EUROPEAN
COMMISSION

Brussels, 2.6.2021
SWD(2021) 402 final

COMMISSION STAFF WORKING DOCUMENT

In-Depth Review for Ireland

in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

Accompanying the

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK

Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy

{COM(2021) 500 final} - {SWD(2021) 401 final} - {SWD(2021) 403 final} - {SWD(2021) 404 final} - {SWD(2021) 405 final} - {SWD(2021) 406 final} - {SWD(2021) 407 final} - {SWD(2021) 408 final} - {SWD(2021) 409 final} - {SWD(2021) 410 final} - {SWD(2021) 411 final} - {SWD(2021) 412 final}

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EXECUTIVE SUMMARY

The 2021 Alert Mechanism Report concluded that an in-depth review should be undertaken for Ireland to examine further the persistence of imbalances or their unwinding. In February 2020, under the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified "macroeconomic imbalances" in Ireland. These imbalances related to high private and public debt and net external liabilities. The analysis shows that these vulnerabilities remain. It should be noted that the context of the assessment of vulnerabilities in this year's new in-depth review (IDR) for Ireland is markedly different from last year. Also, the evolution of the COVID-19 pandemic, the strength of the recovery, and possible structural implications of the crisis are all still surrounded by high uncertainty, requiring caution in the assessment. In general, policy action over the past year focused on cushioning the impact of the COVID-19 shock and facilitating the recovery. This has added to indebtedness but should support adjustment in the medium-term. Looking forward, the Recovery and Resilience Plan provides an opportunity to address imbalances, investment and reforms needs.

Main observations and findings of this IDR analysis are:

- **This IDR is informed by the 2021 spring forecast, which expects an acceleration in economic activity in Ireland with the easing of the COVID-19 crisis.** Despite the pandemic, Ireland's real GDP increased by 3.4% in 2020, as multinational corporations, concentrated in pharmaceuticals and medical equipment as well as information and telecommunication technologies, performed very well. At the same time, the domestic economy of Ireland contracted. Real GDP is projected to increase by 4.6% this year and 5% next year.

- **Vulnerabilities related to the still relatively high stock of private debt remain, though the COVID-19 shock has so far had a limited impact on borrowers' balance sheets.** Non-financial corporate debt is inflated by the presence of multinational companies, most of which have very few linkages to the domestic economy. Excluding this effect, the debt of domestically controlled firms stood at 81% of modified gross national income in 2019, above fundamentals-based and close to prudential benchmarks, but credit flows were negative in 2020 and GDP growth positive. Household debt stood at 62% of modified gross national income in 2019, and while close to the fundamentals-based benchmark and below prudential, it still amounted to 113% of household gross disposable income (GDI), remaining amongst the highest in the EU according to this metric. Household overall net credit flows (transactions) in percent of GDP were close to zero in 2020 and the gross disposable income of households increased, allowing for a sharp increase in the household savings rate.

- **The downward trend in government debt has been interrupted.** The tax base is relatively narrow, with government revenues strongly dependent on corporate tax receipts. Possible reforms towards fairer rules in international taxation pose downside risks to these tax revenues. The public debt-to-GDP ratio increased to 59.5% in 2020, up from 57.4% in 2019 as the government responded to the unprecedented crisis. As a proportion of modified gross national income (GNI*), debt is higher at 105.6% in 2020. Financial market perceptions of sovereign risk, however, remained favourable, as reflected in low sovereign bond yields and credit default swap spreads. Public debt relative to GDP is forecast to increase to 61.4% in 2021 and decrease to 59.7% 2022. The general government balance is forecast to remain negative, at -5% of GDP in 2021 and -2.9% in 2022.

- **The net international investment position is still highly negative, though improving.** It stood at -168% of GDP in 2020. The large presence of multinational enterprises with very limited links to the domestic economy and the mutual fund sector bloat the stock of net external liabilities, while they bear little connection to the underlying domestic economy. Adjusted figures (of around 57 to 82% of GNI*) suggest that Ireland's net external debt remains elevated. The current account balance is estimated at 4.6% in 2020, and forecast to remain in surplus in 2021 and 2022.

- **The banking sector has continuously reduced NPLs in the past years, but these may increase as support measures are withdrawn**. In 2020, the NPL ratio remained essentially unchanged from 2019, at 3.5%, down from 21.6% in 2014. The remaining NPL stock consists mainly of long-term

mortgage arrears, which are a challenge for some households. However, there is a risk that NPLs may increase once specific policies to protect corporates from the impact of the COVID-19 crisis are phased out.

1. ASSESSMENT OF MACROECONOMIC IMBALANCES

Introduction

In February 2020, over the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, the Commission identified "macroeconomic imbalances" in Ireland. These imbalances related to large stocks of public and private debt and net external liabilities, and potential vulnerabilities associated to high levels of non-performing loans (NPLs) and rapidly rising house prices. The 2021 Alert Mechanism Report published in November 2020 concluded that a new in-depth review (IDR) should be undertaken for Ireland with a view to assess the persistence or unwinding of imbalances.

The context of the assessment of vulnerabilities this year is markedly different from last year's IDRs, which took place before the COVID-19 pandemic. The evolution of the pandemic, the strength of the recovery, and possible structural implications of the crisis are still surrounded by high uncertainty requiring caution in the assessment. Policy action over the past year focused on cushioning the impact of the COVID-19 shock and on facilitating the recovery. While this supports adjustment in the medium-term through stronger fundamentals, it also has added to indebtedness. Follow-up to country-specific recommendations from 2019 and 2020, including those that are MIP-relevant, is taking place in the context of the assessment of the Recovery and Resilience Plans (RRPs). The analysis of policies in the present report was finalised before the formal submission of RRPs and does not draw on information included in RRPs. It is therefore without prejudice to the Commission's assessment of RRPs, which is ongoing at the time of publication of this report.

The key features of the IDR remain unchanged. The assessment follows a similar structure as the IDRs that were included in Country Reports in recent annual cycles. This chapter presents the main findings for the assessment of imbalances, also summarised in the MIP assessment matrix. The assessment is backed by selected thematic chapters that look more at length at non-financial corporate debt and household debt. Spillovers and systemic cross-border implications of imbalances are also taken into account. In addition, also assessments of structural issues made in previous IDRs and in the context of fiscal assessments are considered if relevant.

Macroeconomic context

Real GDP grew in 2020, due to multinational firms' performance, but developments in domestic sectors have been more in line with those in other EU countries, with a recovery starting in 2021. Ireland's real GDP grew by 3.4% in 2020, due to the strong performance of multinational corporations headquartered there. In contrast, domestic sectors contracted, more in line with developments in the other EU countries: modified gross national income GNI* decreased by 4.2% ([1]). Although the year 2021 started with a new strict lockdown and slowing economic activity, overall Ireland's economy is projected to grow by 4.6% in 2021 and by 5.0% in 2022. Potential growth is forecast to recover from the sharp drop in 2020 and reach 2.3% in 2022. The output gap is set to improve from -0.5% in 2021 to 0.1% in 2022. The current account balance was positive in 2020 and is forecast to remain in a surplus of 4.5% of GDP in 2021 and of 4.2% in 2022. The gross saving rate of households, which increased to unprecedented heights as a result of the COVID-19 crisis, is forecast to gradually decline, to 13% in 2022. The unemployment rate is forecast to remain high, at 10.7% in 2021, but to decline to 8.1% in 2022, compared to 5.0% in 2019. HICP inflation is projected to gradually increase to 1.3% in 2022, alongside economic recovery.

The economic recovery is expected to be mainly driven by a rebound in domestic demand and be supported by net exports. Consumption is set to benefit from the reopening and the accumulated savings. The vaccination process in Ireland has advanced. Nevertheless, the restrictions have been very stringent and are being lifted only gradually. Investment suffered in the first quarter of 2021 when all construction works except essential ones were banned but is set to rebound once the restrictions are lifted

([1]) GNI* captures more accurately the underlying economic activity by eliminating some of the impact of multinationals.

and uncertainty dissipates. Exports are expected to continue to be a strong driver of GDP growth, led by multinational corporations, particularly those producing medical devices and pharmaceuticals or providing information and communication services, and an improving external environment will benefit Ireland. Policy measures to protect jobs and provide liquidity for firms were extended until mid-2021. Downside risks to growth in the short term are a possible surge in corporate insolvencies once the policy support measures are wound down as well as labour market scarring effects and potential changes of the international taxation regime in the medium term.

Imbalances and their gravity

Private debt relative to GDP in Ireland is still high but continuously declining. It is expected to have decreased to 184.4% of GDP in 2020 amid positive GDP growth and continuous deleveraging from households and corporates. In 2019, private debt amounted to 202.4% of GDP. It has fallen substantially from its 2015 peak (305.1% of GDP) as a result of strong GDP growth and deleveraging by both households and businesses. In 2019, it still stood well above the EU average (133.1%) and the MIP threshold (133%) but high corporate debt levels need to be viewed in light of the heavy presence of multinational companies (see section 2). Households have actively been deleveraging since 2009. Household debt in proportion to GDP (37.2%) was below the EU average (50.4%) in 2019, but it more substantial when compared to modified gross national income ([2]) (61.9%, see section 3).

Ireland's general government balance deteriorated in 2020 amid emergency borrowing, thereby contributing to an increase in the general government debt ratio. The stock of debt increased by around EUR 13.9 billion. Gross general government debt increased to 59.5% of GDP in 2020 from 57.4% in 2019. Even though this is below the MIP threshold (60%), a range of alternative metrics show that Ireland's stock of public debt remains high by international and historical standards: as a proportion of GNI* , debt stood at 95.6% in 2019 and increased to 105.6% in 2020 (Department of Finance). Nevertheless, according to the latest debt sustainability analysis, Ireland faces *low* risk in the medium-term and *medium* risk in the long-term ([3]). Financial market perceptions of sovereign risk are favourable, as reflected in low sovereign bond yields and credit default swap spreads. The interest to revenue ratio was estimated at 4.3% in 2020, compared to 5% at in 2019, continuing a decreasing trend from a 25-year peak of 12.6% in 2013.

Despite its high level, the burden of public debt is mitigated by several factors. Government financing benefits from favourable conditions, as Irish sovereign credit ratings are robust and their outlook is stable. Borrowing and debt servicing costs are low also due to monetary policy actions, such as the Pandemic Emergency Purchase Programme. The 10-year bond yield for Ireland was low at around -0.3% in December 2020. The vast majority of sovereign debt is at long maturities and fixed rates, which limits the risk from interest rate shocks. The effective interest rate has enjoyed a downward trend for about a decade, in line with the performance of the EU average. The maturity profile of the debt remains comfortable, as there are no redemptions until March 2022.

The non-performing loan (NPL) ratio continued its steady decrease before the pandemic. The NPL ratio continued to fall to 3.4% in 2019 – approaching the 2019 euro area average of 2.7%. The share of NPLs was much higher for households (at 7.2%, see also section 3) than for corporates (at 3.2%, see also section 2). Irish banks had made substantial progress in decreasing the share of NPLs through successful restructuring and the sales and securitisations of NPL portfolios. Arrears, while declining, remained significant.

