Creditreform Sovereign Rating

Creditreform Rating

| Rating Object | Rating Information | |
|---|---|---|
| REPUBLIC OF IRELAND | Assigned Ratings/Outlook: **A+ /stable** | Type: Monitoring, unsolicited |
| Long-term sovereign rating<br>Foreign currency senior unsecured long-term debt<br>Local currency senior unsecured long-term debt | Initial Rating Publication Date:<br>Rating Renewal:<br>Rating Methodologies: | 25-11-2016<br>08-11-2019<br>“Sovereign Ratings”<br>“Rating Criteria and Definitions” |

## Rating Action

Neuss, 08 November 2019

Creditreform Rating has affirmed the unsolicited long-term sovereign rating of “A+” for the Republic of Ireland. Creditreform Rating has also affirmed Ireland’s unsolicited ratings for foreign and local currency senior unsecured long-term debt of “A+”. The outlook is stable.

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## Key Rating Drivers

1. While headline figures remain significantly biased by multinational enterprises’ activities, we expect the underlying pace of growth to remain broadly resilient, buttressed by robust though softening domestic demand, and contingent on our baseline assumption of an orderly Brexit
2. Very prosperous economy, benefiting from its business-friendliness and openness towards migration; benign labor market development and demographics; declining but still elevated private sector debt and high macro-financial volatility
3. Very strong institutional set-up, prudent and transparent policy-making, and benefits from EMU and EU membership; key risk of disorderly Brexit is not off the table, but new Brexit deal between EU and UK awaiting to be endorsed by parliament; withdrawal deadline extended again
4. First budget surplus since 2007 and strong improvement in fiscal metrics, which we expect to continue, but debt level and trend somewhat overstated by formulation in GDP terms and buttressed by overshooting and highly concentrated CIT intake; risks related to high stock of NPLs diminishing gradually; prudent debt management
5. Strong MNE presence complicates interpretation of external position and leads to frequent and significant revisions; the large and negative net international investment position is likely to further improve on the back of robust nominal growth

## Reasons for the Rating Decision

The Republic of Ireland’s credit profile reflects the sovereign’s high creditworthiness and is underpinned by its solid macroeconomic performance profile and the very high quality of

its political and economic institutions, somewhat balanced by persisting though receding fiscal and external vulnerabilities

## Macroeconomic Performance

Ireland's macroeconomic performance profile continues to be supported by exceptionally high per capita income levels and the economy's very strong trend growth. While its favorable labor market conditions and welcoming business environment foster the economy's flexibility and resilience, we continue to view elevated private indebtedness and high macro-financial volatility as credit negative.

To begin with, we have to reiterate that Irish national accounts are substantially blurred by the activities of multinational enterprises (MNE), on-shoring of intellectual property (IP), and aircraft leasing operations, rendering the assessment of the underlying economic activity and a comparison on a cross-country basis difficult. Thus, per capita income levels are somewhat inflated. According to the latest update of GDP per capita estimates (IMF data, in PPP terms), Ireland posted the fifth-highest GDP p.c. in the world at USD 79,617 in 2018, up from USD 72,664 a year before; its per capita income stood substantially above the respective "A" median of USD 35,939. We nevertheless view the economy's high level of wealth and productivity as a key rating strength, as these are also underscored by alternative metrics. As was pointed out by Irish authorities, modified gross national income (GNI*) appears to give us a somewhat more realistic picture of the underlying economy. Stripping out the above-mentioned factors for the year 2018 leaves us with a GNI* in the amount of EUR 197.5bn in absolute terms, as compared to a nominal GDP totaling EUR 324.0bn (Central Statistical Office, CSO). That being said, nominal economic growth is still remarkably high, averaging at 7.4% in 2015-18 (GNI*; GDP: 14.2% p.a.). By the same token, per capita income also continues to compare favorably in Europe when referring to GNI*. Drawing on CSO and Eurostat data, we arrive at a GNI* p.c. of EUR 40,655 in 2018 as opposed to a GDP p.c. of EUR 33,820 in the euro area as a whole, or EUR 44,920 and 40,330 in the Netherlands and Germany respectively.

