Ireland Rating Report - July 2018
Rating Report

SCOPE A+ STABLE OUTLOOK

Credit strengths	Credit weaknesses
• EU and euro area membership	• Vulnerability to economic reversal
• Strong institutional environment	• High public- and private-debt stock
• Public and private deleveraging	• External vulnerabilities
• Robust growth potential	• Financial system risks

Rating rationale and Outlook: Ireland's A+ sovereign ratings (and Stable Outlook) are underpinned by the nation's euro area membership and strong institutional framework alongside a wealthy, diversified economy that generates one of the highest per-capita incomes in Scope's rated universe. The rating also acknowledges the robust economic growth potential, improving public finances, a resurgent current account surplus and ongoing multi-sectoral deleveraging. These credit strengths are balanced by the economy's vulnerability to sudden turnarounds contingent on the global cycle and still high private- and public-sector indebtedness, which limit the system's ability to absorb shocks. Moreover, there are downside risks stemming from the impact of Brexit on trade activity with the UK, as well as from the Irish economy's strong dependence on US-based multinational enterprises (MNEs) and their global tax strategies.

Figure 1: Sovereign scorecard results

Scope's sovereign risk categories	Ireland	Peer comparison Average
Domestic economic risk		
Public finance risk		
External economic risk		
Financial risk		
Political and institutional risk		
Qualitative adjustment (notches)	-2	
Final rating	A+	

AAA AA A BBB BB B CCC CC C

NB. The comparison is based on Scope's Core Variable Scorecard (CVS), which is determined by relative rankings of key sovereign credit fundamentals. The CVS peer group average is shown together with two selected countries chosen from the entire CVS peer group. The CVS rating can be adjusted by up to three notches depending on the size of relative credit strengths or weaknesses.

Source: Scope Ratings GmbH

Positive rating-change drivers	Negative rating-change drivers
• Significant reduction in government indebtedness	• Weakening or reversal of downward public-debt ratio trajectory
• Private-sector deleveraging and greater banking system resilience	• Re-gathering of private-sector and banking system risks
• Reduction in external vulnerabilities	• External risks increase or crystallise

Ratings & Outlook

Foreign currency

Long-term issuer rating	A+/Stable
Senior unsecured debt	A+/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	A+/Stable
Senior unsecured debt	A+/Stable
Short-term issuer rating	S-1+/Stable

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Domestic economic risk

Growth potential of the economy

Strong cyclical economic performance

Robust economic growth has meaningfully outperformed that of peers since 2014, which is expected to continue in the near term. Real GDP expanded by 7.2% in 2017, well exceeding forecasts and the highest of European Union (EU) member states. Annual growth in Q1 2018 stood at 9.1%. The strong performance has been broad-based across private and public consumption, recovering investment, and net exports. According to the European Commission, real GDP is projected to grow at 5.7% in 2018 before 4.1% in 2019. The domestic economy is, however, edging towards capacity limitations, in Scope's view. That said, further improvement in private-sector balance sheets can be expected to support private consumption and investment.

However, GDP data overstates underlying growth as well as the size of the economy

Even though Irish GDP data point to robust growth, there are important uncertainties. Irish GDP statistics, though fully compliant with international standards, tend to overstate underlying growth. This is due to headline GDP growth figures also reflecting the substantial activity of mainly US-based multinational enterprises that are partially delinked from underlying Irish economic activity. Relocation of, or investment in, intangible and internationally mobile capital assets as well as contract manufacturing[1] have an important impact on GDP data without the same degree of underlying relevance to on-the-ground activity and labour market developments. This complicates the assessment of economic developments, including for cross-country comparisons.

Moreover, Scope takes into account that credit metrics such as public debt and deficit ratios are also affected by distorted GDP data (discussed later in the Public Finance Risk section of this report). As a response, the central statistics office prudently designed a *modified gross national income (GNI)* metric, a special "de-globalised" measure of Irish annual product that excludes the effects of profits from re-domiciled US companies. This modified GNI metric was about 38% under reported nominal GDP as of 2017. Scope accounts for the data uncertainties with a one-notch analyst downward adjustment (reflected in the A+ sovereign rating) to capture the impact of data distortions on the first step in Scope's rating review – Scope's quantitative model, the Core Variable Scorecard (CVS).

High-frequency indicators so far support continued underlying economic dynamism in 2018. The European Commission's consumer confidence indicator for Ireland stood at a robust 14.4 as of May 2018. Ireland's composite PMI was 58.1 in June 2018 – about its average over the last year. Here, Scope observes that high-frequency indicators in Ireland are an unreliable predictor of Irish GDP growth.

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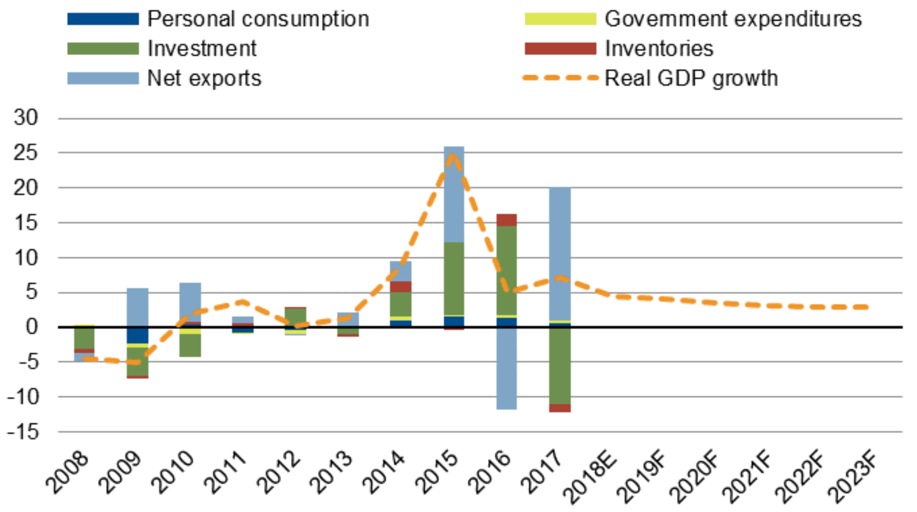
[1] In which international companies register in Ireland but carry out activities offshore, whether by shifting the location of physical manufacturing, or via accounting or legal manoeuvres.