The net international investment position improves but remains negative, even when taking out the distorting impact of multinational companies operating in Ireland. Ireland's net international investment position (NIIP) of -168% of GDP at the end of 2020 was heavily influenced by the activities

([2]) Modified Gross National Income (GNI*) reflects more accurately the income standards of Irish residents than GDP. It differs from actual GNI in that it excludes, inter alia, the depreciation of foreign-owned, but Irish-resident, capital assets (notably intellectual property and assets associated with aircraft for leasing) and the undistributed profits of firms that have re-domiciled to Ireland. It is therefore a better reference for household debt affordability.

([3]) See Article 126(3) report (June 2021) and PPS report (June 2021). The Debt Sustainability Monitor 2020 contains detailed methodological explanations.

of multinational companies and the large net position of a financial offshore centre with limited links to the domestic economy. Although the net external positions of some domestic institutional sectors such as commercial banks and the central bank have improved over the last two years, the NIIP remains negative even when adjusting for the impact of multinational companies (see also section 2). Commission estimates of Ireland's domestic net international investment for 2019, net of multinational firms and Offshore Centre activity, suggest a much lower external liability position of between -34% and -49% of GDP (i.e. -57% and -82% of GNI*), although still likely exceeding MIP thresholds of 35% of GDP and country-specific benchmarks.

The current account balance is positive but often highly volatile due to the heavy influence of multinational corporations, while the underlying "domestic" current account is healthy and positive. The current account swung to a surplus of 4.6% in 2020 from a large negative position in 2019 (-11.3% of GDP), in both years largely affected by the multinational corporation activities. Meanwhile the modified current account balance ([4]), which better reflects domestic economic activity, has increased to 4.6% in 2019. It suggests that the Irish economy appears to have maintained its external competitiveness.

While house price growth slowed down in 2020, housing affordability remains a concern. From 10.2% in 2018, annual house price inflation has moderated substantially to 2.3% in 2019 and to 0.3% in 2020, a level well below the 6% prudential threshold of the MIP scoreboard. Increasing housing supply, coupled with more binding macro-prudential rules, seem to have contributed to this sharp slowdown. Although average national housing prices are not judged to be overvalued, affordability is still a concern: the number of years of gross disposable income required by an average household to buy a 100 square meters dwelling amounted to 14.5 in 2020, the third highest in the EU.

Evolution, prospects and policy responses

In 2020, the health crisis hit the Irish economy, in particular the labour market, but the government intervention reduced the risk of debt defaults. The Irish government provided income support to households that lost jobs due to the COVID-19 pandemic and offered payment breaks to affected borrowers. The crisis seems to have affected mostly people in lower income echelons, who hold less mortgage debt, while income of many mortgage holders remained unaffected (see also section 3). By November 2020, most payment breaks have expired and a majority of debtors have since returned to normal payments. In 2020, the real estate market froze for some time as mobility and other restrictions reduced transactions but with the reopening of the economy and adjustments to the "new normal" the market revived later on. In the last months of 2020, house prices started climbing again as a result of constrained supply due to construction works being temporarily banned as a part of COVID-19 restrictions, while demand remained stable or even increasing. Consumer loans fell as pandemic restrictions constrained consumption and households increased forced and precautionary savings.

Irish companies reduced their debt in 2020, postponing investment decisions amid very high uncertainty. Many businesses have received public support. The prospects of domestic small corporations remain uncertain. In contrast, multinational corporations headquartered in Ireland, concentrated in the pharmaceutical and information and telecommunication sectors, scored well in the crisis with no negative impact expected on their debt (see also section 2).

Policy efforts in 2020 focused mostly on short-term measures to address the impact of the COVID-19 pandemic, contributing to an increase in government expenditure and contingent liabilities. The measures included the strengthening of the resources of the health system, a set of measures to preserve employment (temporary work schemes, exemption of social security contributions etc.) and support to companies (direct liquidity support, guarantees, tax deferrals, moratoria etc.). The delay in raising the statutory pension age and a permanent increase of the number of public employees in the health sector add to long term fiscal sustainability risks. In the Stability Programme Update, the Government set out a medium-term pathway for the debt-income ratio to be on a declining trajectory towards 2025.

([4]) The modified current balance (CA*), developed by the Irish Central Statistics Office (CSO), is adjusted for the main following globalisation-related distortions: intellectual property imports, imports of aircraft related to leasing, the depreciation of capital assets owned by Irish resident foreign-owned firms and the repatriated global income of companies that moved their headquarters to Ireland.

Government revenues are strongly dependent on corporate tax receipts. This constitutes a vulnerability in the context of the ongoing review of the international corporate tax system which might have a negative impact on revenues as of 2022. A relatively narrow tax base weakens the resilience of public finances. The general government deficit is projected at 5.0% of GDP in 2021 and 2.9% in 2022, and the gross government debt-to-GDP ratio is projected at 61.4% in 2021 and 59.7% in 2022.

Although the non-performing loan (NPL) ratio increased only modestly in 2020, short-term trends in NPLs need to be closely monitored. The capital and liquidity positions of the banks remain strong. However, the steady trend of NPL reduction was halted by the COVID-19 pandemic, with the NPL ratio increasing slightly from 3.1% in the first quarter of 2020 to 3.5% in the second and third quarters of 2020. This increase was driven by the NPL ratio for corporates, which grew from 3.1% in the first quarter of 2020 to 5.3% in the third quarter of 2020. ([5]) The increase in NPL ratios would have been much more pronounced without the wide-ranging government support measures in response to the COVID-19 pandemic. Corporate insolvencies declined in 2020, but are likely to increase as support measures are withdrawn (see section 2).

The continuous decline in household debt masks some legacy issues, such as high mortgage arrears. Long-term mortgage arrears remain an issue for many households, despite the existence of a number of schemes that help resolve those arrears (see section 3). These deep arrears are particularly persistent and use of some of those schemes has been low. On the other hand, the mortgage measures put in place by the Central Bank of Ireland are helping limit the share of risky mortgages and safeguard the resilience of both households and banks. The completion of the central credit register in mid-2019 will ensure safer lending and a better monitoring of financial stability risks.

Ireland's overall highly negative NIIP has improved marginally due to an improvement in its domestic component. Its domestic component is projected to decrease further on the back of continued current account surpluses (see also section 2). The evolution of corporate external liabilities (in particular of multinational corporations and the International Financial Services Centre), which comprise the largest share, is hard to predict. That said, the links of these corporations to the domestic economy are limited, which in turn reduces domestic exposure. The general government's substantial NIIP share has diminished over time but it might increase due to borrowing related to the COVID-19 pandemic. The risks associated with general government's external liabilities are somewhat smaller as part of them are loans disbursed by official creditors during the economic adjustment programme, which have long maturity and low interest rates, thus posing little risk in the short and medium term. The net external position of the central bank is positive and has gradually improved over recent years. Large increase in precautionary households savings will have a positive influence on the domestic component in the short run**.** The current account is expected to amount to 4.5% of GDP in 2021 and 4.2% in 2022. Stripping out the activities of the multinationals, the modified current account is expected to remain stable and increasingly positive, following the trend of previous years.

While policies implemented in recent years seem to have been effective in curbing house price growth, challenges remain in further increasing housing supply sufficiently. The housing stock has continued expanding in 2020, although at a slower pace than foreseen as restrictions were placed on construction works due to the COVID-19. The number of new housing units commenced in 2020 also decreased, by 17%. Even a moderate decrease in completions might fuel property and rent prices, with housing supply still running behind needs. Indeed, in the last months of 2020 and first quarter of 2021, a rebound in house price growth was already visible. Capacity constraints in the construction sector and administrative deficiencies in the vacant site levy application remain insufficiently addressed to help supply growth and ultimately improve housing affordability in the medium-term (see also section 3). House price growth is expected to accelerate in 2021 and 2022.

In the rental sector price growth decreased markedly in 2020. The lack of international tourism led landlords to switch from short-term letting to the regular renting, temporarily increasing rental supply,

([5]) The NPL ratio for households was relatively stable around 7% in the first three quarters of 2020 (6.9% in Q1, 7.1% in Q2 and 7.0% in Q3).

particularly in the Dublin area. Furthermore, emergency legislation during the lockdown temporarily banned rent increases and evictions during some months of 2020 and 2021.

Overall assessment

Overall, risks to the domestic economy continued to abate, though stock imbalances, notably large public, private and external debt, still exist and uncertainties related to the COVID-19 crisis persist. Ireland has made steady progress in decreasing indebtedness and NPLs, but vulnerabilities associated with debt stock imbalances remain and these legacy imbalances can amplify adverse economic shocks. In 2020, policy efforts mostly focused on short-term measures to address the impact of the COVID-19 pandemic. The government has been successful in these efforts (providing income support, payment breaks and other alleviating measures), with NPLs increasing only marginally despite the unprecedented health crisis. The full impact of the COVID-19 pandemic, however, is likely to become visible with a delay. A negative impact on domestic corporations is likely, with potential repercussions to the labour market. In contrast, the multinational corporations that account for a large share of the NFC debt, performed very well during this crisis. Hence, while the risk stemming from high private indebtedness might have increased in the medium term, due to the dual nature of the Irish economy, it increased less than in many other European countries, as credit flows remained subdued in Ireland. While before 2020 the NPL ratio had continued its steady decline towards the EU average, the likely delayed impact of the COVID-19 pandemic means the NPL ratio warrants tight monitoring. Public debt has increased as a result of countercyclical fiscal policy and the working of automatic stabilisers.

External vulnerabilities linked to large negative NIIP exist but seem to be unwinding and the associated risks are limited. The current account was positive in 2020 and is projected to remain positive in 2021 and 2022. While the NIIP remains very negative, the imbalances are narrowing. A further mitigating factor is the presence of multinational corporations in Ireland, which, although they account for a very large share of the negative NIIP, have been beneficial for the growth of the Irish economy (effectively the main driver of growth) and their performance in the midst of the crisis has reduced risks rather than increased.

Housing policies seem to have been effective but the crisis is set to have negative repercussions on housing supply. Policies implemented in recent years seem to have been effective in curbing house price inflation. Various measures to support housing supply contributed to increasing housing completions by almost 40% annually from 2017 to 2019. However, the pandemic has slowed housing completions, which could reignite inflationary pressure. Housing affordability remains problematic.

