

TUARASCÁIL ón gComhchoiste Fiosrúcháin i dtaobh na Géarchéime Baincéireachta

An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

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THEME: C5

Appropriateness and effectiveness of international, Ireland-specific policy responses

LINE OF INQUIRY: C5a

European Union (EU) / International Monetary Fund (IMF) / European Central Bank (ECB) programme of assistance



EUROPEAN CENTRAL BANK
EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Reclassified for publication on 6 November 2014

Mr Brian Lenihan
Tánaiste and
Minister of Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010

L/JCT/10/1444

Dear Minister,

As you are aware from my previous letter dated 15 October, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other national central bank of the Eurosystem, is closely monitored by the Governing Council of the European Central Bank (ECB) as it may interfere with the objectives and tasks of the Eurosystem and may contravene the prohibition of monetary financing. Therefore, whenever ELA is provided in significant amounts, the Governing Council needs to assess whether it is appropriate to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the prohibition of monetary financing, it is essential to ensure that ELA recipient institutions continue to be solvent.

As I indicated at the recent Eurogroup meeting, the exposure of the Eurosystem and of the Central Bank of Ireland vis-à-vis Irish financial institutions has risen significantly over the past few months to levels that we consider with great concern. Recent developments can only add to these concerns. As Patrick Honohan knows, the Governing Council has been asked yesterday to authorise new liquidity assistance which it did.

But all these considerations have implications for the assessment of the solvency of the institutions which are currently receiving ELA. It is the position of the Governing Council that it is only if we receive in writing a commitment from the Irish Government vis-à-vis the Eurosystem on the four following points that we can authorise further provisions of ELA to Irish financial institutions:

- 1) The Irish government shall send a request for financial support to the Eurogroup;
- 2) The request shall include the commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;

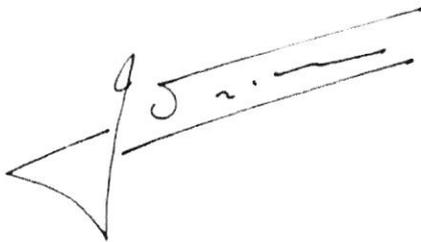
3) The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish government as well as by financial means currently available to the Irish government, including existing cash reserves of the Irish government;

4) The repayment of the funds provided in the form of ELA shall be fully guaranteed by the Irish Government, which would ensure the payment of immediate compensation to the Central Bank of Ireland in the event of missed payments on the side of the recipient institutions.

I am sure that you are aware that a swift response is needed before markets open next week, as evidenced by recent market tensions which may further escalate, possibly in a disruptive way, if no concrete action is taken by the Irish government on the points I mention above.

Besides the issue of the provision of ELA, the Governing Council of the ECB is extremely concerned about the very large overall credit exposure of the Eurosystem towards the Irish banking system. The Governing Council constantly monitors the credit granted to the banking system not only in Ireland but in all euro area countries, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks and the collateral they provide to the Eurosystem. The assessment of the Governing Council on the appropriateness of the Eurosystem's exposure to Irish banks will essentially depend on rapid and decisive progress in the formulation of a concrete action plan in the areas which have been mentioned in this letter and in its subsequent implementation.

With kind regards



Cc.: Mr Brian Cowen, Prime Minister

BN Merkel Debt Plan Provokes Selloff Trichet Foresaw: Euro Credit
Nov 3 2010 0:01:00

"The more you talk about restructuring debt, the harder it is to obtain debt," Irish Finance Minister Brian Lenihan said in an interview with Dublin-based RTE television yesterday. "That is the reality."

Merkel's stance echoes her approach to Greece earlier this year when she initially refused to rush to its aid, sparking speculation about the euro region's ability to handle the worst crisis in its history. While billionaire George Soros at the time said her strategy risked pushing Greece into a "death circle," Merkel said the "tough" terms of the country's eventual bailout vindicated her policy.

The new push comes as her Christian Democrat party loses support to the Social Democrats, with an Oct. 27 Forsa poll putting the opposition 12 percentage points ahead of her CDU-Free Democrat government. The government also faces regional elections from March that involve 25 percent of the population.

Time Bomb?

Leaving taxpayers to shoulder the burden of bailouts may set off "a dangerous social time bomb" of popular dissatisfaction, Finance Minister Wolfgang Schaeuble said in a speech late yesterday. "The currency union was never designed as a model for the enrichment of financial speculators."

Merkel's government was the biggest contributor to April's Greek bailout and would also shoulder the lion's share of any rescue under the current temporary backstop.

"These things are more about politics than economics," said Paul Lambert, head of the global macro team at Polar Capital Holdings Plc in London. "It's clear that for some economies in Europe it's going to be incredibly difficult to make the fiscal adjustments needed on their own. It's either going to mean Germany picking up the tab, or countries in Europe being cut loose."

~~The German proposals are hurting Portuguese debt even after the nation's government and biggest opposition party reached an agreement Oct. 29 on next year's budget.~~ The country's bonds are the third-worst performing government debt securities this year, down 5.7 percent, according to indexes compiled by Bloomberg and the European Federation of Financial Analysts Societies.

Irish Spread

Only Greece, with a 16 percent decline, and Ireland, with a 6.9 percent drop, fared worse. German bonds earned more than 8.2 percent this year.

The spread on Irish bonds has doubled in the past three months as the government tries to cut its deficit in the face of bank-bailout costs that may reach 50 billion euros. The country's 10-year bond yesterday yielded 7.304 percent, the most since 1996.

"The German government is following what the market is telling it," said Nicola Marinelli, a portfolio manager at

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BN Merkel Debt Plan Provokes Selloff Trichet Foresaw: Euro Credit
 Nov 3 2010 0:01:00

Glendevon King Ltd. in London, which oversees \$200 million in assts. "The Greek government, and probably the Irish and Portuguese, will need to be bailed out. If you sense that it's inevitable then it's better to have something to manage than complete chaos."

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Investors' fear sends yield on Irish bonds to new 7.45pc high

By Donal O'Donovan
Wednesday November 03 2010

The spiralling cost of Government borrowing hit a fresh high of 7.45pc yesterday as the European Central Bank (ECB) stepped in to calm the markets.

Germany's plan to get tough with bondholders, the failure to sell AIB's UK arm and fears that too much austerity could stifle the economy all added to the pressure on the bonds.

"The amount of selling has been relatively small, but the market is all sellers and no buyers, which drives up the yield. The ECB has come in to prevent this becoming a rout," said Padhraic Garvey, Head of Developed Markets Debt at ING Bank in Amsterdam.

Value

Yields of more than 7.4pc mean Irish 10-year bonds that pay 5pc in interest per year are being bought for a little more than 83pc of face value. Irish yields have now risen for six days in a row.

Bondholders have been selling Irish and other higher risk sovereign bonds since Germany proposed tough new bailout rules last week.

Under German Chancellor Angela Merkel's plan, lenders to sovereigns that are bailed out by the EU would take a haircut on their debt. If approved by EU members the proposals would come into force in 2013.

The EU needs a mechanism to manage defaults but holding discussions about the plan at a time when the market is so vulnerable has mystified many observers.

Yesterday Ms Merkel said that for rules to have "more bite" to protect the euro, along with steps to prevent EU nations running up excessive debt, a crisis mechanism enshrined in the bloc's treaties is necessary for the longer term.

"We will set it up in such a way that European taxpayers will no longer be on the hook for possible new mistakes and turmoil on the financial markets," Ms Merkel said.

Fears that Ireland's austerity plans could hurt the economy are also turning some bondholders off Irish bonds. "With austerity measures you're damned if you do and damned if you don't. The market wants to see the cuts but at the same time fears they will hurt the economy," said Mr Garvey.

That adds to pressure on Finance Minister Brian Lenihan to produce a four-year plan that convinces investors who are now abandoning Irish debt to buy back in.

If the cuts he proposes are too deep, investors fear there will not be enough growth in the economy to revive the banks. If cuts are too shallow, investors won't believe the deficit can be brought under control.

The cost of insuring Irish bonds against default also hit a new high yesterday.

Credit Default Swaps (CDS) that insure bondholders against a default in the next five years cost 5.3pc early yesterday. This means a bondholder has to pay €530,000 to insure €10m of bonds against default. Bad news from AIB was one factor in the rising cost of insuring Irish bonds, which rose more sharply than Greek or Portuguese CDS, said Gavan Nolan, credit analyst at research firm Markit.

"The banking situation is an extra factor in Irish risk.

"On Tuesday Ireland underperformed the other peripherals after AIB said it could not sell its UK assets.

"That adds to the cost of the bank bailout for Ireland at a time when the sovereign debt market was already very nervy," Mr Nolan said.

- *Donal O'Donovan*

Financial Times

Debt costs jump for Dublin and Lisbon

By Richard Milne in London and Ralph Atkins in Frankfurt
Published: November 1 2010 19:41 | Last updated: November 1 2010 19:41

Borrowing costs for Ireland and Portugal shot up as investors took fright at European proposals to force them to take a greater share of losses in future state bail-outs.

The moves in the bond markets on Monday follow agreement at last week's European Union summit on a Franco-German proposal on a mechanism to resolve future Greek-style sovereign debt crises.

Ireland saw the premium it pays over German benchmark interest rates rise to 4.67 percentage points, while the yield on its 10-year bonds reached 7.14 per cent, up 0.22 percentage points. Both the premium and the yield set new records since the introduction of the euro.

Meanwhile, Portugal's yield rose 0.16 percentage points to 6.11 per cent, while Greece and Spain saw smaller rises and European banking shares fell sharply in a broadly flat market.

"People do seem shocked about the idea of a future eurozone debt restructuring – but this should not have been a surprise unless you really believed that the German taxpayer would always underwrite everything," said Erik Nielsen, Goldman Sachs European economist.

The rise in the yields of the so-called peripheral nations in the eurozone appears to fulfil the forecast of Jean-Claude Trichet, European Central Bank president, who warned European heads of state last week that the proposed rescue system would increase borrowing costs.

Gary Jenkins, head of fixed income at Evolution Securities, said the danger was that by talking about debt restructuring "it could become a self-fulfilling prophecy". Markets are particularly worried that borrowing costs for Ireland and Portugal could become so high that they are forced to tap the eurozone's bail-out fund, a potentially destabilising move.

Exacerbating the discord among Europe's leaders, a top ECB official on Monday sharply criticised Germany's plan to allow a debt rescheduling by a member state. "Calling for an orderly debt restructuring mechanism sounds nice and is costless. Designing and implementing it is somewhat different," Lorenzo Bini Smaghi, an ECB executive board member, said in a speech in Abu Dhabi.

Despite the soaring cost of borrowing – Greece's yields have risen by more than 1 percentage point in a week – the ECB made no purchases in its government bond-buying programme for the third week.

Separately, credit rating agency Moody's said Greece, Portugal and Ireland were likely to avoid sovereign bond defaults because of a strong domestic investor base of local banks and pension funds that would buy their government's debt even in times of stress.

Many investors, however, remain convinced that one or more countries, most likely Greece, will restructure. "You can't get away from the fact that there will be some kind of restructuring in the eurozone periphery," said Rod Davidson, head of fixed income at Alliance Trust Asset Management.

Additional reporting by David Oakley

Extracts from Embassy Summary of French Press Coverage

Paris Press summary, 3 November 2010

Foreign news stories, including the mid-term elections in the US, the Chinese State visit to France and continuing terrorist threats, make the headlines in Paris this morning.

1. Eurozone – Ireland

Le Figaro Economie reports on German Finance Minister Wolfgang Schaeuble's visit to Paris yesterday. "Eurozone: Berlin wants to make the private sector pay up; the German Finance Minister revealed.....his vision of the future mechanism for crisis resolution". The report describes Schaeuble as "an ardent defender of orthodoxy and a convinced partisan of tough measures to heal the ills of Euroland (sic)". Schaeuble set out his vision of the mechanism to resolve crises agreed last week by the European Council. The 27 agreed on the principles but gave themselves two months to work out the details, something that has not failed to cause concern on the markets. Unsurprisingly, Schaeuble defends a strict interpretation of the rescue mechanism. Besides financial sanctions, he is favourable to taking voting rights in the Council away from countries which are not respecting the budgetary discipline agreed by their peers. He calls for a restructuring mechanism for public debt involving private sector participation. "Countries in financial difficulties can't expect that the Community will assist them unconditionally.....Participation by the private sector should be a central element of the Mechanism". Schaeuble: "monetary union was never conceived as a means of enriching financial speculators; neither is it a system for financial transfers from the richer to the poorer countries". In the context of revising the Treaty, the report says that Berlin wants to attach to "the no bail out clause" – the English expression is used – a mechanism for restructuring which would not leave the holders of private bonds, notably banks and insurance companies, indemnified. Schaeuble apparently also availed of the opportunity offered by his visit to Paris to sing the praises of "the German economic model".

<http://www.lefigaro.fr/conjoncture/2010/11/02/04016-20101102ARTFIG00659-zone-euro-berlin-veut-faire-payer-le-prive.php>

A separate article in Le Figaro Economie is headed "Ireland, Portugal, Greece: costs of borrowing take off". The report says that Trichet's fears are being realised. Gilles Moec, an economist at Deutsche Bank, says "the market is thinking like Trichet: it hates uncertainty". Ireland's ten year bonds yesterday reached 7.22%, the highest level since it joined the Eurozone. "Even if Ireland and Portugal were already worrying the markets for the past two months because of their dangerous budgetary situation, investors were reacting in particular to the risk of debt restructuring in the countries of the Eurozone". Another article in Le Figaro reports on a study by Markit on growth rates in Europe. "The diagnosis is nuanced. It reveals in effect a Europe of different speeds, with important disparities depending on the particular country. Growth rates in manufacturing are improving in Germany, in Italy, in Spain, in the Netherlands, in Austria and in Ireland.

Weblinks not available

Paris Press summary, 1st November

1. Outcome of European Council

On Saturday, Le Figaro's headline was "*Economic Governance: Merkel and Sarkozy relaunch Europe*". The report says that the 27 are agreed on "*a limited revision of the*

Lisbon Treaty”.....and “*Pandora's box risks being re-opened*”. In a separate report on prospects for the EU budget, Le Figaro writes that “*Paris, Rome and Berlin had rejected the idea of suppressing direct aids to farmers in the framework of the CAP*”. The editorial in Saturday's Figaro sees the Eurozone as going in the right direction but anticipates difficulties when it come to revising the Lisbon Treaty: “*it's hard to see the Irish — already quite suspicious — putting their heads on the block in ratifying a text of which they could be among the first victims*”. Liberation (Jean Quatremer in Brussels) heads its report “*the 27 swallow the Deauville deal*” (i.e. the outcome of the recent Sarkozy-Merkel meeting). The report says that Merkel explained that she was forced by her country's Constitutional Court to insist on a revision of the Treaty. Le Parisien talks of re-opening Pandora's box.

Le Figaro Economie (Jacques Mével in Brussels) this morning says that ECB President Trichet is concerned about plans to revise the Lisbon Treaty and fears a negative reaction from the markets for sovereign debt. “*The devil is in the detail and after the agreement in principle arrived at with some difficulty in Brussels last Friday, the 27 are faced with a choice which is already causing division: what's the place of the law of the market in the new rescue mechanism for Eurozone countries threatened with bankruptcy?*”. Merkel and Trichet are in opposing camps. What was agreed for Athens can't become the practice. Merkel's tough line was supported by France and Netherlands. Trichet's tough line caused surprise. What's the explanation? “*Announcing that restructuring is just around the corner could dissuade private investors, set off interest rates and worsen the burden of countries like Greece and Ireland*”. The report concludes “*just as the ECB is trying to disengage from buying up government bonds, Trichet's problems are increasing*”.

SPREADS FOR PERIPHERALS

Spread	4.45pm	11.45am	10am	03-Nov	02-Nov	01-Nov	29-Oct	28-Oct	27-Oct
Greece	899	865	852	851	843	833	821	794	794
Portugal	434	416	411	396	386	372	348	345	340
Ireland	546	532	526	512	492	477	447	436	429
Spain	195	191	186	186	182	177	170	164	161
Italy	154	147	145	147	144	141	136	133	133
Bund yield	238	248	248	243	247	248	253	257	257

Government Statement

Announcement of joint EU - IMF Programme for Ireland

The Government today agreed in principle to the provision of €85 billion of financial support to Ireland by Member States of the European Union through the European Financial Stability Fund (EFSF) and the European Financial Stability Mechanism; bilateral loans from the UK, Sweden and Denmark; and the International Monetary Fund's (IMF) Extended Fund Facility (EFF) on the basis of specified conditions.

The State's contribution to the €85 billion facility will be €17½ billion, which will come from the National Pension Reserve Fund (NPRF) and other domestic cash resources. This means that the extent of the external assistance will be reduced to €67½ billion.

The purpose of the external financial support is to return our economy to sustainable growth and to ensure that we have a properly functioning healthy banking system.

The external support will be broken down as follows: €22½ billion from the European Financial Stability Mechanism (EFSM); €22½ billion from the International Monetary Fund (IMF); and €22½ billion from the European Financial Stability Fund (EFSF) and bilateral loans. The bilateral loans will be subject to the same conditionality as provided by the programme.

The facility will include up to €35 billion to support the banking system; €10 billion for the immediate recapitalisation and the remaining €25 billion will be provided on a contingency basis. Up to €50 billion to cover the financing of the State. The funds in the facility will be drawn down as necessary, although the amount will depend on the capital requirements of the financial system and NTMA bond issuances during the programme period.

