bond yield declining to 0.7% from 1.1%. Following the credit rating upgrades by Moody's and Fitch last year, to A3 and A, respectively, now all major credit rating agencies assign Ireland an A rating.

The recovery in the Irish banking sector continued last year, but downside risks prevail. NPLs kept falling in 2016, albeit at a slower pace as banks now must deal with the most problematic ones. The strengthening of Irish banks' capital ratios, which are well above the minimum requirements, continued through the year. Yet for those banks included in the European Banking Authority stress tests, results came in below expectations. Decreasing funding costs and impairment charges continued to be the main drivers of profitability. Brexit uncertainties, however, may weigh on this limited profitability going forward, and also on the government's intention to place its banking assets in the private sector.

Under its Early Warning System, the ESM's monitoring shows that Ireland currently faces no difficulty in meeting its loan service repayments. Nonetheless, maintaining a prudent fiscal policy stance in line with the debt target and building up a fiscal buffer would ensure that Ireland will have the scope to pursue growth-supporting countercyclical fiscal policies in future downturns.

MICHAEL NOONAN

Minister of Finance of the Republic of Ireland, ESM Governor

"The euro enhances the living standards of the citizens of all participating Member States. This is achieved inter alia by greater levels of trade, reduced transaction costs, a deepening of the Single Market and increased financial integration within the EU, all of which are facilitated by the single currency."