Table 1.1: **Assessment of Macroeconomic Imbalances Matrix –- Ireland**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Private debt	Corporate debt (165.2% of GDP at the end of 2019) was strongly influenced by the activities of multinationals. Debt of domestically-controlled firms stood at 48.5% of GDP (or 81% of GNI*[1]), above fundamentals-based benchmark and close to prudential benchmark. Private debt is expected to have further decreased to 184.4% of GDP in 2020 Household debt fell to 37.2% of GDP in 2019, well below the fundamentals-based and prudential benchmarks, though still very high in comparison to household gross disposable income (113.3% in 2019). Mortgages in arrears (7.5% of accounts, of which 5.3% in arrears for more than 90 days) remain a challenge for many borrowers.	The steady decline in household debt relative to GDP, observed since 2008, continued in 2019, supported by active deleveraging and GDP growth. In 2020, amid the COVID-19 induced crisis active deleveraging continued in the household and corporate sectors. The crisis seems to have had limited effect on mortgage-indebted households as these debtors tend to work in sectors less affected by the pandemic. Nevertheless, for some debtors the risk has increased. The prospects of domestic corporations are uncertain as they are getting public aid. Multinational corporations, accounting for large share of corporate debt in Ireland, performed well during this crisis.	A number of policies were put in place to support households in the COVID-19 induced crisis. These included measures to preserve employment (temporary work schemes, exemption of social security contributions etc.), an emergency unemployment support payment, a temporary ban on rent increases and evictions freeze on mortgages and support to companies (direct liquidity support, guarantees, tax deferrals, moratoria etc.).
Public debt	Gross general government debt increased in 2020 but remained just below 60% of GDP. Under alternative metrics, Ireland's stock of public debt remained high, at 105.6 % of GNI* in 2020. Such debt could be considered a heavy burden, though there are mitigating factors such as favourable financing conditions. According to current projections, both the Debt-to-GDP and Debt-to-GNI* ratio should already peak in 2021 before starting a decreasing trajectory.	The structural balance worsened to -4.6% in 2020 from 0.5% in 2019, and it is projected to decrease further (-4.7%) in 2021. The general government deficit is projected at 5.0% of GDP in 2021 and 2.9% in 2022, and the gross government debt-to-GDP ratio is projected at 61.4% in 2021 and 59.7% in 2022. Risks to the fiscal outlook remain skewed to the downside.	In the Stability Programme Update, the Government set out a medium-term pathway for the debt-income ratio to be on a declining trajectory towards 2025.
Financial sector challenges	The non-performing loan (NPL) ratio continued its steady downward trend, falling to 3.4 % at end-2019 – approaching the euro area average of 2.7%. Long-term mortgage arrears remained a major issue, despite the existence of a number of schemes that help resolve those arrears. Bank profitability faced pressure from factors including relatively high costs and a reliance on net interest income.	The postponement of proposed NPL sales due to COVID-19 impacted negatively the pace of NPL reduction. At the same time, the NPL ratio increased slightly in the course of 2020, from 3.1% in the first quarter, to 3.5 % in the second and third quarter, driven by NFCs. It is likely that the NPL ratio will increase further when government support measures in response to the pandemic are phased out. Banks remain well capitalised, with an average common equity tier 1 (CET1) ratio of 22.6 % in the third quarter of 2020. Liquidity is high, also supported by increased deposits.	

(Continued on the next page)

Table (continued)

External sustainability	Ireland had a negative net international investment position (NIIP) of --168% of GDP at the end of 2020. This is linked to the very sizeable onshoring of intellectual property assets to Ireland, arising from the tax optimisation strategies of a small number of multinational enterprises (MNEs) and the large net position of an International Financial Services Centre (IFSC) with limited links to the domestic economy. The riskier instruments of the NIIP belong largely to MNEs and IFSC sector, to which domestic sector has little exposure. The underlying, domestically relevant, NIIP remains hard to gauge. Commission estimates indicate an underlying NIIP (NIIP*) to be between -57% to -82% of GNI* in 2019 (chapter 2).	The NIIP adjusted little due to the presence of MNEs, but the external position of the domestic sectors has improved (chapter 2). The position of the domestic private sector might be affected by the pandemic induced lockdown. The current account was in surplus of 4.6% of GDP, also helped by household precautionary savings. The current account is nevertheless expected to be in surplus of 4.5% of GDP in 2021 and 4.2% in 2022. Stripping out the activities of the multinationals, the modified current account is expected to remain stable and increasingly positive, following the trend of previous years. The maturity profile of external debt is generally favourable, in particular for external liabilities vis-à-vis official creditors.	
Property market	Residential property price growth moderated in 2020 to 0.3% y-o-y in nominal terms (chapter 3). Rental price levels remain high, although rent inflation has decreased markedly in 2020. At this stage, average national housing prices are not judged to be overvalued according to standard measures. However, affordability remains a concern. The number of years of gross disposable income required by an average household to buy a 100 square meters dwelling amounted to 14.5 in 2020, the third highest in the EU. If not addressed, constraints limiting the supply of housing could contribute to imbalances building up.	Despite improvements, housing supply is still falling short of demand. The pandemic induced lockdown of the construction sector had limited effect on new dwelling completions in 2020. However, the number of new housing units commenced decreased by 17% in 2020. The second half of 2020 saw significant increase in activity, due to pent-up demand, which combined with deteriorating supply, contributed to a rebound in house price growth (chapter 2). House price growth is forecast to continue in 2021 and 2022. Rental price growth has decreased markedly in 2020, due to landlords switching from the short-term tourism related letting to the regular renting, increasing at least temporarily the rental supply, particularly in the Dublin area. Emergency legislation during the lockdown temporarily banned rent increases and evictions.	In recent years, the government has actively intervened to address housing supply constraints. The impact of these measures is positive but requires continued monitoring. The legislative reforms to regulate the short term letting sector in areas of high housing demand, which came into effect in July 2019 and may contribute to increase permanently the rental stock (chapter 2). The vacant site levy, increased from 3% to 7% in 2019, seems to have been effective in supporting land development. Solving administrative deficiencies in its application may help supply growth and improve housing affordability. The Help-to-Buy (HTB) scheme has been expanded and extended to December 2021. Better targeting this scheme to lower-income FTBs might increase its effectiveness while reducing the risks of creating inflationary pressures. A new shared equity loan scheme for FTBs was announced for 2021.

Main takeaways

- Ireland has made steady progress in decreasing public and private indebtedness, but vulnerabilities related to large stocks of public, private and external debt remain. Legacy stock imbalances may amplify external shocks.
- In the short term, the COVID-19 crisis seems to have lessened vulnerabilities for private debt, particularly household debt, although the longer-term impact on domestic SME debt is uncertain. The crisis has, however, increased vulnerabilities for government debt, which is high relative to GNI* and set to increase further. Current account figures are very volatile, to a large extent driven by MNE activity, while the "domestic" current account has been in surplus more consistently. Overall NIIP is large and negative, although its domestic component is smaller and improving. House price growth decelerated in 2020, but challenges remain in increasing housing supply sufficiently.
- In 2020, the policy efforts mostly focused on short-term measures to address the impact of the pandemic. These included measures to preserve employment, an emergency unemployment support payment, a temporary ban on rent increases and evictions and various support to companies. While the economic impact of the COVID-19 crisis on real GDP was small, and Ireland was the only country in the EU that grew in 2020, the impact was broadly similar when the domestic economy excluding multinational corporations is considered. The strong performance of multinational corporations has also supported public finances amid the crisis.

Source: European Commission Services

Table 1.2: **Selected economic and financial indicators, Ireland**

	2004-07	2008-12	2013-18	2019	2020	forecast 2021	forecast 2022
Real GDP (y-o-y)	5.7	-1.4	4.5	5.6	3.4	4.6	5.0
Potential growth (y-o-y)	4.3	-0.2	3.6	5.6	2.1	2.5	2.3
Private consumption (y-o-y)	6.0	-1.4	2.6	3.2	-9.0	5.5	8.6
Public consumption (y-o-y)	4.4	-1.8	1.8	5.8	6.6	2.3	2.0
Gross fixed capital formation (y-o-y)	8.3	-6.3	15.8	74.9	-32.3	6.5	6.6
Exports of goods and services (y-o-y)	6.7	1.8	13.0	10.5	6.2	6.8	4.9
Imports of goods and services (y-o-y)	8.2	-0.5	11.5	32.4	-11.3	7.7	5.8
Contribution to GDP growth:							
Domestic demand (y-o-y)	5.6	-2.7	0.8	22.9	-16.6	3.7	4.5
Inventories (y-o-y)	0.0	0.0	0.0	0.1	1.0	-0.2	0.0
Net exports (y-o-y)	-0.3	2.0	4.0	-17.5	20.7	1.1	0.5
Contribution to potential GDP growth:							
Total Labour (hours) (y-o-y)	1.3	-1.7	1.0	1.4	0.5	0.4	0.4
Capital accumulation (y-o-y)	2.2	0.8	0.3	2.6	0.1	0.6	0.3
Total factor productivity (y-o-y)	0.8	0.8	2.3	1.6	1.5	1.5	1.6
Output gap	1.7	-2.8	0.7	0.0	-0.8	-0.5	0.1
Unemployment rate	4.8	13.0	9.6	5.0	5.7	10.7	8.1
GDP deflator (y-o-y)	2.1	-0.9	2.0	3.1	-0.5	1.5	1.2
Harmonised index of consumer prices (HICP, y-o-y)	2.5	0.6	0.3	0.9	-0.5	0.9	1.3
Nominal compensation per employee (y-o-y)	5.1	0.1	1.0	3.5	1.6	2.0	1.8
Labour productivity (real, person employed, y-o-y)	1.3	1.7	2.5	2.6	5.0	.	.
Unit labour costs (ULC, whole economy, y-o-y)	3.8	-1.6	-3.6	0.9	-3.2	-5.9	1.8
Real unit labour costs (y-o-y)	1.7	-0.7	-5.4	-2.2	-2.8	-7.3	0.6
Real effective exchange rate (ULC, y-o-y)	3.3	-3.6	-4.5	-3.7	.	.	.
Real effective exchange rate (HICP, y-o-y)	1.4	-2.3	-0.6	-2.8	0.3	0.6	-0.6
Net savings rate of households (net saving as percentage of net disposable income)	1.6	7.7	5.5	7.5	.	.	.
Private credit flow, consolidated (% of GDP)	30.7	7.1	-1.8	-9.1	.	.	.
Private sector debt, consolidated (% of GDP)	177.1	260.7	256.1	202.4	.	.	.
of which household debt, consolidated (% of GDP)	85.7	107.6	65.4	37.2	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	91.4	153.2	190.6	165.2	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	.	11.8	2.9	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	2.2	8.0	-3.5	-22.7	-1.6	3.9	4.7
Corporations, gross operating surplus (% of GDP)	33.8	33.9	46.8	55.1	58.1	60.3	59.7
Households, net lending (+) or net borrowing (-) (% of GDP)	-8.4	2.2	2.1	2.1	6.3	3.0	2.0
Deflated house price index (y-o-y)	8.4	-13.4	13.3	0.0	0.1	.	.
Residential investment (% of GDP)	12.3	3.9	2.0	2.3	2.1	.	.
Current account balance (% of GDP), balance of payments	-3.9	-3.4	2.3	-11.3	4.6	4.5	4.2
Trade balance (% of GDP), balance of payments	10.4	15.0	21.8	12.3	30.0	.	.
Terms of trade of goods and services (y-o-y)	-1.1	-0.7	-0.6	1.9	-1.5	0.3	-0.2
Capital account balance (% of GDP)	0.2	0.1	-7.1	-9.9	-4.9	.	.
Net international investment position (% of GDP)	-31.4	-120.4	-161.1	-174.0	.	.	.
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (1)	1.3	-225.0	-295.1	-285.4	.	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	951.0	1385.3	1418.9	1354.7	.	.	.
Export performance vs. advanced countries (% change over 5 years)	9.9	-2.1	31.1	68.0	50.8	.	.
Export market share, goods and services (y-o-y)	-2.8	-4.0	3.6	8.3	18.6	-1.0	-0.4
Net FDI flows (% of GDP)	11.2	-4.0	-5.3	-24.5	-19.7	.	.
General government balance (% of GDP)	1.5	-14.9	-2.5	0.5	-5.0	-5.0	-2.9
Structural budget balance (% of GDP)	.	.	-2.9	0.5	-4.6	-4.7	-2.9
General government gross debt (% of GDP)	25.5	84.2	88.5	57.4	59.5	61.4	59.7
Tax-to-GDP ratio (%) (3)	31.8	29.3	26.6	22.7	21.4	20.7	20.5
Tax rate for a single person earning the average wage (%) (4)	22.1	23.5	26.2	25.9	24.8	.	.
Tax rate for a single person earning 50% of the average wage (%) (4)	7.1	8.3	12.1	12.2	11.4	.	.