If drawn down in total today, the combined annual average interest rate would be of the order of 5.8% per annum. The rate will vary according to the timing of the drawdown and market conditions.

The assistance of our EU partners and the IMF has been required because of the present high yields on Irish bonds, which have curtailed the State's ability to borrow. Without this external support, the State would not be able to raise the funds required to pay for key public services for our citizens and to provide a functioning banking system to support economic activity. This support is also needed to safeguard financial stability in the euro area and the EU as a whole.

Programme for Support

The Programme for Support has been agreed with the EU Commission and the International Monetary Fund, in liaison with the European Central Bank. The Programme builds on the bank rescue policies that have been implemented by the Irish Government over the past two and a half years and on the recently announced National Recovery Plan. Details of the measures are set out in the accompanying Notes for Editors.

The Programme lays out a detailed timetable for the implementation of the measures contained in the National Recovery Plan.

The conditions governing the Programme will be set out in the Memorandum of Understanding and the Government will work closely with the various bodies to ensure that these conditions are met. The funding will be provided in quarterly tranches on the achievement of agreed quarterly targets.

The Programme has two parts – the first part deals with bank restructuring and reorganisation and the second part deals with fiscal policy and structural reform. The requirement for quarterly progress reports covers both parts of the programme. When the documentation on the Programme is finalised, it will be laid before the Houses of the Oireachtas.

Bank Restructuring and Reorganisation

The Programme for the Recovery of the Banking System will be an intensification of the measures already adopted by the Government. The programme provides for a fundamental downsizing and reorganisation of the banking sector so it is proportionate to the size of the economy. It will be capitalised to the highest international standards, and in a position to return to normal market sources of funding.

Fiscal Policy and Structural Reform

The Ecofin has acknowledged the EU Commission's analysis that a further year may be required to achieve the 3% deficit target. This analysis is based on a more cautious growth outlook in 2011 and 2012 and the need to service the cost of additional bank recapitalisations envisaged under the programme. The Council has today extended the time frame by 1 year to 2015.

The Programme endorses the Irish Government's budgetary adjustment Plan of €15 billion over the next four years, and the commitment for a substantial €6 billion frontloading of this plan in 2011. The details of the Programme closely reflects the key objectives set out in the National Recovery Plan published last week. The adjustment will be made up of €10 billion in expenditure savings and €5 billion in taxes.

The Programme endorses the structural reforms contained in the Plan which will underpin a return to sustainable economic growth over the coming years.

The Government welcomes the support shown to Ireland by our Eurozone partners and in particular by the United Kingdom, Sweden and Denmark who have expressed their willingness to offer bilateral assistance. The Government also welcomes the assistance of the IMF.

As part of the Programme, Ireland will discontinue its financial assistance to the Loan Facility to Greece. This commitment would have amounted to approximately €1 billion up to the period to mid-2013.

28th November 2010

**Statement by An Taoiseach, Mr Brian Cowen TD on Provision of
International Financial Support for Ireland**

Dublin, 28 November 2010

I can confirm that the Government has concluded negotiations with our European partners and international institutions, including the European Commission, the European Central Bank and the International Monetary Fund.

We have reached agreement on a programme for the provision of significant international financial support for Ireland.

A programme of assistance for Ireland totalling 85 billion euro has been agreed.

This includes external assistance of 67.5 billion euro, comprising 45 billion euro from the EU and bilateral loans from the UK, Sweden and Denmark and 22.5 billion euro from the IMF.

The estimated average interest rate on the loans is in the order of 5.83% per annum, based on current market conditions.

The duration of the programme is 3 years, while the average length of loan is up to 7.5 years.

The remaining 17.5 billion euro in the programme will be funded from Ireland's own resources – 5 billion from our cash reserves and 12.5 billion from the pension reserve fund.

This approach is reasonable in the context of such large loans from other countries and as a means of reducing the total amount of debt involved.

Crucially for Irish jobs, the agreed programme does not involve any change to our Corporation Tax rate of 12.5%.

In addition, we have obtained more room for manoeuvre by agreeing with the European Commission that the timeframe for reducing the deficit below 3% of GDP can be extended to 2015, if the four-year adjustment of 15 billion euro proves insufficient.

This programme is absolutely essential for our country.

The Government's agreement to it follows very tough negotiations over recent days.

Those negotiations, and the agreed programme, have been informed by the most robust consideration of our national interest and the broader interests of the eurozone.

We have carefully considered all available policy options.

In reaching this agreement, the Government has accepted the recommendations of the Minister for Finance, the Governor of the

Central Bank and the Chief Executive of the National Treasury Management Agency.

While the agreement has important implications for the European Union as a whole, I wish to address my remarks this evening to the people of Ireland.

The first point that people should know is that the significant loans being provided to Ireland are necessary to allow us to fund our budgets over the coming years.

These loans will provide money that we had already planned to borrow on the international markets.

That funding will now be available to Ireland at a cheaper interest rate than if we borrowed on the markets.

Without these loans, the necessary tax increases and spending cuts would be far more severe, and they would be imposed far more quickly, than is proposed in the Government's National Recovery Plan.

A large portion of the loans – some 50 billion euro - will be used to fund the Exchequer.

This will be used to help to pay for social welfare payments, pensions, health, education and other public services over the coming years, as we manage the transition to a sustainable deficit and debt position.

The remaining portion of the facility being put in place will be devoted to support for the banking system.

This will be drawn down as required while the necessary reform and restructuring of the Irish banks is brought to a conclusion, and in a manner that facilitates the continued effective provision of credit to Irish businesses.

This support will also include the funds drawn from our own reserves.

10 billion euro will be drawn down immediately for the purposes of bank capitalisation, with the remaining 25 billion available on a contingency basis.

Compared to the National Recovery Plan projections, the programme involves an increase in the national debt.

The precise extent of that increase depends on how much additional funding for the banking system is drawn down, as well as on future economic growth.

The Government estimates that the debt ratio will stabilise in 2013 and that interest payments would represent over 20% of tax revenue in 2014.

It is worth recalling that in 1985 interest payment costs reached close to 35% of tax revenue

This represents a very large increase in our national debt over the course of this unprecedented economic crisis and this must be addressed over time.

Nevertheless, it is sustainable if we fully implement the National Recovery Plan.

The second important issue is that people understand that what has been agreed today is broadly consistent with policies already set out in the National Recovery Plan.

It endorses the proposed adjustment of 6 billion euro next year and 15 billion euro over the next four years.

It does, however, recognise that because of a more cautious outlook for economic growth and additional debt service costs, the timeframe for reducing the budget deficit to 3% of GDP should be extended to 2015.

While this does not alter the existing targeted adjustment of 15 billion euro up to 2014, it does mean that we have further room for manoeuvre if economic growth is lower than expected.

As with the National Recovery Plan, the agreed programme sets out the actions to be undertaken by Ireland to deliver on the structural reforms that are necessary to meet our budgetary targets and to promote economic growth and job creation.

Progress on all the actions set out in the programme will be reviewed on a quarterly basis, while the National Recovery Plan will be reviewed on an annual basis as already announced.

The next step in the implementation of the National Recovery Plan and the programme of international assistance is the passing of the Budget for 2011.

As you are aware, this will be presented to Dáil Eireann on December 7th.

The third important issue agreed today concerns the reform and restructuring of the Irish banking system.

The agreed programme sets out a detailed set of actions in that regard.

This will involve an intensification of the measures already adopted by the Government.

The programme provides for a fundamental downsizing and reorganisation of the banking sector

This will lead to a smaller banking system, more proportionate to the size of the economy, capitalised to the highest international standards, with renewed access to normal market sources of funding and focused on strongly supporting the recovery of the economy.

The Government Statement includes an information note that sets out the key measures within the Programme in relation to the bank restructuring and reorganisation.

In conclusion, I want to reiterate that this agreement is necessary for our country and our society.

It is in the best interests of Ireland and of the European economy on which our future prosperity depends.

In particular, I want to make it very clear that all of the options for reducing the cost to Ireland of the resolution of our banking difficulties – including the importance of requiring subordinated bondholders to share the burden of bank losses - were fully explored by the Government during the negotiations.

The proposed programme has been developed with the assistance of, and is endorsed by, our international partners.

The final agreed programme represents the best available deal for Ireland.

It allows us to move forward with secure funding for our essential public services, our welfare state and for the most vulnerable members of our society who depend on them.

It provides Ireland with vital time and space to successfully and conclusively address the unprecedented problems that we have been dealing with since this global economic crisis began.

ENDS



EUROPEAN COMMISSION

Brussels, xxx
SEC (2010) xxx

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN COMMISSION

AND

IRELAND

MEMORANDUM OF UNDERSTANDING

BETWEEN

THE EUROPEAN COMMISSION

AND

IRELAND

The present memorandum of understanding contains the following documents:

- (a) A memorandum of economic and financial policies
- (b) A memorandum on specific economic policy conditionality
- (c) A technical memorandum of understanding

The memorandum of understanding may be amended upon mutual agreement of the parties in the form of an Addendum. The Addendum will be an integrated part of this Memorandum and will become effective upon signature.

Done in Brussels on .../12/2010 ... and in Dublin on .../12/2010 in three originals, in the English language.

For Ireland

For the Central Bank of Ireland



Brian Lenihan
Minister for Finance



Patrick Honohan
Governor of the ~~Irish~~ Central Bank of Ireland

For the European Commission



Olli Rehn
Member of the European Commission

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. We have concluded that Ireland expeditiously requires a strong programme to restore domestic and external confidence and, thus, snap the pernicious feedback loops between the growth, fiscal, and financial crises.
2. We propose that such a programme comprise of four key elements:
 - A fundamental downsizing and reorganisation of the banking sector—complemented by the availability of capital to underpin solvency—is required to restore confidence. Addressing market perceptions of weak bank capitalisation, overhauling the banks’ funding structure, and immediately beginning a process of downsizing the banking system will be required.
 - An ambitious fiscal consolidation building, on the progress already made.
 - Renewing growth through a multi-pronged effort.
 - A substantial external financial assistance will support the achievement of our policy objectives.

Recent Economic Developments and Outlook

3. After two years of sharp declines in output, the Irish economy is expected to broadly stabilise this year before expanding during 2011–14. As domestic imbalances from the boom years are being repaired, the recovery will, at least initially, be primarily export-driven. We project that GDP growth will increase over time as export performance filters through to investment and consumption, consumer confidence returns, and labour market conditions improve. We recognise that the risks in the short term are tilted to the downside, and, in particular, the headwinds from fiscal consolidation on domestic demand could be larger than anticipated. Over the longer haul also, continued private and public sector balance sheet adjustments, coupled with a weak banking sector, could delay the recovery.
4. Inflation is expected to remain low, reflecting the large output gap and modest external price pressures. Although the inflation rate will likely increase over time, it is expected to remain lower than in trading partner countries. This will have the benefit of improving competitiveness but the low rates of inflation would unavoidably keep real debt burdens high and dampen domestic demand.
5. The current account balance is projected to continue to improve gradually over the medium term, reflecting export expansion and the contraction in domestic demand. However, profit repatriation from multinationals and large interest payments to foreign holders of Irish debt are expected to limit the improvement over the programme period.

Restoring Financial Sector Viability

6. With its large size relative to the economy, its heavy reliance on wholesale funding, and its large exposures to the real estate sector, much of the domestic Irish banking system is in a stressed state. The Government has intervened heavily to safeguard financial stability. In late 2009, we established the National Asset Management Agency (NAMA) to take over certain vulnerable commercial and property development assets of banks. In addition, major efforts have been made to boost banks' capital.

7. Although the Government has made strong efforts to contain the fallout from the sector's vulnerabilities, a continued lack of market access and the loss of deposits have created significant funding pressures, alleviated largely by an increase in recourse to Eurosystem financing facilities and Emergency Liquidity Assistance by the Central Bank. Moreover, capital injections in the banks have placed a heavy burden on public finances.

8. Our proposed programme will take decisive steps to ensure the viability and health of the financial system. We intend to lay the foundations of this process very quickly, if we are to reassure the markets that banks will return to viability and will have the ability to operate without further state support in a reasonable period of time.

9. The key component of our efforts is an overhaul of the financial sector with the objective of substantial downsizing, isolating the non-viable parts of the system and returning the sector to healthy functionality. It will be important to support this process through capital injections into viable financial institutions. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability to the system. It is our goal that the leaner and more robust system that emerges from these efforts will not be dependent on state support, will have a more stable funding base, and will provide the credit required to foster growth.

10. The plan to overhaul the banking system has several elements. First, banks will be required to run down non-core assets. Second, land and development property loans that have not yet been transferred to NAMA will also be transferred. Third, banks will be required to promptly and fully provide for all non-performing assets as needed. Fourth, the banks will be required to securitise and/or sell asset portfolios or divisions with credit enhancement if needed, once the market normalises. And finally, swift and decisive action will be taken to resolve the position of Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS) in a way that protects depositors and strengthens the banking system. To this end, by end-January 2011, we will submit to the European Commission a revised proposal developed in collaboration with IMF, to resolve Anglo and INBS. Each of these initiatives will require technical or legislative measures, most of which we believe can be expeditiously instituted.

11. To achieve the above goals, banks will be required to submit deleveraging plans to the national authorities by end-February 2011. The plans will be prepared on the basis of clear periodic targets defined by the Central Bank, taking into consideration the Prudential Liquidity Assessment Review (PLAR) to be conducted in consultation with the EC, ECB and IMF. By end-March 2011, the Central Bank with assistance from an internationally recognised consulting firm, will complete the assessment of the banks' restructuring plans (structural benchmark). The deleveraging plans will be a component of the restructuring plans to be submitted to the European Commission for approval under EU competition rules.

12. This reorganisation and downsizing of the banks will be bolstered by raising capital standards. While we expect that, in a restructured system, banks will be able to raise capital in the market, we recognise that the higher standards may imply that, in the short run, public provision of capital will be needed for banks that are deemed to be viable. To support this process—and to render it credible—we will undertake a review of the capital needs of banks on the basis of a diagnostic of current asset valuations and stringent stress tests (PCAR 2011).

- As an immediate step, to enhance confidence in the solvency of the banking system, the Central Bank will direct Allied Irish Bank (AIB), Bank of Ireland (BoI) and EBS to achieve a capital ratio of 12 percent core tier 1 by end-February 2011 (structural benchmark) and Irish Life & Permanent (ILP) by end-May 2011 (structural benchmark). This would imply an injection of fresh equity capital of €7bn into these four banks and provide an additional buffer for a potential increase in expected losses. This action, along with early measures to support deleveraging and taking account of haircuts on the additional loans to be transferred to NAMA (see ¶10) would result in an injection of €10bn of fresh capital into the banking system, above and beyond the already committed capital injection of €6.6bn for AIB previously announced by the Irish authorities.
- By end-December 2010, in consultation with EC, ECB, and IMF staff, we will define the criteria to run stringent stress test scenarios (structural benchmark). We will also agree with EC, ECB, and IMF staff, by end-December 2010, on draft terms of reference for the due diligence of bank assets by internationally recognised consulting firms (structural benchmark). We intend to complete the diagnostic evaluation of banks' assets by end-March 2011 and the stress tests (PCAR 2011) by end-March 2011 (both structural benchmarks), and transparently communicate our findings.
- Based on these assessments, starting end-April 2011, banks will be required to maintain a core tier 1 capital ratio of 10.5 percent. Banks will report their capital adequacy ratios to the Central Bank on a quarterly basis. The Central Bank's assessment of banks' capital adequacy ratio will be made public at least semi-annually.

13. The question of whether burden should be imposed on bank sub debt is influenced by two factors: the quantum of capital the State has committed to support the institution and the perceived viability of the bank in the absence of receiving such capital. Forced burden sharing through legislation is possible and legislation is currently being prepared in this regard. Alternatively, in certain cases, a very deeply discounted liquidity management exercise might also be an appropriate option.

14. In addition, we will finalise proposals to strengthen the legal framework for dealing with distressed deposit-taking institutions in line with recent EU developments (including EU competition rules) and international sound practices. Such a special resolution regime will broaden the available resolution tools with the aim of promoting financial stability and protecting depositors. In particular, the draft legislation will (i) provide for the appointment of a special manager where, in the opinion of the Central Bank, an institution's financial condition has severely deteriorated; (ii) grant powers to the Central Bank for the transfer of assets and liabilities to other institutions; and (iii) create a framework for the establishment of bridge banks. We seek to submit draft legislation including the above-mentioned elements to Dáil Éireann by end-February 2011 (structural benchmark).

15. Moreover, we will continue the efforts to strengthen banking supervision by ensuring higher staffing levels and budget allocations in line with OECD best practices. We will enhance the risk assessment framework and raise the corporate governance standards. By end-September 2011, a report by an independent assessor on our compliance with Basel core principles for effective banking supervision will be made public.

16. We will also reform the personal insolvency regime for financially responsible individuals (including sole traders), which will balance the interests of both creditors and debtors. The objectives will be to lower the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline. The new legal framework will include a non-judicial debt settlement and enforcement mechanism as an alternative to court-supervised proceedings.

17. We will continue to provide means-tested financial assistance to limit the economic and social fallout of the crisis. The existing mortgage interest supplement scheme is crucial for providing temporary assistance to distressed mortgage holders. The scheme's administration will be centralised to ensure a more consistent application focusing on households that are most in need, and further modification will be introduced in the 2011 Social Welfare Act.

