IRELAND

MACROECONOMIC BACKGROUND

The Irish economy experienced a period of rapid expansion and growth in the 1990s (the 'Celtic Tiger' period) with real GNP growing by 6.5% per year on average between 1990 and 1999.[1] This exceptional growth performance reflected both sound policies and fortunate circumstances, both of which allowed Ireland to 'catch up' with its European neighbours. Prudent government spending helped reduce government debt and taxes. Gross public debt accounts now for approximately 30% of GDP – among the lowest in Europe. Social partnership agreements and income tax cuts supported wage moderation and today taxes on labour income are relatively low. The maintenance of low corporate tax rates helped support investment and education policies produced a highly skilled workforce. Among the fortunate circumstances was membership of the EU – which provided funds for investment, and participation in EMU led to a sustained reduction in interest rates. The global technology boom encouraged investment and favourable demographics increased the share of working age population. All of these supported strong growth and healthy government finances ; the general government fiscal position has been either close to balance or in surplus since 1996.

The unemployment rate declined from one of the highest to the lowest level in Europe over the past fifteen years, and at 4.3% is indicative of an economy in full employment. The number of people in employment has almost doubled from just over 1 million to just under 2 million over the same period. Rising female labour force participation has been a significant factor in employment growth which has been on a sustained upward trend over the same period ; the rate of employment growth was 5% at the end of H1 2005, twenty times the European average.

There has been a significant shift away from agriculture and manufacturing to services. Between 1998 and 2004 employment in agriculture fell to 6.4% of total employment while employment in the services sector grew to 30%.

Economic growth has continued since 2000, albeit at a more modest pace. Following a downturn in 2001-02, real GNP growth picked up in 2003-04 in line with a global recovery. Annual average GNP growth was 4.75% between 2000 and 2004 which compares very favourably with other European countries. The outlook for the economy remains favourable, with expectations of annual average GNP growth of just under 5% in the period to 2010 assuming that the current pattern of growth in the world economy continues. Key risks to maintaining strong economic performance relate mostly to external factors due to the open nature of the Irish economy. The main external risks are a substantial increase in oil prices or an abrupt slowdown in global growth. The key domestic risk relates to the housing market slowing more quickly than envisaged with adverse consequences for employment and wealth.

DEMOGRAPHICS

The population of Ireland has grown from 2.82 million in 1961 to 4.13 million in 2005. Population growth can be accredited to both natural forces and record levels of inward migration. A baby boom occurred in Ireland during the late 1970s and, with over 52% of the population currently under the age of 35, Ireland has one of the youngest populations in Europe. In addition, Ireland's elastic labour force responded to the real labour demand arising from record growth levels and the net migration trend reversed in recent years. In 1986 net emigration was just under 72,000. By 2002 net inward migration accounted for over 153,000 and approximately half of immigrants into Ireland during the late 1990s were aged between 25 and 44 years. As a result of these factors the demand for housing accelerated during the late 1990s.

It is acknowledged that the population is ageing ; the average age of the population was 35.1 years in 2002 compared with 34.1 years in 1996 and provisions are being made for the future in this respect. The Irish government has initiated a scheme for pre-funding age-related spending. On an annual basis 1% of GNP is contributed to the National Pension Reserve Fund to prepare for future old-age and civil service pension spending.

HOUSING MARKET

a. Demand

Irish people desire to own their own home. Home ownership in Ireland remains very high with over 75% of private dwellings being owner occupied in 2003 despite an increase in the level of private dwellings purchased for residential investment purposes and as second dwellings. 1991 estimates put the level of home ownership in Ireland at almost 20% above the EU average. At that time the level of private renting in Ireland was the second lowest in the EU at only 8% of dwellings. Rental levels increased to 11% of total private dwellings by 2002.

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[1] Because of the substantial contribution of multinationals to Irish output and the associated profit repatriation which creates a large difference between GDP and GNP, GNP is a better measure of national income as it excludes payments to foreign factors of production.