(1) NIIP excluding direct investment and portfolio equity shares
(2) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation
(4) Defined as the income tax on gross wage earnings plus the employee's social security contributions less universal cash benefits, expressed as a percentage of gross wage earnings
Source: Eurostat and ECB as of 2021-05-05, where available; European Commission for forecast figures (Spring forecast 2021)

2. THEMATIC ISSUE: NON-FINANCIAL CORPORATE DEBT

Situation entering the COVID-19 crisis

Excluding the foreign debt of multinationals and re-domiciled PLCs, corporate debt stocks in Ireland have been contained. Non-financial corporate debt in Ireland is significantly affected by foreign debt of companies with a foreign parent (95% of GDP in 2019), which pose limited risk to the Irish economy, and by debt of re-domiciled PLCs (22% of GDP in 2019). ([6]) The amounts concerned correspond roughly to the FDI and foreign arm's length loans (Graph 2.1(a)). The ratio of non-financial corporate debt to GDP, excluding the foreign debt of MNEs and re-domiciled PLCs, amounted to 48.5% of GDP in 2019, which stands below the prudential benchmark and close to the fundamentals-based benchmark. However, including also re-domiciled PLCs, the ratio is close to prudential (Table 2.1). ([7]) Using gross national income (GNI*) as the denominator to exclude the impact of MNEs, domestic non-financial corporate debt amounts to close to 81% of GNI* (or 117.5% including the debt of re-domiciled PLCs corresponding to the grey area in Graph 2.1(b)). These values are above the fundamentals-based benchmark adjusted for GNI* and close to the prudential threshold, which might however be overstated in the case of Ireland. ([8])

Up to the start of the pandemic credit flows to the domestic non-financial corporate sector were limited and deleveraging took place. The domestic non-financial corporates deleveraged in 2018 and to a lesser extent in 2019 (Graph 2.1(b)). In both years, deleveraging was supported by GNI* growth, but in 2018 there was also a decline in nominal debt stocks. Available data on net credit transactions and other changes in debt (e.g. valuation effects) is distorted by the presence of multinationals and is more difficult to interpret, but also points to debt reduction (Graph 2.1(c)). Deleveraging is also observed in debt-to-equity and debt-to-financial assets (Graph 2.1(d)). NFC debt held by banks has substantially fallen, with the share held by other financial institutions exceeding the share held by banks in recent years (Graph 2.1(a)). Loans to the real estate sector continue to represent the largest share of non-financial corporate bank loans, even though substantial deleveraging has taken place in this sector (Graph 2.2(a)).

Distortions in the aggregate balance sheet structure of non-financial corporations are likely to inflate the negative net financial asset position. Net financial assets of non-financial corporations reached an accumulated balance of -211% of GDP in 2019, much more negative than that of other euro area countries. Both assets and liabilities are significantly inflated by the presence of multinationals and re-domiciled PLCs (Graph 2.1(e)), but equity liabilities may be disproportionately inflated.

Local investment is dominated by construction, which is necessary to catch up with the insufficient supply, particularly in housing, but is arguably less productivity-enhancing for the local economy. While provision of housing in Ireland is a long-standing issue, since housing shortage in some areas may constrain labour supply and increase labour cost, other productivity enhancing investment are also important and might be more supportive of higher growth potential and of sustainable corporate debt. Net investment reached 30% in 2019, but the increase in net debt financed just a small part of it

([6]) On re-domiciled PLCs please see: https://www.cso.ie/en/releasesandpublications/ep/p-ia/internationalaccountsq12020final/redomiciledplcs2019/#d.en.241712. These are mostly pharmaceutical companies, headquartered in Ireland, formed following a merger between a small Irish company and a large MNE.

([7]) Fundamentals-based benchmarks are influenced by the initial stock of debt (1995 in this case), but the presence of MNEs and PLCs in 1995 is negligible in the case of Ireland. For details on the methodologies, see Bricongne, J. C., Coutinho, L., Turrini, A., Zeugner, S. (2019), "Is Private Debt Excessive?", Open Economies Review, 1-42 and European Commission (2018), "Fundamentals-based private debt benchmarks: enhanced sample and robustness checks", note to LIME June.

([8]) Modified GNI is an indicator that was recommended by the Economic Statistics Review Group and is designed to exclude globalisation effects that are disproportionally affecting the measurement of the size of the Irish economy. To arrive to modified GNI, one needs to adjust the standard GNI for factor income of redomiciled companies, depreciation on R&D service imports and trade in IP, and for depreciation on aircraft leasing. Please see https://www.cso.ie/en/releasesandpublications/ep/p-nie/nie2019/mgni/. Prudential thresholds are not sensitive to changes in the denominator used, however they are conditional on relative output per capita, which is overstated in the case of Ireland. Fundamental based-benchmarks, which derive from the accumulation of equilibrium flows to an initial stock of debt (1995 debt in this case), can be affected by the denominator used. Part of the foreign debt of firms with an Irish parent could be inter-company, representing lower risk.

(Graph 2.2(d)). In terms of composition, total gross fixed capital formation is dominated by the activities of multinationals, with R&D representing 66% of total investment and transport equipment 12%. Construction investment, including dwellings and other structures, amounted to 16% of total investment, while other investment, including machinery and equipment, represented only 6% of the total and has been contracting since 2014.

Credit developments and repayment capacity

For non-financial corporations net bank credit flows were negative in 2020, despite a moratorium for loan payments, due to the relatively low gross credit flow (Graph 2.2(c)). There has been a peak in suspended payments at around mid-2020 (13% of all loans – both NFC and household), with the share of suspended credit facilities declining since then. A public guarantee scheme was introduced in September 2020, but with a relatively low take-up (possibly also due to Brexit-related uncertainties). The cost of borrowing for corporates remains higher in Ireland than in the euro area (Graph 2.2(b)) and, while this differential has been increasing since 2015, in 2021Q1 the level of interest rates appears to have driven up corporate credit demand according to the ECB lending survey (Graph 2.2(f)). In 2020 corporate credit demand was instead motivated mostly by inventory and working capital needs.

The payment breaks (moratoria) that were granted under the EBA-compliant moratorium scheme have almost all expired, with most borrowers resuming capital and interest payments in full. From March 2020 to September 2020, Irish banks provided payment breaks of up to 6 months (12 months for large corporations) under a national industry-led scheme. At the peak in June 2020, 13% of loans (18% for corporate loans) were subject to such a payment break. The moratorium scheme stopped accepting applications at end-September 2020, but support can still be provided to borrowers that need assistance on a case-by-case basis. By end-December, the vast majority of these payment breaks had resumed a full repayment schedule according to the Banking and Payment Federation Ireland - with active payment breaks representing less than 1% of total outstanding loans in terms of outstanding value.

Credit developments reflected in part measures taken by the government to shield companies from liquidity pressures. Companies have been shielded from liquidity pressures since the start of the pandemic, not only by the moratorium on loan payments but also by a range of fiscal support measures including a wage subsidy scheme and tax deferrals. Rent and trade credit payment breaks also added to the support.

The non-financial corporate debt-to-GDP ratio is estimated to have declined in 2020, owing to the limited credit transactions and positive GDP growth (Graph 2.1(c)). In this respect, Ireland is an outlier in the EU with the GDP increase attributable mostly the multinational sector (ICT and pharmaceuticals), while modified domestic demand, reflecting better domestic activity, has contracted. However, the increase in non-financial corporate debt in percent of modified domestic demand is contained by the low level of net credit transactions in 2020.

Non-financial corporate deposits in the banking sector have increased, while local investment declined. Irish non-financial corporations saved in 2020, with corporate deposits increasing by close to 3% of GDP (ECB BSI data), amidst heightened uncertainty relating to the pandemic and the impact of Brexit. Simultaneously, modified domestic investment decreased by 8.5% y-o-y, driven primarily by the negative contribution of construction (-5.7 pps). According to the ECB bank lending survey, investment plans contributed negatively to explaining the demand for credit by NFCs in 2020, but switched to positive in 2021 Q1, indicating that more firms plan to invest (Graph 2.2(f)).

The commercial real estate sector is particularly vulnerable to structural implications of the COVID-19 pandemic. There has been an annual decline in capital values of 5.6% in commercial real estate (CRE) property in 2020Q3 and year-on-year rental deflation of 0.8 per cent. ([9]) Irish banks' exposure to the sector has declined since 2012, with investment funds (often funded from abroad) holding

([9]) Financial Stability Report 2020, https://www.centralbank.ie/docs/default-source/publications/financial-stability-review/financial-stability/financial-stability-review-2020-ii.pdf?sfvrsn=9

a significant share of the market (above 40%), making the sector vulnerable to withdrawal of foreign capital. ([10])

Non-performing loans

After a reduction from nearly 40% in 2014 to 3% in 2019, non-financial corporate non-performing loans started to increase again in 2020 amid the pandemic. Non-performing non-financial corporate loans started to rise, to 4.5% of non-financial corporate loans in 2020Q2 and 5.3% in 2020Q3 (Graph 2.1(f)). There were signs of significant credit tightening in 2020Q4, but less severe in 2021Q1, according to the ECB bank lending survey (Graph 2.2(e)). The tightening can be mostly attributed to higher risk perceptions. Reduced access to credit for non-financial corporations could delay the recovery.

Corporate insolvencies declined in 2020, but are likely to increase as support measures are withdrawn. Insolvencies in 2020 were held back not only by temporary impediments to the procedures, but also by the support measures in place. ([11]) Calculations based on data from the company registry indicate that in 2020 the rate of insolvent liquidations was close to the "normal annual rate" for Ireland, estimated at around 0.25% of active firms, and do not reflect the economic impact of the COVID-19 crisis. ([12]) Between March and September 2020, only the most affected sectors such as Accommodation and Food Services and Wholesale and Retail Trade, displayed signs of higher liquidations relative to the same period in 2019.

The insolvency framework may face challenges should the flow of applications increase once support measures start to be withdrawn. Ireland scores lower than other EU countries in the World Bank Index of Strength of the Insolvency Framework (with lower scores in creditor participation and reorganization proceedings), as well as on the Quality of the Judicial Index (with lower scores on case management and court automation). ([13]) Despite a relatively benign impact of the COVID-19 crisis when compared to other countries, Ireland may therefore benefit from additional measures in the area of insolvency to cope with a possible additional inflow of filings. Companies facing financial difficulties in Ireland can enter into Examinership for possible restructuring (26 applications in 2019, 20 of which returned to normal status and 1 entered into liquidation) or Receivership, for piecemeal liquidation or sale as going concern (2,188 firms under receivership in 2019). ([14]) The use of Examinership is comparatively lower. The process has considerable court involvement and entails significant costs, particularly in the case of SMEs. The 2019 EU Directive on Preventive Restructuring encourages Member States to enhance the availability of solutions with more limited court involvement. ([15])

External position

Irish external statistics are distorted by the impact of multinational enterprises. As it is the case with corporate debt and GDP, the headline current account and the net international investment position (NIIP) also give a distorted picture due to MNEs' activities. The current account balance jumped from 6% of GDP in 2018 down to -11.3% of GDP in 2019 and back up to 4.6% of GDP in 2020 and is forecast to

([10]) According to the Central Bank of Ireland Financial Stability Report 2020, Irish retail bank lending to the domestic CRE sector stood at €10.8 billion in 2020Q2, down from €11.7 billion in 2019Q2 and approximately €38 billion in mid-2012.

