

RESEARCH

Ireland (Republic of)

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Major Rating Factors**Strengths:**

- Diversified, resilient, and flexible economy
- Strong general government finances
- Strong potential for output growth owing to favorable demographic structure and low unemployment

Sovereign Credit Rating

AAA/Stable/A-1+

Weaknesses:

- High vulnerability to external and domestic shocks
- Weakening cost competitiveness
- Infrastructure deficit

Rationale

The ratings on the Republic are supported by the diversified, resilient, and flexible nature of its economy, strong general government finances, and its favorable demographic structure.

Economic growth has consistently outperformed the 'AAA' median since the mid-1990s, following sizable foreign direct investment inflows, good productivity gains, and strong employment growth. General government finances have posted a surplus of more than 1.0% of GDP on average per year during the past decade, while Ireland has reduced its gross debt burden to 25% of GDP in 2006, from 80% in 1995.

Ireland's young population and its decision to pre-fund future pension liabilities in the National Pensions Reserve Fund (NPRF) mean that the fiscal impact of population aging will be felt much later and less severely than in other European countries. As the government continues to pay back debt and the value of the NPRF increases, net debt, currently in the region of 10% of GDP, is expected to decline to 4% of GDP by 2009. The positive effect of favorable demographics and immigration on the labor supply should also support output growth in the short to medium term.

These strengths outweigh the inherent vulnerabilities posed by a small, open economy. Nevertheless, the boom years of the late-1990s, driven by strong consumer demand growth (at GDP growth more than 10% per year and high employment, are fading, and the annual GDP growth is estimated at 4% in the medium term. This, coupled with expected slowdown in the housing market, will in turn reduce the general government surplus to less than 1% of GDP by 2010, from 2.3% of GDP in 2006. Meanwhile, strong credit growth fuelled by low interest rates and a housing market boom, as well as significant dependence on the construction sector, has increased the risk of a sharp correction in consumer demand.

As an export-oriented economy, Ireland also faces the challenge of eroding competitiveness, particularly in terms of labor costs, resulting in a widening current account deficit (estimated at 3.4% of GDP in 2006). The inflation level (including mortgage payments) has been higher than that of other Eurozone countries, and as a result, over the long term it will be necessary for Ireland's export sector to regain its competitive edge.

Outlook

In the medium term, Ireland's strong credit standing should remain secure against most foreseeable downside economic, political, and financial risks. Strong GDP growth, the ongoing commitment to sustainable public finances, and the implementation of measures addressing the challenge of an aging population will support the ratings. The ratings on Ireland could come under pressure, however, if there is a sharp correction in the housing market or construction sector, undermining output growth, reducing employment, and potentially leading to a deterioration in the public accounts.

Table 1**Republic of Ireland Selected Indicators**

	2009f	2008f	2007f	2006e	2005	2004	2003	'AAA' Median 2006e
GDP per capita (\$)	63,839	63,997	56,645	54,220	48,583	44,247	38,559	40,326
Real GDP (% change)	4.1	4.6	5.3	5.4	5.5	4.3	6.2	3.2
Real GDP per capita (% change)	2.2	2.7	3.3	3.4	3.8	2.4	4.3	2.6
General government balance (% of GDP)	0.6	0.9	1.2	2.3	1.1	1.4	0.3	1.6
General government debt (% of GDP)	20.2	21.5	23.0	25.1	27.4	30.0	31.5	47.1
Net general government debt (% of GDP)	2.9	3.9	6.7	10.0	13.5	18.2	20.7	23.9
General government interest expenditures (% of revenues)	2.0	2.2	2.5	2.7	2.9	3.4	3.6	4.0
Domestic credit to private sector and NFPEs* (% of GDP)	236.8	229.0	213.9	191.0	163.8	137.8	117.8	150.6
Consumer price index (average; % change)	2.2	2.2	2.7	2.9	2.2	2.3	4.0	2.1

*Standard & Poor's estimates that, in a reasonable worst-case scenario, the government's contingent liability from a banking crisis could amount to 5%-15% of bank credit; see table 5 in "Banking Industry Country Risk: These Are The Good Old Days," published on June 6, 2006, on RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis. NFPE--Nonfinancial public enterprise. CARs--Current account receipts. f--Forecast. e--Estimate.

Comparative Analysis

- Real GDP growth continues to outperform that of peers.
- Ireland has the lowest government debt-to-GDP ratio in its peer group.
- The fiscal implications of an aging population will come into play in Ireland later than in its peers.

Ireland's peer group are all rated 'AAA/A-1+' with a stable outlook. Among non-EMU members they are the Kingdom of Sweden, the United Kingdom (U.K.), and the Kingdom of Denmark; among EMU members they are the Republic of Austria, the State of The Netherlands, and the Republic of Finland.

Like its Nordic peers, Ireland has comfortably adhered to the fiscal restraints imposed by the Stability and Growth Pact since 1999, while the U.K., Austria, and The Netherlands have posted deficits. The U.K. has recently reached the boundaries of the 3% deficit target.

Ireland is more exposed to external shocks than peers

At about \$229 billion in 2006, Ireland's economy is one of the smallest in the peer group, broadly comparable with those of Finland (\$210 billion) and Denmark (\$273 billion). Ireland's GDP is less than one-tenth of the U.K.'s (\$2,377 billion) and significantly trails other peers. Increased vulnerability due to the small size of Ireland's economy is amplified by a high degree of openness--exports account for more than 80% of Ireland's GDP, compared with 76% for the Netherlands and 50% for the 'AAA' median. The resilience and flexibility of the Irish economy, however, has largely enabled it to overcome these inherent vulnerabilities and to perform comparatively well in the past decade.