Figure 2: Real GDP growth by expenditure contribution, with IMF 2018-2023 forecasts



Source: IMF, Central Statistics Office Ireland, calculations by Scope Ratings GmbH

Job-rich recovery, though muted inflation

The Irish economic recovery has been job-rich. Broad-based job creation has led to a rapid decline in the unemployment rate to 5.1% as of June 2018 from the peak of 16.0% in early 2012. Wage growth is rising, pointing to reduced slack in the labour market. Average hourly earnings stood at 2.7% YoY in Q1 2018, up from 0.3% YoY as of Q3 2016. However, labour market participation remains low compared with that in EU peers (at 62.1% in Q1 2018).

Inflation has remained muted, however: 0.7% YoY in June 2018, and just 0.1% on a core measure. Credit growth shows disparate trends. While there is positive credit growth in areas like consumer lending, aggregate metrics show continued cross-sectoral deleveraging (discussed more in the Financial Stability Risk section of this report). Loans to households stood at -0.9% YoY as of May 2018, with loans to non-financial corporations at -4.9% YoY, driven by redemptions surpassing new loans.

Strong medium-run growth potential

Structural long-run growth estimates remain robust, even if somewhat tamer than recent elevated growth. Scope estimates Ireland's medium-run growth potential at about 3.5%. This estimate acknowledges demographic growth, with 0.7% annual working-age population increases assumed over 2018-2023 (source: United Nations) alongside robust productivity growth. Scope's potential growth estimate is higher than that of the IMF (2.8%)[2].

Economic policy framework, and macro-economic stability and sustainability

Strong institutions, and wealthy, diversified economy

Ireland holds strong institutions, bolstered via its EU and euro area membership, and a wealthy and diversified national economy that generates one of the highest per-capita incomes in Scope's rated universe (USD 70,638 in 2017). Scope believes that institutional developments and adjustments at the European level of past years (since the Great Financial Crisis (GFC)) have increased euro area members' protections against adverse shocks. This European-level anchor, including Ireland's status within a large common market, a strong reserve currency, and an independent European Central Bank effectively acting as a lender of last resort, is reflected in Ireland's A+ ratings.

[2] IMF's April 2018 World Economic Outlook estimate for 2023 growth in Ireland.

Risk of sudden economic reversals constrains rating

Recent economic performance has been robust; however, this strength has had in part cyclical derivations (and quarterly growth figures are distorted partially by the investment activities of MNEs) – related to economic recovery from a deep recession alongside supportive regional and global conditions. The high volatility of Ireland's small, open economy (nominal GDP of EUR 294bn in 2017) means that phases of strong growth may be followed by sudden, significant downturns – driven by either domestic or international causes. Learning from the experience during the GFC and sovereign debt crisis, the risk of sudden economic reversal remains a credit constraint to the sovereign rating level. **Table 1** shows Ireland and euro area peers compared via several indicators exhibiting Ireland's small, very open economic structure alongside exposures to global economic downturns.

Table 1: Ireland versus euro area peers, economic vulnerability and openness

		Economic vulnerability/volatility			
Ireland and euro area peers	Scope long-term rating	Size of economy: nominal GDP, 2017 (EUR bn)	Real growth volatility 2000-17 (%)[1]	Real GDP cum. decline in GFC (%)[2]	Current account exports/imports (% of GDP)
Ireland	A+/Stable	294.1	6.4	-11.7	142.9
Belgium	AA/Stable	437.2	1.4	-3.8	98.9
France	AA/Stable	2,291.7	1.4	-3.9	40.8
Slovakia	A+/Stable	85.0	3.4	-9.1	99.9
Spain	A-/Stable	1,163.7	2.6	-9.6	39.4
Italy	A-/Negative	1,716.9	2.1	-9.6	34.8
Latvia	A-/Stable	26.9	6.3	-22.8	70.1

[1] Standard deviation of annual growth performance
[2] Peak to trough decline in Great Financial Crisis

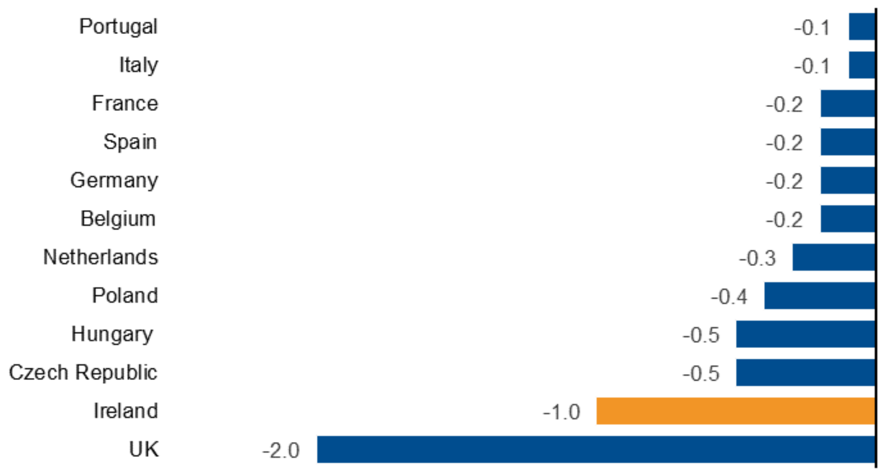
Source: Haver Analytics, Scope Ratings GmbH

A disorderly Brexit is a risk

Ireland is significantly exposed to the UK, with about 13% of goods exports going to the UK, and 24% of goods imports coming from the UK most recently. The UK's exit negotiations concentrate on the maintenance of a soft border between Northern Ireland and Ireland. However, the risk that negotiations break down and a hard border materialises presents a downside risk, even though Scope does not anticipate this.

Consultancy Oxford Economics concluded that Ireland is the most exposed of any EU country (aside from the UK itself) to a hard Brexit, with Ireland facing an estimated 1.0% decline in GDP by 2020 in a no-deal exit scenario, compared with a baseline forecast. This represents a far greater impact than, for example, the potential impact on France (0.2%), Spain (0.2%), Germany (0.2%) or Italy (0.1%), as shown in **Figure 3**.

Figure 3: Real GDP impact of no deal Brexit on EU countries by 2020 relative to a baseline forecast, %



Source: Oxford Economics

Scope observes that Brexit has both negative and positive effects on Ireland. The slowdown in the UK economy is impacting the Irish economy and the scenario of a hard Brexit remains a low-probability, high-impact risk. At the same time, however, Brexit has prompted financial and non-financial companies to consider moving some operations to EU countries, including Ireland. This includes announcements from Bank of America, Barclays, JP Morgan and Citigroup, to ensure trading within the EU continues via Dublin as a new EU hub. Greater clarity over the minimisation of Brexit risks could support a stronger assessment on Ireland's creditworthiness in the future, in Scope's view.