([11]) Prior to the pandemic, there was a requirement to hold a physical meeting with creditors to initiate a creditors' voluntary liquidation. This became impractical during the acute phase of public health restrictions and so the main channel for insolvent liquidations was blocked, but in late-April, the Consultative Committee of Accountancy Bodies of Ireland issued guidance that creditors' meetings could be held by telephone or video conferencing.

([12]) McGeever N., C. Sarchi and M. Woods (2020), "Irish company births and insolvent liquidations during the COVID-19 shock", Central Bank of Ireland Economic Letter Vol. 2020, No. 13. Data on corporate insolvencies is not homogeneous across countries. This study uses data from the company registry on exit by status. Insolvent liquidations combine creditors voluntary liquidation with court ordered liquidations for which the status of the company is insolvent, however, there are also a number of companies involuntarily stricken off the registry for not submitting annual returns and financial statements, with unknown status.

([13]) World Bank Doing Business Indicators 2020. The low availability of electronic means in the Irish judicial is also reflected in the assessment of the EU2020 Justice Scoreboard.

([14]) Companies Registration Office Annual Report 2019.

([15]) Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and the amending of Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L 172/18. Article 4(6) states that Member States may put in place provisions to limit judicial or administrative authority involvement to where it is 'necessary and proportionate' while ensuring that rights of any affected parties and relevant stakeholders are safeguarded

remain above 4% in 2021 and 2022 (Table 2.2, BoP). To adjust for the MNEs effects, the Irish Central Statistical Office (CSO) developed complementary indicators, such as the modified current account balance (denoted as CA*), which adjusts the headline current account figures in a way consistent with the calculation of the GNI*. ([16]) CA* is often expressed in % of the GNI* and it has been much less volatile than the headline measure. It amounted to 4.6% of GDP in 2019, up from 3.7% in 2018, which corresponds to 7.7% of GNI*, up from 6.1% in 2018, indicating a large and widening gap between domestic savings and domestic investment, which is supporting the correction of the negative NIIP.

The headline net international investment position of Ireland has been very negative over the last decade. The Irish NIIP reached -174% of GDP in 2019 (-180% in 2020Q1), far below the MIP threshold of -35%, but also below the prudential and fundamental NIIP benchmarks amounting to -135% and 7% of GDP, respectively. ([17]) The NIIP excluding the non-defaultable instruments (NENDI) was even more negative at -285% of GDP. However, the NIIP is strongly affected by the large negative position of MNEs and specifically of the International Finance Service Centre (IFSC) ([18]), to which the domestic sector has only very little exposure. A sectoral breakdown shows a negative NIIP of the general government at -35% of GDP in 2019, (slightly worsening to -37.5% in 2020Q1) and positive net positions of around, respectively, 13% and 9% of GDP for the monetary authorities and for monetary and financial institutions (MFI) not in the IFSC sector. Thus, the substantial negative NIIP originates from other sectors, with financial intermediaries in the IFSC sector (other than monetary authority and MFI) holding gross external assets and liabilities in excess of the tenfold of GDP in 2019, and their net position equal to -53% of GDP (-50% in 2020Q1). ([19]) The NFC sector ([20]) has had gross external assets and liabilities amounting to, respectively 272% and 441% of GDP end of 2019, yielding a negative NIIP of -173% of GDP (178% in 2020Q1).

The estimated NIIP adjusted for the impact of multinationals is much less negative and has been improving over recent years. To adjust the NIIP for the MNEs effects, one can start with the earlier NIIP figures known to be less affected by the offshore activities than the current data and cumulate the modified current account balances. ([21]) For 2019, this procedure yields an estimate range between -34% and -49% of GDP (i.e. -57% and -82% of GNI*), depending on the choice of the base year. This is much more favourable than the headline NIIP, but still considerably below the fundamental NIIP benchmark. The adjusted NIIP has been improving steadily at least since 2014, given the CA* surpluses and growing GDP and GNI* recorded over this period.

([16]) For more details see https://www.cso.ie/en/releasesandpublications/ep/p-macip/macroeconomicscoreboard2019/hi/#indicator_8.

([17]) Prudential NIIP threshold is a country-specific threshold that denotes the level of NIIP below which an external crises becomes more likely. The fundamental NIIP benchmark is the NIIP that would be obtained if a country had run its current account norm in the past. It is obtained by cumulating CA norms (current account balances explained by fundamentals) over time. For the methodology see: Turrini and Zeugner (2019), "Benchmarks for Net International Investment Positions", European Economy, Discussion Paper 097/2019.

([18]) The International Finance Service Centre is a hub for international financial transactions that does not play an important role in financing of the domestic economy (European Commission (2019), Country Report Ireland 2020, Commission Staff Working Document SWD(2019) 1006 final, Publications Office of the European Union, Luxembourg.

([19]) The MFI in the IFSC also hold substantial gross assets and liabilities (of around 250% of GDP), but a comparatively small positive net position equal to 9% of GDP end of 2019.

([20]) Implicitly includes households, see Table 7.4 at: https://www.cso.ie/en/releasesandpublications/ep/p-ia/internationalaccountsq12020final/internationalinvestmentposition/

([21]) For details, please see European Commission (2020), "Interpreting external sector statistics: taking into account the role of financial globalization and MNEs", Note for the attention of the EPC LIME Working Group, January.

Table 2.1: **Non-financial corporations debt indicators, Ireland**

	Source	2003-07	2008-12	2013-17	2019	2020	2021f	20Q2	20Q3	20Q4
Stocks										
Debt, consolidated (% of GDP)	*(a,d)*	89	153	207	165	149		160	147	149
Debt, consolidated (% of potential GDP)	*(a,b,d)*	90	149	211	165	148		159	146	148
Prudential threshold (% of GDP)[1]	*(c)*	94	74	99	110	109	109			
Fundamental benchmark (% of GDP)[1]	*(c)*	51	74	61	48	50	50			
Debt, consolidated (% of gross operating surplus)	*(a,b,d)*	262	450	431	300	257		282	256	257
Interest paid (% of gross operating surplus) [3]	*(a,b)*	8.2	10.9	7.9	6.6			7.3	7.0	
Debt, consolidated (% of gross financial assets)	*(a,d)*	86	78	49	39					
Domestic loans in forex (% dom. Loans)	*(d)*	10.7	10.2	10.5	12.5	10.3		11.7	11.2	10.3
Flows										
Credit flows (transactions, % of GDP) [2]	*(a)*	12.1	9.6	-2.8	-9.1	-3.2	0.0	3.4	-27.0	-1.1
Benchmark for flows (% of GDP)[1]	*(c)*									
Investment (% of value added)	*(b)*	20.6	19.0	32.8	54.4	34.6	34.6			
Savings (% of value added)	*(b)*	25.2	22.3	36.3	37.6	38.8	42.9			
p.m. Banks NFC NPLs (% of NFC loans) [2]	*(d)*			*18.7*	*3.2*					

(f) European Commission forecast. (1) Benchmarks for flows (% of GDP) are estimated on the basis of non-consolidated flows. (2) Gross non-performing bank loans and advances to Non-financial corporations (% of total gross bank loans and advances to Non-financial corporations). (3) Quarterly data is annualized.
Source: (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) ECB

Table 2.2: **Selected external indicators, Ireland**

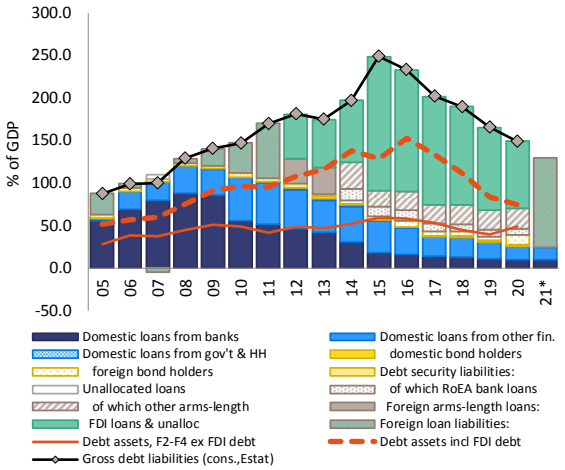
Flows [1]	Source:	2003-07	2008-12	2013-17	2018	2019	2020	2021f	2022f
CA balance as % of GDP, NA	*(b)*	**-3.0**	**-3.4**	**0.7**	**6.0**	**-11.3**	**5.0**	**4.5**	**4.2**
CA balance as % of GDP, BoP	*(a)*	-3.0	-3.4	0.7	6.0	-11.3	4.6	4.5	4.2
Cyclically adj. CA balance as % of GDP [2]	*(c)*	-2.6	-4.7	4.0	5.5	-13.6	14.0	8.4	4.8
CA req. to stabilize NIIP above -35% [3]	*(c)*	-0.9	-2.4	1.4	8.9	9.5	10.0		
CA explained by fundamentals (CA norm) [4]	*(c)*	-0.7	0.2	1.6	2.9	3.2	3.5	3.4	3.5
Required CA for specific NIIP target [5]	*(c)*	0.4	0.6	5.5	13.4	14.2	14.8		
Trade bal. G&S, % of GDP, NA	*(b)*	11.3	15.0	20.6	28.4	12.3	30.0	29.9	28.9
Required TB for specific NIIP target [5]	*(c)*	18.5	14.0	20.5	30.4	31.1	34.1		
Capital account bal. as % of GDP, NA	*(b)*	**0.2**	**0.1**	**-2.9**	**-15.9**	**-9.9**	**-4.9**	**-2.5**	**-0.3**
Stocks									
NENDI as % of GDP	*(a)*	**13**	**-225**	**-283**	**-257**	**-285**	**-286**		
of which: net portfolio debt	*(a)*	179	226	375	368	408	408		
of which: net mutual fund shares	*(a)*	0	-444	-638	-597	-691	-738		
of which: net other investment	*(a)*	-13	-15	-26	-31	-6	41		
NIIP as % of GDP	*(a)*	**-30**	**-120**	**-167**	**-181**	**-174**	**-168**		
Prudential NIIP/NENDI benchmark [6]	*(c)*	-94	-87	-106	-131	-135	-136	-137	-137
Fundamentally expl. NIIP benchmark (NIIP norm) [6]	*(c)*	-10	-10	-4	4	7	11	13	16

(1) Flow data refer to national account concept, unless indicated otherwise.
(2) Cyclically adjusted Current Account is the Current Account adjusted for the domestic and foreign output gaps, taking into account trade openness.
(3) The average Current Account needed in order to stabilise the NIIP is based on T+10 ECFIN projections.
(4) The Current Account explained by fundamentals refers to the expected Current Account given the level of its fundamentals with respect to world average.
(5) The Current Account or Trade Balance needed either to halve the distance to fundamental NIIP benchmark, or to reach the prudential NIIP benchmark in 10Y, whichever is higher. Based on T+10 ECFIN projections.
(6) The country-specific prudential benchmark denotes the NIIP level beyond which the probability of an international economic and financial crisis becomes higher. The NIIP level explained by fundamentals ('NIIP norm') represents the NIIP that would result if a country had run its current account in line with fundamentals since 1995. For details see Turrini and Zeugner (2019), "Benchmarks for Net International Investment Positions", European Economy, Discussion Paper 097/2019.