Turning to last year's economic development, despite trade and Brexit related uncertainties, the Irish economy defied uncertainties related to Brexit and trade tensions, and retained its growth momentum. After real GDP growth clocked in at 8.1% in 2017, the economy expanded by 8.2% last year. Thus, Ireland posted the highest growth rate in the euro area for the second consecutive year. More generally, the country exhibits an extraordinarily strong growth record. We note that the Irish economy has continuously outpaced the euro area since 2012, with real GDP growth averaging at 7.9% compared to 1.2% in the EA-19. Again, it has to be highlighted that the country's economic outperformance is partly explained by significant business operations of Irish-based MNEs. Although MNE operations have limited links to the domestic economy, their activities are recorded in Ireland's national accounts and balance of payments, leading to significant distortions in commonly used indicators on growth dynamics and external trade. In recent years, headline aggregates have typically understated the growth contribution from domestic demand, while significantly overstating the impact of net exports.

According to latest Central Statistical Office (CSO) data, external demand has proven resilient so far. Net exports accounted for the bulk of economic growth last year, with its growth contribution rising from an already high 10.1 p.p. in 2017 to 15.7 p.p. last year, as export growth accelerated from 9.2 to 10.4%, driven by vividly expanding goods exports, which edged up by 13.6% (2017: 3.3%). In particular, medical and pharmaceutical product exports performed strongly, soaring by 30.7% on the year. In service exports, growth moderated from 17.7% to a still robust 6.4% in 2017-18, mainly due to the slowing momentum in the important segment of business services. Meanwhile, total imports contracted by 2.9% in 2018 (2017: +1.1%), reflecting a double-digit decline (-10.0%) in service imports, chiefly a result of declining business service imports (-28.6% y-o-y) which include, among others, the transfers of intellectual property from abroad and aircraft leasing activities.

Headline figures on investment point to a pronounced weakness in capital spending last year. Following a 6.7% decline in 2017, gross fixed capital formation fell by another 21.1% in 2018. As in the previous year, the poor performance was primarily attributable to plummeting R&D expenditures in the MNE sector, which more than halved from EUR 52.6bn to EUR 23.4bn in 2017-18. Against this background, it appears more appropriate to assess alternative metrics. Modifying gross fixed capital formation to take into account the volatile components of investment in intangibles and aircraft leasing, investment evolved much more favorably than suggested by national accounts data. Modified investment leapt from 1.3% in 2017 to 8.5% in 2018, mirroring vividly growing capital spending on construction projects, as well as machinery and equipment. Investment in transport equipment returned to positive growth, skyrocketing to 45.1% (2017: -11.7%). At the same time, construction investment (dwellings, roads and other buildings) remained on a steep upward trajectory, increasing by 22.7% (2017: +17.3%) thanks to brisk demand for housing and the ongoing implementation of the government's National Development Plan 2018-27.

Apart from investment, underlying domestic demand was also supported by robustly growing private consumption, which added another 1.1 p.p. to last year's economic expansion (2017: 1.0 p.p.). Growth in household spending picked up from 3.1 to 3.4% in 2017-18, on the back of further improving labor market fundamentals. Although consumer sentiment started to weaken in the second half of 2018, employment and real wage growth did not show signs of weakening, thereby supporting households' propensity to consume. Wage growth continued to accelerate, responding to increasing staff shortages in the labor market. As illustrated by CSO data, average hourly earnings grew by 2.5% last year, up from 0.3 and 1.7% in 2016/17, corresponding to the highest growth rate in nine years (2009: +4.3%). Meanwhile, inflation remained subdued, partly due to a weak sterling which kept import prices in check.

Looking forward, we anticipate a gradual slowdown in economic growth to 4.8 and 3.5% in 2019 and 2020 respectively, as robust but softening domestic demand should partly compensate for the weaker trade performance over the coming two years. Quarterly national accounts data also points to a slowing pace of the Irish economy. After Ireland had enjoyed double-digit yearly growth rates (Q1: 12.2%; Q2: 10.6%) in the first half of 2018, growth moderated to 7.2 and 6.0% y-o-y in 1Q19 and 2Q19 respectively, and we expect a further easing of economy activity over the coming quarters.

It has to be pointed out that we are sticking to our baseline scenario, which assumes an orderly Brexit. While the EU and the UK have reached a new agreement, a hard Brexit has been averted for now, as the deadline for the UK's withdrawal from the EU has been extended for the third time. The recent events are set out in more detail below (see Institutional Structure). The economic fallout of a disorderly Brexit would be severe in 2020 given the economy's strong trade and financial linkages with the UK. The Central Bank of Ireland (CBI) estimates that a hard Brexit could cost the Irish economy more than 3 p.p. of GDP growth in 2020 as compared with the deal scenario. The Department of Finance reckons that real GDP growth could be 2.4 p.p. lower in the case of a no-deal Brexit.