Real GDP growth continues to exceed the 'AAA' average

Since 2000, Ireland's real GDP growth has outpaced that of peers, averaging 5.9%, compared with 2.5% for the 'AAA' median. Ireland's growth has slowed from an average 9.6% in the previous five years to 5.4% in 2006, however, as the productivity- and employment-led boom has faded (see chart 1). Nevertheless, Ireland's GDP per capita, at a projected \$54,220, is expected to exceed the 'AAA' median by more than \$14,000 in 2006 (see chart 2). Using the gross national product (GNP) measure, however, which better reflects Ireland's standard of living, income per capita in 2006 at \$44,570 is closer to the 'AAA' average (\$40,326). Significant risks to the outlook are posed by the rapid, housing-related increase in domestic credit, and in the larger construction sector, with Ireland second only to The Netherlands in terms of credit as a share of GDP in 2006 (see charts 3 and 4; and commentary article "European Economic Forecast: The Storm Clouds Gather Over European Housing Markets," published on Nov. 29, 2006).

Chart 1

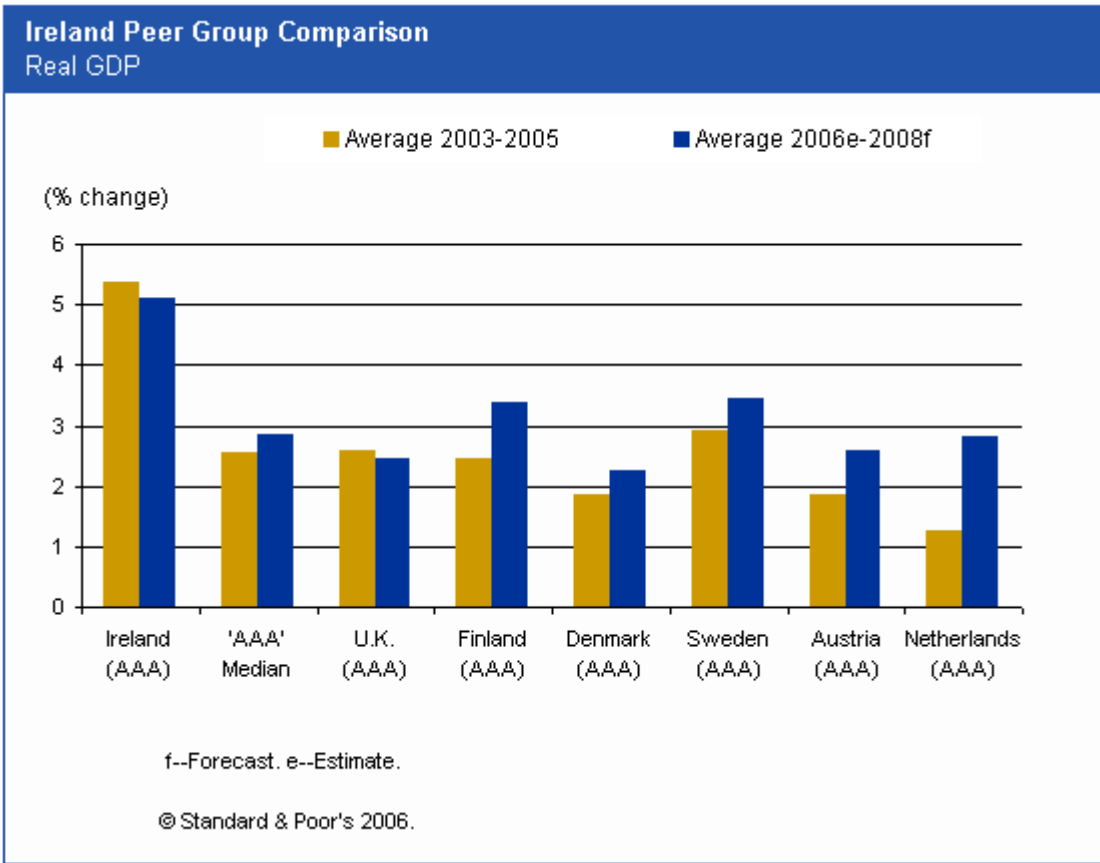


Chart 2

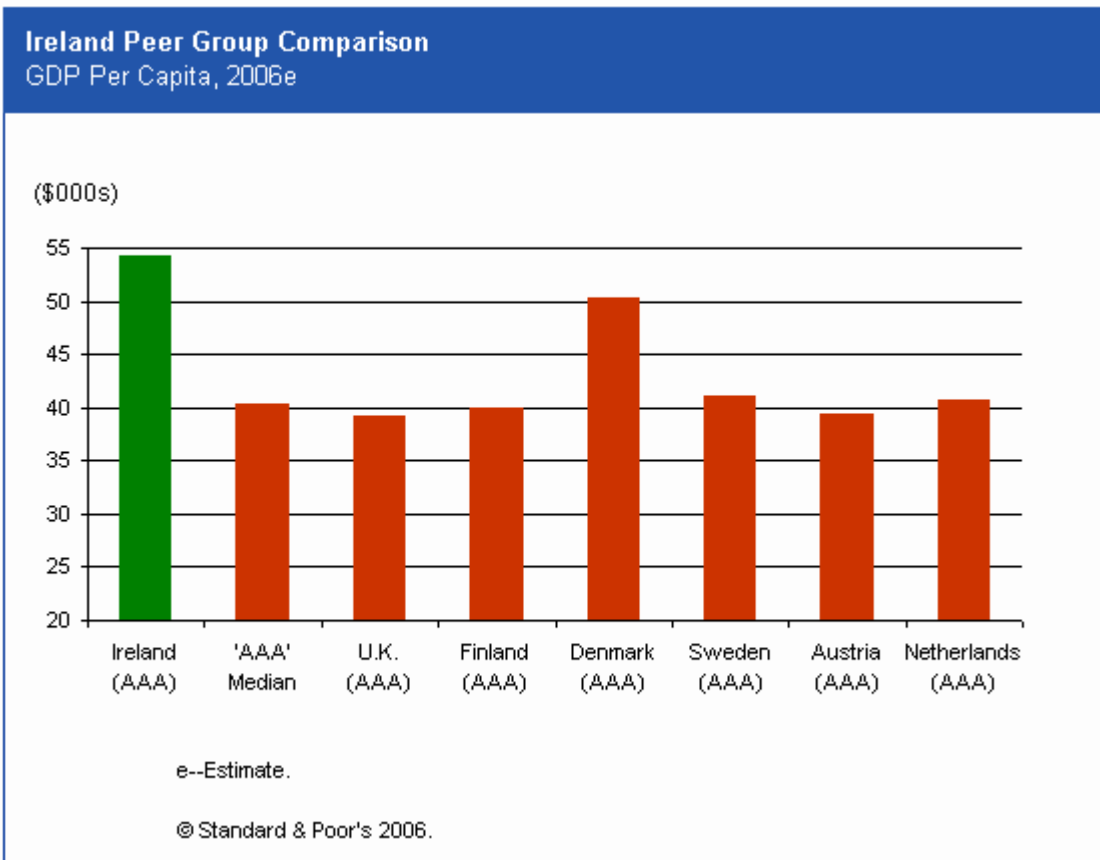


Chart 3

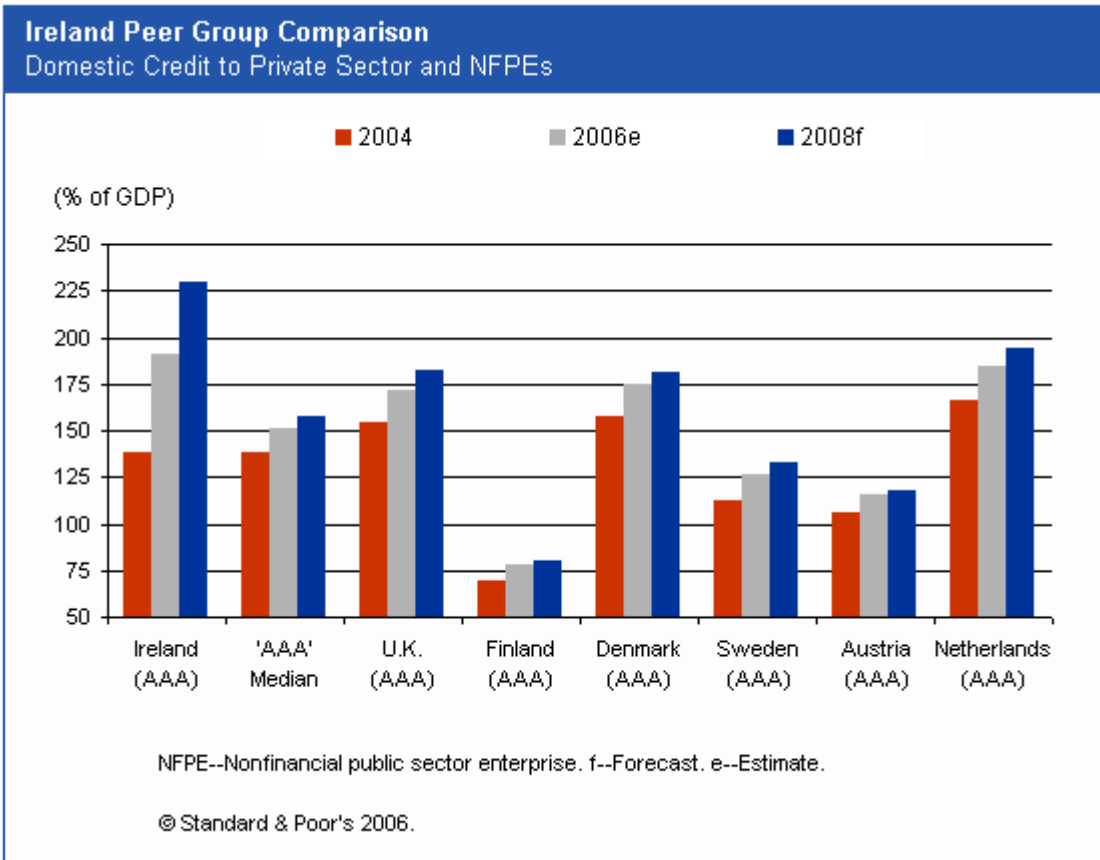
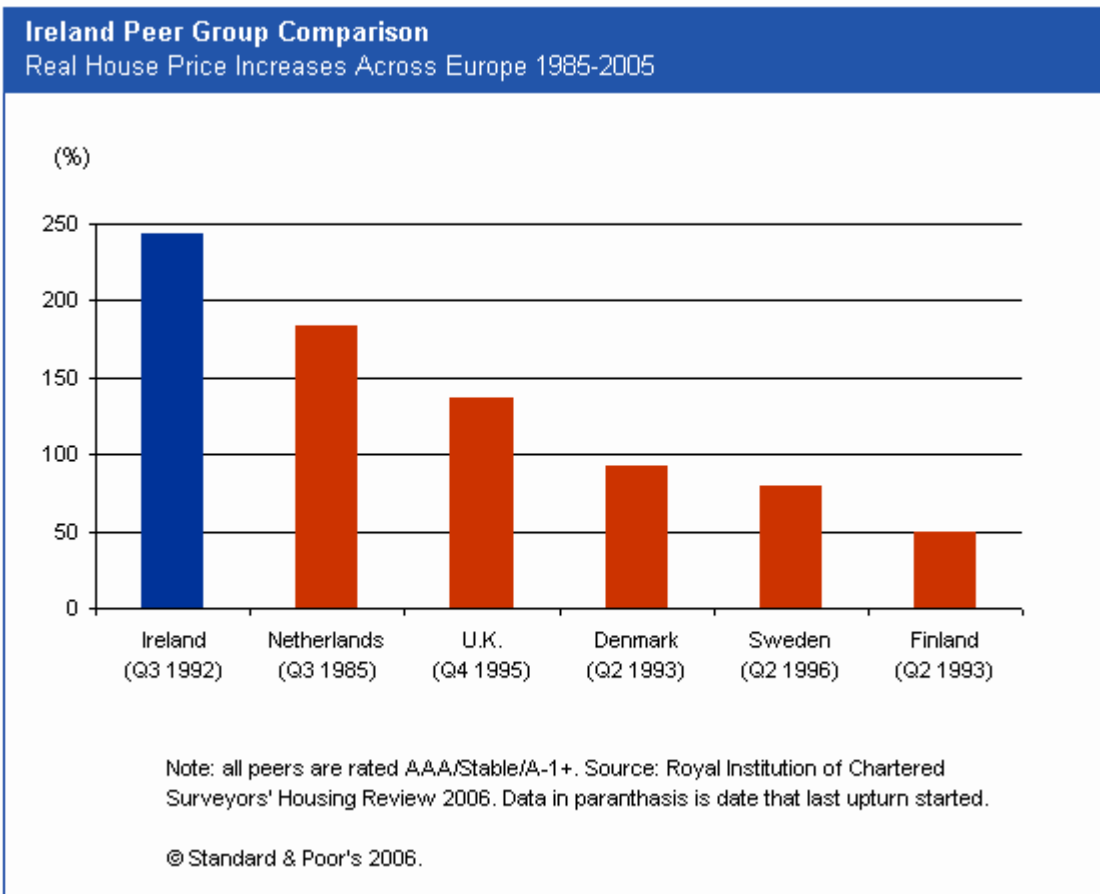


