

## Fitch Affirms Ireland at 'AAA'; Outlook Stable

15 Jan 2008 4:14 AM (EST)

Fitch Ratings-London-15 January 2008: Fitch Ratings has today affirmed the Republic of Ireland's Long-and Short-term foreign currency Issuer Default ratings (IDRs) at 'AAA' and 'F1+', respectively. At the same time, the agency has affirmed the Long-term local currency IDR and Country Ceiling at 'AAA'. The Outlooks on the IDRs are Stable.

"Ireland faces weaker economic growth in 2008 than it has experienced at any point since the early 1990s, caused partly by weak international demand but exacerbated by a sharp decrease in residential investment and falling house prices," says Chris Pryce, Director in Fitch's Sovereigns Group. "However, we do not expect turbulence in the housing market and low growth for a year or two to undermine Ireland's 'AAA' rating. Ireland remains one of the richest countries in Europe and has amply demonstrated its economic flexibility while the government has shown its consistent determination to maintain sound public finances. Government debt, at 25% of GDP, is still almost the lowest in Europe."

Ireland continues to benefit from the results of its rapid growth in the past 15 years even if it now faces some hiatus. Of all 16 'AAA'-rated sovereigns, Ireland is fourth in terms of GDP per head although it ranks somewhat lower (eighth in its peer group) when allowance is made for (net) profits and dividends paid abroad (GNI per capita). This factor also weighs against the Irish current account. Most of the other factors that were powerful inducements to growth during the 1990s continue to play a role, although less intensively in some cases. The government fostered an environment attractive to foreign as well as domestic business, through low corporate taxation - a particularly strong incentive for investments in high technology, both manufacturing and services. Foreign direct investment (FDI) has been a key factor behind persistently strong productivity growth, which continues albeit at a lesser rate, and a massive increase in merchandise exports. FDI remains an important source of economic flexibility and has contributed to the diversity in Ireland's production and export base which includes pharmaceuticals, technology and financial and business services. The government also contributed to productivity by sponsoring the emphasis on education, particularly scientific and technological. This, combined with demographics - Ireland still has the youngest population in the EU - has supported the supply side including through increasing female labour force participation rates.

However Ireland's growth in the last couple of years has seen elements of excess investment which now look set for a potentially sharp correction. In particular the growth of residential investment has been exceptional by international standards. Housing completions rose to almost 90,000 in 2006 from about 25,000 a year in the 1970s and 1980s. At this level

almost 90,000 in 2006 from about 25,000 a year in the 1970s and 1980s. At this level residential investment accounted for over 14% of GDP, by far the highest in Europe. The focus, since last year, however, has been on the decline in housing output, the first since 1993, with output in 2007 thought to be about 75,000 completions, falling perhaps to 55,000 or so in 2008. This is no surprise as it has been clear for some time that the level of new house building had become unsustainable when set against the growth in population and new household formation. Rising interest rates and other uncertainties have also brought house price declines in every month since the early spring of 2007. Nevertheless dwellings per household remain low in Ireland despite the surge in building, and the proportion of 'empty properties' is below average for the EU. With real interest rates likely to remain low there is therefore reason to expect that a new equilibrium will emerge in the housing market as rising wages meet falling house prices and 'income - house price' ratios return to more sustainable levels.

Strong public finances, a sound banking sector and economic flexibility and diversity underpin sovereign credit strengths in the face of near term macroeconomic risks. Government debt has fallen by 39% of GDP in the last 10 years and is the 2nd lowest in the AAA category. The government balance has been in surplus for all but one of the past 11 years giving the authorities room to allow automatic stabilisers to operate and to employ discretionary fiscal stimulus to support growth as is indeed planned in the area of public infrastructure projects. Ireland's banks are well capitalised, enjoy minimal non-performing loan rates, and are efficient and profitable. Fitch expects them to be able to cope with a property market downturn.

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