Irish exports held up remarkably well between January and July 2019, considering the multiple headwinds to external demand such as a cyclical slow-down in euro area growth, trade tensions, and rising fears of a disorderly Brexit. Seven months into the year, merchandise exports stood 11.5% above their 2017 levels. Positive growth was observed across the country's main export markets, with exports to the EU (excl. UK) and North America up by 11.3 and 15.3% respectively. Surprisingly, exports to the UK grew by a solid 5.6% y-o-y (Jan-Jul-18: -1.8%). However, it appears unlikely that this marks the beginning of a sustainable recovery in external demand from Ireland's largest trading partner. Survey data compiled by the Bank of England earlier this year indicates that the risk of a border gridlock caused by a no-deal Brexit led British manufacturers to significantly ramp up their stockpiling efforts in the first quarter, providing a transitory boost to import demand. Absent further stock building, we expect exports to the UK to taper off over the next quarters, as economic activity in the UK has essentially stagnated. We expect net external trade to significantly weigh on this year's growth, mainly due to the exceptional spike in IP imports in 2Q19. Export growth should hold up well this year, but level off going forward owing to normalizing pharma and ICT export growth, and to the broad-based downturn in international trade and easing euro area demand more generally.

There are also signs that fears over a disorderly Brexit are increasingly weighing on underlying domestic demand. Modified gross domestic fixed capital formation contracted at the beginning of the year (Q1: -2.5% y-o-y), followed by positive but sluggish growth in the second quarter (+1.3%). Most importantly, investment in machinery and equipment (excl. aircraft) performed weakly, falling by 27.4% on the year in 1Q19. We expect firms to be rather cautious on machinery and equipment investment in view of persisting external uncertainties and easing capacity pressures. Capacity utilization in the manufacturing sector has steadily declined throughout the year, decreasing from 80.3 (Q1) via 76.9 (Q2) to 74.1% in the third quarter of 2019. Hence, capacity utilization is now somewhat below its long-term average (1985-2018: 76.6%). At the current juncture, we believe that equipment investment is unlikely to emerge from its soft patch during the remainder of the year, as the lack of clarity on Brexit is likely to persist over the coming months. Meanwhile, early indicators suggest that construction investment should continue to expand at a healthy, albeit slower pace than in 2018. After the number of completed dwellings more than tripled from 5,518 to 18,016 in 2014-18, the residential property market has shown no signs of saturation yet. Building permits for dwellings increased by 17.6% y-o-y in the first six months of 2019, but less vigorously than the year before (H1-18: +59.8). In general, benign financing conditions

– reflecting the ECB's decision to keep the key interest rates at their present or lower levels until the inflation outlook converges robustly to a level sufficiently close to, but below, 2% – should bode well for sustained growth in construction activities in 2019/20.

While we expect a sustained expansion in private consumption in 2019/20, growth should ease somewhat in view of the presumably slower job growth and cooling consumer sentiment. The European Commission's consumer confidence indicator has continued to deteriorate since the beginning of the year, hitting a 58-month low in August 2019; however, data also showed that the slump has so far been primarily triggered by concerns over Ireland's economic prospects rather than by consumers' fears about their personal finances. These findings are consistent with CBI projections, according to which growth in compensation per employee should exceed the 3% mark this and next year. Furthermore, a minimum wage hike entering into effect in January, the implementation of some tax relief measures (see below), and moderate inflationary pressures should bolster consumers' purchasing power. Adding to this, improving household balance sheets coupled with the recent pick-up in new lending for consumption should cater for sustained growth in consumer spending.

Nevertheless, indebtedness remains among the highest in the EU-28, weighing on the risk-bearing capacities of households. As measured by disposable income, household debt equaled 122.8% at the end of the second quarter 2019, down from 127.4% a year before. We have to mention, though, that Irish households have gone a long way in cleaning up their balance sheets, as Q2 marked the lowest level since the second quarter of 2003. Meanwhile, non-financial corporation (NFC) debt totaled 172.7% of GDP in 2Q19 (2Q18: 177.9%). Despite the headway being made in terms of deleveraging and acknowledging that corporate debt is propelled by the strong MNE presence, NFC debt is also high from an EU perspective (third highest reading in the EU-28).

