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September 18, 2007

The Acting Chair's Summing Up
Ireland—2007 Article IV Consultation
Executive Board Meeting 07/80
September 14, 2007

Executive Directors agreed with the thrust of the staff appraisal. They commended Ireland's continued impressive economic performance, characterized by one of the highest growth rates of GNP per capita among advanced countries and one of the lowest unemployment rates. This performance has been underpinned by outward-oriented policies, prudent fiscal policy, low taxes, and labor market flexibility.

Given the Irish economy's strong fundamentals and the authorities' commitment to sound policies, Directors expected economic growth to remain robust over the medium term. At the same time, however, a number of downside risks will need careful attention in the period ahead. Directors pointed to inflationary pressures in the context of an economy that is operating at or above full capacity, declining competitiveness and a widening current account deficit, a deterioration in global financial market conditions and the growth outlook of the United States, and the adjustment to a cooling of the housing market. Directors underscored that rapid house price increases and a boom in residential construction have been an important driver of growth and bank lending. While the slowdown of the housing sector has been gradual so far, and will help to rebalance growth and contain inflationary pressures, a sharper correction in house prices could significantly slow economic growth.

Directors commended Ireland's sustained strong fiscal performance, and the authorities' firm commitment to fiscal discipline over the medium term. Many Directors, however, saw the planned reduction in the fiscal surplus in 2007 as an undesirable pro-cyclical fiscal stimulus, while acknowledging Ireland's pressing need to increase infrastructure and social spending, and the leeway to do so provided by the strong fiscal position. Looking ahead to 2008, Directors cautioned against discretionary measures that would weaken the underlying fiscal position. They encouraged the authorities to restrain current expenditure growth and to continue to focus on improving the quality of public spending through cost-benefit analysis. They also welcomed the decision to establish a Commission to review the tax system.

Over the long term, Directors considered the projected increase in age-related spending to be the most important fiscal challenge. They concurred that Ireland is well-placed to meet this challenge, noting that the authorities have been preparing for it, and welcomed the forthcoming Green Paper on Pension Policy. They agreed that a combination of measures is preferable to a policy based solely on increasing social security contribution rates. In this regard, Directors saw merit in reviewing the state pensionable age and the level of contributions to the National Pensions Reserve Fund, and strengthening incentives for private savings. They also supported the authorities' commitment to improve public understanding of fiscal challenges.

Directors welcomed the indicators confirming the soundness of the Irish banking system, including the stress tests suggesting that cushions are adequate to cover a range of shocks even in the face of large exposures to the property market. Nevertheless, financial sector vulnerabilities, including those arising from high household indebtedness and rising interest rates, require continued supervisory vigilance. In this context, Directors commended the progress in implementing the recommendations of the 2006 FSAP update. They called for continued careful monitoring of banks' risk management practices, including those pertaining to commercial property lending. Directors supported the envisaged upgrading of the stress-testing framework and the commitment to continue to improve supervision.

Directors stressed that preserving and enhancing Ireland's external competitiveness will be key to underpinning future growth prospects. To this end, wages should continue to grow in line with productivity, and increases in global energy prices and mortgage costs should not be allowed to feed into wage growth. Directors recommended that both the implementation of the current social partnership agreement and the forthcoming public sector pay benchmarking exercise avoid adding to wage pressures. Directors underlined the importance of labor market flexibility in facilitating adjustment to the cooling housing market.

The next Article IV consultation with Ireland is expected to be held on the standard 12-month cycle.