Public finance risk

Fiscal policy framework

Improvements in public finances, with a structural surplus seen in 2020

Strong tax revenues, particularly corporate and value-added tax receipts, alongside a decline in the interest burden, supported a drop in the 2017 fiscal deficit to 0.3% of GDP, from 0.5% of GDP in 2016.

In 2018, the headline government deficit is foreseen at 0.2% of GDP, with a general government surplus aimed for by 2020. The central government balance was -0.3% of GDP year-to-date through June, compared with 0.9% of GDP through the same month in 2017, however. The primary surplus is expected to remain flat at 1.5% of GDP in 2018 from 1.6% of GDP in the year prior. In structural terms, the cyclically-adjusted fiscal deficit is seen at 0.6% of GDP in 2018, up from 0.1% in 2017, before dipping under the medium-term objective of 0.5% by 2019 and reaching a surplus in 2020 – representing significant fiscal efforts planned in the years 2020 and 2021. Going forward, some further spending is envisioned, including capital spending from the *National Development Plan*.

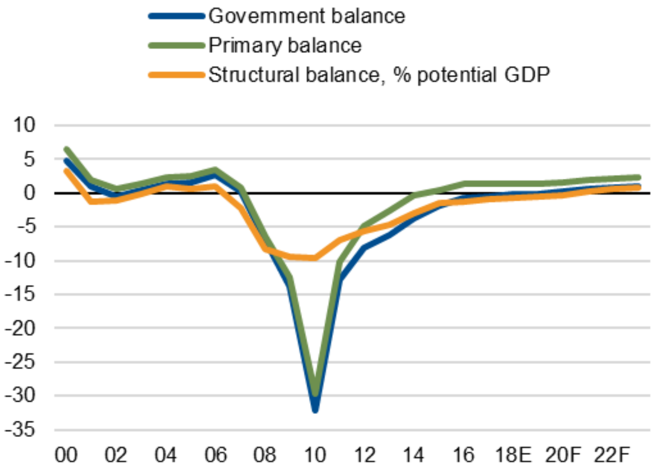
Ireland's fiscal framework enhanced via regional institutions alongside post-bailout surveillance

Ireland's fiscal framework is enhanced via its EU and euro area membership. Ireland is subject to the preventive arm of the EU's Stability and Growth Pact (SGP) and the European Fiscal Compact, which require it to ensure progress towards a medium-term budgetary objective of a structural deficit of up to 0.5% of GDP. As Ireland's debt ratio still stands above the 60% of GDP reference level, the nation must also comply with the SGP's debt reduction benchmark. In its latest assessment, the European Commission noted that Ireland is compliant with its medium-term objective and debt criteria, though it cautioned about deviations in the structural deficit and expenditure growth benchmarks in

2018. In addition, having corrected its excessive deficit in 2015, Ireland is in the transition period as regards the debt criterion for the three years following the correction. The EU's fiscal rules inform Ireland's national fiscal framework, enshrined in the Fiscal Responsibility Act of 2012 – this incorporates assessment of macroeconomic forecasts by the Irish Fiscal Advisory Council. These fiscal improvements and an enhanced fiscal framework abet Ireland's rating level and outlook.

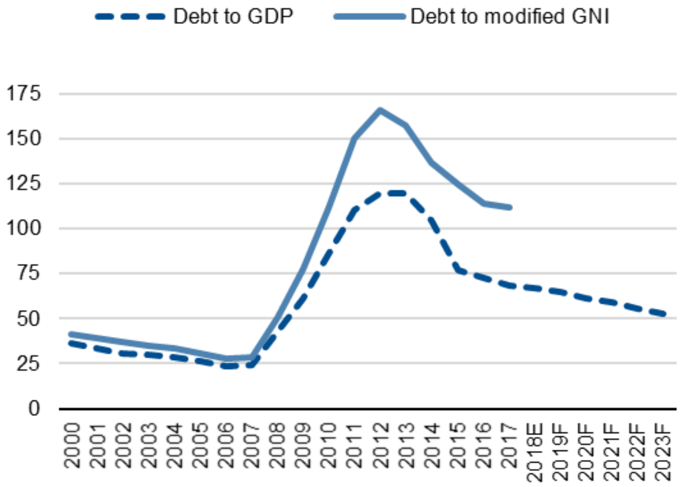
Moreover, Scope notes that Ireland remains under post-programme surveillance from the European Commission and European Central Bank after the conclusion of its 2011-13 bailout programme. Surveillance should last until at least 2031, barring early repayments (until 75% of financial assistance received has been repaid) – with oversight supporting prudent policy making.

Figure 4: Fiscal developments, % of GDP



Source: IMF

Figure 5: Debt to GDP, and debt to modified GNI, %



Source: IMF, Haver Analytics, calculations by Scope Ratings GmbH

Debt sustainability

Downward trajectory of debt ratio

General government debt has continued a decline to 69.3% of GDP as of Q1 2018, from 75.8% a year prior and 124.6% during the Q1 2013 peak. This impressive drop has been driven by high nominal growth, improvements in the fiscal position, and proceeds from the state's bank holdings. Scope expects the debt ratio to continue the downward path over the foreseeable future. IMF baseline projections see the debt ratio falling to 52.4% by 2023, helped moreover by the sale of the government's remaining holdings in Allied Irish Banks, Bank of Ireland and Permanent TSB. On a net debt basis, this decline is from 59.8% of GDP in 2017 to 47.8% by 2023, according to the IMF.

However, public-debt sustainability remains highly vulnerable to adverse economic growth shocks. At the same time, interest rate risk is relatively low due to the structure and long average maturity of public debt.

Despite projected improvements in Ireland's debt metrics, Scope notes that general government debt to revenues, at 273% in Q1 2018, remains elevated. Moreover, the impact of multinational companies in Ireland inflating GDP statistics means public-debt sustainability needs to be assessed against complementary indicators, such as debt to modified GNI. Here, public debt as a share of modified GNI is significantly higher (**Figure 5**) and substantially above debt to GNIs of peers: Ireland's being around 111.1% of modified GNI as of 2017. The modified GNI ratio in 2017 remains much higher than it was pre-crisis (27.7% of modified GNI as of 2006), even though Ireland has also reduced this significantly from its peak (166.1% in 2012). Given Ireland's vulnerability to external shocks, coupled with debt on private sector balance sheets (and thus, risk for spill-over in a stressed case), continued public-sector debt reductions should remain a core priority in facilitating greater resilience and shock-absorption means, in Scope's view.