Benign labor market conditions should stay supportive of economic growth. Labor market metrics have continued to improve, with unemployment falling to historically low levels. The LFS adjusted quarterly unemployment rate dropped from 5.6% in 3Q18 to 5.3% in this year's third quarter (EA-19, Q2: 7.6%), but has inched up from the 5.0% seen in Q1. Likewise, employment has shown unabated strong growth of 3.6 and 2.0% y-o-y in the first and second quarters respectively. Yet, the significant degree of uncertainty appears to have put the brakes on employment growth, as the Q2 growth was the slowest since 1Q13. We note that labor participation has also continued on its upward trajectory, but remained sub-par in a euro area comparison (2Q19: 73.0 vs. 73.7%). While we expect robust though gradually easing employment growth, the further development will obviously be highly dependent on a further vivid influx of migrant workers. Demographics have been helpful so far. In the twelve months to April 2019, a net inward migration of 33,700 persons was recorded, broadly the same as in the year before (CSO data). According to Eurostat, Ireland displayed one of the highest crude rates of net migration in the EU-28 last year.

The increasingly tight labor market is set to boost wage growth going forward. At this stage, however, we do not believe that competitiveness will be jeopardized. To be sure, we observe vivid increases in real compensation per employee, having risen by 4.8% between 2015 and 2018 – well above the readings of the euro area as a whole and that of main

trading partners (AMECO data). At the same time, real unit labor costs are following a steep downward trend, as wage growth is significantly outstripped by real labor productivity growth. It has to be kept in mind that labor productivity data is also distorted by MNE activities. Referring to CSO data on the decomposition of productivity, there is reason to assume favorable underlying labor productivity. Labor productivity growth in sectors dominated by foreign-owned MNEs displayed stellar growth of 87.8% in 2010-17, but other sectors excluding the MNE-dominated sectors also grew considerably in terms of labor productivity (21.0%). Moreover, Ireland has been able to expand its global export market share from 1.06% in 2014 to 1.88% in 2018 on the back of brisk services exports. Perception-based indicators such as the World Economic Forum's global competitiveness indicator (2019: rank 24 out of 141 economies) and the World Bank's doing business indicator (rank 24 out of 190 economies) also confirm Ireland's favorable competitiveness position.

## Institutional Structure

Our assessment of Ireland's creditworthiness continues to reflect its very strong institutional conditions. In general, we believe that the Irish economy is aided by the country's EU/EMU membership which entails significant benefits stemming from the free movement of labor and capital, as well as broader and deeper capital markets and advantages related to the euro as a reserve currency.

The latest edition of the World Bank's Worldwide Governance Indicators (WGIs) reaffirms our view of a persistently very high quality of Irish economic and political institutions. Along all WGI dimensions we assess, Ireland continues to outperform not only the respective WGI median ranks of the EU-28 and the euro area, but also those of our A-rated sovereigns. In fact, Irelands WGI ranks are broadly in line with our "AA" median. The World Bank thus ranks Ireland at 22 out of 209 economies when it comes to the quality of policy formulation and implementation, as compared to a euro area median rank 35. The sovereign also fares better with regard to the perceived quality of contract enforcement, property rights, and courts, as well as the freedom of association, expression, and a free media, marking the 22th and 17th rank respectively (EA-19: ranks 32 and 25). Corruption may also not be deemed as an issue in Ireland, as hinted by the WGI control of corruption where the sovereign takes rank 20 (vs 41 in EA-19).

We note that government stability has endured since our last review. The incumbent Fine Gael-led minority government rests on a confidence and supply agreement with Fianna Fáil, its main opposition party. This agreement, originally set for three years, was extended for another year in December 2018, ruling out an early election in 2019 and strengthening Ireland's position over the course of Brexit negotiations. While the next general election is regularly scheduled for April 2021, we think there is an elevated probability that a snap election may take place over the course of the next year, if the UK's departure from the EU is sealed. What might speak against a snap election is that it is unlikely to bring a new political constellation, judging by recent polls which signal continued high levels of popular support for Fine Gael and Fianna Fáil alike, both lying neck-to-neck. Still, we believe that policy continuity will be given, as there is a broad consensus on the main policy lines, and

since the sovereign is characterized by prudent and transparent policy-making from our point of view.

While a disorderly Brexit is not off the table, we believe that economic, fiscal and political risks have abated more recently. The EU and the UK have reached a new Brexit agreement on the basis of a regulation for the future EU external border in Ireland. Under this arrangement, Northern Ireland will remain within the EU's customs territory and internal market until a free trade agreement is concluded between the UK and the EU. The Brexit dispute thus appears to be resolved. However, tail risks remain in place as the UK's parliament has refused to endorse the agreement so far.

As mentioned above, a hard Brexit on 31 October was averted as the deadline for the UK's withdrawal from the EU has been extended for the third time. The UK should now leave the EU by 1 February at the latest, but can do so earlier, on 1 December or at the turn of the year, if the Brexit Treaty passes parliamentary hurdles before that. To break the political deadlock, the British government is seeking to hold early parliamentary elections on 12 December. Against this backdrop, a deal-Brexit continues to represent our baseline scenario.