Source: (a) Eurostat, (b) AMECO, (c) European Commission calculations, (d) WIOD database

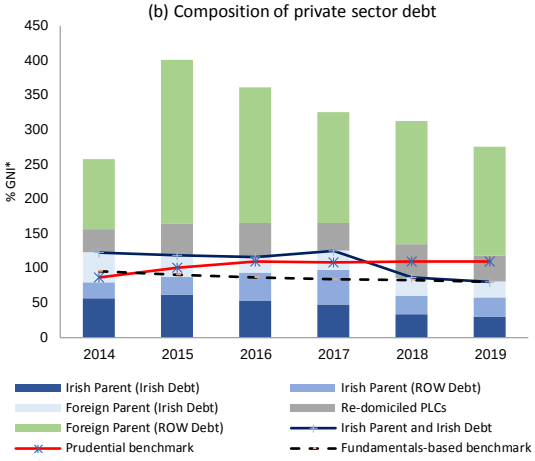
Graph 2.1: **Thematic Graphs: Non-financial corporate debt**

(a) Non financial corporations debt liablities by creditor



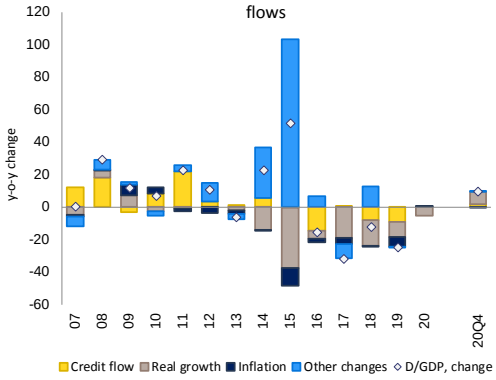
Source: Calculations based on Eurostat and ECB

(b) Composition of private sector debt



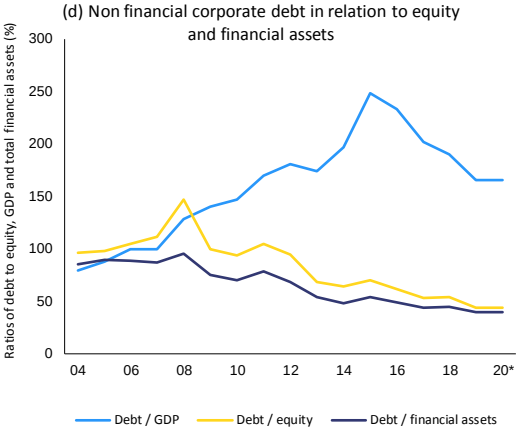
Note: ROW: rest of world
Source: CSO

(c) Decomposition of non financial corporations debt flows



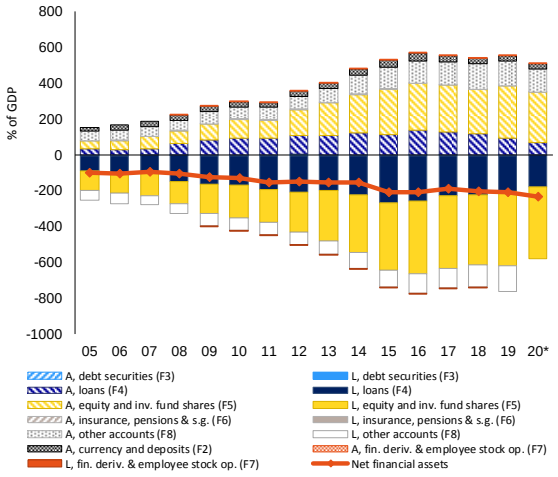
Source: Eurostat

(d) Non financial corporate debt in relation to equity and financial assets



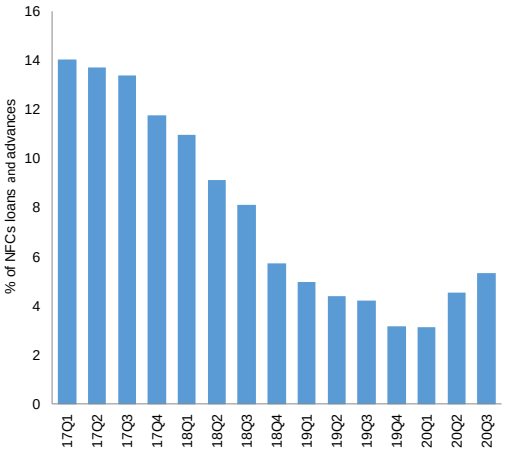
Source: Eurostat

(e) Non financial corporation balance sheet



Source:Eurostat

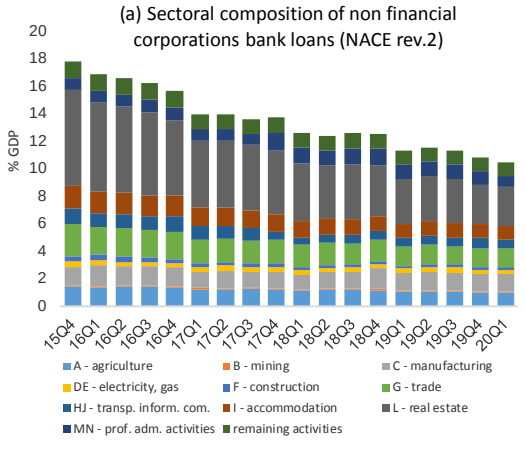
(f) Non financial Corporations Non performing loans



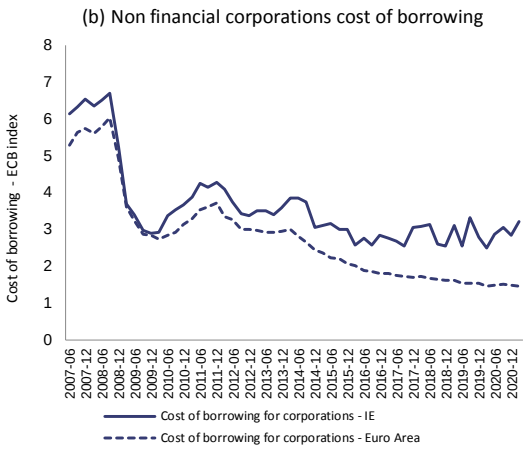
Source: Non performing loans and advances, ECB consolidated data

Source: European Commission Services

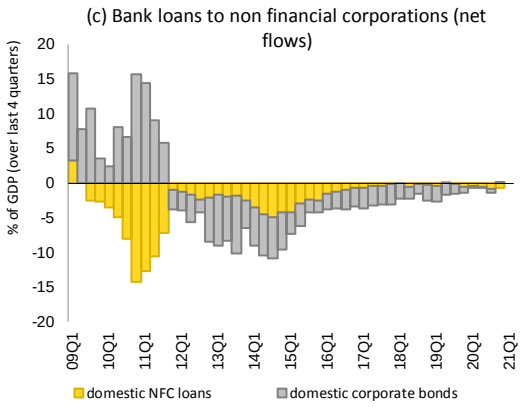
Graph 2.2: **Thematic Graphs: Non-financial corporate debt (cont.)**



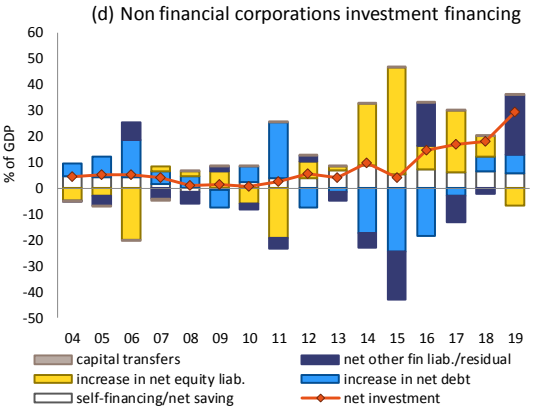
Source: ECB and Ameco



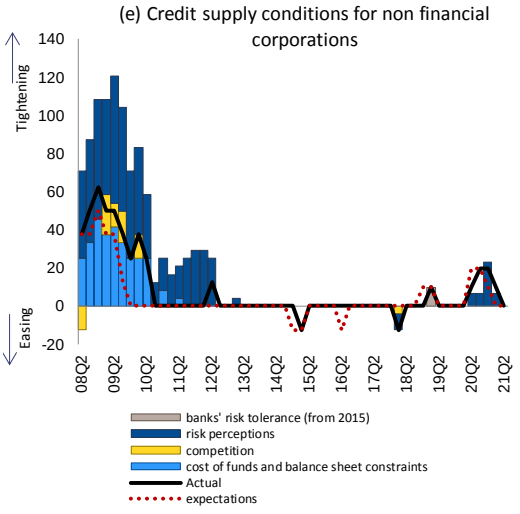
Source: ECB MIR



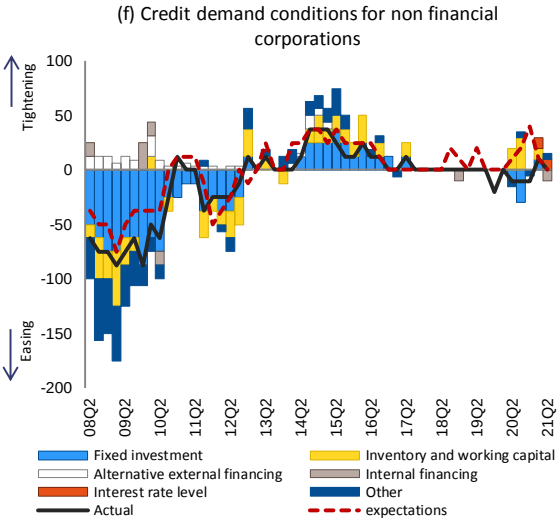
Source: ECB BSI



Source:Calculatios based on Eurostat



Source:ECB bank lending survey



Source:ECB bank lending survey

Source: European Commission Services

3. THEMATIC ISSUE: HOUSEHOLD DEBT

Situation entering the COVID-19 crisis

The stock of household debt in Ireland has declined since the Irish banking crisis, though deleveraging needs may remain. The ratio of household debt to GDP declined significantly from an average of 108% in the period 2008-2012 to 37% in 2019 (Table 3.1 and Graphs 3.1(b)). Deleveraging has concerned not only bank debt but also other debt liabilities (Graph 3.1(a)) and was achieved through both negative net credit flows (transactions) and GDP growth (Graph 3.1(c)). The household debt stock in 2019, at 37% of GDP, was significantly below the prudential benchmark and below but close to the fundamentals-based benchmark. ([22]) However, GDP in Ireland is overstated by the presence of multinationals and is misleading as a denominator for household debt. Household debt in percent of modified gross national income (GNI*), which is a better measure of domestic output, stood at 62%, below prudential (72%), but this benchmark could be overstated in the case of Ireland. ([23]) Irish household debt still amounted to 113% of household gross disposable income (GDI) in 2019, remaining amongst the highest in the EU according to this metric.