Long-term sustainability risks due to unfunded pension liabilities

Even though birth rates in Ireland are above typical international replacement rates, and the old-age dependency ratio (65+/ages 15-64) compares well against that in other OECD countries (supported by a young workforce)[3], Ireland's long-term debt sustainability is challenged by very high unfunded pension liabilities as evidenced by generational accounting conducted by the Freiburg-based Market Economy Foundation.[4] The European Commission judged Ireland to face "medium" fiscal sustainability risks stemming from ageing costs.

Market access and funding sources

Near-term collections include back taxes from Apple, increasing government assets

Ireland is in the process of collecting EUR 13bn in back taxes (plus interest and penalties) that the European Commission in August 2016 ordered Apple to pay; both the company and Ireland have appealed. The EU ruled that the Irish government offered illegal state aid to Apple in the way it allowed the company to arrange its tax affairs. Apple is now paying the monies into an escrow account, overseen by the Irish government, pending the outcome of appeals. It is currently unclear when the appeals will be resolved (and payments finalised). Irish officials expect to have all funds (worth over 4% of GDP) in the escrow account by the end of September.

Irish yields are very low within an accommodative funding environment

Ten-year Irish bond yields remain very low from a historical perspective, about 0.85% at the time of this writing (with the spread to German Bunds at around 50bps). In this environment, by Q2 2018, the National Treasury Management Agency (NTMA) had issued EUR 8.25bn in government bonds of a planned EUR 14bn-18bn for the calendar year. Presently, Scope does not anticipate the exit process from the European Central Bank's quantitative easing programme to significantly negatively impact Ireland's funding terms, though it will increase upside risk on yields in times of market stress.

Very long average debt maturity

As of December 2017, 64% of gross national debt was outstanding in the form of government bonds. 23% of national debt is composed of European bailout loans (from the European Financial Stabilisation Mechanism (EFSM), European Financial Stability Facility (EFSF), and bilateral loans), though this share is dropping. The weighted average maturity of Ireland's long-term marketable and official debt is very long at about 11.7 years at end-2016. The NTMA has extended the maturity of debt instruments, including the issuance of Ireland's first 100-year note in March 2016, conducted bond swaps, repaid higher-interest IMF loans early, and pre-funded ahead of future obligations, increasing resilience. Official sector loans carry a long maturity, reflecting in part the seven-year EFSF and EFSM maturity extensions agreed with European partners in June 2013.[5] The new maturity dates of individual EFSM loans will be decided as the loans approach original maturity dates.

In Scope's view, risks concerning Ireland's capacity to service debt remain low. The sovereign's access to funding markets continues on favourable terms and the NTMA plans to prudently maintain strong cash buffers (presently at EUR 23.4bn as of June 2018) in advance of large redemptions over the medium term, notably in 2019 and 2020.

57% of Irish government bonds was held by the rest of the world as of March 2018 (with only 43% held by residents) – a risk in stressed scenarios, in Scope's view.

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[3] European Commission. "The 2018 Ageing Report: Underlying Assumptions & Projection Methodologies", Institutional Paper 065 | November 2017.
[4] http://www.stiftung-marktwirtschaft.de/fileadmin/user_upload/Generationenbilanz/Key_Results_Honorable_States_2016.pdf
[5] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/137563.pdf

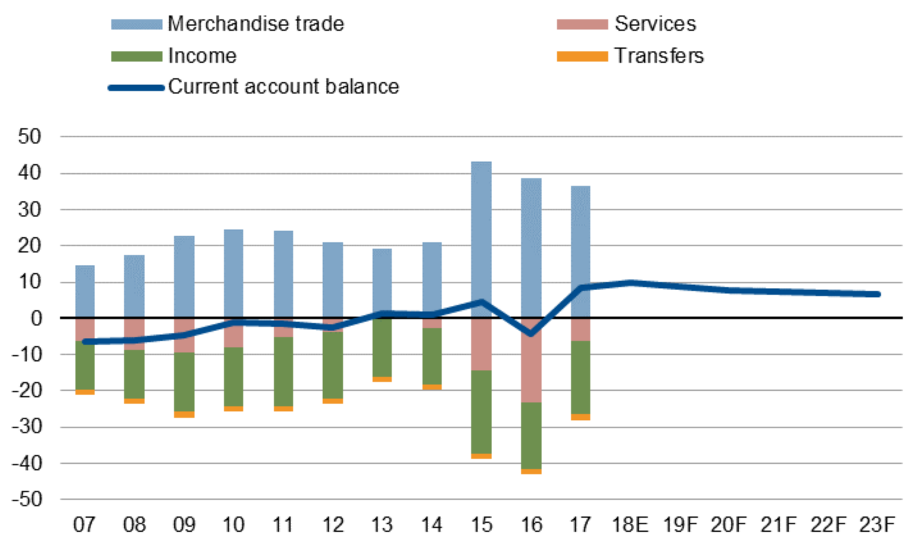
External economic risk

Current account vulnerability

Current account volatility is a vulnerability, but there is a significant surplus

Ireland's current account is volatile – reflecting in part the effects from contract manufacturing and intellectual property-related imports. The current account surplus increased significantly to 9.7% of GDP in the year to Q1 2018 from -2.6% of GDP in the year to Q1 2017, in large part due to globalisation effects – tying to higher computer services exports and lower research and development costs (including intellectual property imports). Ireland's current account reflects a large surplus in the goods balance, which more than offsets the deficits in services, income and transfers. The IMF sees Ireland's current account balance gradually correcting from an elevated surplus, to 9.8% of GDP in 2018 and 8.7% in 2019, before 6.5% by 2023 (**Figure 6**).

Figure 6: Current account balance, % of GDP



Source: IMF, Central Statistics Office Ireland, calculations by Scope Ratings GmbH

External debt sustainability

Large negative net international investment positions remain vulnerability

Net external debt remains higher than that of peers, and the net international investment position is strongly negative at -156.6% of GDP in 2017. External balance sheets have strengthened, however, with the banking sector recovery and economy-wide deleveraging (with gross external debt of 721% of GDP in Q1 2018, down from 1,022% of GDP as of Q1 2015 – though the former remains very high compared with peers' levels).

Ireland's Target2 balance has recovered and is now positive at EUR 13.3bn (4% of GDP) as of May 2018, having reversed capital losses incurred during the crisis, when the balance reached EUR -144.4bn (-79.6% of GDP).

Vulnerability to short-term external shocks

Vulnerability to external shocks

As a small and highly globalised economy, Ireland is vulnerable to adverse external shifts that can impact economic activity and revenue generation. This inherent vulnerability has not necessarily changed since the GFC (and has increased under some metrics) – with the potential to amplify downturns, especially if coupled with the unwinding of domestic imbalances, such as related to economy-wide debt.