Chart 4



Ireland is still an attractive destination for FDI but mounting cost pressures may erode international competitiveness

FDI inflows are large in Ireland, relative to the size of its economy, which reflects a political environment that has actively encouraged outside involvement by minimizing barriers to foreign investment. According to the OECD, Ireland is the second least restrictive country after the U.K. in terms of controls on foreign ownership. Outward investment has also been increasing in recent years, however, rising to 23% of GDP, in line with the levels in the Kingdom of Spain (25%; AAA/Stable/A-1+) and the Federal Republic of

Germany (26%; AAA/Stable/A-1+), but well below those of Finland (42%), the U.K. (63%), and The Netherlands (75%).

Compensation per employee in Ireland's business sector is relatively high, however, and is expected to grow by 4.2% per year in real terms over 2000-2006, compared with 2.1% on average for the Eurozone. Containing wage growth will be key for reducing price pressures and safeguarding Ireland's competitive position. Nevertheless, Ireland's productivity growth continues to exceed the European average, and has done so since 1997. Irish labor productivity per person employed was 25% above that of the Eurozone and 33% above the EU-25 in 2005. Despite this, costs remain out of line relative to Ireland's trading partners, and recovering cost competitiveness is a high government priority. Real unit labor cost growth has averaged more than 1.0% since 2003, compared with a decline of 0.7% in the Eurozone.

A general government budget comfortably at surplus

Ireland's general government surplus, at about 2.3% of GDP in 2006 and 1.0% of GDP in the medium term on average, is in line with surpluses in Finland, Denmark, and Sweden, but in contrast to Austria, The Netherlands, the U.K. (see chart 5). Estimated at about 25% of GDP in 2005, Ireland has the lowest debt-to-GDP ratio in its peer group, and the second-lowest in the Eurozone, behind the Grand Duchy of Luxembourg (7.5% of GDP; AAA/Stable/A-1+; see chart 6). With a high level of both revenue-raising potential and the capacity to control expenditures in times of fiscal stress, Ireland ranks one of the highest in terms of fiscal flexibility, particularly regarding expenditure (see chart 7, and commentary "The 2006 Fiscal Flexibility Index: Gauging European Sovereigns' Room For Maneuver," published on June 27, 2006).