As well as these cultural factors, one of the key drivers of the housing market was the bulge in the population in the household formation age group (between 25 and 34 years). This results from a combination of a natural increase (excess of births over deaths) and positive net migration into Ireland. The impact of the change in the population structure is reflected in significant increases in house market activity.

Cultural and demographic changes only partially explain the exceptional demand of housing experienced during the 1990s in Ireland. The average household size has fallen consistently over the past decades (4.48 persons in 1926 compared to 2.94 persons in 2002). When average annual household formation levels and average annual new house completions over the past number of years are compared, it is clear that more houses were built than were needed to cater for new households alone. There are no official data available but market estimates are that 50% of new houses built in recent years were to satisfy demographic demand, 20% for second dwellings, 20% for residential investment and 10% was a combination of pent up, new migrant and obsolescence demand.

b. Supply

Between 1911 and 1946 the total Irish housing stock fell by over 20,000 dwellings due to a combination of high levels of emigration and the demolition of unfit dwellings. Since 1946 housing stock has risen steadily, with growth in new house completions at record levels year on year since 1994 in response to a sudden increase in demand due to demographic and economic growth. The annual rate of growth peaked at 25.0% in 1994, falling to 5% in 2001 and rising again to 12% in 2004. The volume of housing units completed in 2004 was just under 77,000 (a 12% growth rate) and it rose again by 5% in 2005 to 81,000 units. It is expected that the level of completions will remain relatively flat in 2006 before reducing gradually in line with a slow reduction in demand to an average annual rate of 50,000 between 2006 and 2011. Despite the expansion of the housing stock over the past fifteen years, the number of dwellings per 1,000 of the population is the lowest in the EU at 330 compared to the EU average of 437.

As a consequence of the high levels of new building activity in recent years, the Irish housing stock is significantly younger than the EU average. It is also distinguished by the high number of dwellings which are detached, semi detached or terraced houses in contrast to other EU member states where apartments make up a large proportion of the housing stock. Only 17% of housing stock in the capital (Dublin) was for apartments and duplexes at the end of 2004. In recent years, however, there has been a move towards constructing high quality, high density housing and this is expected to result in a much higher proportion of apartments and townhouses in the overall housing stock mix.

c. Housing Finance

In response to strong and pent up first time buyer demand in the late 1990s the Irish government removed tax relief for loan interest payments for investors in 2000 which dampened demand for new investors in the market. Year on year growth in residential mortgage credit fell from 25% in June 2000 to 21% in June 2001 and 18% in December 2001. This policy was reversed in 2002 with consequential increase in house price inflation as new investors swelled demand. Since then the rate of growth in mortgage credit has increased steadily to annual average growth of 26% on average in 2005, almost double the annual average growth rate of 13.6% a decade ago. 100% mortgages were made available for a specific segment of the first time buyer market in July 2005. The value of the Irish mortgage market was €99 billion at the end of 2005, including securitisations of €4.76bn.

Private-sector indebtedness levels are at record highs as private sector credit as a percentage of GDP grew from 111.5% in 2002 to 115% in 2003 and to 134% by end year 2004. Private-sector indebtedness continues to increase and at an accelerating rate which largely reflects residential mortgage growth which accounts for approximately 80% of personal lending.