Specific externally-driven risks in Scope's opinion include those associated with Brexit. The economic slowdown in the UK, together with the weak British pound, adversely impacts Irish trade. Lawless and Morgenroth[6] have analysed the trade effects of applying WTO tariffs to UK trade – i.e. a significant hard Brexit scenario. By matching over 5,200 products to the WTO tariffs applicable to ex-EU trade, the authors found that such an outcome would result in widely varying impacts across countries, but Ireland would be the hardest hit.

However, as important may be trade disputes between the United States and the European Union (in which the EU has responded to US steel and aluminium tariffs with tariffs on US goods of up to EUR 2.8bn, with now new threats of tariffs from the US on EU-assembled automobiles). Ireland's strategic position as an inroad to European markets for US companies makes the resolution of these trade disputes that much more important in its position.

International tax policy changes are an external risk factor. Ireland has been a favoured destination for foreign direct investment (FDI) by MNEs in past decades, including those using special tax schemes. Corporate tax cuts in the US and EU may substantially slow such flows and affect MNE operations in Ireland, with potentially adverse repercussions for output, employment and the fiscal position. According to the IMF[7], the top 50 companies represent about half of corporate income tax revenues; US companies make up about 60% of this total. MNEs also pose a potentially large indirect risk to taxes, accounting for about a fifth of the total compensation of employees, social contributions and income taxes.

Along the same lines, the European Commission's ongoing actions against illegal state aid (including that concerning Apple in Ireland) will have an impact on MNE activities in Ireland. Relevant risks stemming from Brexit, global trade disputes, changes in the global economic cycle, shifts in international corporate tax policies and EU anti-state aid policies will be assessed by Scope vis-à-vis implications on Ireland in the period ahead.

Financial stability risk

Banking sector performance and financial imbalance/fragility

Continued deleveraging but still very high private debt

Private-sector indebtedness remains high. New lending for house purchases has risen from low levels, but strong income growth and repayments have resulted in further reductions in household debt relative to disposable income. Corporate indebtedness amounted to 312% of GDP in Q4 2017, resulting in total non-financial private-sector debt of 364% of GDP in Q4 2017 (**Figure 7**).

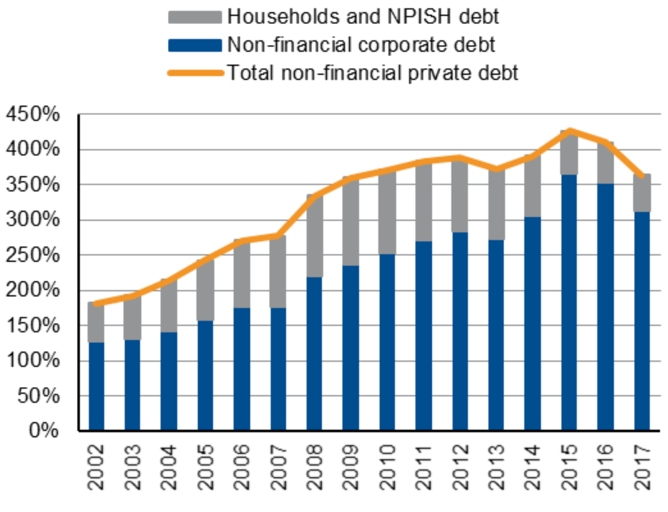
More resilient financial system, but vulnerabilities tied to leverage still exist

Several years after the crisis, Irish banks have deleveraged (with outstanding financial system debt of 423% of GDP, down on the 2011 peak of 646%) and core tier 1 capital ratios have strengthened (18.3% of risk-weighted assets in Q4 2017, from 16.8% in Q4 2016). That stated, the degree of leverage still within the Irish banking system remains a major vulnerability.

In **Table 2**, debt outstanding in Ireland is shown both i) as a share of nominal GDP (towards the top) and ii) equally as important, as a percentage of Ireland's modified GNI, shown at the bottom. Under either metric, however, the size of economy-wide debt or external debt remains much higher than those of "a" or "aa" rated euro area peers. In combination with Ireland's vulnerability to the global cycle, the amount of outstanding public- and private-sector debt poses a risk in a future crisis as liabilities mature. Recognising this, continued debt reduction in the private sector remains an area of concentration.

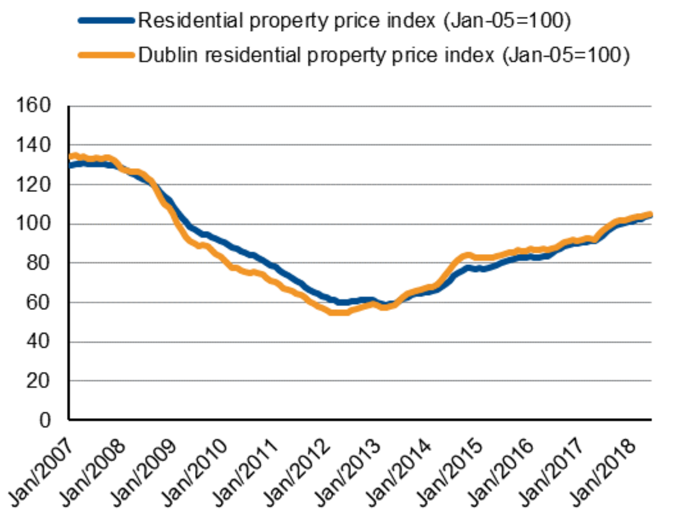
[6] The Economic and Social Research Institute. "The Product and Sector Level Impact of a Hard Brexit across the EU", ESRI Working Paper, 24 November 2016.
[7] International Monetary Fund. Ireland: 2017 Article IV Consultation-Press Release; and Staff Report, 26 June 2017.

