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Analysis

IRELAND
Europe/M.East/Africa

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Ireland

Macroeconomic performance

For nearly a decade the Irish economy has been characterised by high growth rates which, supported by a favourable demographic profile and outward oriented policies, contributed to a substantial rise in wealth levels. Moreover, structural changes that have taken place since the 1980s in the context of Ireland's membership in the European (Monetary) Union have made the economy much more resilient, flexible and better able to sustain shocks. Strong investment spending and foreign direct investment (FDI) remain catalysts for the economy's capacity to generate growth and income.

GDP growth levels back at sustainable levels

GDP growth rates slowed down substantially between 2001 and 2003 from levels near 10% the years before. The most important external factor for this trend has been the US economic downturn, due to Ireland's strong export and FDI links with the US. Economic recovery since 2004 is mainly driven by international trade and increasing consumer confidence, with real GDP growth now back on track for rates above 5%. Demographics (young population), immigration and increasing labor market participation have led to increases in employment, average earnings, real disposable income and housing demand, thus continuing to be important drivers for GDP growth. Net export contribution has declined, due to some sector specific manufacturing weakness (basic chemicals), subdued demand in the Eurozone, a slowing UK economy and robust Irish domestic demand.

Exceptional role of the construction sector

The booming construction sector plays an exceptional role in the Irish economy, supporting growth and employment. It accounts for 12% of total employment, which is far in excess of other developed countries. The building sector, with its strong impacts also on linked (services) sectors, directly and indirectly has accounted for one in every two new jobs in 2004. This indicates to Moody's that in case of a profound correction a major impact on the drivers of GDP growth must be expected. Overall activity levels in the construction sector seem to have peaked, and it seems there is consensus that recent levels of house building are well in excess of the economy's medium-term requirements. Housing price inflation has started to react by decelerating, but prices have not yet started to fall.

Housing boom seems fundamentally backed

Housing market developments in Ireland are a risk factor for the economy, and some correction may develop. However, we think the relatively broad and sustainable basis for housing demand is set to continue, reflected by strong demographics, substantial real income development and ongoing catching up effects. Therefore, the housing boom seems fundamentally backed and does not seem to be just a function of historically low interest rates. Furthermore, Ireland's economic base has broadened and become more stable over the years, indicating substantial resources to cope with risk of correction. As an example, even though private households' accumulation of debt and hence debt service ratio is important, real income after debt service has risen substantially and no bad debts have been recorded. Cyclically rising interest rates would imply a larger income basis and therefore do not pose a particular risk. An external interest rate shock would hit households' budget balance but does not seem likely in the medium term. Irish households are not an outlier in this kind of interest rate risk, with comparable developments in other former high yield countries, like Portugal or Spain.

FDI inflows help to keep economic growth potential high

An ongoing solid volume of FDI inflows helps to keep a high growth potential of an economy which faces the challenge to move further on the value-added chain. Former very high FDI inflows, which have helped in the past to catch up with productivity of main competitors, are not realistic today and would be difficult to absorb, due to labor market tightness. On the other hand, Central and Eastern European countries do not seem able to detract FDI flows away from Ireland, which go mainly into typical Greenfield investments. Furthermore, foreign companies continue to value the business-friendly regulatory environment, low taxation, highly educated workforce and efficient co-operation with Irish authorities. Infrastructure bottlenecks are an issue, and authorities are seeking to remove them.

Wage inflation remains a risk for international cost competitiveness

Inflation seems to continue its converging downward trend towards the Eurozone average of around 2%. Inflation has fallen remarkably since 2003, causing an elimination of the differential with the Eurozone. However, after years of higher than Eurozone average inflation the consumer price level in Ireland is now the highest in the Eurozone.

Supply of foreign labor force has further increased after EU enlargement, helping to limit ongoing tightness on the labor market and to support wage discipline. However, national wage agreements between government, trade unions and business leaders have not prevented wage inflation from moving significantly higher than in the country's main trading partners. The resultant loss in cost competitiveness seems to have been more than offset in the past by relative productivity gains in the tradeable goods sector, thanks to large FDI inflows in high-technology sectors. However, output figures tend to overstate productivity because of tax-induced temporary profit transfers to Ireland of multinationals. Furthermore, since the beginning of 2000 economy-wide relative unit wage costs (EC index) have increased strongly, indicating a clear deterioration in the Irish cost competitiveness position with main trading partners. The moderate outlook for consumer price inflation should support further moderation in wage demand.