Despite being heavily engaged in Brexit contingency planning and playing a pivotal role during the negotiations between the EU and the UK, the Irish government remains committed to pursuing structural reforms, addressing bottlenecks to its business environment and future growth. While the government continues to push forward the implementation of its National Development Plan 2018-27 more generally, authorities published the Climate Action Plan 2019 this June. Against the background that Ireland has rather underachieved goals associated with climate change and renewable energies, we assess as favourable that a plan was put forward to sketch out the road map on the country's low carbon and energy transition, implying significant spending in this area. In the same vein, as suggested by the recently published Draft Budget 2020, plans are expedited to enhance the country's transport, water and digitalization infrastructure. Furthermore, policy-makers intend to advance policy action targeted towards enhancing upskilling and participation in the labor force, and fostering access to affordable childcare. We also observe policy efforts devoted towards compliance with international tax standards and cooperation with the EU and OECD in addressing tax system features conducive to aggressive tax planning. Since the beginning of this year, three out of the five components of the Anti-Tax Avoidance Directives (ATAD) have become effective, and Ireland's transfer pricing rules shall be updated in the near term.

## Fiscal Sustainability

Although risks to the sovereign's fiscal sustainability have diminished over recent years, these continue to represent a weakness, mainly reflecting high, though subsiding, government debt and interest outlays, as well as perils related to Brexit, a high but diminishing stock of NPLs, and to the sustainability of highly concentrated corporate income tax receipts.

We acknowledge that significant headway has been made with regard to fiscal consolidation in recent years. Since the country successfully exited the EFSF program in 2013, the fiscal deficit steadily narrowed from 6.2 to 0.3% of GDP in 2017, before the sovereign ran a modest headline surplus for the first time since 2007 (+0.3% of GDP) last year – slightly outperforming the government's target (-0.2% of GDP) outlined in the in the 2018 SPU.

Above all, last year's budgetary outperformance is explained by stronger-than-anticipated revenue growth. Thanks to vigorous GDP growth and positive one-offs, revenues expanded by 7.5% (2017: +4.2%). Most importantly, the revenue side of the budget benefited from a hefty CIT intake which accounted for roughly 40% of total revenue growth. Drawing on data from the Irish Office of the Revenue Commissioners, CIT payments edged up by EUR 2.2bn in 2018 (+26.7%) to EUR 10.4bn. About EUR 0.7bn (0.2% of GDP) of the overall increase is estimated to be one-off in nature, partly reflecting the transition of Irish based MNEs to the new IFRS15 accounting standard. Other revenue items, such as VAT and net social security contributions, also evolved dynamically, increasing by 8.4 and 6.4% respectively. The strong revenue intake more than offset higher government spending, which also came in above expectations. Expenditure growth accelerated from 2.8 (2017) to 6.0% in 2018, corresponding to the strongest expansion since 2010. Total gross voted current expenditures were 2.0% (EUR 1.1bn) above profile, mainly due to in-year expenditure increases in the areas of healthcare, education, and justice.

Looking forward, we believe that public finance will remain in good shape, as the government introduced only minor discretionary policy measures with its 2019 budget. Being the most significant revenue-enhancing measure, the VAT rate on tourism-related activities was increased from 9 to 13.5% this year. According to Ministry of Finance estimates, this should yield additional revenues of EUR 466m or 0.1% of GDP in 2019. Furthermore, several excise duty hikes entered into effect at the beginning of the year, with the proceeds being earmarked to fund some tax relief measures and higher government spending. A number of adjustments to income tax bands and social security contributions were thus implemented to lower the tax burden on employees. On the expenditure side, funds allocated to the Department of Housing, Planning and Local Government are envisaged to grow by 25% in order to mitigate the lack of affordable housing in Ireland, and the Department of Education and Skills will see its funding rise by 6.7% to hire 1,300 school employees and to create an additional 3,500 undergraduate places in 2019. Furthermore, the proposed increase in health care funding is approx. EUR 900m or 5.8%.

Taking into account that the latest Exchequer data outturn was somewhat more positive than expected, Ireland appears to be well on track to meet its fiscal target of a slightly improving headline surplus in 2019 (0.2% of GDP). The Exchequer deficit was approx. EUR 993mn ahead of profile to end-August, with revenue outperforming expectations by EUR 530mn or 1.2%, and expenditure being behind profile by EUR 993mn or 1.0% (Fiscal Monitor Aug-19).