18. Our strategy for the credit union sector is based on three components. First, we will complete a full assessment of their loan portfolios by end-April 2011 (structural benchmark). Second, by end-April 2011, we will have ready a comprehensive strategy to enhance the viability of the sector. And third, by end-December 2011 we will submit legislation to

Dáil Éireann to assist the credit unions with a strengthened regulatory framework including effective governance and stabilisation requirements.

19. We will continue efforts to ensure the flow of credit to viable businesses, building on actions already taken under previous recapitalisations and NAMA legislation. Allied Irish Bank and Bank of Ireland have agreed, in connection with recapitalisation last March, to make available not less than €3 billion each for targeted lending for new or increased credit facilities to small and medium-sized enterprises in both 2010 and 2011 as well as funds for seed and venture capital and for Environmental lending. The lending policies and decisions of both banks are subject to review by the Credit Review Office, which enables businesses who have had credit refused or withdrawn, to apply for an independent review of the bank's decision.

20. NAMA is subject to an extensive range of statutory Governance and Accountability arrangements and these will be fully adhered to. Members of the NAMA Board must have relevant experience and expertise, and the work of the Board is supported by audit and other sub-committees. NAMA operations are also subject to statutory codes of practice. NAMA is required to prepare various reports, including quarterly reports of its activities, and these are subject to scrutiny by Oireachtas committees. The Comptroller and Auditor General audit the annual accounts and prepare reports on NAMA for review by the Public Accounts committee.

Safeguarding Public Finances

21. To continue with the programme of fiscal consolidation, a comprehensive National Recovery Plan 2011-14 was approved by the Government and published on 24 November 2010. This Plan forms the basis for the 2011 budget consistent with fiscal consolidation measures amounting to €15 billion, a 9 percent of GDP budgetary correction over the period 2011–14. Having stabilised the deficit, albeit at a high level, the steps announced in the Plan will place the budget deficit-to-GDP ratio on a firm downward path. While the debt-to-GDP ratio will remain at high levels for the next few years, it is projected to decline thereafter, underpinning debt sustainability. We also propose to keep under review progress towards meeting the Stability and Growth Pact targets.

22. Budget 2011 which will include adjustment measures of €6 billion, will be submitted to Dáil Éireann for passage on 7 December (prior action). As set out in the National Recovery Plan, most of this adjustment will come from the expenditure side. The capital budget will be reduced, partly through greater value for money in our infrastructure procurements. On current expenditures, we are pursuing public service numbers reductions through natural attrition and voluntary schemes, adjustments in public service pensions, and further savings on social transfers (from reductions in working age payments, reductions in universal child benefit payments and other reforms). Protecting the socially vulnerable at a

time of difficult economic adjustment remains a central policy goal. Current savings will also be realised from streamlining government programmes and through administrative efficiencies. Should these savings or the expected numbers reductions not materialise, we reserve the option to take further measures.

23. An income tax-led revenue package—sized at over €2 billion in a full year—will supplement the above expenditure measures in 2011. Over the past decade, the proportion of citizens exempt from income tax has risen to 45 percent and tax credits have doubled, resulting in a comparatively low burden of tax on ordinary incomes. This is no longer sustainable. Accordingly, we are widening the tax base, by lowering income tax bands and credits by 10 percent, and by reducing various pension-related tax reliefs. We are also taking action on other tax expenditures, and distortions arising from the existence of multiple levies.

24. To secure our fiscal targets, a number of fiscal measures have been identified for 2012–14. We will continue to rely on expenditure savings (€6.1 billion), led by current spending (€4.9 billion), as outlined in the National Recovery Plan. We are targeting further reductions in public sector numbers, social benefits and programme spending, and have anchored the prospective savings by publishing multi-year expenditure ceilings by Vote Group through 2014. We are also planning to move towards full cost-recovery in the provision of water services and ensuring a greater student contribution towards tertiary education, while ensuring that lower-income groups remain supported. In addition, we will accelerate the process of placing the pension systems on a path consistent with long-term sustainability of public finances. On the tax side, we will build on the base-broadening measures outlined above and establish a sound basis for sub-national finances through a new residential-property based site value tax. The Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

25. We are preparing institutional reform of the budget system taking into account anticipated reforms of economic governance at the EU level. A reformed Budget Formation Process will be put in place. Furthermore, we will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by end-July 2011 (structural benchmark). A Budget Advisory Council, to provide an independent assessment of the Government's budgetary position and forecasts will also be introduced by end-June 2011 (structural benchmark). These important reforms will enhance fiscal credibility and anchor long-term debt sustainability.

Raising the Growth Potential

26. We recognise the need to restore strong sustainable growth. The structural changes to the financial and fiscal sectors, described above, are critical for improving the prospects of economic recovery and raise the medium-term growth potential. Although, as is widely recognised, Ireland is a global leader in providing a business-friendly environment, the

National Recovery Plan includes a strategy to remove remaining structural impediments to competitiveness and employment creation. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, which will also support growth and promote jobs.

27. Specifically, we will continue to press ahead with other structural reform as set out in the Memorandum of Understanding on specific economic policy conditionality:

- We will promote service sector growth through vigorous action to remove remaining restrictions on trade and competition, and will propose amendments to legislation to enable the imposition of financial and other sanctions in civil law cases relating to competition.
- Building on the forthcoming report of the Review Group on State Assets & Liabilities the government will undertake an independent assessment of the electricity and gas sectors with a view to enhancing their efficiency. State authorities will consult with the Commission Services on the results of this assessment with a view to setting appropriate targets for the possible privatisation of state-owned assets.
- To reduce long-term unemployment and to facilitate re-adjustment in the labour market, we will reform the benefits system and legislate to reform the national minimum wage. Specifically, changes will be introduced to create greater incentives to take up employment.

Programme Financing

28. Ireland is facing large and medium-term balance of payments needs that arise from (i) substantial pressures on the capital account that need to be relieved, and (ii) the need to build up reserves to improve banks' ability to meet their large external debt rollover needs. The programme's success is dependent on substantive external financial assistance. This external financing will serve as a bridge during the implementation of the critical reforms to fundamentally restructure the banking system and restore fiscal sustainability. It is our view that, given Ireland's medium-term structural adjustment needs, an arrangement under the Extended Fund Facility (EFF) would be appropriate. Such an arrangement would also have the added benefit of a more realistic repayment schedule for Ireland.

29. Notwithstanding the large fiscal adjustment, we estimate the financing need to be up to €85 billion until the end of 2013. This includes a contingency element for bank recapitalisation. An amount of €17.5 billion will be covered by an Irish contribution through the Treasury cash buffer and investments of the National Pension Reserve Fund. We expect commitments from the IMF under the Extended Arrangement to amount to €22.5 billion and EU financial support from the European Financial Stability Mechanism/European Financial Stability Facility and bilateral arrangements to amount to €45 billion. Ireland will draw on

these resources in parallel throughout the programme period. While the envelope of resources to be provided to Ireland is a source of reassurance to the authorities and to financial markets, we plan to draw *pari passu* on IMF and EU financial support on an as needed basis. Moreover, if market access is restored on a sustainable basis, we would anticipate paying down the drawings made on an advanced schedule.

30. We are confident that the implementation of the fiscal and banking sector reforms will help the economy recover.

Programme Monitoring

31. Progress in the implementation of the policies under the programme will be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews and compliance with requirements under the Excessive Deficit Procedure (EDP). The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer balance (central government cash balance) excluding interest payments will be monitored through quarterly performance criteria and net central government debt will be an indicative target (Table 1). As is standard in IMF arrangements, there will be a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms will be monitored through structural benchmarks (Table 2). A joint EC-ECB Memorandum of Understanding specifies, notably, the structural policies recommended in the MEFP, and sets a precise time frame for their implementation,

32. As is standard in all Fund arrangements, a safeguards assessment of the Central Bank of Ireland will be completed by the first review of the arrangement. In this regard, the Central Bank will receive a safeguards mission from the Fund and provide the information required to complete the assessment by the first review. As a related matter, and given that financing from the IMF will be used to provide direct budget support, a framework agreement will be established between the government and the Central Bank of Ireland on their respective responsibilities for servicing financial obligations to the IMF. As part of these arrangements, Fund disbursements will be deposited into the government's account at the Central Bank.

33. We authorise the IMF and the European Commission to publish the Letter of Intent and its attachments, and the related staff report.

Table 1. Ireland: Quantitative Performance Criteria and Indicative Targets under the Economic Programme for 2010–11

	December 31, 2010	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
(In billions of Euros)					
	Performance Criterion	Performance Criterion	Indicative Target	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 1/	-15.3	-7.8	-11	-14.3	-14.6
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 2/	0	0	0	0	0
	Indicative Target	Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	83.1	91.6	96.5	100	102.2

1/ Measured by the exchequer balance excluding interest payments. Cumulative from the start of the relevant calendar year.

2/ Applies on a continuous basis.

Table 2. Prior Action and Structural Benchmarks Under the Economic Programme for 2010–11

Measure		
Submit the 2011 Budget to Dáil Éireann (MEFP, ¶22).	7 December 2010	Prior Action
Define the criteria to run stringent stress tests scenarios (MEFP ¶12).	End-December 2010	Structural Benchmark
Agree on terms of reference for the due diligence of bank assets by internationally recognised consulting firms (MEFP, ¶12).	End-December 2010	Structural Benchmark
The Central Bank will direct the recapitalisation of the principal banks (AIB, BOI and EBS) to achieve a capital ratio of 12 percent core tier 1 (MEFP, ¶12).	End-February 2011	Structural Benchmark
Submit to Dáil Éireann the draft legislation on a special resolution regime (MEFP, ¶14).	End-February 2011	Structural Benchmark
The Central Bank to complete the assessment of the banks' restructuring plans (MEFP, ¶11).	End-March 2011	Structural Benchmark
Complete the diagnostic evaluation of banks' assets (MEFP, ¶12).	End-March 2011	Structural Benchmark
Complete stress tests (PCAR 2011) (MEFP, ¶12).	End-March 2011	Structural Benchmark
Complete a full assessment of credit unions' loan portfolios (MEFP, ¶18).	End-April 2011	Structural Benchmark
The Central Bank will direct the recapitalisation of ILP to achieve a capital ratio of 12 percent core tier 1 (MEFP, ¶12).	End-May 2011	Structural Benchmark
Establish a Budget Advisory Council (MEFP, ¶25).	End-June 2011	Structural Benchmark
Introduce a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area (MEFP, ¶25).	End-July 2011	Structural Benchmark

Fiscal measures included in the programme

2011

<i>in million EUR</i>		% of GDP
Revenue measures	1400	0.9
One-off and other revenue measures	700	0.4
Current expenditure measures	2090	1.3
Capital expenditure measures	1800	1.1
TOTAL IMPACT in 2011	5990	3.8

2012

<i>in million EUR</i>		% of GDP
New revenue measures	880	0.5
Revenue carryover from previous year	620	0.4
Current and capital expenditure measures	2100	1.3
TOTAL ANNUAL IMPACT	3600	2.2

2013

<i>in million EUR</i>		% of GDP
New revenue measures	850	0.5
Revenue carryover from previous year	250	0.1
Current and capital expenditure measures	2000	1.2
TOTAL ANNUAL IMPACT	3100	1.8

Ireland
Memorandum of Understanding
on

SPECIFIC ECONOMIC POLICY CONDITIONALITY
8 December, 2010

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism, and in particular Article 3(5) thereof, this Memorandum of Understanding details the general economic policy conditions as embedded in Council Decision 17211/1/10 of 7 December 2010 on granting Union financial assistance to Ireland.

The quarterly disbursement of financial assistance from the European Financial Stabilisation Mechanism (EFSM)¹ will be subject to quarterly reviews of conditionality for the duration of the programme. Release of the instalments will be based on observance of quantitative performance criteria, respect for EU Council Decisions and Recommendations in the context of the excessive deficit procedure, and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and in this Memorandum of Understanding on specific economic policy conditionality (MoU), which specifies the detailed criteria that will be assessed for the successive reviews up to the end of 2013. If targets are (expected to be) missed, additional action will be taken.

The authorities commit to consult with the European Commission, the ECB and the IMF on the adoption of policies that are not consistent with this Memorandum. They will also provide the European Commission, the ECB and the IMF with all information requested that is available to monitor progress during programme implementation and to track the economic and financial situation. Prior to the release of the instalments, the authorities shall provide a compliance report on the fulfilment of the conditionality.

The release of the first instalments will be conditional on the successful adoption of Budget 2011 as described in the MEFP and this MoU.

¹ On 28 November 2010 Eurogroup and ECOFIN Ministers issued a statement clarifying that euro-area and EU financial support will be provided on the basis of the programme which has been negotiated with the Irish authorities by the Commission and the IMF, in liaison with the ECB. Further to the Union support from the EFSM, loans from the EU and its Member States will include contributions from the European Financial Stability Facility (EFSF) and bilateral lending support from the United Kingdom, Sweden, and Denmark. The Loan Facility Agreements on these financing contributions will specify that the disbursements thereunder are subject to the compliance with the conditions of this Memorandum.

1. Actions for the first review (actions to be completed by end Q1-2011)

i. Fiscal consolidation

Government submits the draft budget for 2011 for Dáil approval. The budget provides information and prudent projections on the entire general government sector and targets a further reduction of the general government deficit in line with the MEFP. It includes a detailed presentation of fiscal consolidation adjustments for 2011 of €6 billion.

The budget includes the following measures (in exceptional circumstances, measures yielding comparable savings could be considered in close consultation with European Commission, IMF and ECB staffs);

- Revenue measures to raise at least €1,400m in 2011 and an extra €620m in a full year will be introduced to the Houses of the Oireachtas, including:
 - A lowering of personal income tax bands and credits or equivalent measures to yield €945m in 2011 and an extra €300m in a full year.
 - A reduction in pension tax relief and pension related deductions to yield €155m in 2011, and an extra €105m in a full year.
 - A reduction in general tax expenditures to yield €220m in 2011, and an extra €185m in a full year.
 - Excise and miscellaneous tax measures to raise €80m in 2011 and a further €30m in a full year will be introduced.
 - The government will outline methods to raise at least €700m in one-off and other measures in 2011.

- A reduction of current expenditure in 2011 of at least €2,090m will be implemented including;
 - Social Protection expenditure reductions.
 - Reduction of public service employment numbers in 2011.
 - A reduction of existing public service pensions on a progressive basis averaging over 4% will be introduced.
 - Other expenditure savings of €1,030m including savings on goods and services.

- A reduction of at least €1,800m in public capital expenditure against existing plans for 2011 will be introduced.

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

Recapitalisation measures

- The measures proposed for the recapitalisation of Irish banks in the government statement of 30 September 2010 will be implemented, taking into account any changes in strategy for the future of the banking sector agreed under the programme.

- Further deleveraging of the banks will be achieved by the extension of the NAMA programme to include approximately €16bn of land and development loans in AIB and Bank of Ireland, which had previously been excluded as they were below a value threshold of €20m. NAMA will categorise sub-€20m AIB and BOI land and development and associated loans (roughly estimated to number 10,000) by reference to asset type and region. NAMA will then apply different discounts to each category based on NAMA's loan valuation experience up to the point of valuation. On this basis it is expected that all loans will be transferred by end-March 2011. NAMA will issue bonds in return for the assets transferred. NAMA would build on the existing outsourcing arrangements with the banks for the management of these smaller loans and performance will be incentivised as appropriate. The NAMA legislation will be amended to underpin the valuation and acquisition of these assets on a portfolio basis. The additional capital requirement will be met by the programme and is included in the figure below. These measures will be notified to the European Commission in accordance with EU competition rules.

- Prudential Capital Assessment Review (PCAR) minimum capital requirement for the Irish banks (AIB, BOI, EBS and ILP) will be set at 10.5% core tier 1;

- In addition the Irish authorities will ensure that AIB, BOI and EBS are initially recapitalised to a level of 12% core tier 1 capital, which will take account of haircuts on the additional loans to be transferred to NAMA and will fund early deleveraging by making available EUR 10 billion in the system; the recapitalisation will take the form of equity shares (or equivalent instruments for EBS);

- The PCAR exercise will be enhanced to provide a comprehensive evaluation of the underlying assets of the banks, taking into account future expected losses.

- The PCAR for 2011 will be completed based on comprehensive Terms of Reference for its design and implementation, which will have been previously agreed between the Central Bank, the European Commission, IMF and ECB staff. The methodology used will be published in detail. The Commission, IMF and ECB shall be involved in the validation of the PCAR process. In particular, key data and information that relates to the PCAR exercise will be available to the Commission, IMF and ECB upon request.

Deleveraging measures

- The Central Bank will complete a Prudential Liquidity Assessment Plan (PLAR) for 2011, outlining measures to be implemented with a view to steadily deleveraging the banking system and reducing the banks' reliance on short term funding by the end of the programme period. Ambitious target loan to deposit ratios, to be achieved by end 2013, will be established for each bank by the Irish authorities in consultation with the ECB, EC and the IMF by end Dec 2010. These targets will be designed to ensure that convergence to Basel III standards can be readily met by the relevant dates. To this end, the PLAR will establish target funding ratios for 2013 for each of the banks, identify non core assets and set an adjustment path to these targets based on specified non public annual benchmarks. Banks will be informed of necessary actions to be taken so as to comply with the respective funding targets and adjustment paths. The design and implementation of the PLAR will be agreed with the European Commission, the ECB and the IMF. Compliance with the PLAR benchmarks will be monitored and enforced by the Central Bank taking account of prevailing market conditions. The PLAR will be updated on an annual basis.