Political/Social Developments

Public services face increasing costs and value-for-money problem

Despite considerable expenditures over the last decade, the quality of public services, especially in health care and education, and the state of infrastructure are perceived as insufficient and will necessitate further investments by the government. The health sector faces a value-for-money problem: government health care costs are rising markedly, with large staff increases but only moderate efficiency gains, especially in the hospitals sector. The establishment of a Commission on Financial Management and Control Systems in the Health Service in 2002 is an important step towards better budgetary control. The approved merger of the current eleven health authorities into one major national health agency (Health Services Executive) seems appropriate to re-organize the system, to clearly assign responsibilities and to raise cost efficiency.

Authorities seek to further secure long-term sustainability of public finances

Concerning the long-term pension issue, Ireland is in a better position than most other Eurozone countries: its favourable demographic situation does not only continue to support growth but is also limiting financial obligations to the welfare system. The declining dependency ratio (the number of those under 15 and over 65 years old as a share of the total population) alleviates pressures on public finances and on future pension obligations. However, to enhance long-term sustainability of public finances, the government aims at increasing the effective retirement age in the public sector by installing more restrictive approaches to early retirement. Ireland benefits from a developed second pillar of corporate and private pension schemes. Personal pension savings schemes can be moved between different employers and provide further support, as do special savings incentives for younger people. Moreover, the government is setting aside budget revenues in a National Pensions Reserve Fund, equal to 1% of GNP per year. These annual transfers and planned contingency reserves against unforeseen developments represent important factors of long-term sustainability.

Government Finance and Debt

General government budget: well under control and structurally balanced

After an extraordinary surplus of 4.4% of GDP in 2000 the general government budget posted a slight surplus in 2001 and a roughly balanced position in 2002 and 2003. Part of this surplus decline can be attributed to slower revenue growth in line with the economic slowdown at that time. Some revenue under-performance was also due to lower structural revenue growth, as a result of income tax cuts and tax credits. In the 2003 budget, various revenue-raising measures such as increases in indirect taxes and user charges were introduced. Measures to increase tax discipline have helped to support tax revenues above target since then. Even though in 2004 this development was to a good part due to one-off factors (special tax investigations and high revenues from capital gains tax), yielding in a 1.4% of nominal GDP general government surplus, it also points to an underlying economic recovery.

The expected 1% deficit ratio for 2005 again is mainly the result of a one-off phenomenon, which is the government's refund of nursing home charges which were based on an unsecure legal basis. 2005 tax receipts are ahead of profile due to expenditure taxes which reflect relatively strong consumer demand. Expenditures are behind target, with capital expenditure facing capacity problems in the construction sector. The way from former general government budget surpluses to roughly balanced budgets also mirrors new priorities on the expenditure side. Government spending increased substantially on health care, education and social welfare. Furthermore, the government intensified investment into infrastructure and the quality of public services. The government remains committed to the investment spending plans of the National Development Plan, with continuously strong investment spending into infrastructure and capital investment at 5% of GNP until 2008.

Authorities likely to continue prudent policies, even though new priorities arise

The fact that people continue to complain about problems with infrastructure and (timely) access to (emergency) healthcare services indicates that further reforms are necessary to guarantee more efficient services. It seems likely that the government will continue to use the increased (cyclical) scope of fiscal revenues to further improve public services. However, Moody's also expects that the government will continue with prudent fiscal management, taking into account that medium-term economic growth (and hence fiscal revenues) will probably turn out to be more moderate than exceptionally high growth rates of the 1990s. Close monitoring of current spending and ministries' responsibility to respect agreed budget limits act as a factor of discipline. It also seems that recent restrictions of public sector recruitment are largely maintained with the effect of lowering government expenditures. In general, Moody's notes that the Irish government's fiscal position remains sound. Moody's impression is that the government's public finances continue to follow a structurally balanced track. The fiscal consolidation process continues to favour the downward trend in general government debt as a percentage of nominal GDP, now below the 30% level.

International Investment Position and Banking Sector

Ongoing FDI inflows reflect a strong interest by high-tech companies to research and produce in Ireland. Within EU25 Ireland was the largest net recipient of FDI in 2003, followed by Germany. In 2004, Ireland was the second largest net recipient of FDI within EU25, after the UK.