With a view to next year, authorities have changed their assumptions on which the budget 2020 is based, with a no-deal Brexit now being the central scenario upon which the Irish government's budget plans rests. By contrast, we continue to assume that the UK will not leave the EU without signing a withdrawal agreement with the EU (also see above), and

expect the headline surplus to inch up to 0.3% of GDP next year. We thus attach a higher probability to more vivid tax revenue and net social security contributions. Most importantly, we refrain from adding the contingency package which the budget sets out as a disorderly Brexit response. This includes various items totaling EUR 1.22bn or 0.4% of 2018 GDP to cushion the fallout of a hard Brexit. Against this backdrop, the budget deploys EUR 650m alone to support farmers, the tourism industry, and border regions that would be most affected by a no-deal Brexit. A further EUR 410mn would be made available to cater for increased social protection with a view to the expected rise in redundancies. Also, EUR 160mn shall be spent immediately to provide the needed funds for staff, facilities, and infrastructure in travel, transport, and regulation.

Apart from contingency planning, the government envisages a raft of discretionary measures with a total budgetary impact of 0.3% of GDP. Spending priorities remain centered around social protection, healthcare, education, and housing. Policy-makers thus foresee to increase spending targeted towards children and families, including e.g. more funds for Tusla, and the introduction of the National Childcare Scheme. Upskilling remains an integral part of the government's strategy, reflected by measures to support the National Training Fund and the Human Capital Initiative. Spending on social protection shall be stepped up, with a focus on the qualified child increase, the working family payment, and several allowances (e.g. living alone allowance, fuel allowance). In addition, the government affirms its commitment to reforming the health sector by increasing voted health expenditure by 6.3%.

The revenue side will see several carry-overs from previous years, as Home Carer Tax and the Earned Income Credit, as well as the reduced USC rate, will be extended by one year. The tax base is further broadened by raising the stamp duty on non-residential property. In addition, indexation of income taxes will not enter into effect in 2020. Concurrently, climate and environmental measures have been seized as the government plans to e.g. increase the carbon tax rate from EUR 6 to 20 per ton. Overall, the additional revenue raked in is forecast to total approx. 0.1% of GDP.

As we understand, no additional funds will be devoted to a Rainy Day Fund which is being set up as a contingency reserve for 'unforeseeable and serious events' going forward. In view of questions concerning the sustainability of CIT receipts, we assess ramping up this facility as positive in terms of strengthening the State's budget against external shocks. According to the Corporate Tax Report 2018 (May-19), the ten largest payers accounted for 45% of CIT receipts in 2018.

The sovereign's credit rating continues to be constrained by high debt levels. At first glance, the public debt ratio does not appear to be alarmingly high. According to the latest autumn notification, general government debt stood at a mere 63.6% of GDP in 2018, slightly above the Maastricht threshold and well below the euro area average (85.9% of GDP). Also, we have seen pronounced and durable improvements more recently, as debt came down from 76.7% of GDP in 2015 after peaking at 119.9% in 2012. Other metrics, however, continue to paint a more differentiated picture. While general government debt totaled EUR 206.0bn, just 2.0% below the level in 2012, it equated to 104.3% of modified gross national income (GNI*, see above) in 2018. Having said this, the positive debt trend remains in place, as

debt-to-GNI* has also steadily fallen, and was 32.4 p.p. lower than five years ago. In the medium term, we expect the public debt ratio (measured by GDP and GNI*) to decline further after prospectively falling below the 60% of GDP threshold this year, underpinned by resilient nominal GDP growth, moderate headline surpluses, and diminishing interest expenditure. Although we do not factor in unrealized proceeds from winding down NAMA, the Department of Finance estimates receipts will add up to EUR 4.0bn in 2020/21 which will be allocated towards bringing down general government debt.

What is more, debt affordability is set to continue to evolve favorably. We continue to view sound and forward-looking debt management by the National Treasury Management Agency (NTMA) as credit positive, as it has contributed to lower borrowing costs. The NTMA has thus taken advantage of the current extraordinarily low interest rate environment on an ongoing basis. 10y government bond yields have been dwindling from one historical low to the next. After turning negative this August, long-term bond yields fell to -0.03% in October (04-10-19) as compared to 1.08% a year before (05-10-18) – with the Bund spread moving in a band between 20 and 80bp for quite some time now.

As a result of the NTMA operations, including the issuance of EUR 56bn of long-term debt with a weighted average maturity of approx. 13.5y in 2015-18, the EUR 4.5 and 1bn repayments of IMF and bilateral loans to Sweden and Denmark respectively, as well as the sale of floating rate notes to NTMA, the sovereign exhibits a balanced maturity profile. Ireland displays a weighted average maturity of 10.0y, one of the longest in the EU-28 and a diversified holding structure from a geographical and investor base point of view. On a side note, EFSM and EFSF loan repayment will not commence before 2027.