Reorganisation of banking sector

- The strategy for the future structure, functioning and viability of Irish credit institutions will be developed in detail and agreed with the European Commission, the ECB and the IMF. Within the context of a comprehensive reorganisation and downsizing of the banking sector the strategy will identify the appropriate path to ensure that the banking system will operate without the need of further State support. The Irish authorities are committed to divest the participations in the banks acquired during the crisis within the shortest timeframe possible which is compatible with financial stability and public finance considerations. Building on restructuring undertaken to date, further restructuring and viability plans for the institutions concerned will be submitted in accordance with EU competition rules; these plans will also be made available to the IMF and ECB. Commitments undertaken by the Irish authorities in the context of EU competition decisions will be maintained.
- In the context of the above strategy, a specific plan for the resolution of Anglo Irish Bank and Irish Nationwide Building Society will be established and submitted to the European Commission in accordance with EU competition rules. Any related legal procedures will be set in motion under a precise timetable. This plan will seek to minimise capital losses arising from the working out of these non-viable credit institutions. The Government will ensure that these credit institutions adhere to the requisite capital ratios.
- Legislation on improved procedures for early intervention in distressed banks and special bank resolution regime (SRR) will be introduced. The SRR should include a robust set of powers and tools to ensure the competent authorities can promptly and effectively resolve distressed banks e.g. when they pose a risk to financial stability. The legislation will be consistent with the EU Treaty rules and will be consistent with similar initiatives ongoing at EU level.

- Central Bank staffing in relation to the PCAR and PLAR exercises will be reviewed and augmented as necessary to guarantee that both exercises can be conducted on a timely and efficient basis.

Burden sharing by holders of subordinated debt

- Consistent with EU State aid rules, burden sharing will be achieved with holders of subordinated debt in relevant credit institutions over the period of the programme. This will be based on the quantum of capital and other financial assistance the State commits to support specific credit institutions and the financial viability of those institutions in the absence of such support. Resolution and restructuring legislation which will address the issue of burden sharing by subordinated bondholders will be submitted to the Oireachtas by end-2010. Where it is appropriate in line with the above criteria, the process of implementing liability management exercises similar to that which is currently being undertaken in relation to holders of subordinated debt in Anglo Irish Bank will be commenced by end-Q1 2011.

iii. Structural reforms

To facilitate adjustment in the labour market

The government will introduce legislation to reform the minimum wage in such a way as to foster job creation notably for categories at higher risk of unemployment and prevent distortions of wage conditions across sectors associated with the presence of sectoral minimum wages in addition to the national minimum wage. Measures will be as follows:

- Reduce by €1.00 per hour the nominal level of the current national minimum wage.
- Enlarge the scope of the "inability to pay clause" permitting firms to invoke this clause more than once;

These measures should come into effect by May 2011.

An independent review of the Framework REA and ERO arrangements will be initiated by the end of Q1 2011. Terms of Reference and follow up actions will be agreed with European Commission Services.

To reduce the risk of long-term unemployment

The government will reform the unemployment benefit system in such a way as to provide incentives for an early exit from unemployment. This reform of unemployment and social assistance benefits will be part of overall reforms in the welfare system designed to reach budgetary savings of €750m in 2011.

Legislative measures will be *introduced* with a view to:

Taking steps to tackle unemployment and poverty traps including through reducing replacement rates for individuals receiving more than one type of benefit (including housing allowance).

The government reforming the system of activation policies in such a way as to adapt it to the reform in benefits and make it more effective. Legislative and other measures will be introduced with a view to:

- improving the efficiency of the administration of unemployment benefits, social assistance and active labour market policies, by exploiting synergies and reducing the overlapping of competencies across different departments;
- enhancing conditionality on work and training availability;
- strengthening activation measures via:
 - i. the introduction of instruments to better identify of job seekers' needs ("profiling") and increased engagement;
 - ii. a more effective monitoring of jobseekers' activities with regular evidence-based reports;
 - iii. the application of sanction mechanisms for beneficiaries not complying with job-search conditionality and recommendations for participation in labour market programmes set in such a way as to imply an effective loss of income without being perceived as excessively penalising so that it could credibly be used whenever lack of compliance is ascertained.

At each subsequent review of the programme, the government will submit reports containing an assessment (including by means of quantitative indicators) of the management of activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.

Legislative measures should come into effect by May 2011.

An in-depth review of the personal debt regime will be published shortly. Work will commence on reform of legislation which will balance the interests of both creditors and debtors.

2. Actions for the second review (actions to be completed by end Q2-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress will be assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

The government will submit a timetable for implementing the recommendations of the Memorandum. Upon consideration by the European Commission, IMF and ECB staffs the measures in this timetable shall become the performance benchmarks for future reviews.

ii. Financial sector reforms

- The results of the PCAR for 2011 will be assessed by the authorities, together with the European Commission, the ECB and the IMF. The results will be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2011, the Government will ensure that the banks are recapitalised in the form of equity, if needed, so as to ensure that the minimum capital requirement of 10.5% will be maintained.
- Introduce legislation for the enhancement of financial regulation, expanding the supervisory and enforcement powers of the Central Bank.
- The Irish authorities will ensure that ILP is recapitalised to a level of 12% core tier 1 capital.
- Progress in implementation of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural reforms

To enhance long-term fiscal sustainability

- The Authorities undertake to introduce legislation to increase the state pension age. Under the Government's National Pension Framework the age at which people will qualify for the State Pension will be increased to 66 years in 2014, 67 in 2021 and 68 in 2028.

iv. Structural fiscal reforms

To reinforce a credible budgetary strategy

- The government will continue to ensure the reliability and the regular availability of budgetary data for both the whole of the general government sector and its breakdown into government layers. Specifically, reporting will comply with the provisions included in annex 1 of the MoU.
- Under the period of this financial assistance programme, any additional unplanned revenues must be allocated to debt reduction.
- In accordance with the proposal set out in the National Recovery Plan 2011-2014, the government will establish a budgetary advisory council to provide an independent assessment of the Government's budgetary position and forecasts.
- Government extends the voluntary 15 day rule relating to prompt payments to the health service executive, local authorities and state agencies.

3. Actions for the third review (actions to be completed by end Q3-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU).

Government will consider an appropriate adjustment, including to the overall public service wage bill, to compensate for potential shortfalls in the projected savings arising from administrative efficiencies and public service numbers reductions.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements.

iii. Structural reforms

To increase growth in the domestic services sector

Government will introduce legislative changes to remove restrictions to trade and competition in sheltered sectors including:

- the legal profession, establishing an independent regulator for the profession and implementing the recommendations of the Legal Costs Working Group and outstanding Competition Authority recommendations to reduce legal costs.
- medical services, eliminating restrictions on the number of GPs qualifying and removing restrictions on GPs wishing to treat public patients as well as restrictions on advertising.
- the pharmacy profession, ensuring that the recent elimination of the 50% mark-up paid for medicines under the State's Drugs Payments Scheme is enforced.

To enhance competition in open markets

- Government should introduce reforms to legislation to (1) empower judges to impose fines and other sanctions in competition cases in order to generate more credible deterrence and (2) require the competition authorities to list restrictions in competition law which exclude certain sectors from its scope and to identify processes to address those exclusions.

To encourage growth in the retail sector

- The government will conduct a study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers and discuss implementation of its policy implications with the Commission services.

iv. Structural fiscal reforms

To put the public service pension system on a more sustainable basis

- Pension entitlements for new entrants to the public service will be reformed with effect from 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New public service entrants will also see a 10% pay reduction. New entrants' retirement age will also be linked to the state pension retirement age.

To ensure a more credible fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

To facilitate better government at a local level

- Government will ensure that effective measures are in place to cap the contribution of the local government sector to general government borrowing at an acceptable level. The mechanisms in place to underpin this position will be kept under close review, in consultation with the Commission services. The review will also consider how to provide data on the financial position including assets and liabilities of the sector on a timelier basis.

4. Actions for the fourth review (actions to be completed by end Q4-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU).

The government will provide a draft budget for 2012 aiming to further reduce the general government deficit in line with the National Recovery Plan and the programme and including the detailed presentation of consolidation measures amounting to at least €3.6bn.

- Revenue measures to yield €1,500m² in a full year will be introduced, including:
 - A lowering of personal income tax bands and credits.
 - A reduction in private pension tax reliefs.
 - A reduction in general tax expenditures.
 - A property tax.
 - A reform of capital gains tax and acquisitions tax.
 - An increase in the carbon tax.
- The budget will provide for a reduction of expenditure in 2012 of €2,100m including:
 - Social expenditure reductions.
 - Reduction of public service numbers. and public service pension adjustments.
 - Other programme expenditure, and reductions in capital expenditure.

The Authorities will introduce measures to ensure that the deficit reduction targets as set out in the National Recovery Plan are achieved.

² Inclusive of 2011 carryover

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural reforms

To assist in financing need and to increase competition

- Building on the forthcoming report of the Review Group on State Assets & Liabilities the government will undertake an independent assessment of the electricity and gas sectors. State authorities will consult with the Commission Services on the results of this assessment with a view to setting appropriate targets.

In advance of the introduction of water charges

- The government will have undertaken an independent assessment of transfer of responsibility for water services provision from local authorities to a water utility, and prepare proposals for implementation, as appropriate with a view to start charging in 2012/2013.

iv. Structural fiscal reforms

To reinforce the credibility of the budgetary process

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.
- The Government will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by Q4 2011. This will take into account any revised economic governance reforms at EU level and will build on reforms already in place.

5. Actions for the fifth review (actions to be completed by end Q1-2012)

i. Fiscal consolidation

Government will rigorously implement the budget for 2012 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU). Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- PCAR for 2012 will be completed. The methodology used will be published in detail. The Government will ensure that the banks adhere to the requisite capital ratios.
- PLAR 2012 will be completed and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF
- Legislation to reform the personal debt regime to be presented to the Houses of the Oireachtas.

iii. Structural reforms

To boost the integrity of the fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

6. Actions for the sixth review (actions to be completed by end Q2-2012)

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- The results of the PCAR for 2012 will be assessed, together with European Commission, the ECB and the IMF. The results will then be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2012, the Government will ensure that the minimum capital requirement of 10.5% will be maintained.
- Progress in implementation of the strategy for the restructuring of the Irish credit institutions banking system will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural fiscal reforms

To further enhance the credibility of the fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

7. Actions for the seventh review (actions to be completed by end Q3-2012)

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.

- Progress in implementing of the strategy for restructuring of the Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements.

8. Actions for the eighth review (actions to be completed by end Q4-2012)

i. Fiscal consolidation

The government will provide a draft budget for 2013 aiming at a further reduction of the general government deficit in line with the 4-year plan and the programme and including the detailed presentation of consolidation measures amounting to at least €3,100m.

- Revenue measures to raise at least €1,100m³ in the full year will be introduced, including:
 - A lowering of personal income tax bands and credits.
 - A reduction in private pension tax relief.
 - A reduction in general tax expenditures.
 - An increase in property tax.
- The budget will provide for a reduction in expenditure in 2013 of no less than €2,000m, including:
 - Social expenditure reductions.
 - Reduction of public service numbers and public service pension adjustments.
 - Other programme expenditure, and reductions in capital expenditure.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Progress in implementation of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Implementing of the plan for restructuring and strengthening the balance sheets of the credit union sector will be completed.

³ Inclusive of carryover from 2012

9. Actions for the ninth review (actions to be completed by end Q1-2013)

i. Fiscal consolidation

Government will rigorously implement the budget for 2013 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- PCAR for 2013 will be completed. The methodology used will be published in detail.
- PLAR 2012 will be completed and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural fiscal reforms

- Assessment of work in progress related to the fiscal reforms considered in the previous quarters.
- The nominal value of the State pension should not rise over the period of the programme.

10. Actions for the tenth review (actions to be completed by end Q2-2013)

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- The results of the PCAR for 2013 will be assessed, together the European Commission, the ECB and the IMF. The results will then be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2013, the Government will ensure that the minimum capital requirement of 10.5% will be maintained.
- The PLAR for 2013 will be completed.
- Progress in implementation of the strategy for the restructuring the banking system will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

11. Actions for the eleventh review (actions to be completed by end Q3-2013)

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements

12. Actions for the twelfth review (actions to be completed by end Q4-2013)

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

ii. Financial sector reforms

- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF staffs by the authorities on a regular basis.

To be provided by the Department of Finance

Monthly data on adherence to budget targets (Exchequer statement, details on Exchequer revenues and expenditure with information on Social Insurance Fund to follow as soon as practicable).	Monthly, 10 days after the end of each month
Updated monthly report on the central government's budget execution and prospects for the remainder of the year.	Monthly, 30 days after the end of each month
Quarterly data on main revenue and expenditure items of local government.	Quarterly, 90 days after the end of each quarter
Updated annual plans for the general government balance showing transition from the Exchequer balance to the general government balance (using presentation in Table 1 and Table 2A of the EDP notification).	Monthly, 30 days after the end of each month
Quarterly data on the public service wage bill, number of employees and average wage (using the presentation of the Pay and Pension Bill with further details on pay and pension costs of local authorities). Information on the main Government spending and receipt items	Quarterly, 30 days after the end of each quarter
Quarterly data on general government accounts, and general government debt as per the relevant EU regulations on statistics.	Weekly on Friday, reporting on the previous Thursday
Updated annual plans of the general government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general government budgetary prospects.	Quarterly accrual data, 90 days after the end of each quarter Together with EDP notification

To be provided by the NTMA

Weekly information on the Government's cash position with indication of sources as well of number of days covered	Weekly on Friday, reporting on the previous Thursday
Data on below-the-line financing for the general government.	Monthly, no later than 15 days after the end of each month
Data on public debt, new guarantees and other instruments issued by the general government to public enterprises, banks and the private sector.	Monthly, 30 days after the end of each month
Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months for the general government (interest and amortisation) and for central government and local authorities	Monthly, 30 days after the end of each month
Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months for State-guaranteed enterprises (interest and amortisation) (or Dept of Finance)	Quarterly, 30 days after the end of each quarter
Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and government sectors in the next 12 months	Monthly, 30 days after the end of each month

To be provided by the Central Bank

Assets and liabilities of the Central Bank	Weekly, next working day
Assets and liabilities of the Irish banking system - aggregate monetary balance sheet of credit institutions	Monthly, 30 days after the end of each month
Short-, medium- and long-term debt falling due (by type of instrument) over the next 36 months for domestic banks of systemic importance (interest and amortisation).	Monthly, 30 days after the end of each month
Weekly individual operational balance sheets of commercial banks (of systemic importance), including detailed information on deposits (by maturity and type of depositor) and loans provided to the public and the private sector (households and corporates)	Weekly, next working day

Public debt and new guarantees issued by the general government to banks.	Monthly, 30 days after the end of each month
Financial stability indicators (IMF core set: deposits, non-performing loans, capital adequacy ratios) for systemic domestic banks	Monthly, 30 days after the end of each month
Estimates of domestic banks' capital needs in the next 12 months	Monthly, 30 days after the end of each month
Estimates of funding sources for the banking sector for the next 12 months	Monthly, 30 days after the end of each month

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

3 December, 2010

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to performance criteria and indicative targets under the arrangement supported by the Extended Fund Facility (EFF). These performance criteria and indicative targets are reported in Table 1 attached to the Memorandum of Economic and Financial Policies (MEFP). This TMU also describes the methods to be used in assessing the programme performance and the information requirements to ensure adequate monitoring of the targets.
2. For programme purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “programme exchange rates”, with the exception of the items affecting the government fiscal balances, which will be measured at current exchange rates. The programme exchange rates are those that prevailed on November 24, as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 SDR.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Floor on the Exchequer Primary Balance

3. The exchequer balance is the traditional domestic budgetary aggregate which measures the net surplus or net deficit position of the Exchequer Account. The Exchequer Account is the single bank account of the Central Fund and is held at the Central Bank of Ireland. The annual audited accounts of the Exchequer Account produced by the Department of Finance are known as the Finance Accounts. An unaudited summary known as the Exchequer Statement is produced at the end of each month. Under the Irish Constitution, all Government receipts are paid in to the Central Fund and all Government expenditure is funded from it, unless provided otherwise by law.⁴ The Exchequer balance is the difference between total receipts into, and total expenditure out of, the Exchequer Account. It measures the sum of the current and capital balances. The current balance is defined as current receipts (tax and non-tax revenue) minus current expenditure (voted expenditure and non-voted expenditure charged directly on the Central Fund, including the Sinking Fund). The capital balance is defined as capital receipts (Sinking Fund and other capital receipts) minus capital expenditure (voted and non-voted expenditure). The Sinking Fund provision is a transfer from

⁴ Receipts of the Central Fund comprise Exchequer tax revenues, non-tax revenues, receipts from the European Union and other capital receipts. Charges on the Central Fund include the expenditure of Government departments and offices, payments related to the servicing of the national debt, payments to the European Union Budget, the salaries, pensions and allowances of the President, judiciary, and Comptroller & Auditor General and the running costs of the Houses of the Oireachtas (Parliament). Extra-budgetary funds (including the National Pensions Reserve Fund), the Social Insurance Fund, semi-state bodies and local governments are not part of the Exchequer system.

the current account to the capital account to reduce national debt and has no effect on the overall exchequer balance.

4. The performance criteria are set on the exchequer primary balance (the exchequer balance excluding net debt interest payments in the service of the National Debt)⁵.

5. For the purposes of the programme, the floor on the exchequer primary balance (quantitative performance criterion) will be adjusted downward by payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. Such payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation), unrequited recapitalisation, and purchases of troubled assets, which are carried out in line with programme objectives. Any other financial operation by Government to support banks, including the issuance of guarantees or provision of liquidity, will be reported to IMF staff.