Supervision of the Ireland's banking sector has been enhanced by the unification of supervision under the Irish Financial Services Regulation Authority within the Central Bank (Central Bank and Financial Services Authority of Ireland Act, 2003). High levels of capitalization and profitability have strengthened the Irish banks' capacity to weather potential macroeconomic shocks without systemic distress. Irish banking institutions currently operate in a less dynamic but more sustainable economic growth environment than during the 1990s. Nevertheless, profitability remains robust, despite the overall contraction in net interest margins and upward wage pressure. Irish banks and building societies present ongoing strong operating performance and robust domestic market shares. Asset quality remains sound, reflected by low arrears levels. The fact that a significant proportion of banks' lending portfolios are secured against residential mortgages mitigates risks generally. The shock absorption capacity of the banking system seems adequate in the case of a sudden fall in residential property prices. However, whilst Moody's is not anticipating a significant increase in either unemployment or interest rates, a sharp rise in either would present a threat to the credit quality of mortgage lenders generally. Residential mortgage lending has continued to increase and accounts for over one third of total private sector credit. Although Irish banking institutions derive considerable advantage from the availability of strong retail deposit bases, the fact that loan growth has been outstripping deposit growth places added pressure on banks' funding bases. Banks have been countering this pressure via the ongoing diversification of funding resources.

Peer Group Comparison

In contrast to many other Eurozone governments, Irish authorities have managed to keep general government budget balances well under control. Furthermore, the Irish general government debt ratio has further decreased to below 30% of GDP in 2005, remaining well below Eurozone average at some 71.1% and below the 57.2% mean of advanced industrial countries. The Irish general government debt to revenue ratio at some 85% is largely below the Eurozone average at 155.9% as well as below the mean of advanced industrial countries at 143.9. While risks to long-term sustainability suggest the necessity of further medium-term reform efforts in many Eurozone countries, Ireland is in a better position than most other Eurozone countries due to its favourable demographic situation and a highly developed pension system.

Related Research

Banking System Outlook:

[Banking System Outlook: Ireland, October 2005 \(94644\)](#)

Special Comments:

[Moody's Sovereign Ratings: A Ratings Guide, March 1999 \(43788\)](#)

[A Quantitative Model for Local Currency Government Bond Ratings, September 2003 \(79404\)](#)

[A Quantitative Model for Foreign Currency Government Bond Ratings, February 2004 \(81176\)](#)

[Has Fiscal Consolidation Stopped in Europe?, October 2002 \(76312\)](#)

[EU Enlargement – From A Ratings Perspective, July 2004 \(88160\)](#)

[French Rejection of Draft EU Constitution will Hamper – but not Derail – the Dynamics of European Unity, May 2005 \(92620\)](#)

[European Union: New Stability and Growth Pact's Focus on Sustainability Might Prove Positive, May 2005 \(92684\)](#)

Rating Methodologies:

[Revised Country Ceiling Policy, June 2001 \(67679\)](#)

[Piercing the Country Ceiling: An Update, January 2005 \(91215\)](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Ireland