Despite the increase in house prices and mortgage debt, mortgage repayment affordability has improved since the early 1990s on a national basis. In 2002, the mortgage outgoings of a typical household represented about 24% of their disposal income, compared to 22% in 1995 and 29% in the early 1990s on a national basis. In effect, house price inflation during the 1990s was balanced by a significant reduction in mortgage interest rates, rising disposable incomes and falling taxation levels.

d. House Prices

House prices have risen by a factor of 2.5 on a national basis since 1996 ; house prices in the capital, Dublin, have tripled in value over the same period. The rate of growth, however, has slowed in recent years. Nominal annual house price growth peaked at 30% in December 1998 and gradually declined thereafter, falling as low as 2.4% in January 2002. The rate of house price inflation rose again with the reinstatement of tax relief for investors in 2002, rising to 15.5% in July 2003. The expectation of a soft landing in relation to house prices is supported by a month on month reduction in house price growth in the fifteen months to September 2005 before the effects of the government policy measure to abolish stamp duty for first time buyers[2] and the impact of high levels of net

[2] Stamp duty was exempt for new houses throughout the 1990s and 2000s. In its 2005 Budget the government abolished stamp duty for purchases of second hand properties also.

migration fed through. House price inflation in H1 2005 was 2.4% ; it was 6.9% in H2 – bringing overall inflation to 9.3% nationally in 2005. The impact of the stamp duty changes was evident in the widening gap between house price inflation for first time buyers (12.7%) and second time buyers (8.3%). Record house completions levels in 2004 (77,000) and 2005 (81,000) helped to meet some, but not all, of the new surge in demand arising from reduced purchase costs and the as yet unmeasured effects of strong net immigration. Unsatisfied legacy demand, particularly in Dublin where the supply of new housing units has consistently fallen below requirements, coupled with strong real demographic demand will sustain house price inflation of between 7% and 9% in 2006.

GOVERNMENT POLICY

In recent years the state has focused its support for home owners on low-income households through a number of measures including a range of social and affordable housing initiatives. Tax relief on mortgage interest has been provided at source (through credit institutions) since 1 January 2002. In addition to direct support, the government does not levy property tax or local residential rates on home owners and there is no property tax on second dwellings. First Time Buyers benefit from stamp duty exemptions, although the level of stamp duty is high in Ireland ranging from 3% on properties valued between €317.5k and €381k, up to 9% on properties valued over €635,000.

OUTLOOK

The Irish housing market has come through a period of very strong growth over the past fifteen years. The outlook still points to a soft landing, although risks remain. Strong real demand for housing will be a feature of the market coupled with low and slowly adjusting interest rates in the medium term. The economy is set to maintain a near full employment position out to the end of the decade.

The level of household debt in Ireland has increased at a rapid pace in recent years, however debt levels have risen from a historically low base and current figures are in line with European levels. The demographic profile of Ireland supports higher debt levels, with a high proportion of young people – who tend to be net borrowers - relative to the total population than many European countries who experienced their population boom in the post war 1950s rather than the 1970s. The ratio of private-sector debt to income in Ireland remains below the corresponding US and UK figures. Also, unlike many of these countries and unlike the US, in Ireland savings ratios are remaining stable – at between 11% and 13%. In aggregate, there is limited concern in relation to average affordability as the strong prospects for the Irish economy serve to mitigate some of the potential risks such as declining income or increasing unemployment.

There are risks, of course, to the economy, such as the pro-cyclicality of government policy in recent years, and the exposure of the economy to the construction sector (which contributed 1% to GDP in 2003 and in 2004). In addition there is the pensions risk ; following the boom in population in the 1970s population growth fell away in the 1980s and 1990s. It is estimated that 17% of the population will be aged 65 or older by 2025, and over a quarter of the population requiring pension support by 2050. For this reason making adequate provision now for pension requirements is a key focus of both government and individuals. As a small open economy the primary risks are external, however, rather than domestic in nature. Ireland proved to be more resilient than might have been expected to the challenges of the early 2000s – the collapse of the dot.com sector, 9/11, the severe downturn in equities and, closer to home, foot and mouth disease in the UK. With strong employment and demand, economic growth is expected to continue at a steady pace over the course of the coming decade, and at a significantly higher level than most of its European neighbours.