6. The floor on the exchequer primary balance (quantitative performance criterion) in each year will be measured cumulatively from the start of that calendar year.

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2010:	
End-December 2010 (performance criterion)	-15.3
From January 1, 2011:	
End-March 2011 (performance criterion)	-7.8
End-June 2011 (indicative target)	-11.0
End-September 2011 (indicative target)	-14.3
End-December 2011 (indicative target)	-14.6

7. The performance criterion on the exchequer primary balance (floor) for end-March 2011 and thereafter, will be adjusted upward (downward) for the full amount of any over-performance (under-performance) in Exchequer tax revenues, pay-related social insurance contributions (PRSI), health levy and national training fund contributions against the current projection which is listed below⁶:

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
End-March 2011 (projection)	9.7
End-June 2011 (projection)	19.4
End-September 2011 (projection)	29.7
End-December 2011 (projection)	41.9

⁵ Net debt interest payments are as per the end-month Exchequer Statements.

⁶ Exchequer tax receipts are comprised of income tax, value added tax (VAT), corporation tax, excise duties, stamp duties, capital gains tax, capital acquisitions tax and customs duties.

8. Any policy changes, including in tax administration and enforcement, which impact the above revenue projection will lead to a reassessment of the adjustor in the context of program reviews.

B. Ceiling on the Stock of Central Government Net Debt

9. The stock of central government net debt, for the purposes of the programme, is defined as the National Debt, less liquid assets of the National Pensions Reserve Fund (NPRF). The National Debt is defined as the total outstanding amount of principal borrowed by central government and not repaid to date, less liquid assets available for redemption of those liabilities at the same date. These liquid assets comprise the Exchequer cash balances (including cash in the Capital Services Redemption Account), Exchequer deposits with commercial banks and other institutions, investments in investment grade sovereign bills. For the purposes of the programme, NPRF liquid assets include the asset classes listed above, and also all marketable securities such as equities, government bonds and other listed investments. NPRF shares in domestic Irish banks are excluded from the definition of liquid assets.

10. For the purposes of the programme, the ceiling on the central government net debt (indicative target) will be adjusted upward by debt arising from payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. These payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation); unrequited recapitalisation; and purchases of troubled assets, which are carried out in line with programme objectives. The programme exchange rates will apply to all non-euro denominated debt.

11. The ceiling on the outstanding stock of central government net debt will be adjusted upward (downward) by the amount of any final upward (downward) revision to the stock of end-October 2010 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-October 2010 (provisional)	78.6
End-December 2010 (indicative target)	83.1
End-March 2011 (indicative target)	91.6
End-June 2011 (indicative target)	96.5
End-September 2011 (indicative target)	100.0
End-December 2011 (indicative target)	102.2

C. Non-accumulation of External Payments Arrears by Central Government

12. The central government will accumulate no external payment arrears during the programme period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the central government on its contracted or guaranteed

external debt that has not been made within five business days after falling due. The performance criterion will apply on a continuous basis.

13. The stock of external payments arrears of the central government will be calculated based on the schedule of external payments obligations reported by the National Treasury Management Agency. This performance criterion does not cover arrears with regard to trade credits.

II. REPORTING REQUIREMENTS

14. Performance criteria under the programme will be monitored using data supplied to the IMF. The Irish authorities will transmit promptly any data revisions in a timely manner.

- The Department of Finance will report the Exchequer balance to the IMF staff, with a lag of no more than seven days after the test date.
- The National Treasury Management Agency will provide provisional figures on the outstanding stock of net government debt with a lag of no more than seven days after the test date. The revised figures will be provided within three months of the test date.
- The National Treasury Management Agency will provide the final stock of the central government system external payments arrears to the IMF staff, with a lag of not more than seven days after the arrears arise in accordance with the definition of external payments arrears as set forth in paragraph 12 of this memorandum.



22/11/2013

Ref:

Oifig an Aire Airgeadais
Memorandum for the Government
12th Review Mission of the EU-IMF Programme of Financial Support for
Ireland

1. Matter/Issue for Decision

1.1 Following completion of the twelfth and final quarterly review mission of the EU-IMF Programme from 29 October to 7 November 2013, the Minister for Finance asks the Government to agree:

- i) The draft Letters of Intent (LoI) to the IMF - **Annex A** - and to the EU- **Annex B**.
- ii) To give authority to the Minister for Finance to sign the Letters of Intent to the IMF and the EU.
- iii) To give authority to inform the Dáil accordingly.
- iv) To ensure that all remaining programme actions are prioritised; that commitments requiring legislation should be progressed in sufficient time to enable the orderly achievement of the relevant deadline; that all approvals necessary, including Government approval, are obtained by the end of quarter 4 deadline. The date for the end quarter 4 2013 deadline is **13 December 2013**.

And to note:

- v) As is normal for programmes of this nature, post programme monitoring will apply following the conclusion of the programme on 8 December for the EU and 15 December for the IMF (Refer to Section 7 for details).

2. Background

The EU/IMF Programme of Financial Support for Ireland stipulates that the provision of funding to Ireland is conditional on compliance with the conditions specified in the Programme documents (MOU, MEFP, TMU). The Government agreed on 13 May 2011 (S180/20/10/1379A) that all necessary action will be taken by the appropriate Ministers and their Departments to ensure that the targets to be met under the Programme are given the highest priority to ensure they are met on time as agreed under the Programme.

3. Mission Outcome

The key issues for Ireland on this mission were:

- **Elements of the 8 Point Plan:** The preliminary results of the BSA/AQR were made available on 31 October. Discussion on the preliminary results has continued through November. The final BSA/AQR results are expected by end November.
- **Stress Test:** It was agreed that the stress test for our banks would take place at the same time as the European wide exercise. The ECB announced its comprehensive assessment on 23 October, with a process that will start in November this year and will conclude in October 2014 prior to implementation of the SSM in November 2014
- **Fiscal Consolidation:** The Troika received extensive briefing on the implementation of Budget 2013 and the measures included in Budget 2014. They have indicated broad agreement to the approach adopted and stated that communication would be positive.

Overall, our strong programme performance was maintained with the completion of the Q3 2013 and end October deliverables bringing to over 260 the number of actions completed to date. The actions for the end-September/October 2013 deadlines have now been met with two exceptions (Water Services II Bill and the Health Identifier Bill which were not published by the appropriate deadline).

4. Timing of approval for 12th Review

i. IMF: The final part of the IMF's approval process, the Executive Board discussion and approval is scheduled to take place on 13 December 2013, with disbursement of funding and publication of the staff report expected within a few days of this discussion. In order to meet this timetable, the Letters of Intent will need to issue by 27 November. Some €600 million will be drawn-down on approval by the IMF.

ii. EU: The EU's approval process concludes with discussion by the Eurogroup Working Group/ and Economic and Financial Committee in early December with discussion by Finance Ministers at the Eurogroup and ECOFIN meetings on 09/10 December, and finally with the adoption of the Commission decision approving the 12th Review.

5. Key Remaining Commitments

There are 26 commitments due by the end of the year. The full list of remaining actions to be completed under the programme is attached at Annex C.

Fourteen commitments relating to Financial Sector Restructuring are due by the end of the year including the completion of the Balance Sheet Assessment and Asset Quality Review due at the end of November. The BSA/AQR is one of the critical deliverables for the programme.

Twelve commitments relating to Structural Reform are due by the end of the year. Commitments relating to the publication of legislation in respect of Health identifiers and Water Services along with progression of the Legal Services Bill are the main priorities.

6. Programme Exit

The Government agreed on 14 November 2013 to exit the Programme without a pre-arranged precautionary facility or backstop.

7. Post Programme Surveillance

Post Programme Surveillance has been a long standing feature of IMF programmes, and is also now a feature under the new EU governance rules. The new governance arrangements for all eurozone member states help deal with some of the major problems that faced the euro area in the past and they will help avoid such problems emerging in the future. These new governance arrangements provide reassurance to the markets. They provide an early warning system if problems begin to emerge, they reduce the risk of contagion spreading from one Member State to another, and they increase peer review pressure to help ensure responsible policies are pursued by all Member States in the euro area.

These new governance arrangements are important for small Member States with very open economies such as Ireland as it ensures that large member states are pursuing policies that are in the interests of the Euro. Of course, it works both ways and we must act responsibly too and the post-programme surveillance arrangements must be seen in that context.

Both the IMF and the EU conduct post programme monitoring following completion of a programme. This provides for regular missions and reports on a bi-annual basis.

- For the IMF, monitoring focuses on a reduced range of indicators: balance of payments, public finances, debt sustainability and macroeconomic performance, essentially assessing Ireland's continued ability to pay.
- For the EU, the arrangements for post programme surveillance are set out in the enhanced surveillance regulation of the 'Two Pack'. This also provides for regular reports and missions which would be expected to be twice yearly. It is important to

note that, on exiting the programme all the provisions of the EU's expanded economic policy coordination arrangements as set out, for example in the "Six Pack", the European Semester and the previously mentioned "Two Pack" will become effective. This would be in addition to the fiscal constraints already applying, in terms of complying with the Commission's recommendation under the Excessive Deficit Procedure, and also the provisions of the Stability Treaty.

In this context, it is worth noting that the normal regime for countries outside a programme is to have annual visits from the EU Commission's country desks and from the IMF for its Article IV review. Surveillance will move to the bi-annual post programme arrangements – essentially adding one additional mission to the usual annual visits from the EU and the IMF.

8. Loan Disbursements

As of end-October 2013, just over €63½ billion (or around 94%) of the external funding available under the EU/IMF Programme had been drawn down. On 7 November, the final instalments – €150 million and €100 million respectively – of the Swedish and Danish bilateral loans were drawn down. Some €2.9 billion is due from the EFSF and IMF in December and the final EFSM disbursement of €0.8 billion is due in February 2014. The receipt in 2014 is for technical reasons and does not affect the Programme end date.

In view of its relatively strong funding position the NTMA announced, on 1 October, a suspension of its monthly Treasury Bill auctions for the final quarter of 2013. The NTMA also decided to defer consideration of any further medium/long term bond issuance until early 2014.

On the basis of the successful market operations during the early part of the year, together with the remaining EU/IMF Programme disbursements, Ireland is well placed to have 12-15 months of advance Exchequer funding in place at year-end, as the Programme ends.

Looking ahead to 2014, the NTMA is targeting in the range of €6 - €10 billion market issuance next year.

9. Observations Returned

No observations supplied

Ireland's Economy Back from the Brink, But Continued Progress Needed

IMF Survey

December 19, 2013

- Signs of growth emerging and unemployment has started falling
- Considerable achievements, but strong policy efforts still needed
- Lessons from the Irish experience for global policymakers

The successful completion of Ireland's EU/IMF-supported program has left the country in a much stronger position than when its program began, say the IMF's Ajai Chopra and Craig Beaumont.

Ireland has pulled back from an exceptionally deep banking crisis, significantly improved its fiscal position, and regained its access to the international financial markets.

In an interview, former Ireland country reviewer Chopra and current Ireland mission chief Beaumont—who were involved with the program from start to finish—share their views on the main achievements and the road ahead. Ireland needs to persevere with steady fiscal consolidation and reforms to help an emerging economic recovery become strong and lasting, say Chopra and Beaumont, noting that the program's success owes much to the full commitment by the Irish authorities and its people—who persisted despite challenges and uncertainty during their program.

IMF Survey: Jai, you oversaw the Fund's work on Ireland—what do you see as major successes under the program and what is left to do?

Chopra: Ireland has achieved a tremendous amount in the three years since the EU/IMF-supported program began in December 2010. Remember that this period included threats to the very existence of the euro area, making Ireland's achievements all the more impressive.

The crisis in Ireland was first and foremost a banking crisis. Hence the immediate priority was to recapitalize and stabilize the banking system, which was achieved early in the program, stemming the outflow of deposits. Progress has also been made in reducing the size of the banking system, which had assets of almost 500 percent of GDP when the program started.

On the fiscal side, budget consolidation started even before the program. Over 2009–13, the structural primary deficit has been reduced by about 10 percentage points of GDP. This consolidation has been achieved in a pragmatic way with a good balance of spending and revenue measures and with due regard to fairness. As a result of this adjustment, Ireland should be able to achieve a primary balance in 2014 and government debt should soon be on a declining path.

We are also beginning to see signs of growth emerging and unemployment has been falling. Back in 2011, I had said that employment growth, which has been accelerating in recent quarters, would be the real test of whether the program is working.

Ireland has also implemented a range of institutional reforms to address weaknesses that led to the crisis. The medium-term fiscal framework has been strengthened and a credible and well-functioning fiscal council has been established. And on the financial side, regulation and supervision, which were deficient in the run-up to the crisis, have also been revamped.

But all that said, there is still much that needs to be done. This is not unusual—when problems are as severe as what Ireland faced, it is not possible to fix matters in three short years. This was recognized at the outset, and it does not detract from what has already been achieved.

Importantly, there's still a large overhang of debt that needs to be worked out. Households' debts amount to almost 200 percent of disposable income. Sovereign debt is also still high—we project it to peak at about 124 percent of GDP in 2013. So private balance sheet repair and fiscal consolidation both need to continue. Inevitably, these processes take time.

Despite the progress in recapitalizing and stabilizing the banking system, banks are not yet supporting the economy with adequate lending. Nonperforming loans are still high and progress in dealing with these impaired assets has been slow. And bank profitability remains weak. Work needs to continue to address these impediments to sustained recovery.

Looking forward, the critical objective is to generate higher growth based not only on exports, but also a revival of domestic consumption and investment. Such balanced growth is essential to create more jobs and make a bigger dent on unemployment.

The Irish authorities recognize that continued sound policies are needed to support Ireland's growth and they recently released a medium-term economic strategy to cover the period from 2014 to 2020. The determination to articulate and implement such a strategy is most encouraging.

IMF Survey: Thank you, Jai. And Craig, as mission chief, what do you think were the major steps that Ireland took to regain access to capital markets?

Beaumont: Ireland began to regain market access in the middle of 2012. It started by issuing Treasury bills, with the first issue happening to come immediately after the end-June Summit that called for banking union. Access continued to strengthen, especially after ECB President Draghi announced Outright Monetary Transactions.

Ireland was well placed to take advantage of improved market conditions in the euro area because its strong program implementation had addressed the acute uncertainties around public debt that prevailed at the end of 2010. The deficit target for 2011 was met and the budget for 2012 continued fiscal consolidation at a steady pace. As Jai mentioned, decisive actions on the banking sector during 2011 identified and met the banks' capital needs in a credible way, at an overall cost below expectations. Perhaps most importantly, markets gained confidence in Ireland's capacity to recover from the banking crisis as export-driven growth was quite strong in 2011 at 2.2 percent; investors we talked with considered that important.

So regaining market access reflected a combination of steadfast policy implementation, signals of Ireland's potential to recover economically from its deep banking crisis, and the significant steps forward in addressing the euro area crisis. Market access was confirmed through well subscribed bond issues in January and March this year, including a 10-year issue at a 4.15 percent yield, which is now trading at about 3.5 percent.

IMF Survey: How did the Fund and its European partners collaborate in support of Ireland during this period of turmoil and crisis?

Beaumont: Working with our EU Commission and European Central Bank counterparts was a very collaborative process, seeking a common position on all the key policies. This collaboration helped produce better policy proposals which were then very intensively discussed with the Irish authorities.

In advance of the missions in Dublin, we would coordinate on what the main policy issues were and alert the Irish authorities to those. During the missions we would learn a great deal from our discussions with the authorities, and also with private sector and academic economists, and need to adjust our views.

Typically during the weekend the troika teams would work together on drafts of the policy agreements (the Memorandum of Understanding and Memorandum of Economic and Financial Policies), which often required lengthy discussions among the experts on each issue—we would sometimes bet on when the meetings would finish!

The Irish authorities were the key party in developing and implementing the policies for the program supported by the EU and the IMF. This reflected Ireland's strong commitment to recover from the crisis, as seen in its significant contribution to program financing, with €17.5 billion of the total package of €85 billion coming from the Irish state.

IMF Survey: What was a broader social and political impact of the bailout?

Beaumont: The bailout was a dramatic shock for Irish society. The government that had negotiated the program soon resigned and elections were held in February 2011. The new coalition government formed in March had a strong mandate to implement its program for Ireland to recover from the crisis. It began by engaging with the troika on redesigning aspects of the program supported by the EU-IMF, including by revising the mix of budget measures to promote job creation.

The social impact of the bailout is hard to disentangle from the ongoing fallout from the banking crisis. Often the bailout is linked to difficult budget measures, though Ireland had been undertaking such measures for 2–3 years before the program, and in the absence of EU-IMF financing, even larger measures would have been required. There was also disappointment in Ireland that the program did not provide a more immediate turnaround in the economic situation. For example, unemployment kept on rising until it peaked in early 2012, though it has declined more recently. But the program did avert a sharper deterioration in the economy, which was likely given the deep loss of domestic and external confidence at the end of 2010, especially in the banking system.

Chopra: I would also add that the teams from the IMF, EC, and ECB made a concerted effort to have a dialogue with labor unions and with other organizations that had direct experience

in dealing with vulnerable parts of society. This dialogue was very useful. No doubt, our counterparts will consider that not enough was done to address their concerns and I can understand that perspective. But we encouraged the government to design its fiscal consolidation measures with fairness and equity very much in mind.

IMF Survey: How do you see the prospects for Ireland's economy going forward?