Chart 5

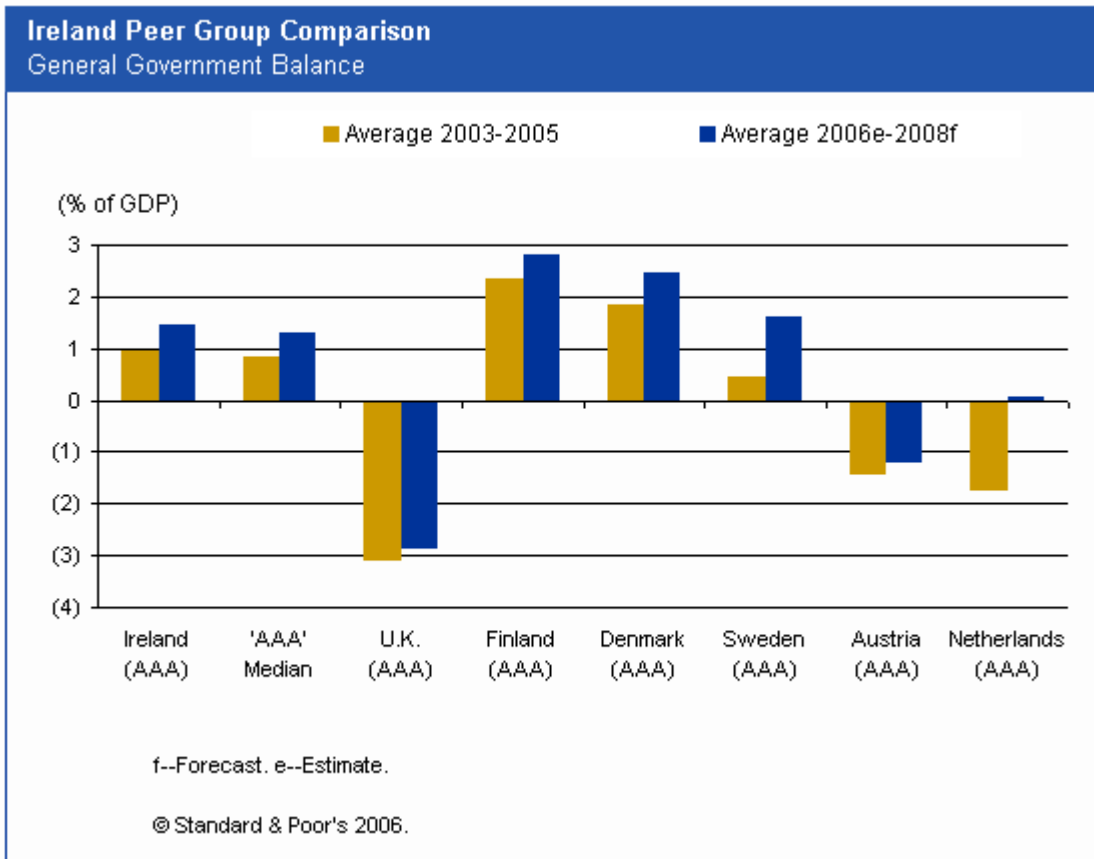


Chart 6

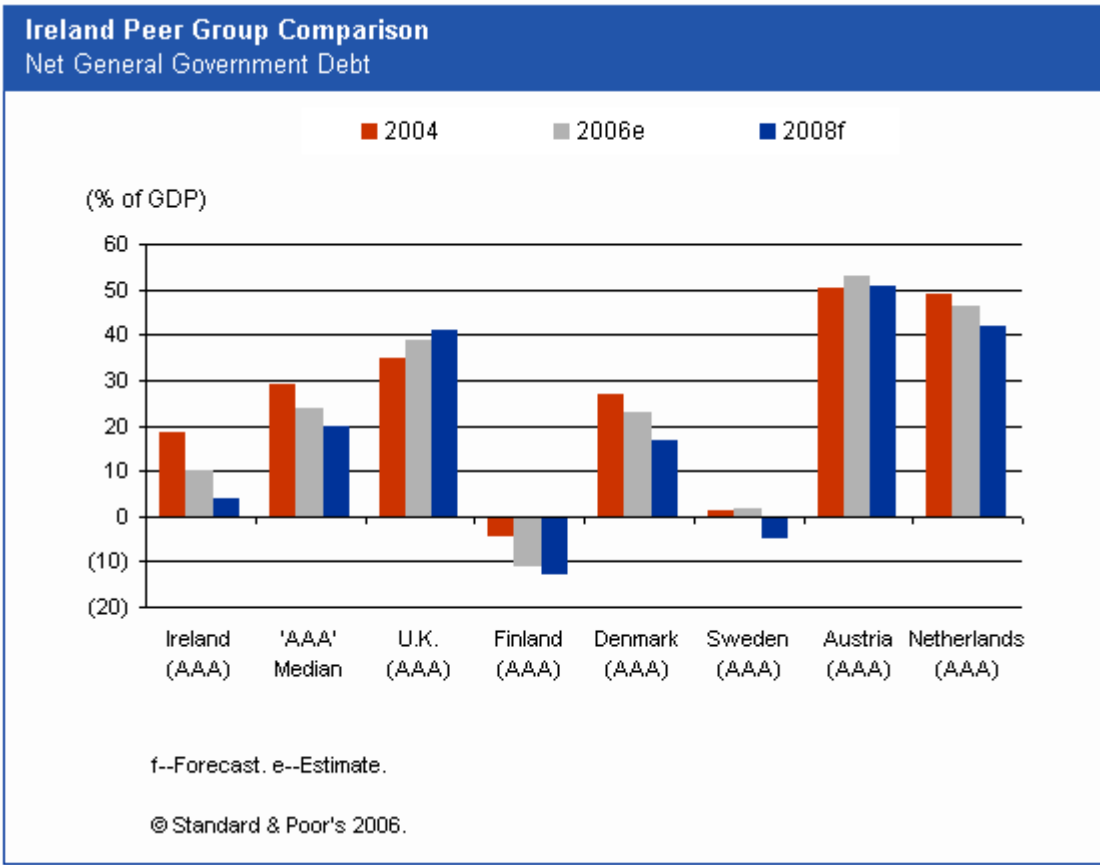
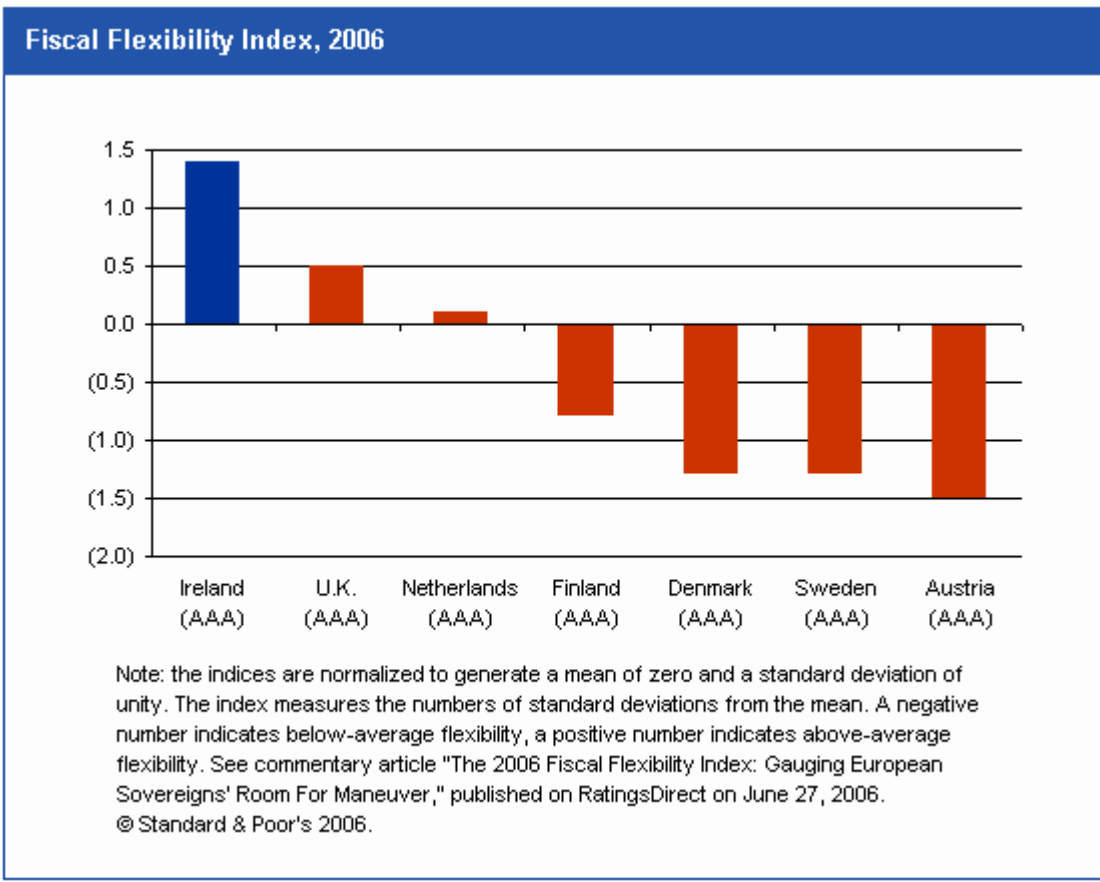