Main Economic Indicators	1997	1998	1999	2000	2001	2002	2003	2004	2005F	2006F
Real GDP (%/y)	10.8	8.9	11.1	9.9	6.0	6.1	3.7	4.5	5.1	5.1
Private Consumption (%/y)	7.2	7.2	8.8	9.0	5.2	2.6	2.6	2.9	3.9	4.9
Public Consumption (%/y)	5.1	7.4	7.4	8.1	11.3	8.4	2.6	2.8	2.7	2.7
Gross Fixed Investment (%/y)	18.2	16.4	15.5	7.3	-1.5	3.0	3.4	6.0	3.3	4.7
Domestic Demand (%/y)	9.8	9.5	8.5	9.1	3.8	3.4	3.3	3.4	3.5	4.5
Contribution to GDP Growth										
Net Exports	2.5	-0.1	4.4	2.2	2.8	3.1	1.2	2.6	2.1	1.5
Domestic Demand	9.9	8.3	7.5	7.8	3.2	2.9	2.7	2.8	2.8	3.5
Stockbuilding	0.6	0.5	-1.4	0.6	-0.6	-0.2	0.4	-0.2	0.0	0.0
Unemployment Rate (%)	9.9	7.5	5.6	4.3	3.9	4.3	4.6	4.5	4.6	4.6
GDP Deflator	4.4	6.4	3.8	4.8	5.7	4.5	1.6	2.9	2.6	2.6
CPI (harmonized index, %/y)	1.2	2.1	2.5	5.3	4.0	4.7	4.0	2.2	2.4	2.4
Comparison: Prices in Eurozone										
CPI (harmonized index, %/y)	1.7	1.2	1.1	2.1	2.4	2.3	2.1	2.1	2.2	2.0
Indicators of Competitiveness										
Output (% growth)	10.8	8.9	11.1	9.9	6.0	6.1	3.7	4.5	5.1	5.1
Employment (% growth)	5.6	8.6	6.2	4.6	3.0	1.8	2.0	3.0	1.8	1.5
Productivity (% growth)	5.2	1.9	4.9	5.3	3.0	4.3	1.7	1.5	3.3	3.6
Wages (per worker, manufact., % growth)	4.1	6.5	4.6	8.6	7.7	5.0	4.7	5.7	5.0	4.7
Unit Labor Costs (manufact., % growth)	-1.1	4.6	-0.3	3.3	4.7	0.7	3.0	4.2	1.7	1.1
Comparison: Eurozone										
Output (% growth)	2.3	2.9	2.8	3.5	1.6	0.9	0.5	2.1	1.0	1.5
Employment (% growth)	0.8	2.0	1.8	2.2	1.4	0.5	0.2	0.6	0.7	0.9
Productivity (% growth)	1.5	0.9	1.0	1.3	0.2	0.4	0.3	1.5	0.3	0.6
Wages (% growth)	2.1	1.2	2.2	2.7	2.8	2.7	2.5	2.1	2.0	2.4
Unit Labor Costs (% growth)	0.6	0.3	1.2	1.4	2.6	2.3	2.2	0.6	1.7	1.8
Public Finances (% of GDP)										
General Government Balance	1.1	2.4	2.6	4.4	0.9	-0.4	0.2	1.4	-1.0	-0.6
Central Government				4.1	0.7	0.1	-0.5	-0.2	-0.2	-1.3
Local Governments				0.1	-0.1	-0.1	0.4	0.2	0.0	-0.1
Social Security Funds				0.4	0.4	-0.2	0.2	0.3	0.3	0.3
General Government Revenues/GDP	38.7	37.2	36.9	36.4	34.5	33.6	34.6	35.7	34.7	34.0
General Government Expenditures/GDP	37.5	34.8	34.4	32.0	33.6	33.9	34.4	34.3	35.7	34.6
Primary Expenditures	33.3	31.4	32.1	30.0	32.1	32.5	33.1	33.1	34.6	33.6
Interest Payments	4.2	3.4	2.3	2.0	1.5	1.4	1.3	1.2	1.1	1.0
Primary Balance	5.3	5.7	4.9	6.4	2.4	1.0	1.5	2.5	0.1	0.4
General Government Debt/GDP	64.7	53.7	48.7	38.3	35.8	32.6	32.0	29.4	29.1	29.0
External Accounts										
Total Exports (% volume growth)	17.4	22.0	15.2	20.4	8.4	5.7	-0.8	4.5	6.4	6.5
Total Imports (% volume growth)	16.7	26.0	12.1	21.3	6.7	3.3	-2.3	2.5	5.5	6.3
Current Account (% of GDP)	3.1	0.8	0.3	-0.4	-0.7	-1.3	-1.4	-1.3	-1.1	-1.4

Rating History Ireland

Action	Date	Foreign Currency Bonds and Notes		Foreign Currency Bank Deposits		Local Currency Government Bonds
		Long-term	Short-term	Long-term	Short-term	
Rating Assigned	December 4, 1986		P-1		P-1	
Rating Assigned	July 15, 1987	Aa3		Aa3		
Rating Assigned	September 4, 1992					Aaa
Rating Placed on Review for Possible Upgrade	June 4, 1994	Aa3		Aa3		
Rating Upgraded	August 31, 1994	Aa2		Aa2		
Rating Placed on Review for Possible Upgrade	January 24, 1997	Aa2		Aa2		
Rating Placed on Review for Possible Downgrade	January 25, 1997					Aaa
Rating Upgraded	February 13, 1997	Aa1		Aa1		
Rating Confirmed	February 14, 1997					Aaa
Rating Placed on Review for Possible Upgrade	March 18, 1998	Aa1		Aa1		
Rating Upgraded	May 4, 1998	Aaa		Aaa		
Rating Withdrawn	July 15, 1999	[1]	[1]	[1]	[1]	

[1] Ireland's country ceilings were replaced by the Aaa and P-1 ceilings assigned to the Eurozone.

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