The household sector on aggregate holds a significant stock of liquid financial assets, including currency and deposits. The ratio of debt to gross financial assets was close to 32% in 2019 (Table 3.1) and households hold a significant share of deposits (Graphs 3.1(f)). In the third wave (2017) of the ECB household finance and consumption survey, about 3% of households with mortgage debt showed a negative net wealth. ([24])

Despite the relatively comfortable aggregate net wealth position, arrears remained high for many borrowers entering into the COVID-19 pandemic. The ratio of household non-performing loans in the banking sector remained at 7%, despite a significant decline since peak (Graph 3.1(d)). This stock was a legacy from the global financial crisis. A significant percentage of household borrowing from the banking sector (and arrears) corresponds to collateralized housing loans (Graph 3.2(a)), thus household debt sustainability in Ireland is linked to housing market developments analysed below. A number of government schemes have been implemented to help resolve long-term mortgage arrears, but the take up has been low ([25]). On the other hand, the mortgage measures put in place by the Central Bank of Ireland are helping limit the share of risky mortgages and safeguard the resilience of both households and banks, while the completion of the central credit register in mid-2019 will also help in this respect.

Credit developments and repayment capacity

Net bank lending to households has been negative in 2020, despite the possibility of payment breaks. New credit to households declined in 2020 relative to 2019 and net bank credit transactions have been overall negative (Graph 3.2(c)). The take-up of payment breaks was relatively moderate, with a peak of 13% (for all loans – both NFC and household) observed around mid-2020 and take-up steadily declining since. The cost of borrowing for households has been relatively stable in 2020, but remains above the average costs in the euro area (Graph 3.2(b)).

([22]) For details on the methodologies, see Bricongne, J. C., Coutinho, L., Turrini, A., Zeugner, S. (2019), "Is Private Debt Excessive?", Open Economies Review, 1-42 and European Commission (2018), "Fundamentals-based private debt benchmarks: enhanced sample and robustness checks", note to LIME June.

([23]) Prudential benchmarks are not affected by the choice of denominator, however, they are conditional on relative output per capita and this has been oerstated in the case of Ireland. Fundamental based-benchmarks, which derive from the cumulation of equilibrium flows to an initial stock of debt (1995 debt in this case), can be affected by the denominator used.

([24]) https://www.ecb.europa.eu/home/pdf/research/hfcn/HFCS_Statistical_Tables_Wave_2017.zip,Table F3.

([25]) The Mortgage-to-rent scheme (under which a total of 5,749 cases have been submitted of which 1,179 have been completed), the Personal Insolvency Arrangement (5,209 arrangements approved between 2014 and 2020), and the Abhaile scheme, which supports homeowners with mortgage arrears mainly by providing advice (helped 14,623 households between July 2016 and December 2019).

Table 3.1: **Household debt indicators, Ireland**

	Source	2003-07	2008-12	2013-17	2019	2020	2021f	20Q2	20Q3	20Q4
Stocks										
Debt, consolidated (% of GDP)	*(a,d)*	81	108	62	37	35		36	36	35
Debt, consolidated (% of potential GDP)	*(a,b,d)*	82	104	62	37	35		36	36	35
Prudential threshold (% of GDP)[1]	*(c)*	67	48	63	72	71	71			
Fundamental benchmark (% of GDP)[1]	*(c)*	46	72	59	49	53	54			
Debt (% of gross disposable income)	*(a,b,d)*	172	206	156	113	104		109	107	105
Interest paid (% of gross disposable income) [3]	*(a,b)*	5.0	4.7	1.5	1.7			2.1	2.1	
Debt (% of gross financial assets)	*(a,d)*	51.4	62.2	41.8	32.0			31.2	30.4	29.4
Share of variable rate loans for house purchase (%)	*(d)*	82.1	82.5	65.9	27.7	23.3				
Domestic loans in forex (% of dom. loans)	*(d)*	1.4	1.4	0.5	0.1	0.1				
Flows										
Credit flows (transactions, % of GDP) [4]	*(a)*	14.2	-2.5	-1.5	-0.1	0.0	0.1	0.6	-0.4	0.2
Benchmark for flows (% of GDP)	*(c)*	6.4	3.1	2.0	3.1	3.1	2.9			
Savings rate (% gross disposable income)	*(b)*	8.9	12.4	9.6	12.2	23.8	15.5			
Investment rate (% gross disposable income)	*(b)*	26.2	8.7	5.5	6.2	5.6	6.2			
p.m. Bank HH NPLs (% of HH loans) [2]	*(d)*			*17.0*						

(f) European Commission forecast.
(1) Benchmarks for flows (% of GDP) are estimated on the basis of non-consolidated flows.
(2) Gross non-performing bank loans and advances to Households and non profit institutions serving households (% of total gross bank loans and advances to Households and non profit institutions serving households).
(3) Quarterly data is annualized.
Source: (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) ECB

The household debt-to-GDP ratio is estimated to have slightly declined in 2020, owing to the limited credit transactions and positive GDP growth. This was due to the limited net credit flows (transactions) that were overall close to zero in percent of GDP reflecting the limited credit from the banking sector, and to the positive GDP growth (Graph 3.1(c)). In this respect Ireland is an outlier in the EU, but modified domestic demand, which excludes the impact of MNEs has declined.

Household gross disposable income increased in 2020, allowing for sharp increase in the household savings rate. Household incomes in 2020, which have been supported by a range of government measures have increased by 5% in 2020. The household savings rate has increased in 2020 well above the increase for the euro area, as private consumption was contained.

A tightening of credit conditions for households has been observed in 2020 but there are signs of ease in 2021 and the income of mortgage borrowers seems to have been less affected. According to the ECB bank lending survey, credit conditions for households tightened in 2020 on account of higher risk perceptions, but have eased in 2021Q1 (Graph 3.2(d)). Although unemployment increased from 5% in 2019 to 5.7% in 2020 and is forecast to peak at 10.7% in 2021 ([26]), the crisis appears to have affected mostly the lower income echelons, typically holding less debt, while the income of many mortgage borrowers and potential borrowers with higher earnings remained unaffected.

Housing Market

A large share of loans to households are collateralised mortgage loans, with collateral values having recovered about half way relative to the 2008 peak. Prices have recovered since the trough of 2012 but do not seem to approach unsustainable levels, as they did in 2008. A certain share of mortgage loans is therefore likely to have remained "underwater", making legacy issues more difficult to resolve (Graph 3.2(e)). Nominal house price growth slowed down in the last years (10.2% in 2018, 2.3% in 2019, 0.3% in 2020), likely due to a combination of increased supply and macroprudential measures. The slowdown has been driven by a decline at the high end of the market (i.e. Dublin). However, in the last months of 2020 Irish house prices have accelerated, due to pent-up demand from the spring lockdown combined with fewer new units built, curtailing supply.

Valuation gaps are slowly closing compared to previous years, though affordability remains low. Price-to-income gap was 15.8 in 2019 (Graph 3.2(f)), the second highest in the EU. Housing stock is

([26]) The COVID-19 pandemic has however impacted the unemployment statistics and the forecasts should be taken with caution. A monthly unemployment measure adjusted for the COVID-19 impact has ranged between about 16% and 30% in the months between March 2020 and March 2021.

expanding, and dwelling completions hit a record in 2019, increasing by 40% in just two years, but still falling below estimated needs. Although prices measured in years needed to buy an average dwelling are relatively high, internal benchmark metrics do not overall signal overvaluation. Housing supply is still running behind needs. Due to the COVID-19 pandemic, completions experienced a drop in 2020, although relatively mild compared to expectations. However, building commencements show a worrying drop, probably due to the lockdown restrictions of the construction sector. Therefore, house price growth is forecast to become again more dynamic in 2021 (12.9%) and 2022 (8%).

The government has actively intervened to address housing supply constraints. The impact of measures has been overall positive but requires continued monitoring. Measures include (1) regulating the short-term letting sector in areas of high housing demand. This came into effect in July 2019. However, in light of the COVID-19 disruption of the tourism industry, the impact of recent reforms has been difficult to monitor. (2) a vacant site levy to support land development was introduced, with the rate increased from 3% to 7% in 2019. Legal provisions may need some refinement to increase its effectiveness. (3) extensive construction of social housing was conducted through the "Rebuilding Ireland" government programme. (4) on the demand side, the 2021 budget included the extension of the Help-to-Buy (HTB) providing a refund for first time buyers (FTBs) under certain conditions of up to 10%. Better targeting this scheme to lower-income FTBs might increase its effectiveness while reducing the risks of creating inflationary pressures. (5) the government announced the introduction of a shared equity loan scheme, still to be approved by parliament, which will further provide a 20-30% equity stake to FTBs of newly built homes.

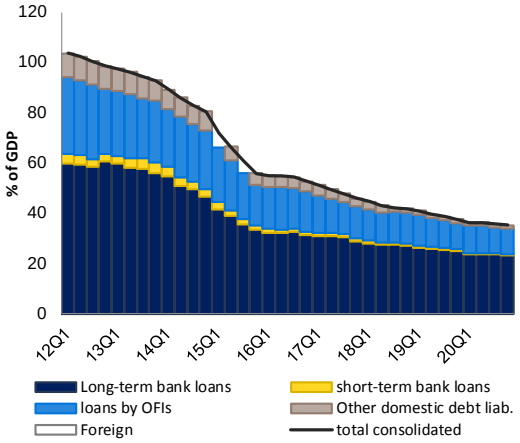
Table 3.2: **Selected housing indicators, Ireland**

			2003-07	2008-12	2013-17	2018	2019	2020	20Q1	20Q2	20Q3
House price developments	Unit	Source									
Real house price, yoy growth	%	(a)	8.7	-13.3	8.6	7.9	0.0	0.1	-1.2	1.4	-0.9
Nominal house price, yoy growth	%	(a)	11.5	-14.0	9.5	10.2	2.3	0.3	1.0	0.3	-0.8
Price to income in level [1]	years	(b)	19.6	15.1	13.7	16.4	15.8	14.5	14.5	14.2	14.5
Valuation gaps											
Price to income gap [2]	%	(c)	25.6	-3.3	-11.8	5.0	1.6	-7.2	-8.6	-6.8	-6.7
Price to rent gap [2]	%	(c)	35.3	6.9	-17.9	-10.6	-13.1	-13.0	-17.6	-13.0	-11.2
Model valuation gap [3]	%	(c)	35.8	5.1	-24.0	-20.3	-25.5	-31.0	-34.5	-30.7	-29.6
Average house price gap [4]	%	(c)	32.2	2.9	-17.9	-8.6	-12.3	-17.1	-20.2	-16.8	-15.9
Housing credit											
Mortgages (% GDP)	%	(d)	52.7	56.2	33.6	23.3	21.5	20.1			
Mortgages, yoy growth	%	(d)	19.1	-6.9	-2.5	1.8	0.5	-3.6			
Housing supply											
Residential construction - dwellings (% GDP)	%	(e)	11.9	3.9	1.7	2.3	2.3	2.1			
Residential construction - dwellings, yoy growth	%	(e)	4.2	-28.3	14.1	19.5	0.1	-7.6			
Non-residential construction (% GDP)	%	(e)	6.8	4.7	4.4	5.1	5.6	5.0			
Value added in the construction sector, yoy growth	%	(e)	5.4	-15.0	9.4	11.8	7.5	-12.7			
Building permits, yoy growth	%	(a)	5.4	-39.5	29.4	40.1	34.8	13.5			
Number of transactions, yoy change	%	(f)	-4.0	-22.6	25.0						
Other housing market indicatos											
Share of owner-occupiers, with mortgage or loan	%	(a)	34.5	34.4	33.4	32.4	31.3				