Beaumont: After relatively strong growth in 2011, growth was sluggish in 2012 and into this year owing to weak trading partner activity and a “patent cliff” shock to Ireland’s large pharmaceutical sector. But a range of indicators signal the economy is beginning to pick up in the second half of 2013.

We are projecting growth to rise to about 1¾ percent in 2014—a little below consensus estimates—and then to about 2½ percent in the medium term. Ireland’s economy is highly open so the main contributor to higher growth is the recovery expected in trading partners, especially the United States, the United Kingdom, and the euro area.

By contrast, we anticipate modest gains in domestic demand next year, with the revival of domestic demand expected to be a protracted process as strained private balance sheets gradually become more healthy and also as the pace of fiscal consolidation eases. Improving financial sector health will also help sustain recovery through renewed lending, although near-term contributions are not expected to be significant.

Chopra: Here I think it’s worthwhile to pick up on a point that Craig made, about the strength of trading partners. Ireland has grown faster than the eurozone average over the last three years. This is encouraging, but it should not obscure the fact that Ireland’s prospects are inextricably intertwined with those of the eurozone. Therefore, Ireland’s prospects will depend very much on the progress made to address demand and supply deficiencies in the eurozone, to achieve the ECB’s inflation target rather than undershoot it, to reduce fragmentation, and to make more meaningful progress in improving the architecture of the monetary union.

IMF Survey: What lessons does the Irish experience hold for global policymakers?

Chopra: IMF rules require an independent staff team to prepare an ex-post evaluation of the Ireland program before the end of 2014. That evaluation will provide a more definitive view, but for now I’ll offer five preliminary lessons.

The first is when the government is dealing with a systemic banking crisis it needs to come to grips with the situation quickly. It is essential to identify whether institutions are viable or not and then deal with them accordingly. Nonviable banks need to be resolved while viable ones need to be recapitalized, restructured and restored to healthy functionality.

Even though systemic banking problems in Ireland first blew up in 2008, confidence that these problems were being adequately tackled did not come till the publication of stress test results in March 2011, about three months into the program. These stress tests, together with the underlying asset quality diagnostics that were undertaken with the help of independent experts, have served as a model in other cases. The Irish also set a high bar for the transparency with which they communicated the results of the analysis underpinning banks’ capital needs.

But it is not just a matter of recapitalizing banks. The banks also need to improve their profitability and get back into the business of lending. And to do that they need to be forceful in dealing with the bad debts on their books. Ireland was quick to set up an asset management company, NAMA, to deal with the large problem loans, especially in the property sector. But it is also essential to deal with smaller distressed borrowers, a problem that became more acute with the rise in residential mortgages that are in arrears. On this front, it took some time to develop a political consensus and the necessary legal framework and banks' operational capacity to deal with mortgage arrears. In retrospect, more rapid progress in dealing with mortgage arrears would have been worthwhile.

The second lesson is that it is unfair to impose the burden of supporting banks primarily on domestic taxpayers while senior unguaranteed bank bond holders get paid out. This not only adds to sovereign debt, but it also creates political problems, making it harder to sustain fiscal adjustment. Eurozone partners precluded the Irish from imposing haircuts on senior creditors of insolvent banks. But subsequent developments in the principles of orderly resolution of banks, after Ireland had paid off these creditors at great cost, have shown that imposing losses on senior bank bond holders is now becoming more accepted.

Third, on the fiscal front, steady but gradually phased fiscal consolidation that is designed within a well-specified medium-term plan, and that allows for the free play of automatic stabilizers, can be consistent with the return of confidence. There are some who wanted Ireland to move even faster with fiscal consolidation. This would have been a grave mistake. Investors also care about growth.

The fourth lesson from the Irish case is that it demonstrates how pernicious feedback loops can be. Weak balance sheets of banks, of the government, of households, and of companies all interact with each other. These interactions cause economic activity to stagnate and increase deflationary tendencies, further worsening all these sectors' balance sheets all over again. These feedback loops need to be arrested.

Some of this requires a domestic effort, which the Irish have accomplished as has already been outlined, although much remains to be done to reduce over indebtedness. But in a monetary union support is also needed from partners in the union. No doubt eurozone and EU partners have been generous and supportive of Ireland's efforts through various initiatives. Nevertheless, there remains an excellent case for even greater eurozone solidarity to break these adverse feedback loops, especially between banks and sovereigns. Such additional support would have a positive payoff, making it an investment that is worth undertaking.

Finally, and perhaps most importantly, the government's design and ownership of the program is critical. The Irish authorities' excellent record of policy implementation and compliance with conditionality under the program owes much to the fact that key components of the program were designed by the Irish themselves, and adopted only after they had been debated intensively both internally and with external partners. Social and political cohesion was maintained. Only then do you get full commitment to the measures as in Ireland. Moreover, the Irish persisted despite uncertainty and some dark moments. This makes me more confident that they will continue to persevere to get the economy growing again and to improve people's lives.

IMF Survey: Finally, Jai, you are leaving the program and the Fund and many people in Ireland are interested to hear about your plans.

Chopra: My involvement with Ireland over the past few years has been the capstone of a three-decade career at the IMF. This experience, together with other stimulating work I've done over the years at the IMF, motivates me to stay engaged in economic policy analysis and advocacy, but in a different setting here in Washington, D.C. I am also interested in doing volunteer work on financial literacy with low-income families and students. The manipulation of borrowers leading up to the crisis demonstrates the need for improving such literacy.

Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – Lines to Take

What the Treaty is.....

- It is a **part of Europe's response** to the current economic crisis.
(Along with growth-enhancing measures and firewalls – ESM, EFSF)
- It **strengthens the rules** underpinning the euro.
(As set out in current Treaties, Stability and Growth Pact and six legislative measures adopted last year – 'the six-pack')
- It **requires Member States to run balanced budgets** over the cycle – that is, to ensure that in good times and bad taken together, what they spend is balanced by what they take in by way of taxes. And it **requires them to return their debt to manageable levels**.
(Deficit brake in Article 3 – main new element is the requirement for inclusion of an 'automatic correction mechanism' in domestic law; Debt brake in Article 4 – obligation to get to 60% of GDP already exists in EU law, as does required step-down by 1/20th per year)
- It helps Europe – the Euro Area in particular – **show to the outside world that it is serious about the future stability of its currency**.
- It means that **everyone has to play by the rules** - in particular the larger Member States will no longer be able to use their bigger voting weight to wriggle out of their obligations.
(Article 7 requires signatories to support Commission recommendations under Excessive Deficit Procedure in a way that would prevent France and Germany from doing what they have done in the past to escape sanction).

And what it is not.....

- It is **not an 'austerity' treaty**. It **says nothing about how much each Member State raises in taxes or how much it spends**. It just says that income and spending should be in balance. Nothing else is sustainable.
(Preamble recognises the need to "promote conditions for stronger economic growth in Europe". The Treaty is also only part of a package. The European

Council adopted an ambitious programme on growth at the same time and the Government will be holding partners to it.)

- It is not a major departure in policy terms. **Most of what it contains** - including the need for balanced budgets and sustainable debt – **already exists in EU law**. It simply brings them into sharper focus and tightens some of the rules.
(the Stability and Growth Pact has existed since Maastricht and was reformed in last year's 'six-pack' of legislative measures. Budgets are already required to be 'close to balance or in surplus' (the new Treaty requires 'in balance or in surplus') and the debt rules exist also. What is new is the need for national legislation to correct any deviation from the rules).
- It is **not the full picture** – and nobody is claiming that it is.
- The Government has consistently argued that Europe also needs **measures to generate growth and to get people back to work**, particularly young people.
- It is also not a sufficient response on its own to the current crisis. For as long as Member States face pressure in the markets, we will need **strong and credible firewalls**. The recently agreed ESM Treaty is an important measure in this regard.
- The Government has also long argued for the **ECB to play the fullest role that it can in defending the currency**. It is interesting to note the extent of the support the ECB has provided to the Irish banking system since the crisis broke. Also of interest is the support which the ECB has provided to banks across Europe since December through three-year auctions.

What it means for Ireland (in economic terms).....

- We will be **part of a stronger and more credible currency**; others will have to play by the rules; one Member State will not be able to run unsustainable budgetary practices that put us all at risk.
- No **future Government will be able to run unsustainable budgetary policies** without regard for the long-term consequences.

And what it does not.....

- It **does not impose decades of austerity that we could otherwise avoid**. We are already **in a stringent Programme**. That will take precedence until we exit it.
- **We would, in any event, have to close the current gap between spending and tax and get our debt levels down**. This will take time and hard work.
(economists - including Karl Whelan, Alan Ahearne and John McHale - addressed the Joint Committee on European Affairs this week and confirmed that given our economic situation, it will take a great deal of work in the years to come to get back onto a sustainable footing. This cannot be avoided).
- It **does not commit any Government in any Member State to one economic philosophy or another** – it is for each Member State to decide how to tax and how to spend.
- It **does not tie the hands of future governments in a significantly new way** – the rules of the common currency already apply and must be observed whichever Government is in office. Rather, it will enshrine those commitments in domestic as well as international law.
(the main parameters in the new Treaty – budgets in balance or in surplus; structural deficits under 0.5%; debt under 60% and stepping down towards that figure in 1/20ths, already exist in EU law).
- It **does not entail permanent interference in our economy** – it is entirely right and proper that members of a common currency view their economic policy as a shared concern – that is already set out in the Treaties.
- Being open to peer review – under the supervision of the Commission - and playing by the rules is a necessary part of that.

What it means for Ireland (in legal terms).....

- The **Government will take whatever steps are necessary to ratify** the new Treaty.

- The **Attorney General's views have been sought** on whether a referendum is required – that is whether the Treaty is compatible with the Constitution or not.
- She will study the matter carefully and reach a view. **The Government will then decide** on the basis of that advice.
(the Tánaiste wrote to the AG this week formally seeking views –she will be given as much time as she needs)
- **If a referendum is required, one will be held.**
- The Government **negotiated to secure a good deal for Ireland and for Europe**. Our team – political and official – had a set of priority goals, which they secured.
(including protecting our position as a Programme Country (preamble 20); ensuring the Treaty was as close as possible to existing EU Treaties and law (Article 2); Making sure the rules on structural deficit could be applied in a way that made sense for all Member States (Article 3.1(b));
- We **did seek flexibility on how Member States bring the new arrangements into their national law** – there are different traditions on this in Member States. Many, if not most, can change their Constitutions by parliamentary procedure. We generally don't put the details of law into ours.
(Article 3.2 states rules will be adopted through "provisions of binding character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary processes")
- There is **nothing wrong with an outcome that is compatible with Bunreacht na hÉireann**, if that turns out to be the case.
- There is **nothing undemocratic in proceeding by the parliamentary** route, if that turns out to be what is required. It is how we normally do business in this state, including on some of the most important issues confronting us as a society.



**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 25 November 2008

15947/08

**Interinstitutional File:
2008/0199 (COD)**

**ECOFIN 525
EF 112
CODEC 1593**

COVER NOTE

from: Mr Jean-Claude TRICHET, President, European Central Bank
date of receipt: 19 November 2008
to: Mr Javier SOLANA, Secretary-General/High Representative
Subject: OPINION OF THE EUROPEAN CENTRAL BANK of 18 November 2008 at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on Deposit-Guarantee Schemes as regards the coverage level and the payout delay (CON/2008/70)

Dear Mr Solana,

Following your consultation received by the ECB on 24 October 2008, please find enclosed , for your information, the English version of the requested ECB Opinion. Copies of the Opinion in 21 other official Community languages will follow.

The Opinion has been transmitted to the European Commission and European Parliament (Committee on Economic and Monetary Affairs), and will be published in the Official Journal of the European Union in due course.

I should be grateful if you would kindly, following completion of the decision making-process, send me a copy of the final Regulation.

Encl.:



OPINION OF THE EUROPEAN CENTRAL BANK

of 18 November 2008

at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on Deposit-Guarantee Schemes as regards the coverage level and the payout delay

(CON/2008/70)

Introduction and legal basis

On 24 October 2008 the European Central Bank (ECB) received a request from the Council of the European Union for an opinion on a proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on Deposit-Guarantee Schemes as regards the coverage level and the payout delay¹ (hereinafter the ‘proposed directive’).

The ECB’s competence to deliver an opinion on the proposed directive is based on Article 105(4) of the Treaty establishing the European Community. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. General observations

- 1.1 The ECB notes that the current financial market crisis has confirmed that deposit-guarantee schemes are vital for maintaining depositors’ confidence and therefore safeguarding financial stability. The ECB supports the underlying aim of enhancing depositors’ confidence and understands that for urgency reasons the proposed directive focuses on increasing the coverage level of national deposit-guarantee schemes (hereinafter the ‘national schemes’) in line with the Ecofin Council’s conclusions of 7 October 2008², reducing payout delay and discontinuing the current option for co-insurance.
- 1.2 At the same time the ECB supports the Commission’s intention to continue work on convergence of the national schemes, with particular regard to harmonising their funding mechanisms, and to submit a report on the matter to the European Parliament and to the Council by

¹ COM(2008) 661 final.

² See the press release of the 2894th Council meeting (13784/08), available on the Council’s website at www.consilium.europa.eu, as mentioned in the sixth paragraph of section 1 of the explanatory memorandum to the proposed directive.

31 December 2009³. In view of the importance of the funding arrangements of the national schemes for the effectiveness of the financial safety net and for safeguarding financial stability, the ECB looks forward to contributing to the Commission's future work in this field and encourages timely completion of the Commission's report. In this context, the ECB underlines that national schemes' funding arrangements must, *inter alia*, comply with the monetary financing prohibition laid down in the Treaty, and in particular with the prohibition on national central banks providing overdraft facilities or any other type of facility within the meaning of Article 101 of the Treaty⁴, as more specifically considered in past ECB opinions concerning draft national legislation⁵ and in the ECB's Convergence Reports⁶.

2. Specific observations

2.1 Coverage level of the guarantee

The ECB welcomes the increase in the minimum amount of guaranteed deposits to EUR 50 000 by the end of 2008 and the further increase to EUR 100 000⁷, as mentioned in the Council's conclusions of 7 October 2008⁸. At the same time, the ECB emphasises that any increase in the coverage exceeding the latter of the above mentioned amounts should be preceded by close coordination at the EU level, as substantial differences between national measures may have a counter-productive effect and create distortions in the single market.

2.2 Reduction of payout delay

The ECB welcomes the intention to reduce delays in payouts of guaranteed deposits significantly and thereby strengthen depositors' confidence⁹. In this context, the ECB would emphasise that recent analysis at international level has highlighted that a prompt payout of depositors' claims is

³ Article 12 of Directive 94/19/EC, as amended by Article 1(6) of the proposed directive; cf. recitals 1 and 7 of the proposed directive.

⁴ Interpreted in line with Council Regulation (EC) No 3603/93 of 13 December 1993 specifying definitions for the application of the prohibitions referred to in Articles 104 and 104b(1) of the Treaty (OJ L 332, 31.12.1993, p. 1).

⁵ See paragraphs 11-14 of ECB Opinion CON/2001/32 of 11 October 2001 at the request of the Portuguese Ministry of Finance on a draft decree law amending the legal framework of credit institutions and financial companies; paragraphs 11-13 of ECB Opinion CON/2005/50 of 1 December 2005 at the request of Národná banka Slovenska on a draft law amending the Act No 118/1996 Coll. on the protection of bank deposits and on amendments to certain laws, as last amended; paragraphs 2.1-2.3 of ECB Opinion CON/2007/26 of 27 August 2007 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund; and paragraphs 2.2-2.8 of ECB Opinion CON/2008/5 of 17 January 2008 at the request of the Polish Minister for Finance on a draft law amending the Law on the Bank Guarantee Fund.

⁶ See, e.g., the ECB's Convergence Report December 2006, p. 30.

⁷ Article 7(1) of Directive 94/19/EC, as amended by Article 1(3)(a) of the proposed directive and as complemented by the first and second subparagraphs of Article 2(1) of the proposed directive, which provides for retroactive application of the increased coverage level from 15 October 2008; cf. recital 3 of the proposed directive and section 5.3 of the explanatory memorandum to the proposed directive.

⁸ The Council agreed that 'all Member States would, for an initial period of at least one year, provide deposit-guarantee protection for individuals for an amount of at least EUR 50 000, acknowledging that many Member States determine to raise their minimum protected amount to EUR 100 000'.

⁹ Article 1(3) of Directive 94/19/EC, as amended by Article 1(1) of the proposed directive, and Article 10(1) and (2) of Directive 94/19/EC, as amended by Article 1(5) of the proposed directive; cf. recital 5 of the proposed directive and section 5.1 of the explanatory memorandum to the proposed directive.

of key importance for effective deposit protection. At the same time, a pragmatic approach should be taken to introducing the necessary reduction in payout delays, thereby preserving credibility of the deposit-guarantee schemes. This implies establishing efficient operational processes for verifying claims and paying depositors, as well as ensuring that sufficient funding is available. In particular, procedures need to be put in place so that if a bank that operates on a cross-border basis fails, depositors receive payouts as efficiently as they would if the failed bank were operating in a single Member State. Moreover, the ECB suggests that the Commission's plan to assess whether it would be possible to harmonise further the funding arrangements used by the national schemes should be accompanied by a review of the effectiveness of payout procedures. Finally, in addition to shortening the payout period, the ECB suggests that public confidence in deposit-guarantee schemes could be enhanced by improving depositors' awareness of the terms and conditions of deposit protection, *inter alia* through appropriate disclosure of the terms and conditions by credit institutions.

Done at Frankfurt am Main, 18 November 2008.