Chart 7



Ageing challenge less pronounced than for peers

As a result of the young age profile of the population, the fiscal implications of ageing will come into play much later in Ireland than in many of its European peers. Standard & Poor's expects age-related public spending as a percentage of GDP to remain stable at 11.2%, before rising to about 16.0% by 2030. The old-age dependency ratio (the proportion of persons of pensionable age relative to those of working age) is set to increase steadily to 45.0% by 2050 from about 16.0%. This will increase the strain on the capacity of future governments to continue to fund social welfare and public service pension liabilities on a pay-as-you-go basis.

Nevertheless, the situation is more pressing in other countries, particularly Finland, where age-related spending is expected to increase to about 25% of GDP by 2030, from an already high 19% in 2005 (see commentary "Global Graying: Aging Societies And Sovereign Ratings," published on June 27, 2006).

To address the strain of funding social welfare and public service pension liabilities on a pay-as-you-go basis, in 1999 the Irish government decided to accumulate pension assets in the NPRF, to partially prefund future pension liabilities

Political Environment: 2007 Elections No Risk To Consensus

- The political environment benefits from strong cross-party consensus on public finances.
- Elections in 2007 are unlikely to change the medium-term policy outlook.
- Infrastructure investment and increasing value for money from public sector spending are the main areas of public debate.
- Wage agreements emphasize a need to tackle labor productivity.

Irish political parties do not fall into the usual left/right categories found in most other European countries. General consensus is maintained across the political spectrum in support of the goal of sustainable public finances, meaning that a change of government is unlikely to signal any significant loosening of fiscal policy or weaker adherence to the Stability and Growth Pact targets.

The Fianna Fail and Progressive Democrat coalition government is expected to see out its term of office until elections scheduled for May 2007. It is likely that a similar consensus-based coalition will emerge after elections and that the government will continue to keep the fiscal balance in surplus, well above the limits of the Maastricht 3.0% deficit target.

Macroeconomic stability remains at the heart of the policy agenda. This is particularly important as the economy will experience lower growth from 2008 (see section headed "Economic Prospects" below) as the housing market slows down, reducing the government's revenue-raising potential. The government will need to increase revenue-raising capacity in order to reconcile its simultaneous objectives of fiscal prudence and public service improvements. Nevertheless, despite continued expenditure control, weaker tax receipts are likely to result in smaller fiscal surpluses in the next couple of years.