The forecast of house prices is computed on the basis a housing valuation model shared with Member States in the context of the EPC LIME working group. The forecasts represent real house price percentage changes expected based on economic fundamentals (population, disposable income forecast, housing stock, long-term interest rate, and the price deflator of private final consumption expenditure), as well as the error correction term summarising the adjustment of prices towards their long-run relation with fundamentals. The source for the forecast of other variables is Ameco.
(1) Price to income in level is the number of years of income necessary to buy an assumed 100m2 dwelling. See Bricongne, J-C, A Turrini, and P Pontuch, 2019, "Assessing House Prices: Insights from HouseLev, a Dataset of Price Level Estimates", Discussion Paper 101, European Commission, available in ""https://ec.europa.eu/info/publications/assessing-house-prices-insights-houselev-dataset-price-level-estimates_en"".
(2) Price to income and price to rent gaps are measured in deviation to the long term average (from 1995 to the latest available year).
(3) The model valuation gap is estimated in a cointegration framework with nominal house prices as the dependent variable and five fundamental explanatory variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. See Philiponnet and Turrini, Assessing House Price Developments in the EU (2017) available in ""https://ec.europa.eu/info/publications/economy-finance/assessing-house-price-developments-eu_en"" and revision notes presented to LIME in October 2019 and June 2020.
(4) The average house price gap is the simple average of the price-to-inome, price-to-rent and model valuation gaps.
Source: (a) Eurostat, (b) Eurostat, OECD, ECB, BIS, Ameco, national sources, European Commission calculations, (c) European Commission calculations, (d) ECB, Ameco (e) Ameco (f) ECB

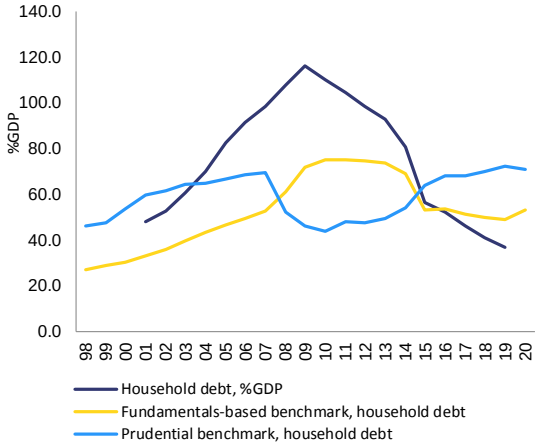
Graph 3.1: **Thematic Graphs: Household debt**

(a) Household debt liabilities by creditor



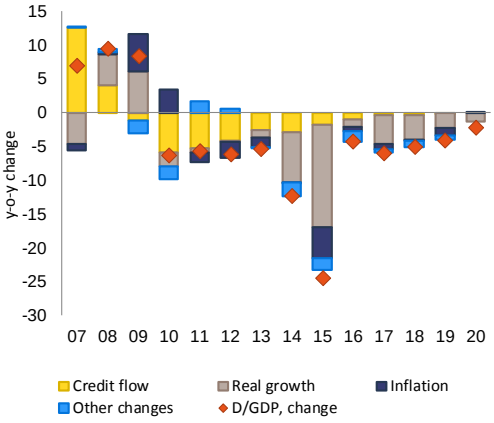
Source: Calculations based on Eurostat and ECB

(b) Household debt and benchmarks



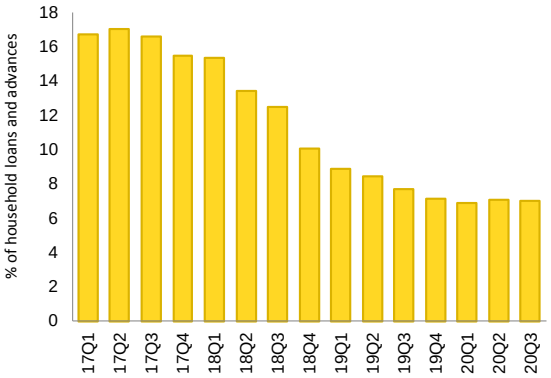
Source: Eurostat and European Commission

(c) Decomposition of household debt flows



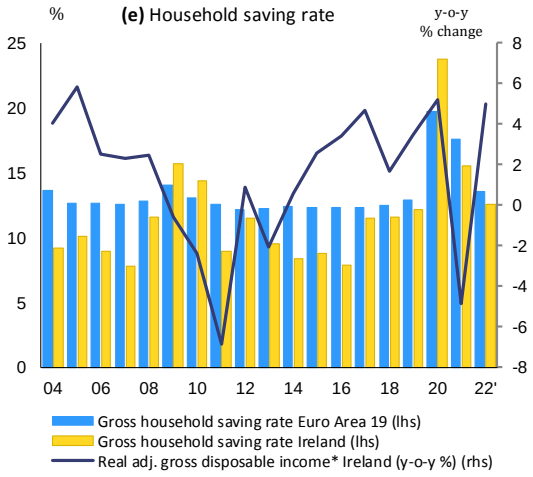
Source: Eurostat and Ameco

(d) Households non-performing loans



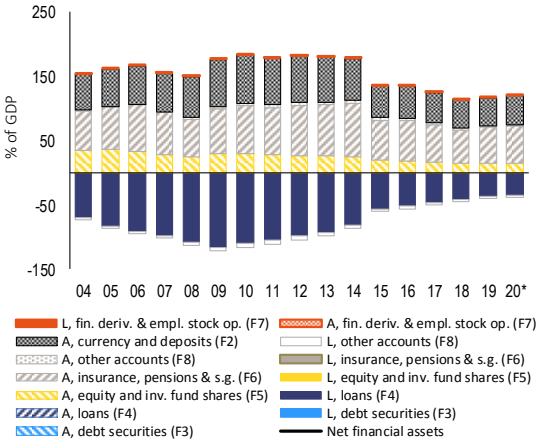
Source: Non-performing loans and advances, ECB consolidated banking data.

(e) Household saving rate



Source: Eurostat

(f) Household balance sheets

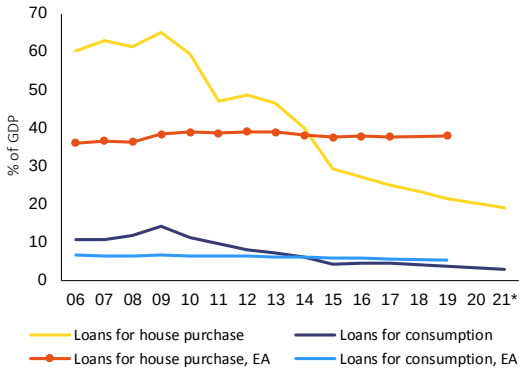


Source: Eurostat

Source: European Commission Services

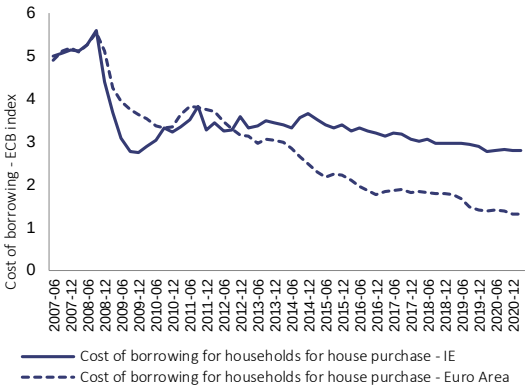
Graph 3.2: **Thematic Graphs: Household debt (cont.)**

(a) Bank loans to households by type



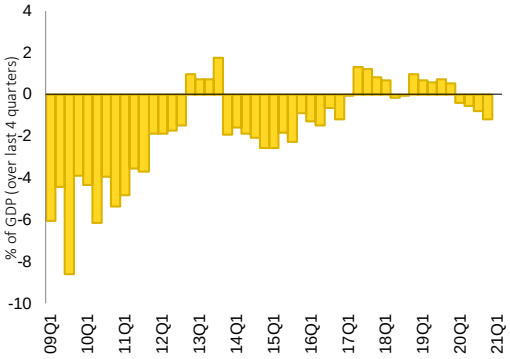
Source: ECB BSI

(b) Households cost of borrowing



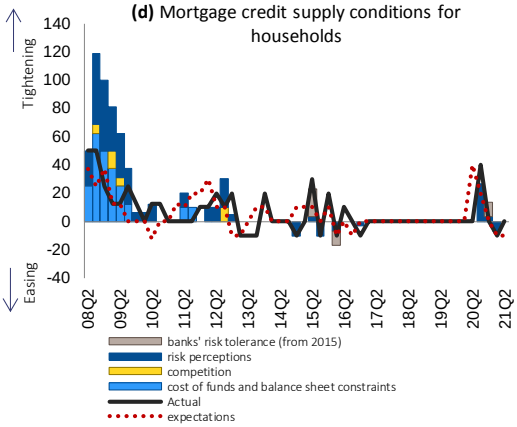
Source: ECB MIR

(c) Bank loans to households (net flows)



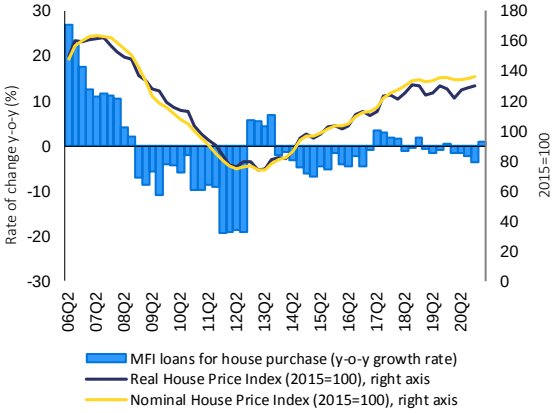
Source: ECB BSI

(d) Mortgage credit supply conditions for households



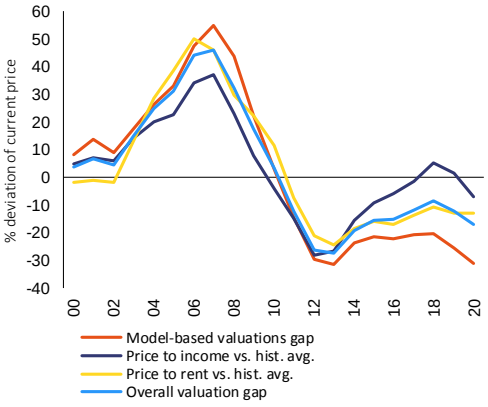
Source: ECB BSI

(e) House prices and mortgage credit growth



Source: Source: ECB Bank Lending Survey

(f) House prices valuation gaps



Source: Source: ECB Bank Lending Survey.

Source: European Commission Services