Fitch Affirms Ireland at ‘AAA’

Fitch Ratings–London–27 October 2006: Fitch Ratings has today affirmed the Republic of Ireland’s foreign currency Issuer Default and Short-term foreign currency ratings at ‘AAA’ and ‘F1+’, respectively. At the same time the agency has affirmed the Long-term local currency Issuer Default rating and Country Ceiling at ‘AAA’. The Outlook on the Issuer Default ratings are Stable.

“Strong public finances, high income levels and robust underlying growth performance continue to underpin Ireland’s ‘AAA’ rating. Near-term uncertainties exist over the macroeconomic outlook given the rate of bank credit growth and possible exuberance in the housing market, but these are unlikely to impinge on Ireland’s credit profile,” says Chris Pryce, Director in Fitch’s Sovereigns Group.

Ireland’s ratings derive strong support from its continuing high economic growth, which at an average of 5% per annum since 2000 has been more than double the EU average and which will continue to increase Ireland’s lead in income per head over most of its fellow EU members. Of all 16 ‘AAA’-rated sovereigns, Ireland is fourth in GDP per head. Ireland’s population growth is also the highest in the EU, an average of 1.8% per year, mainly due to immigration. Ireland’s rapid convergence towards the world’s highest income economies reflects a strong political consensus built around an open economy, EU and EMU membership, deliberate and successful targeting of inward foreign investment, low corporate taxes and a strong commitment to education at all levels. Social and demographic developments, such as the surge in the female participation rate and the continuing rise in net immigration during the last decade also remain critical factors, as does the rapid labour productivity growth, which partly reflects Ireland’s youth. With its median age at 34 years, the youngest in the EU25, ageing pressures on the public pension system will arrive later than in most other EU countries, while the government has already started accumulating pension reserves.

“None of the above, however, would have been of much significance had the public finances not been put on a sounder basis and kept there,” says Mr. Pryce, who now expects Ireland to run a fiscal surplus close to the ‘AAA’ median for the foreseeable future. Government gross debt, the usual rating measure, is now only 27% of GDP and only Luxembourg in the ‘AAA’ peer group performs better. Ireland also has the National Pensions Reserve Fund, which now accounts for about 10% of GDP and is expected to be about 25% of GDP in 2025 when it will be used over several decades to support the official pension system. Furthermore, Ireland remains one of the world’s largest net external creditors, despite some weakening in the current account.

Bank credit to the private sector has increased sharply, particularly to households for house mortgages. The year-on-year growth in private sector credit began accelerating in Q403 and has been running close to 30% for most of the past year. House price inflation is correspondingly strong and house prices are already among the highest in Europe. Lending to the construction industry, which accounted for 18% of GDP in 2004, has also been high. Last year, about 85% of new bank credit went to the industry broadly defined to include housing, commercial development and the government’s continuing high capital spending on infrastructure, especially transport. The associated rapid expansion of new housing supply raises the risk of a housing market correction at some point, although demand for housing is likely to remain relatively robust in the medium term founded on demographics, rising incomes and a still low stock of dwellings per capita. These factors help explain why Ireland receives a poor macro-prudential score in Fitch‘s bank systemic risk analysis. However, overall risks are mitigated by a mortgage interest service burden which is still moderate by historical standards, euro area membership and a strong and soundly managed banking sector. A robust starting point also diminishes concerns about the impact of a possible housing market correction and macroeconomic adjustment on the public finances.

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