Accordingly, interest payments as measured by general government revenue, our preferred measure of debt affordability, are likely to continue along their downward trajectory. For now, Ireland features one of the highest interest-to-revenue ratios in the EU-28, coming in at 6.4% in 2018. However, interest costs have decreased rapidly over the last years, having dropped from 7.6% of total revenues in 2017 and 12.6% in 2013.

We still believe that the Irish banking sector entails some fiscal sustainability risks, while acknowledging further improvements since our last review. As highlighted by EBA data, the Irish CET 1 ratio remains comfortably above the EU-28 average of 14.6%, though having fallen from 19.4% to 18.8% in the year to the second quarter of 2019. The same applies to banks' profitability, as mirrored by the 0.9% in return on assets (EU-28: 0.5%). Arguably most importantly, asset quality has further improved since last year, but the stock of non-performing loans is still elevated. The NPL ratio has thus come down further, now standing at 4.6% (2Q18: 7.0%). At the same time, mortgage arrears are also high and only gradually declining. At the latest count, total mortgage accounts in arrears accounted for 13.6% of the total volume of outstanding mortgages in 2Q19, down from 15.0% a year before, with long-term arrears (over 90 days) decreasing from 11.9 to still high 10.9% (CBI data).

Risks emanating from the housing market seem to subside, as residential property prices have been on the retreat more recently. As the 3-year growth rate, our preferred measure, has exceeded 25% for 18 consecutive quarters, we continue to monitor house price developments closely. That being said, the second quarter of 2019 saw the lowest annual growth

rate in six years, having dwindled from 12.6% in 2Q18 via 7.2% in Q4 to 2.5 in 2Q19. The price-to-income ratio stood only 2.6% (1Q19) above its long-term average since 1995, pointing to no serious misalignment at this stage. In any case, loans for house purchase have shown sluggish growth over the last year. In September, the outstanding volume of mortgage loans stood 1.0% below the previous year's level.

## Foreign Exposure

As Ireland is a small and open economy with a strong MNE concentration, its current account continues to be exceptionally volatile and subject to large distortions which thwart the interpretation of its external position. Ireland thus recorded a very large current account surplus of 10.6% of GDP in 2018, having increased by more than 10 p.p. as compared to the year before (2017: 0.5% of GDP). The large headline current account surplus came mainly on the back of a substantially narrowed deficit in the trade in services balance, from 14.6 to 1.7% of GDP in 2017-18, owing to sharply increasing computer service exports. As suggested by the Economic Statistics Review Group (ESRG), we arrive at a clearer view on Ireland's underlying external position when assessing the modified current account, which considers revenue from R&D-related IP exports and the investment of R&D service imports, while using depreciation on net imports of IP and imports of R&D services. Accordingly, we observe a significantly less volatile development of the underlying current account and, equally important, one that points to a continued improvement in the competitiveness of Ireland's domestic economy. As measured by GNI*, the modified current account surplus rose to 6.5% in 2018, up from 3.7% in 2017. After having posted current account deficits between 2005 and 2013, the 5-year-average since 2014 amounts to surplus of 2.0% of GNI*.

While forecasting the current account is clearly a challenging task, we expect the headline current account to deteriorate and remain close to balance this and next year. The current account surplus should narrow significantly in 2019, mainly due to the already mentioned exceptionally sharp increase in IP imports driven by MNEs, which led to a current account deficit of -32.0% of GDP in 2Q19.

In terms of headline figures, Ireland is thus set to remain a net external debtor. In fact, Ireland displayed the most negative net international investment position (NIIP) in the EU-28 last year, slightly improving from -167.2% of GDP in 2017 to -165.0% of GDP. Again, MNEs play a decisive role, as does the International Financial services Center (IFSC), and due to the somewhat limited impact on the domestic economy, we do not believe that the highly negative NIIP does poses an immediate risk. As regards the general government sector, we observe a gradual decline in net obligations to non-residents, with the NIIP rising from -41.3 to -38.3% of GDP in 2017-18 (CSO data). Abstracting from the IFSC, gross external debt continued on the downward trajectory which it has followed since 2015, coming in at 257% of GDP in 2018, after 261.7% of GDP in 2017 (2015: 300.1%).

In general, we note that the Irish economy is highly susceptible to global growth and trade dynamics. In fact, we regard Ireland as one of the countries which appear to be most integrated into global value chains. As evidenced by OECD TiVA data for 2015, the share of domestic value added embodied in foreign final demand stood at 64.6% – the second-highest value among all OECD members (behind Luxembourg).