The President of the ECB

Jean-Claude TRICHET

DÁIL QUESTION

NO

To ask the Minister for Finance if he will outline and clarify Ireland's obligations under the fiscal treaty and other EU rules in terms of debt and deficit reduction, budgeting and monitoring following an exit from the Troika programme; the implications of these obligations for future budgets; and if he will make a statement on the matter.

- Richard Boyd Barrett.

* For ORAL answer on Wednesday, 20th November, 2013.

Ref No: 49253/13

REPLY

Minister for Finance (Mr Noonan) :

Ireland is on track to exit the EU-IMF Programme of Financial Support at the end of this year. Until the end of 2015, Ireland remains subject to the requirements of the corrective arm of the Stability and Growth Pact. These requirements are for a general government deficit that does not exceed 5.1% of GDP in 2014 and 2.9% of GDP in 2015. Budget 2014 targets a general government deficit of 4.8% of GDP in 2014 and we remain on track to correct our excessive deficit in 2015. These are legal requirements; but even leaving these aside it is imperative that we bring our deficit down to more sustainable levels.

Once the excessive deficit has been corrected, the public finances in Ireland will be subject to the preventive arm of the Pact and the Treaty on Stability, Co-ordination and Governance (TSCG).

The preventive arm of the Pact requires Member States to be at or adjusting sufficiently rapidly towards their country-specific medium term objective (MTO). For Ireland our MTO is a balanced budget in structural terms. From 2016 onwards, therefore, the general government deficit (after adjusting for the impact of the cycle and other one-off factors) is required to converge at a sufficiently rapid pace towards balance, at a minimum rate of 0.5% per annum.

Revisions to the preventive arm under the Six Pack introduce the concept of the expenditure benchmark. The rationale for this is to ensure that public expenditure is not permanently increased on foot of temporary tax (and or other) revenues.

From 2016 onwards, the requirement of the debt correction rule as laid out in both the Pact and the TSCG will also begin to apply. The debt correction rule states that debt in excess of 60% of GDP must be reduced by an average of at least 1/20th of the difference between the actual debt ratio and 60% of GDP threshold per year, based on changes in the debt ratio over three years. In relation to the debt correction rule, there is a transition period for Member States, like Ireland, which were subject to an excessive deficit procedure as of November

2011. This means that the 1/20th rule only fully applies from 2019 onwards,. In the interim , satisfactory progress in reducing the debt-to-GDP ratio will be needed and this will be assessed by the Commission and ECOFIN. My Department projects that having reached and maintained our MTO of structural budget balance, the debt correction rule will, under reasonable growth assumptions, be achieved.

In conclusion, Ireland will be required to implement fiscal policy that keeps us on the adjustment path towards our MTO of a balanced budget in structural terms and sustains it thereafter. Ireland will also be required to comply with the expenditure benchmark in the Stability and Growth Pact. This will limit the growth in nominal expenditure to very modest levels. However, it should be noted that complying with our fiscal requirements in the post-2015 period will not necessarily require further tax increases or cuts in nominal expenditure, as constraining spending growth to comply with the expenditure benchmark will help considerably towards this end.

Supplementary PQs

What level of consolidation is forecast for 2015?

At present, it is forecast that the level of consolidation required in Budget 2015 may be of the order of 2 billion euro. However, this will be revised closer to the time, dependent on levels of growth and budgetary outturns in the interim.

What is the timeline envisaged for the rapid progress towards achieving our medium term budgetary objective as required by the Stability and Growth Pact and the Fiscal Compact?

Once Ireland reduces its deficit below 3% of GDP in 2015, the Excessive Deficit Procedure to which we have been subject since April 2009 will be abrogated (lifted) and we will no longer be subject to the corrective arm of the Stability and Growth Pact (SGP). Thereafter, however, we will be subject to the preventive arm of the SGP, which requires that we converge towards our country-specific medium-term objective (MTO). Article 3(1)b of the Treaty on Stability Coordination and Governance in EMU (TSCG or Fiscal Compact), stipulates we must 'ensure rapid convergence towards our MTO'. In line with Article 3(2) of the Treaty on Stability Coordination and Governance in EMU (TSCG or Fiscal Compact), the European Commission has prepared a 'calendar of convergence' towards Member States' MTOs. On this basis, the Commission foresees that Ireland will reach its MTO of a balanced structural budgetary position (net of impact of the economic cycle and temporary one-off factors) by 2018.

Under the preventive arm, we are required to make structural correction of at least 0.5% of GDP per annum from 2016 onwards. On the basis of Budget 2014 arithmetic, Ireland is projected to comply with this, despite no further consolidation assumed in the fiscal arithmetic.

The European Commission will judge progress towards our MTO on the basis of making 'sufficient progress' in structural terms, including with an assessment of compliance with the so-called 'expenditure benchmark' as outlined in the 'Six Pack'. By constraining net expenditure growth below the medium-term reference rate of potential output, this can deliver an improvement in the structural balance without necessarily requiring further expenditure cuts or revenue increases.

What is the Structural Balance?

When an economy is performing strongly, tax receipts are higher than 'normal' and unemployment spending is lower than 'normal'. Thus, the headline fiscal balance is flattered by the strength of the economy and, similarly, in a downturn the deterioration in the headline fiscal balance is exaggerated by taxes being weaker than 'normal' and unemployment payments being above 'normal'.

The structural balance is the fiscal position that would prevail if movements in the economic cycle are excluded. In principle, it is a better measure of the underlying fiscal position than the headline balance. In practice, however, it is difficult to measure especially for a small and very open economy such as Ireland. Unlike the headline deficit which is easy to measure, the structural deficit cannot be measured directly and must be estimated. All estimates for Ireland are subject to very strong health warnings for many reasons. Estimating the 'normal' level of labour contribution to output in the economy is very difficult as Ireland is unusually open to both inward and outward migration. In other words, Irish labour supply is particularly elastic.

Also, given wage rigidities in the Irish economy it can be difficult to assess the underlying structural rate of unemployment. As the drivers of the cyclical component of the deficit cannot be measured and must be proxied by statistical filtering techniques, they can often be prone to large revisions.

What is included in the structural balance? (More technical)

The structural balance is the cyclically-adjusted budgetary balance adjusted for one-off and temporary measures. The adjustment for one-offs means that the large capital injections made into the financial sector in recent years do not count against us..

The *cyclical adjustment* refers to the adjustment made to take account of the economic cycle. This is calculated using the deviation of *actual GDP* from *potential GDP*, i.e. what the economy would look like in the absence of wage and inflation pressures. This deviation is proxied by a measure known as the ‘output gap’. This difference is then scaled and subtracted from the actual deficit to provide the cyclically-adjusted deficit, i.e. producing a picture of what the deficit would be like under ‘normal circumstances.’

This is difficult for Ireland for many reasons. Firstly, the supply of labour and capital in Ireland in ‘normal’ circumstances is very difficult to estimate as we have such an open economy. The degree of efficiency with which labour and capital are used (productivity levels) is also difficult to measure. Sensitivity of the deficit to the economic cycle (the scale factor or fiscal semi-elasticity) used above is also uncertain and can vary particularly when the economy is undergoing structural change.

Estimates of potential GDP and the structural balance for Ireland are calculated using a complex European Commission approved methodology agreed by the Member States. This approach forms the reference method for the Commissions’ assessment of our Stability Programme Update (SPU) and hence our compliance with the SGP. These estimates can and do vary over time.

What are the latest forecasts for structural balance?

The latest estimates for the structural balance are set out below. These *figures are estimates and subject to revision*.

Decomposition of General Government Balance (% GDP) 2012-2016

	2012	2013	2014	2015	2016
1. Headline General Government Balance (% GDP)	-8.2	-7.3	-4.8	-3.0	-2.4
2. Cyclical budgetary component (% potential GDP)	-1.4	-1.6	-1.4	-1.4	-1.2
3. One-off temporary measures (% GDP)	0.0	-0.4	0.2	-0.1	0.0
4. Interest Expenditure (% GDP)	3.7	4.6	4.8	4.9	5.0
5. Structural Budget Balance (% GDP) [(1)-(2)-(3)]	-6.9	-5.3	-3.6	-1.6	-1.1
6. Structural Primary Balance (% GDP) [(5)+(4)]	-3.1	-0.7	+1.2	+3.4	+3.9

Source: Department of Finance estimates. Consistent with *Budget 2014* arithmetic.

How is the MTO calculated?

The European Commission sets minimum MTOs which take account of the need to slowly converge to a debt of 60% of GDP over the long term, as well as taking into consideration some implicit pension costs suggested by the future ageing of the population. Member States then adopt an MTO which can be the same or more ambitious than that suggested by the Commission.

When will the MTO be met?

The April 2013 SPU indicated MTO compliance by 2019. In line with the *Treaty on Stability Coordination and Governance* in EMU (TSCG or Fiscal Compact), the European Commission subsequently prepared a 'calendar of convergence' towards Member States' MTOs. On this basis, the Commission foresees that Ireland will reach its MTO of a balanced structural budgetary position (net of impact of the economic cycle and temporary one-off factors) by 2018.

What is the expenditure benchmark?

Complementary to the MTO is the 'expenditure benchmark,' which helps ensure control of the growth in general government expenditure. Such control will further aid the improvement in the structural budget balance. It stipulates that nominal general government expenditure, net of discretionary measures and excluding interest and the effects of cyclical unemployment, must not grow faster than combined effect of the average potential growth rate of the economy and the relevant GDP deflator when a Member State is at its MTO. When as Member State is not at its MTO, expenditure growth is further constrained to assist achievement of the latter by applying a "convergence margin" to the permitted benchmark expenditure growth rate. Expenditure above the level permitted by the benchmark is allowed only if new revenue measures are introduced to pay for it.

What rate of expenditure growth will be permitted under the expenditure benchmark?

As already outlined, Ireland is also required to comply with the expenditure benchmark introduced into the Stability and Growth Pact by the "six-pack". The medium term rate of potential growth for Ireland of 0.6% applies for the period 2014 to 2016. As Ireland does not expect to be at its MTO until after 2016, a lower benchmark rate is required that incorporates a convergence margin of around 1.4% reducing applicable reference rate for 2014-2016 to -0.7% of GDP. In 2016, a new benchmark rate and convergence margin will be calculated for the period between 2017 and 2019.

In practical terms, this means higher levels of expenditure cannot be funded from revenue buoyancy (tax revenues coming in ahead of target) and must be paid for by raising discretionary revenue measures. It should also be noted that Ireland is not permitted to make aggregate discretionary revenue reductions (i.e. tax decreases) until the year after it has reached its MTO.

Do these rules mean permanent consolidation?

No, these rules do not mean permanent additional consolidation. These fiscal rules are about ensuring balanced budgets over the economic cycle. This is prudent fiscal management and is in all of our interests.

An annual improvement in the structural balance will be necessary post-2015 to achieve the MTO. This does not necessarily imply further consolidation from this point on. Restricting expenditure growth at prudent levels will go a long way towards delivering the improvement in the structural budget position every year to reach the MTO. Once this MTO is achieved, nothing further will be required; we will simply have to keep the underlying balance at this MTO. This will mean allowing net Government spending to grow in line with Government revenue.

Economic growth is the best medicine for reducing deficits as well as high debt levels. The structural reform currently being implemented in Ireland is designed to reduce obstacles to growth and enhance the potential level of output of our economy. This ranges from increasing activation of the unemployed, to reforming the legal sector to increase competition, to targeting public investment in education, and to streamlining sectoral wage-setting arrangements (JLCs and REAs) to make them more responsive to changing economic conditions.

When will Ireland be subject to the debt correction rule?

In relation to the debt rule, there is a transition period for Member States, like Ireland, which were subject to an excessive deficit procedure as of November 2011. It is very important to note that the application of the 1/20th debt rule does not apply until three years after the correction of the excessive deficit. Ireland's excessive deficit is due to be corrected at the end of 2015. Our transition period will then begin at the start of 2016 and run for three years. The application of the 1/20th rule then comes into play in 2019.

It is also important to understand that while we have been given the benefit of a transition period before the rule applies, Ireland must be seen to be making consistent progress in the meantime. Sufficiency of this progress will be judged by the European Commission on the basis of country-specific considerations.

What level of monitoring will Ireland be subject to?

In common with other member states, Ireland will be subject to monitoring of the European Commission with regard to our macroeconomic and fiscal position. In addition, we will be subject to post-programme surveillance, which will mean monitoring visits every six months.

MINISTERIAL BRIEFING



Material for opening speech to Joint Committee on Finance and PER 1 September 2011

Introduction

There have been significant improvements in the process of stabilizing the banking system and improving banking regulation over the past five months with some major milestones achieved.

As a background, during the course of 2010, the former Minister for Finance, the Department, the Central Bank and the National Treasury Management Agency took a number of actions to address the worsening situation in the banking sector, including stress tests, further recapitalisation, and following the agreement of a programme of support with the EU and IMF authorities, legislation to facilitate the reorganisation and restructuring of the banking sector in the form of the Credit Institutions (Stabilisation) Act.

In March 2011, following the completion of the prudential capital assessment review, PCAR, and the prudential liquidity assessment review, PLAR, by the Central Bank, I announced the Government's proposals to restructure the banking sector comprehensively.

This restructuring was designed to create two Government supported domestic universal pillar banks that would be smaller and more focused on the Irish economy. At that time, the pillar 1 was identified as Bank of Ireland and pillar 2 was to be a merger of AIB and EBS.

The existence of these two pillar banks and a radically restructured Irish Life and Permanent along with the continued operation of Ulster Bank, KBC Bank and National Irish Bank and other foreign owned institutions that operate in the Irish market would ensure a competitive environment is maintained in the banking sector.

Restructuring and renewal

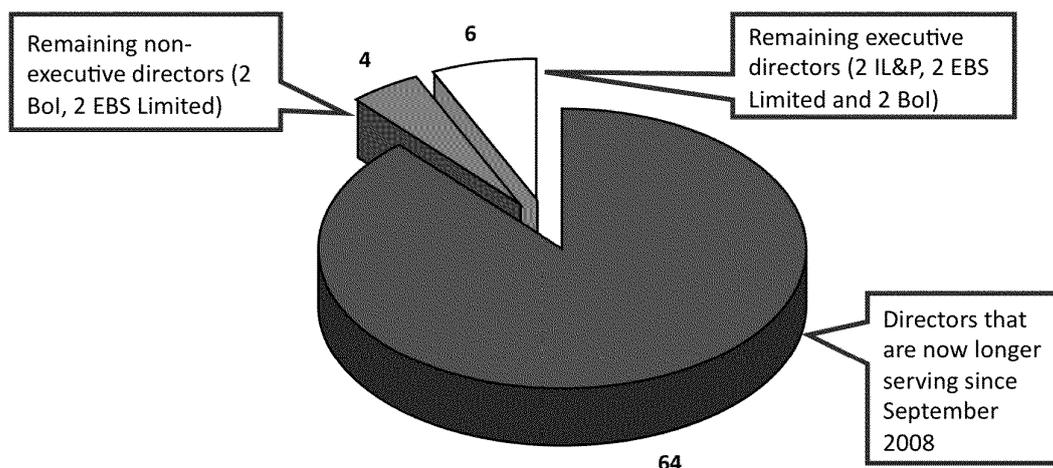
Core to the process around the banking stabilization has been the issue of renewal of the banks. As verified by the troika, significant steps have taken place since March 31 on the banking side.

The legal merger of Allied Irish Banks and EBS was completed on 1 July 2011, well ahead of the end of September 2011 deadline. The merger of Anglo Irish Bank and Irish Nationwide Building Society to form the Irish Bank Resolution Company, IBRC, was also completed on 1 July 2011.

The process of reshaping the banking sector has continued to progress in a rapid and effective manner. The mergers of AIB and EBS as well as Anglo Irish and INBS were effected on 1st July 2011 which was 3 and 6 months ahead of schedule respectively.

In line with this restructuring has been the renewal of the boards at the banks.

Once again, considerable progress has been made in this regard with 10 directors from pre-September 2008 still serving on bank boards.



Further changes at the banks continue with changes at IL&P in process and the potential sale of Irish Life requiring new NEDs and strengthening of permanent TSB management and structures.

At Anglo Irish Bank/INBS, the operating model, including composition of the Board, for Anglo/INBS is currently under discussion with the Department. Anglo/INBS name is to change to Irish Bank Resolution Corporation with effect from mid-October. Anglo/INBS has submitted a redundancy proposal to the Department for consideration.

The AIB/EBS merger has seen a revised operating model announced in May 2011 along with a number of appointments to the executive management team. The divisional structure will be replaced with more customer facing units and 'Enterprise Lending Services' units are being established to directly manage the recovery of impaired loans.

Bank recapitalization

A key goal of the Government's programme has been to ensure that the banks are adequately capitalized to ensure that they can resume their core domestic banking activities.