SUMMARY DATA

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Real GDP Growth	5.8%	9.5%	7.7%	10.7%	8.6%	11.1%	10.0%	6.0%	6.1%	3.7%	4.9%
Real GNP Growth	6.3%	8.0%	7.2%	9.3%	7.9%	8.8%	10.7%	3.8%	1.5%	2.8%	5.5%
Employment Rate	3.2%	5.0%	3.7%	3.9%	8.3%	6.3%	4.7%	3.1%	1.8%	1.9%	3.0%
Unemployment Rate[3]	14.7%	12.2%	11.9%	10.3%	7.6 %	5.5%	4.2%	3.9%	4.4%	4.6%	4.4%
Consumer Price Inflation EU Harmonised[4]	_	_	2.1%	1.2%	2.2%	3.9%	4.6%	4.4%	4.6%	2.9%	2.4%
Residential Mortgage Debt Outstanding €M	10,537	11,938	13,879	17,195	20,855	26,186	32,546	38,343	47,212	59,362	77,029
Residential Debt / GDP Ratio	22.9%	23.8%	24.5%	25.3%	27.4%	29.9%	31.6%	33.2%	36.8%	45.0%	52.7%
Total No. Households	_	1,150.4	1,160.2	1,191.9	1,224.6	1,253.9	1,283.6	1,302.5	1,344.4	1,383.8	1,405.9
Home Ownership Rate[5]	_	_	_	_	_	_	_	_	77%	_	77%
House Price Index[6]	109	116	130	153	187	222	253	273	296	336	373
Annual House Price Growth Rate[7]	4.7%	7.1%	13.3%	17.6%	28.8%	20.4%	15.3%	8.0%	3.6%	14.1%	8.6%
Typical Loan to Value – New Houses[8]	62%	62%	58%	59%	57%	60%	58%	56%	68%	68%	67%
Typical Loan to Value – Second Hand Houses	63%	66%	64%	62%	57%	58%	55%	51%	61%	62%	59%
Number of Private Dwellings[9]	23,588	26,604	30,132	35,454	39,093	43,024	46,657	47,777	51,932	62,686	71,808
Housing Completions[10]	30,575	33,725	38,842	43,349	46,512	49,812	52,602	57,695	68,818	76,954	81,000
Mortgage Interest Rates (Average Annuity Rates)	7.2%	7.6%	7.1%	7.5%	6.0%	4.4%	6.2%	4.7%	4.7%	3.5%	3.5%
Annual Net lending against Residential Property €M	1,282	1,401	1,940	3,316	3,659	5,331	6,360	5,797	8,869	12,151	17,787
MBS outstanding €M	0	0	259	244	709	1,751	3,072	4,318	3,796	_	3,928
Covered Bonds Outstanding as % Mortgage Debt O/S	_	_	_	_	_	_	_	_	_	0.88%	2.5%

[3] Seasonally Adjusted Post 1998
[4] Data not reliable pre 1996
[5] Data available for specific periods only
[6] Taken from Department of Environment & Local Government Quarterly Index : Base Q1 1991 = 100
[7] Taken from Department of Environment & Local Government Quarterly Index : Base Q1 1991 = 100. PTSB/ESRI Index available from March 1996 which tracks prices based on loans issued rather than loans approved and produced monthly data. This alternative index is generally used by the industry and data quoted in the summary text are based on this alternative index.
[8] Calculated from Department of Environment and Local Government Published Data for new mortgages
[9] Number of new Private Dwellings Built within the year
[10] Includes local authority and social housing.

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Bilateral € Exchange Rate $US per €1[11]	0.9	0.8	0.8	0.8	0.9	1.1	0.9	0.9	0.9	1.1	1.2
Mortgage Balance Outstanding as % of nominal disposal income	35.7%	37.1%	40.2%	43.6%	46.5%	50.9%	54.6%	56.4%	64.8%	76.7%	96.0%e

* Average price of all residential property approved for a mortgage (PTSB/ESRI Index based on advances)

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[11] Exchange rates as at 1 January 1994-1998 ; period average from 1999.