## Rating Outlook and Sensitivity

Our Rating outlook on Ireland's sovereign ratings is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – is likely to remain fundamentally unchanged over the next twelve months.

We could raise Ireland's credit ratings if medium-term growth comes in significantly higher than we expect, if public debt continues to decline on a sustained basis – also measured by alternative metrics such as debt/GNI* - and/or if we observe that the ratio of non-performing loans moves closer to the European average, accompanied by progress in clearing long-term mortgage arrears.

We could consider lowering the ratings or the related outlook if fiscal slippages lead to a reversal in the downward trend of general government debt, or if Ireland's medium-term growth deteriorates significantly. Downward risks to Ireland's economic and fiscal prospects are primarily related to the risk of the UK leaving the EU without an agreement. In view of intense trade, financial, and labor market linkages, a no-deal Brexit is likely to have serious negative effects. This is underscored by our Brexit Risk Indicator, according to which Ireland is the EU economy most heavily exposed to UK-related trade and capital flows in the EU-27 (BRI: 3.8, EU-27 median 2.0; see "What if... – Consequences of a hard Brexit for the EU-27 states"). Downward pressure on the ratings could also arise if we see resurfacing macro-financial imbalances stemming from the residential property market in tandem with rising household debt, or if changes in international taxation standards result in adverse effects on the economy's competitiveness in terms of foreign direct investment, and the government's revenue intake.

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## Ratings*

| | |
|---|---|
| Long-term sovereign rating | A+ /stable |
| Foreign currency senior unsecured long-term debt | A+ /stable |
| Local currency senior unsecured long-term debt | A+ /stable |

*) Unsolicited

## Economic Data

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019e | 2020e |
|---|---|---|---|---|---|---|---|
| Real GDP growth | 8.6 | 25.2 | 3.7 | 8.1 | 8.2 | 4.8 | 3.5 |
| GDP per capita (PPP, USD) | 51,500 | 64,465 | 66,705 | 72,664 | 79,617 | 83,399 | 86,988 |
| HICP inflation rate, y-o-y change | 0.3 | 0.0 | -0.2 | 0.3 | 0.7 | 0.9 | 1.1 |
| Default history (years since default) | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Life expectancy at birth (years) | 81.4 | 81.5 | 81.8 | 82.2 | n.a. | n.a. | n.a. |
| Fiscal balance/GDP | -3.6 | -1.9 | -0.7 | -0.3 | 0.1 | 0.2 | 0.3 |
| Current account balance/GDP | 1.1 | 4.4 | -4.2 | 0.5 | 10.6 | n.a. | n.a. |
| External debt/GDP | 951.5 | 865.7 | 822.3 | 733.8 | 740.5 | n.a. | n.a. |

Source: International Monetary Fund, Eurostat, own estimates

## Appendix

### Rating History

| Event | Publication Date | Rating /Outlook |
|---|---|---|
| Initial Rating | 25.11.2016 | A /stable |
| Monitoring | 24.11.2017 | A /positive |
| Monitoring | 26.10.2018 | A+ /stable |
| Monitoring | 08.11.2019 | A+ /stable |

### Regulatory Requirements

In 2011 Creditreform Rating AG (CRAG) was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

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The rating was conducted on the basis of CRAG´s “Sovereign Ratings” methodology in conjunction with its basic document “Rating Criteria and Definitions”. CRAG ensures that methodologies,

models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of CRAG´s rating methodologies and basic document "Rating Criteria and Definitions" is published on the following internet page: www.creditreform-rating.de/en/regulatory-requirements/.

To prepare this credit rating, CRAG has used the following substantially material sources: International Monetary Fund, World Bank, Organization for Economic Co-operation and Development, Eurostat, European Commission, European Banking Authority, European Central Bank, World Economic Forum, Central Bank of Ireland, Central Statistics Office (CSO), Republic of Ireland - Department of Finance, National Treasury Management Agency.

A Rating Committee was called consisting of highly qualified analysts of CRAG. The quality and extent of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with. No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in CRAG´s "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

As regards the rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the credit rating report. There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. In case of providing ancillary services to the rated entity, CRAG will disclose all ancillary services in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the rating report; the first release is indicated as "initial rating"; other updates are indicated as an "update", "upgrade or downgrade", "not rated", "affirmed", "selective default" or "default".

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An explanatory statement of the meaning of each rating category and the definition of default are available in the credit rating methodologies disclosed on the website.

Creditreform Rating

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