To address existing capital infrastructure needs, the government extended the National Development Plan (NDP) to 2007-2013, setting out its infrastructure development priorities for the period. The government's annual target for capital spending is about 5% of GNP for 2005-2009, much higher than the EU average. The economic reform agenda, however, must be seen in the context of the government's continued commitment to expenditure restraint--a necessary policy objective for preserving Ireland's competitive tax regime.

A new national wage agreement (under the "T-16" program) includes a pay increase of 10.7% over 27 months that is tied to the national inflation measure, which potentially may lead Ireland to experience higher wage growth than the EU average. From September 2006, and a minimum wage rise in January 2007. The pay agreement also contains benchmarking intended to bring pay in the public service (which covers about one-third of the labor force) more into line with rising wages in the private sector, alongside modernization of the public sector. Ireland's labor costs are much higher than EU levels, however. With at least a 20% rise in labor costs, compared with 10% in the EU, in recent years, and the challenge of eroding trade competitiveness and rising labor costs, the government is expected to address wage modernization and maintain low inflation in the medium term.

Economic Prospects: Domestic Demand A Key Driver For Sustained Growth, But Imbalances Are Widening

- Favorable demographic structure and strong employment growth are expected to support medium-term growth.
- Surging credit growth and overdependence on the construction sector raise the prospect of a severe slowdown in consumption if interest rates or unemployment increase more sharply.
- Strengthening export competitiveness is required to support long-term growth prospects in the context of rising external imbalances.

Table 2

Republic of Ireland Economic and Financial Indicators

	2009f	2008f	2007f	2006e	2005	2004	2003
Nominal GDP (bil. €)	211.5	195.2	181.8	169.6	158.6	145.4	136.9
Nominal GDP (bil. \$)	285.5	280.9	244.0	229.3	201.5	180.5	154.5
GDP per capita (\$000s)	63.8	64.0	56.6	54.2	48.6	44.2	38.6

Real GDP (% change)	4.1	4.6	5.3	5.4	5.5	4.3	6.2
Real GDP per capita (% change)	2.2	2.7	3.3	3.4	3.8	2.4	4.3
Real domestic demand (% change)	3.8	4.5	6.1	6.8	8.3	5.8	7.5
Real investment (% change)	3.3	3.3	3.3	9.0	20.2	13.4	10.0
Gross domestic investment (% of GDP)	28.6	29.1	29.5	28.9	27.7	25.5	24.2
Real exports (% change)	5.2	5.2	5.4	5.1	5.6	6.6	-0.29
Unemployment rate (average claimant count; %)	4.8	4.8	4.5	4.3	4.3	4.5	4.7
Consumer price index (% change)	2.2	2.2	2.7	2.9	2.2	2.3	4.0
Domestic credit to private sector and NFPEs (% change)	12.0	15.0	20.0	24.7	29.7	24.3	13.0
Domestic credit to private sector and NFPEs (% of GDP)	236.8	229.0	213.9	191.0	163.8	137.8	117.8

NFPE--Nonfinancial public enterprise. f--Forecast. e--Estimate.

Economic structure

The Irish economy has a large foreign-owned multinational sector, as a result of significant inward foreign investment during Ireland's boom. Owing to sizable income outflows, income and expenditure measures of economic activity tend to diverge, and GNP gives a better measure of the standard of living in Ireland than GDP, albeit less so in recent years. Strong economic growth (at more than 5.0% of GDP per year since 2000) has brought prosperity, with GDP per capita more than \$50,000 in 2006.

The Irish economy is small (estimated at GDP of \$212 billion in 2006), however, and extremely open. It is subject to global economic conditions, especially in the U.S., the rest of the EU, and the U.K. The share of services in overall output has steadily increased since 2000, at the expense of industry and agriculture, with the service sector reaching about 60% of gross value added (GVA) and expected to increase its share of GVA in the coming years. Nevertheless, the chemicals and engineering sectors continue to reduce their output, while foreign-owned companies still play a significant role in the Irish economy, exporting almost 95% of their output. Concerns remain about Ireland's competitive position, which has worsened in recent years due to increasing domestic costs and the appreciation of the euro exchange rate. Meanwhile, competition for FDI is also increasing from emerging economies outside Europe, and new EU members.

Economic growth

GDP growth continues to be robust at an estimated 5.4% in 2006, fuelled by strong private consumption supported by the release of Special Savings Incentive Scheme (SSIA) funds--a government scheme with a five-year maturity date (2001-2006). Strong consumer spending, particularly in the housing market, is supported by robust employment (at 4.4% growth in 2006), earnings growth, and low interest rates. The positive wealth effects of a strong housing market and investment fuelled by house-building have also supported growth. Consumer price index inflation (the national measure which includes mortgage payments) surged to more than 4% in 2006, however, emphasizing the boom in the construction and housing sectors.

GDP growth is expected to remain strong in 2007, forecast at 5%, and will slow to 4% in the medium term as the SSIA funds phase out and the housing market slows. Meanwhile, investment growth is expected to moderate as the recent surge in housing construction abates. Lower labor supply expansion is also expected to reduce the economy's growth potential in the longer term. Net migration flows from new EU entrants are expected to remain supportive of growth over the medium term, however.

Sluggish performance in net merchandise exports added to the rising imbalances of the external sector in recent years, which, coupled with rising imports, produced a current account deficit of 3.4% of GDP in 2006. This implies a loss of competitiveness, which, if not counterbalanced by strong labor productivity and reducing inflationary pressures, may lead to a severe slowdown in the economy. External risks to the outlook remain, if a return to euro appreciation and high oil prices affect external demand. Furthermore, household indebtedness has doubled since 2000, and continued to rise to account for about 130% of disposable income in 2005. At the same time, Ireland has one of the lowest deposit-to-GDP ratios in the Eurozone. The largest component of this is mortgage lending, at least 60% of the total in 2005, and which continues to grow by about 10% on average, which is higher than household income. This leaves the economy susceptible to a sharp rise in interest rates, with adverse consequences for employment and growth.