Figure 7: Non-financial private debt, % of GDP



Source: Central Bank of Ireland, Central Statistics Office Ireland

Figure 8: Housing price indicators, 2010=100



Source: Central Statistics Office Ireland

Table 2*: Ireland versus euro area peers, debt ratios by sector*

Ireland and euro area peers	Scope long-term rating	Government	Household sector*	Corporate	Financial system	Total economy	External debt
		Debt metrics by sector					
		% of nominal GDP, 2017					
Ireland	A+/Stable	68.4	51.5	312.2	423.3	855.4	724.7
Belgium	AA/Stable	103.4	61.0	164.3	95.0	423.6	256.7
France	AA/Stable	96.8	67.1	171.3	119.8	455.1	210.8
Slovakia	A+/Stable	50.9	43.5	96.3	21.4	212.1	110.8
Spain	A-/Stable	98.3	66.6	133.5	68.0	366.3	164.9
Italy	A-/Negative	131.8	51.8	106.8	63.2	353.6	124.2
Latvia	A-/Stable	40.1	27.2	119.8	23.1	210.3	140.8
		% of modified GNI, 2017					
Ireland (using modified GNI)	A+/Stable	111.1	83.6	506.8	687.1	1,388.6	1,176.4

*Latvia's household debt number as of 2016

Source: Haver Analytics, Scope Ratings GmbH

The structure of the balance sheet as well as the quality of banks' assets have improved, supported by robust economic conditions, restructurings, asset sales and write-offs as well as rising collateral values. While still high, the ratio of non-performing loans (NPLs) has declined. In Q4 2017, NPLs constituted 10.7% of total loans, down sharply from 27.1% in 2013. However, still high *levels* of NPLs are a concern, weighing on bank balance sheets and profitability. Brexit-related uncertainties and international regulatory changes (including the minimum requirement for own funds and eligible liabilities) pose challenges. Given fragilities in Ireland's two systemic banks (Allied Irish Banks and Bank of Ireland) in the European Banking Authority (EBA)'s 2016 EU-wide stress tests, Scope will monitor closely the EBA's upcoming biennial stress test results to be published by November 2018, although the two Irish banks are expected to perform much better owing to lower NPL levels.

However, significant strides have been made post-crisis. For example, the National Asset Management Agency (NAMA), Ireland's bad bank established in 2009, has now repaid

100% of its senior debt, with the last redemption made three years ahead of schedule in October 2017. NAMA's projections suggest a potential profit of up to EUR 3.5bn by the time it completes work in 2020.

Scope is monitoring the speed of the housing rebound to assess development of imbalances

Improved labour market conditions and rising incomes have contributed to higher housing prices. Residential property prices are up 12.4% YoY as of May 2018 (with Dublin at 10.7% YoY) and are now up 78% nation-wide compared with a March 2013 trough. However, prices are still down 20.4% compared with the pre-crisis peak. Recent price increases seem to reflect in part supply shortages, with only a modest supply response to date despite the recovery in housing demand. Scope is closely monitoring the housing price rebound to assess any form of inchoate imbalances. The central bank has observed that "*the cyclical risk of house prices moving ahead of fundamental values is now more elevated than in recent years"*.[8]

Dynamics in the commercial real estate (CRE) market require close attention, in addition. While domestic banks' exposures to this market have declined, loan books are still heavily exposed to property-related lending, leaving banks still vulnerable to adverse developments in both residential and CRE markets. Non-domestic investment and funding has increased into the CRE market. While Irish commercial property price growth has recently eased, the market has recovered significantly. Growth in the Dublin office market has been of particular significance, reflecting demand from existing businesses.

Banking sector oversight and governance

The Central Bank of Ireland introduced a counter-cyclical capital buffer (CCyB) in December 2015. On 5 July 2018, the central bank announced an increase in the CCyB rate to 1% (from 0%) effective 5 July 2019, to protect the banking sector against the "build-up of cyclical systemic risk and thereby support a sustainable provision of credit to the real economy throughout the financial cycle".

Institutional and political risk

Recent events and policy decisions

Strong competitiveness and governance

Ireland is an attractive destination for foreign investment, ranking well in various indicators of global competitiveness (24th in the World Economic Forum's 2017-18 Global Competitiveness Index), premised on a sound legal and regulatory system, a skilled workforce, flexible labour market, and low corporate income tax rates. EU membership and the English-native-speaking environment are also relevant to the mainly US-based MNEs, which have invested in high-productivity industries such as pharmaceuticals and information technology and account for about 50% of measured gross value added. Ireland's Worldwide Governance Indicators scores have also been consistently strong.

A political crisis late in 2017 between minority ruling party Fine Gael and supporting party in the opposition Fianna Fáil was defused upon the resignation of Deputy Prime Minister Frances Fitzgerald. The scandal involved Ms Fitzgerald having known of the legal strategy used against a whistleblower in Ireland's Garda police force. Fianna Fáil had threatened a confidence motion, potentially forcing an early election, if Ms Fitzgerald (supported by Prime Minister Leo Varadkar over the crisis) refused to resign.

Next general election by April 2021

Ireland's next general election will be held by April 2021. A recent poll has Fine Gael on about 31%, Fianna Fáil on 24%, Sinn Féin on 24%, and the Labour Party on 4%. This represents a discernible gain in support for both Sinn Féin and the ruling Fine Gael since early 2017. This poll also comes after a May 2018 national referendum that will permit the

[8] https://centralbank.ie/docs/default-source/financial-system/financial-stability/macroprudential-policy/countercyclical-capital-buffer/ccyb-rate-announcement-july-2018.pdf?sfvrsn=6, page 2

Oireachtas (parliament of Ireland) to legalise abortion. Ireland's next presidential election is tentatively slated for 26 October 2018; the presidency in Ireland is a ceremonial post.

Methodology

The methodology applicable for this rating and/or rating outlook "Public Finance Sovereign Ratings" is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope's definition of default, definitions of rating notations can be found in Scope's public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

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I. Appendix: CVS and QS Results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on the relative rankings of key sovereign credit fundamentals, provides an indicative "AA" ("aa") rating range for the Republic of Ireland. This indicative rating range can be adjusted by the Qualitative Scorecard (QS) by up to three notches depending on the extent of relative credit strengths or weaknesses as compared to peers, based on Scope analysts' qualitative findings.

For Ireland, relative credit weaknesses have been identified for the following analytical categories: i) macro-economic stability and sustainability; ii) current account vulnerability; iii) external debt sustainability; iv) vulnerability to short-term external shocks; and v) financial imbalances and financial fragility. No relative qualitative credit strengths against peers were identified. Combined relative credit strengths and weaknesses generate a downward adjustment and signal an AA- sovereign rating for the Republic of Ireland. The lead analyst has recommended a further adjustment of the indicated rating to A+ in order to take into account important distortions in Irish economic data that tend to overstate the performance of underlying fundamentals and credit metrics in the CVS. The results have been discussed and confirmed by a rating committee.

Rating overview	
CVS indicative rating range	aa
QS adjustment	AA-
Final rating	A+

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates to an indicative rating range that is always presented in lower-case letters.

Within the QS assessment, analysts conduct a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, a review of debt sustainability, fiscal and financial performance assessments, and policy implementation assessments.

There are three assessments per category for a total of 15. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment, which is the basis for the analysts' recommendation to the rating committee.

II. Appendix: CVS and QS Results

CVS

Rating indicator	Category weight
Domestic economic risk	**35%**
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	**30%**
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	**15%**
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exchange rate	
Total external debt	
Institutional and political risk	**10%**
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	**10%**
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**aa**
QS adjustment	**AA-**
Final rating	**A+**

QS

Maximum adjustment = 3 notches

	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	○ Strong outlook, good growth potential	◉ Neutral	○ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential wel under trend or negative
Economic policy framework	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macro-economic stability and sustainability	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Fiscal policy framework	○ Exceptionally strong performance	○ Strong performance	◉ Neutral	○ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	○ Strong sustainability	◉ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	○ Very good access	◉ Neutral	○ Poor access	○ Very weak access
Current account vulnerability	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
External debt sustainability	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Vulnerability to short-term external shocks	○ Excellent resilience	○ Good resilience	○ Neutral	○ Vulnerable to shock	◉ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Geopolitical risk	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Banking sector performance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Banking sector oversight and governance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Financial imbalances and financial fragility	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate

*** Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10**

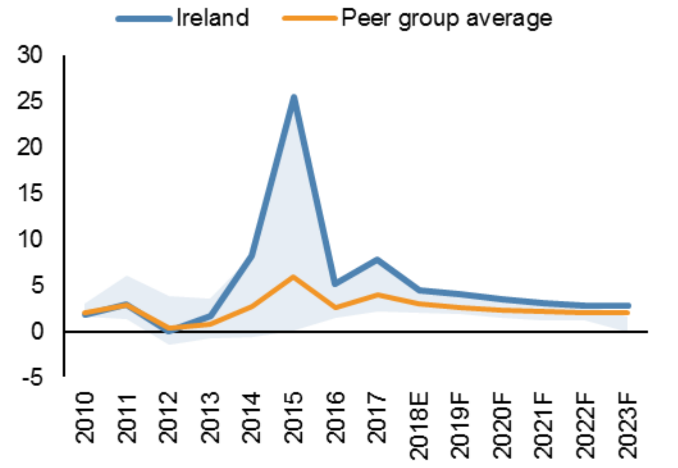
Source: Scope Ratings GmbH

Foreign- versus local-currency ratings

Ireland's debt securities are issued in euros. Scope sees no evidence that Ireland would differentiate among contractual debt obligations based on currency denomination.

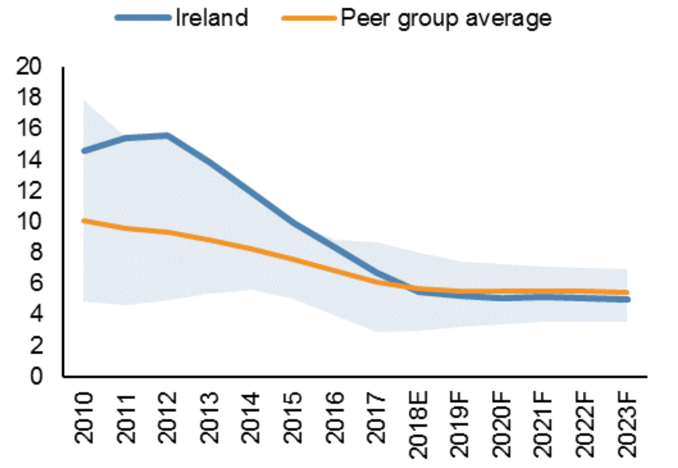
III. Appendix: peer comparison (CVS rating category)

Figure 9: Real GDP growth, %



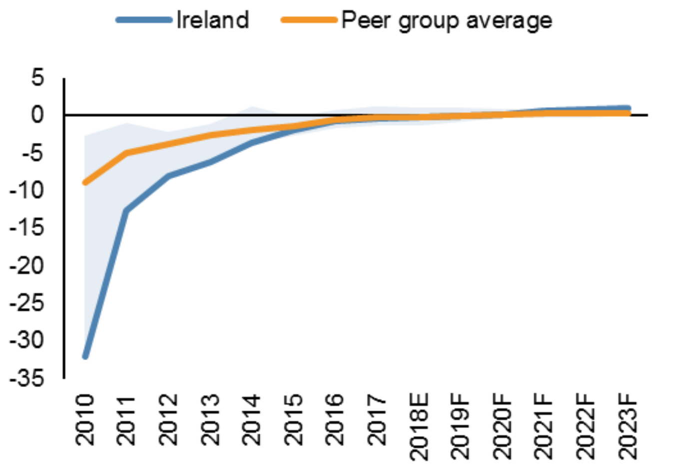
Source: IMF, Calculations Scope Ratings GmbH

Figure 10: Unemployment rate, % of total labour force



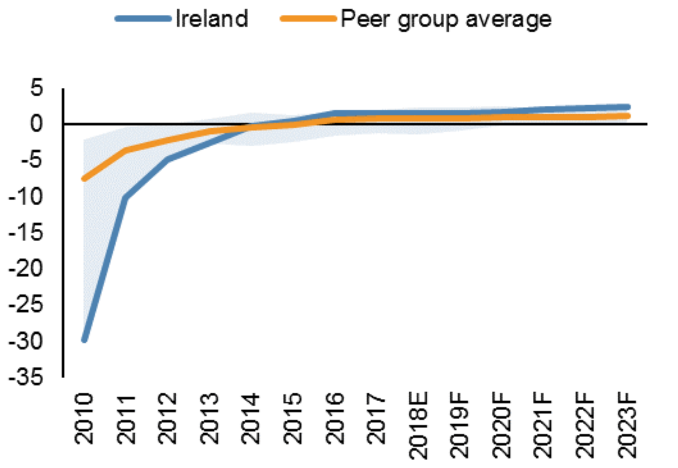
Source: IMF, Calculations Scope Ratings GmbH

Figure 11: General government balance, % of GDP



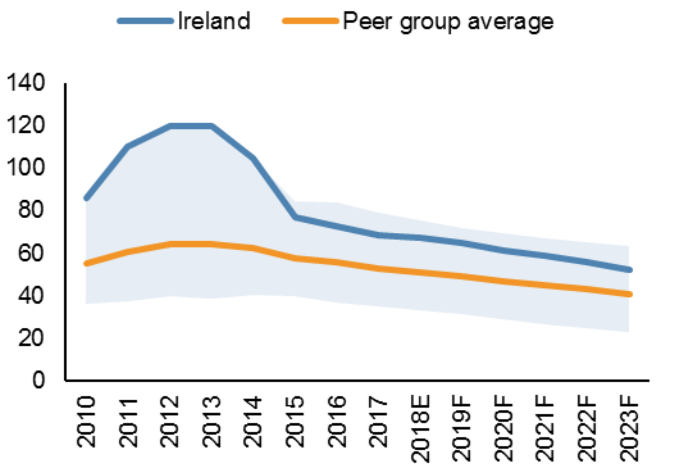
Source: IMF, Calculations Scope Ratings GmbH