Fiscal Flexibility: Healthy Public Finances

- General government budget estimated at a surplus at 2.3% of GDP in 2006 and about 1.0% of GDP in the medium term.
- Debt levels remain the lowest among peers.
- Strong domestic credit growth in construction sector adds to off-budget and contingent liabilities.

Table 3

Republic of Ireland Fiscal Indicators

(% of GDP)	2009f	2008f	2007f	2006e	2005	2004	2003
General government debt	20.2	21.5	23.0	25.1	27.4	30.0	31.5
Of which central government debt	13.8	15.5	17.4	19.8	23.3	26.0	27.5
General government net debt	2.9	3.9	6.7	10.0	13.5	18.2	20.7
Of which central government net debt	(3.5)	(2.0)	1.1	4.7	9.4	14.3	16.6
General government revenues	35.6	36.0	36.6	36.9	35.8	36.0	34.4
Of which central government	28.1	28.4	29.1	29.3	27.7	28.5	27.1
General government expenditures	35.0	35.1	35.4	34.6	34.7	34.6	34.1
Of which central government	27.6	27.7	28.1	27.3	27.1	27.5	27.2
General government balance	0.6	0.9	1.2	2.3	1.1	1.4	0.3
Of which central government	0.5	0.7	1.0	2.0	0.6	1.0	(0.1)
Of which local authorities	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	0.2	0.2
General government primary balance	1.3	1.7	2.1	3.3	2.1	2.6	1.6
Central government primary balance	1.2	1.4	1.8	2.9	1.6	2.2	1.1
General government balance (% of revenues)	1.7	2.5	3.3	6.2	3.1	3.8	0.9
General government interest payments (% of revenues)	2.0	2.2	2.5	2.7	2.9	3.4	3.6
Central government interest payments (% of revenues)	2.5	2.5	2.7	3.1	3.6	4.2	4.5

f--Forecast. e--Estimate.

Revenue, expenditure, and balance performance

The general government budget is estimated at a surplus of 2.3% of GDP in 2006, compared with the official forecast of a deficit of 0.6% in last year's budget. This is due to a strong windfall of capital gains and stamp duty as the housing boom further expanded, while expenditure was lower than expected.

The 2007 budget is forecast at a surplus of 1.2% of GDP. A series of tax relief measures (including on mortgage payments) will be discontinued and tax measures with regard to higher income earners will be tightened further. Meanwhile, an increasing number of low-income earners were excluded from the tax net. Overall, government spending is expected to increase by about 11.0% in 2007 (as a part of government pre-electoral spending)--with the main increases in health, welfare benefits, education, and R&D spending, in addition to higher capital spending on infrastructure projects.

In the medium term, the general government budget is expected to post surpluses of 0.9% of GDP in 2008 and 0.6% of GDP in 2009, owing to the slowdown in the economy and larger infrastructure investment, more than double the EU average, about 5% of GNP.

Government debt and interest burden

Ireland's general government debt burden is estimated at 25.0% of GDP in 2006, compared with about 40.0% in 2000 (see chart 5). In the same period, general government interest payments are estimated at about 1.2% of GDP in 2006. Under the Pensions Reserve Act of 2000, the government has committed to set aside 1.0% of GNP each year toward the NPRF to help fund future pension obligations. The NPRF (from which no expenditure is scheduled before 2025) does not affect the general government balance, but does restrict the reduction of general government debt, as the monies transferred to the NPRF would otherwise be used to pay off debt. Assets held by the NPRF, were moved into equity and nongovernment bonds in 2002. Total NPRF assets are estimated at 12.5% of GNP in 2006, compared with 11.4% in 2005. In 2006, the general government's net debt position is estimated to be about 10.0% of GDP.

Off-budget and contingent liabilities

The main areas of government ownership in Ireland are energy, transport, communications, and health care, although public-private partnerships are likely to be a more commonly used tool for public service delivery in the short term. The government no longer issues guarantees to its public enterprises, and total government-guaranteed debt was at a very low 2.3% of GDP in 2006, most of which was accounted for by the Housing Finance Agency PLC (AAA/Stable/A-1+).

Rapid house price inflation and low interest rates have contributed to a strong rise in credit growth in the household sector, especially in mortgage lending. This increase in private sector indebtedness has so far not led to any deterioration in banking sector asset quality, and general provisions remain high. Although a rise in interest rates could pose risks to the system, any rise is unlikely to be large enough to present an immediate threat. The estimated contingent liability faced by the sovereign from financial system stress in a worst-case scenario is estimated at 5%-150% of domestic credit to the private sector and nonfinancial public enterprises, or 14%-29% of GDP.

Ratings Detail (As Of 22-Dec-2006)*

Ireland (Republic of)

Sovereign Credit Rating	AAA/Stable/A-1+
Commercial Paper	A-1+
Senior Unsecured	AAA

Sovereign Credit Ratings History

03-Oct-2001	AAA/Stable/A-1+
03-Oct-2000	AA+/Positive/A-1+
06-May-1998	AA+/Stable/A-1+

Default History

None

Population	4.2 million
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Per Capita GDP	\$54,220
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Current Government

Prime Minister Bertie Ahern heads a Fianna Fail/Progressive Democrat coalition government. President Mary McAleese is head of state.

Election Schedule

Parliamentary

Last held.....May 2002

Next due.....May 2007

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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