Figure 12: General government primary balance, % of GDP



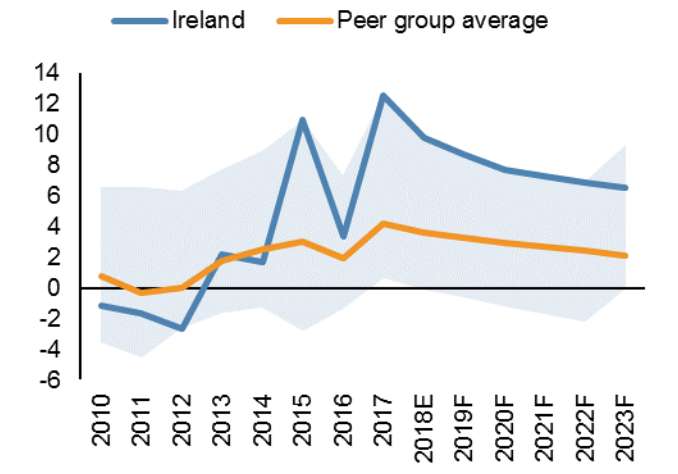
Source: IMF, Calculations Scope Ratings GmbH

Figure 13: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

Figure 14: Current account balance, % of GDP



Source: IMF, Calculations Scope Ratings GmbH

IV. Appendix: Statistical tables

	2013	2014	2015	2016	2017	2018E	2019F
Economic performance							
Nominal GDP (IMF, EUR bn)	180.0	194.2	261.6	275.2	295.8	310.7	326.3
Population ('000s)	4,609.0	4,622.0	4,655.0	4,700.0	4,728.0	4,776.0	4,824.0
GDP per capita PPP (USD)	48,067.1	50,994.3	68,576.7	71,388.8	76,304.7	-	-
GDP per capita (EUR)	39,055.9	42,019.5	56,196.4	58,550.6	62,558.7	65,046.7	67,647.7
Real GDP, % change (IMFWEO)	1.6	8.3	25.5	5.1	7.8	4.5	4.0
GDP growth volatility (10-year rolling SD)	4.0	4.2	8.5	8.5	8.6	8.0	7.3
CPI, % change	0.6	0.3	-0.1	-0.2	0.3	0.9	1.3
Unemployment rate (%)	13.8	11.9	10.0	8.4	6.7	5.5	5.2
Investment (% of GDP)	18.8	22.4	21.1	32.4	24.2	25.9	26.8
Gross national savings (% of GDP)	20.9	24.0	32.1	35.7	36.7	35.7	35.4
Public finances							
Net lending/borrowing (% of GDP)	-6.1	-3.7	-1.9	-0.7	-0.4	-0.2	-0.1
Primary net lending/borrowing (% of GDP)	-2.6	-0.3	0.5	1.5	1.4	1.5	1.5
Revenue (% of GDP)	34.2	34.0	27.0	26.4	25.3	25.2	24.9
Expenditure (% of GDP)	40.3	37.6	28.9	27.1	25.8	25.4	25.0
Net interest payments (% of GDP)	3.5	3.4	2.4	2.2	1.9	1.7	1.6
Net interest payments (% of revenues)	10.4	10.0	8.8	8.2	7.3	6.5	6.3
Gross debt (% of GDP)	119.6	104.7	77.1	72.9	68.5	67.1	64.9
Net debt (% of GDP)	89.7	86.1	65.9	63.8	59.8	58.1	56.0
Gross debt (% of revenues)	350.0	308.3	285.5	276.1	270.7	265.9	260.3
External vulnerability							
Gross external debt (% of GDP)	837.7	915.6	843.2	773.2	688.7	-	-
Net external debt (% of GDP)	-352.9	-415.7	-299.8	-368.6	-383.8	-	-
Current account balance (% of GDP)	2.1	1.6	10.9	3.3	12.5	9.8	8.7
Trade balance (% of GDP)	-	20.9	43.3	38.4	36.2	35.0	34.3
Net direct investment (% of GDP)	-7.2	1.6	-16.3	5.3	-3.1	-	-
Official forex reserves (EOP, EUR mn)	3.0	163.4	678.0	1,336.0	1,737.0	-	-
REER, % change	0.0	0.0	-0.1	0.0	0.0	-	-
Nominal exchange rate (EOP, USD/EUR)	1.38	1.21	1.09	1.05	1.20	-	-
Financial stability							
Non-performing loans (% of total loans)	25.7	20.6	14.9	13.6	11.5	-	-
Tier 1 ratio (%)	17.3	20.5	23.2	23.0	23.4	-	-
Consolidated private debt (% of GDP)	267.7	278.3	306.0	280.5	-	-	-
Domestic credit-to-GDP gap (%)	-2.8	3.6	9.5	-17.3	-66.3	-	-

Source: IMF, European Commission, European Central Bank, Central Bank of Ireland, World Bank, Scope Ratings GmbH

V. Regulatory disclosures

Responsibility

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

Rating prepared by Dennis Shen, Associate Director

Person responsible for approval of the rating: Dr Giacomo Barisone, Managing Director, Public Finance

The ratings/outlook were first assigned by Scope as a subscription rating in January 2003. The ratings/outlooks were last updated on 28.07.2017.

The senior unsecured debt ratings as well as the short-term issuer ratings were last updated by Scope on 28.07.2017.

Rating Committee: 1) economic and fiscal policy framework; 2) debt metric improvements and sustainability; 3) Ireland's economic model and boom/bust structure; 4) impact of Brexit on the Irish economy; 5) public- and private-sector deleveraging and lingering vulnerabilities; 6) Irish nominal GDP data issues; 7) financial stability and vulnerabilities; and 8) peers comparison.

Solicitation, key sources and quality of information

The rating was initiated by Scope and was not requested by the rated entity or its agents. The rated entity and/or its agents did not participate in the ratings process. Scope had no access to accounts, management and/or other relevant internal documents for the rated entity or related third party.

The following material sources of information were used to prepare the credit rating: public domain and third parties. Key sources of information for the rating include: Ireland's Department of Finance, Central Statistics Office (Ireland), Central Bank of Ireland, NTMA, IMF, OECD, European Commission, United Nations, World Bank, Eurostat, and Haver Analytics.

Scope considers the quality of information available to Scope on the rated entity or instrument to be satisfactory. The information and data supporting Scope's ratings originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the rating, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds upon which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Conditions of use / exclusion of liability

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