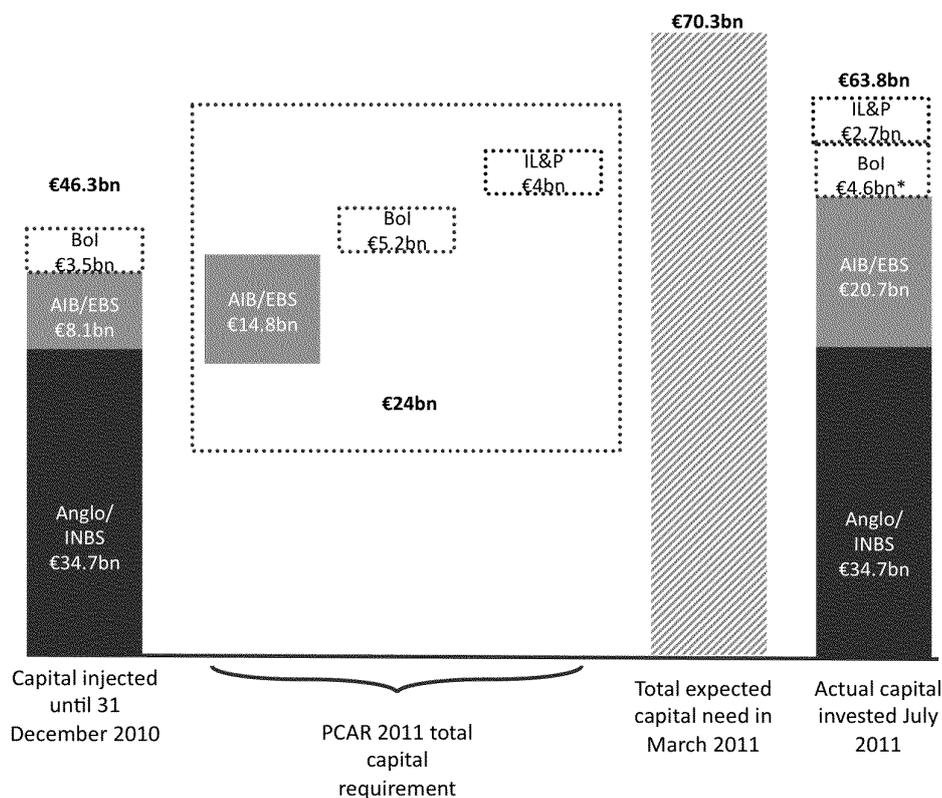
Some €46.3bn had been injected into the banks by the end of December 2010. The PCAR/PLAR processes identified a capital requirement of €24 billion, including a buffer of €5.3 billion.

The €24bn was to be funded by way of cash, €17.5bn, from the National Pensions Reserve Fund and the remaining €6.5bn provided by troika funds. Therefore some €70.3bn was the total amount earmarked as the total core Tier 1 capital required for the banks.

While the Government was committed to ensuring the banks would be fully capitalised up to that level, direct contributions to solving the capital issues of the banking system

had been sought by looking for further significant contributions from subordinated debt holders, by the sale of assets to generate capital and, where possible, by seeking private sector investors. It was expected that the effect of these actions would be to reduce very significantly the amount of capital required. A target of achieving a reduction of at least €5 billion in the capital requirement was set by my department.

If we consider the position today, we have overachieved that goal with some €63.8bn committed.



* Subject to completion of investment process which requires certain preconditions to be satisfied and regulatory clearance

The reasons for the lower commitment from the Irish State is the result of two decisive actions take :

1. Liability Management exercises with subordinated bondholders

The burden sharing with bondholders has saved some €4.9bn to-date.

AIB/EBS completed their Liability Management Exercise in July resulting in a total capital gain of €2.15bn. No further LME's are planned. Less than €100m of subordinated debt remains outstanding, down from €4.6bn in January 2010.

Bank of Ireland announced on 8 July that it generated c. €2bn from liability management exercises. Further burden sharing with outstanding subordinate bondholders is expected to raise additional equity capital of c. €0.4bn by 31 December 2011 and the exercise was launched on 24th August. The troika have extended the timetable for the residual capital required in order to allow this final LME to be completed by year end.

IL&P completed their LME on 24 August with a €1bn gain from €1.2bn sub-debt. €10.5m of subordinated debt is maturing at end August 2011. A further €23m nominal value, held by credit unions, remains outstanding. The Irish Life subsidiary has been offered for sale again in advance of the October 2011 deadline for that process.

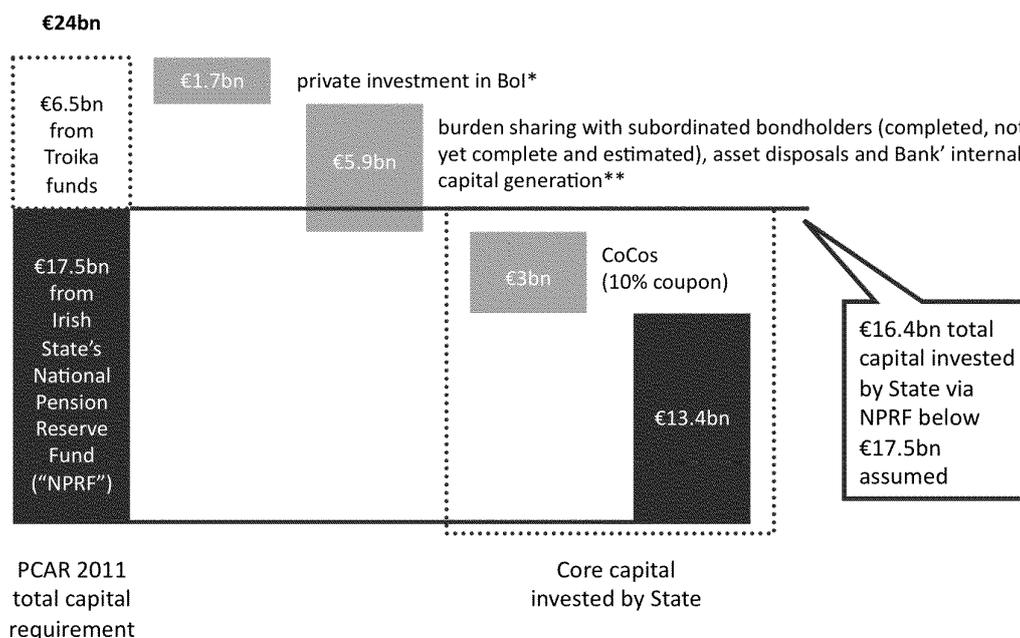
2. Private investment in Bank of Ireland

Under PCAR/PLAR, Bank of Ireland required an additional €5.2bn of capital.

On 25th July 2011, private investors agreed to an investment of up to €1.123bn* (34.9%) in Bank of Ireland's Tier 1 capital. Those investors were led by Fairfax Financial Holdings and include WL Ross, Capital Research (part of The Capital Group), Fidelity Investments and Kennedy Wilson – leading, internationally respected investors.

This transaction, in addition to other equity participation from existing shareholders/bondholders of some €600m, ensured that the State's commitment was significantly reduced while retaining a significant equity shareholding in the banks.

I would like to take this opportunity to re-iterate that the investors are taking genuine equity risk – there is no risk protection or additional guarantees from the State (such as those from the FDIC for IndyMac Bank and BankUnited in the US or LTCB/Shinsei in Japan).



* Subject to certain preconditions and regulatory clearance ** assumes progress on targeted assets disposals and remaining LME transactions

These actions ensured that the State's commitments, through the NPRFC, at the end of July was well within the €17.5bn that had been set aside for this investment.

The recapitalizations in July 2011

I would like to summarise the details of the injections that were made.

AIB/EBS required an additional injection for PCAR/PLAR of €14.8bn which was completed on 28th July. The final breakdown of the capital injections is as follows :

1. €5bn share placement via the NPRFC ;
2. €1.6bn provided in contingent capital notes ;
3. €6.05bn provided by way of a capital contribution ; and
4. €2.15bn raised through LME exercises.

The NPRFC now holds 99.8% of the total issued ordinary shares in AIB

Bol required some €4.2bn under 2011 PCAR capital requirements. This was raised via a combination of :

1. Private investors (subject to regulatory clearance and certain due diligence) invested some €1.1bn which equates to a shareholding of 34.9% ;
2. contribution from existing shareholders/bondholders of some €600m ;
3. Net equity contribution by State (through NPRFC) recapitalisation €265m ;
4. €2.0bn of equity raised from liability management exercises (while further burden sharing with remaining subordinated bondholders is expected to generate c. €0.4bn); and
5. An additional €1.0bn was injected by the State in the form of contingent capital

Following the bank's LME, capital raise, rights offering and the private equity investment, the NPRFC will retain a minimum 15.1% shareholding (subject to regulatory clearance and certain due diligence).

IL&P required some €4bn and this has been achieved in two ways:

1. €2.7bn capital injected by way of Direction Order before end July ; and
2. a further €1.1bn capital outstanding under PCAR awaiting completion of the outstanding LME and sale of Irish Life. It should be noted that two challenges to the Direction Order will be mentioned in High Court on 19 September 2011.

The State now holds in excess of 99% of the total issued ordinary shares in IL&P.

It should be noted that while there has been obviously significant investment in the banks, there has also been a return on the State's support :

Deposit guarantee schemes	CIFS Scheme (Sept 2008 - Sept 2009)	€0.8bn
	ELG Scheme	<u>€1.5bn</u> €2.3bn
Bank of Ireland	Sale of preference share warrants	€0.5bn
	Cash dividend on preference shares	€0.2bn
	Sale to private investors	<u>€1.1bn*</u> €1.8bn
	Total cash return to date	€4.1bn

Deleveraging

Deleveraging plans had been agreed with all the banks, subject to Government support, providing for the deleveraging in the aggregate of approximately €70 billion of assets, more than 70% of which are assets located outside of Ireland.

Each of the pillar banks has moved to establish core and non-core divisions and management teams for each business. Deleveraging committees with involvement of staff from the Department of Finance banking division have been set up in each of AIB/EBS, Bank of Ireland, IL&P and Anglo Irish Bank to ensure delivery of the targets.

Progress has been made on the plans that were agreed with each bank.

AIB/EBS has seen non-core deleveraging progressing well with net loan balances down €8.5bn to €19.2bn at 30th June 2011. The reduction to date has been driven primarily through amortization and provisioning but it also includes €1.5bn of asset disposals.

While no major transaction has been completed by Bank of Ireland to-date, there are transactions expected to close in the third quarter.

Anglo/INBS's sale of its \$9.2bn US commercial property loan portfolio is progressing well, despite turbulence in the markets and a single preferred bidder is emerging from that process.

IL&P are preparing for sale of CHL and other relevant asset assessments are underway.

Funding

The banks are on track to meet their forecast Loan to Deposit Ratios that have been set for year end.

Retail deposit levels in the banks have remained static over the past months with the rate of outflow stabilizing. The banks themselves are organizing intensive marketing campaigns and creating focused treasury teams in order to try to rebuild the deposit levels.

While there has been a continuing reliance on ECB funding, the Committee should be aware of the positive developments that have been seen during a very turbulent period in the international capital markets.

Bank of Ireland were able to achieve some £2.5bn (€2.9bn eq.) of secured repo funding from two large international banks for a term of up to 3 years. Further progress is being made with other available assets and, notwithstanding the market difficulties, a large number of interested parties still remain in negotiations.

IL&P have also achieved secured repo funding for up to 2 years for some £1.4bn (€1.6bn) of collateral. Further opportunities and avenues will continue to be explored by the banks in order to re-establish their position in the banking market.

The department is also working with the banks to try to identify strategies that can build on this success in other asset classes and allow further reduction in ECB funding. The Committee should also be aware that the Irish banks themselves relying on some 70% of the reported Irish ECB funding when the IFSC banks are excluded.

At the time of the PLAR, we had anticipated that the banks would not be able to access the wholesale funding markets until the second half of 2013 and we are, once again, ahead of that schedule.

Credit provision

The Government is acutely conscious of the effect of SME credit on the overall economy and recognises that SMEs will need credit if they are to be the basis of the recovery of the Irish economy. There are a number of initiatives in train to assist SMEs in obtaining the credit they will require to take active part in the economic recovery.

The Central Bank has estimated for that SME and mortgage credit of €11 to €16.5 billion of gross new lending will be required in total over the next three years. The restructuring of the domestic banking sector creates capacity for the Pillar Banks to lend in excess of €30 billion over the same three year period in SME and other important sectors – in other words, they should be more than able to meet lending requirements. We have ensured that the banks are able to meet likely demands for credit. Both Pillar Banks are concentrating on the Irish economy and need to issue credit in order to make profits and rebuild their balance sheets.

The Government has imposed lending targets on the two domestic universal pillar banks for the three calendar years, 2011 to 2013. Both banks will be required to sanction lending of at least €3 billion this year, €3.5 billion next year and €4 billion in 2012. The two banks are also obliged to submit revised lending plans to the Department for how they will meet new targets.

The banks continue to report monthly to the Credit Review Office and the Department on their lending to SMEs. This is commercially sensitive information and it is not in the public interest that it be released, not least because it would give AIB and Bol information about each others performance.

However in the context of the timing and with the agreement of both banks, the report of the Credit Review Office on the period to end March 2011 stated that the two banks had approved SME lending of €8 billion between them and that each had exceeded the target of €3 billion each in that year. I think that it is fair to say that both banks will find it challenging to meet the €3 billion target for 2011.

Both banks highlight the need for sufficient demand for credit from viable firms as an issue in their reaching the targets. The Department of Finance will commission an independent survey on demand for SME credit shortly and a meeting of the steering group to scope the exercise, consider the questions and initiate the survey was held last week.

I do want to stress that we need demand for credit from viable businesses in order to get the banks to hit their lending targets. We have no intention of forcing banks to lend to businesses that are not capable of repaying funds advanced. Such an approach will only create further difficulties for the economy.

The Government has agreed to introduce a temporary, partial credit guarantee scheme targeted at market failures owing to lack of collateral or banks not understanding the business sector. The contract to design the scheme has just been awarded and design should be completed in early October.

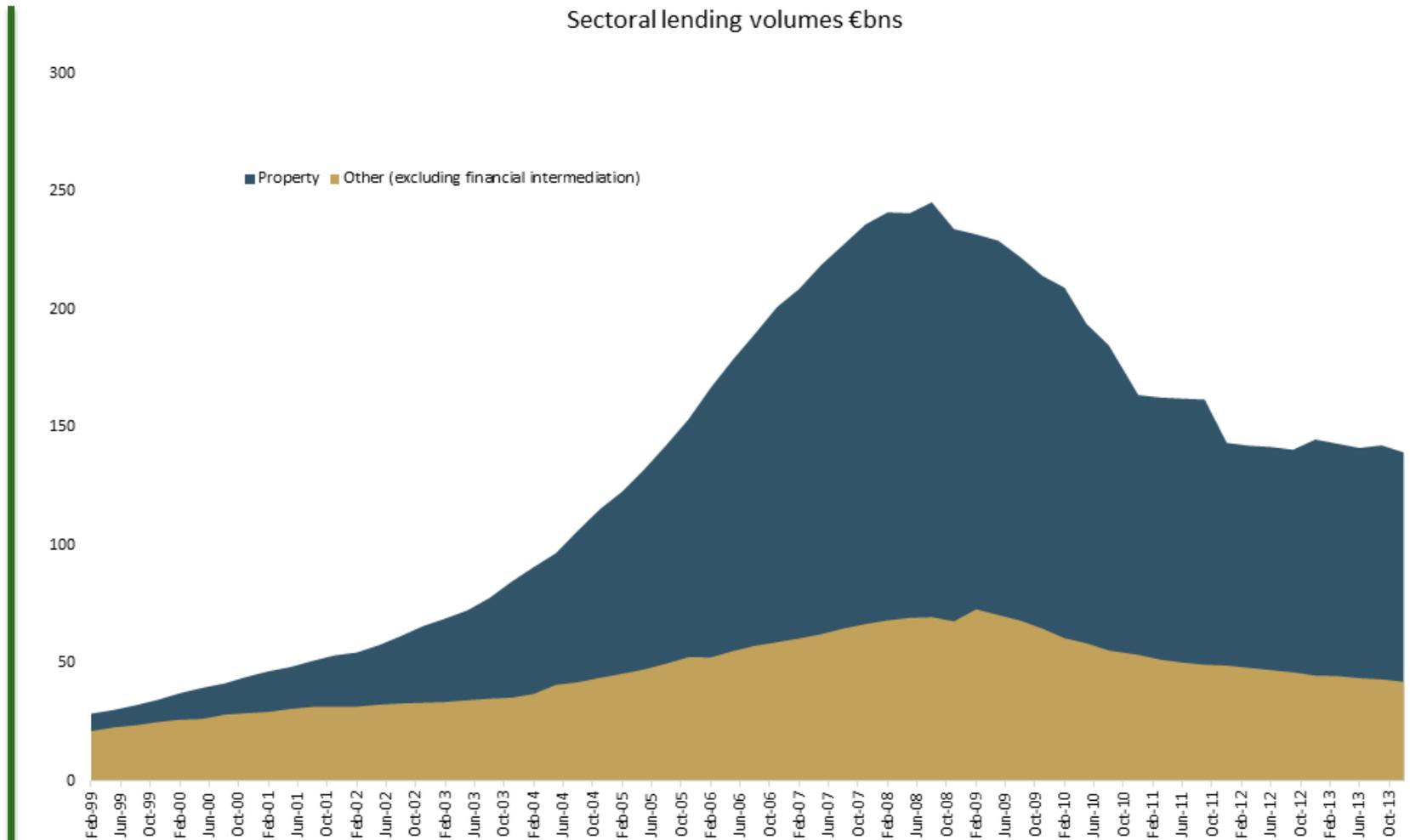
This Government does not claim to have all the solutions to the credit issue and last May, under the title of a Credit Suggestions Initiative, I called for suggestions from members of the public on what can be done to encourage viable businesses to seek

credit. Over one hundred suggestions were sent in by members of the public in response to the CSI. The most frequent, relevant and productive suggestions were published on 6 July last. My officials have written to the banks and business representative organisations regarding implementation and will be progressing the other suggestions over the autumn.

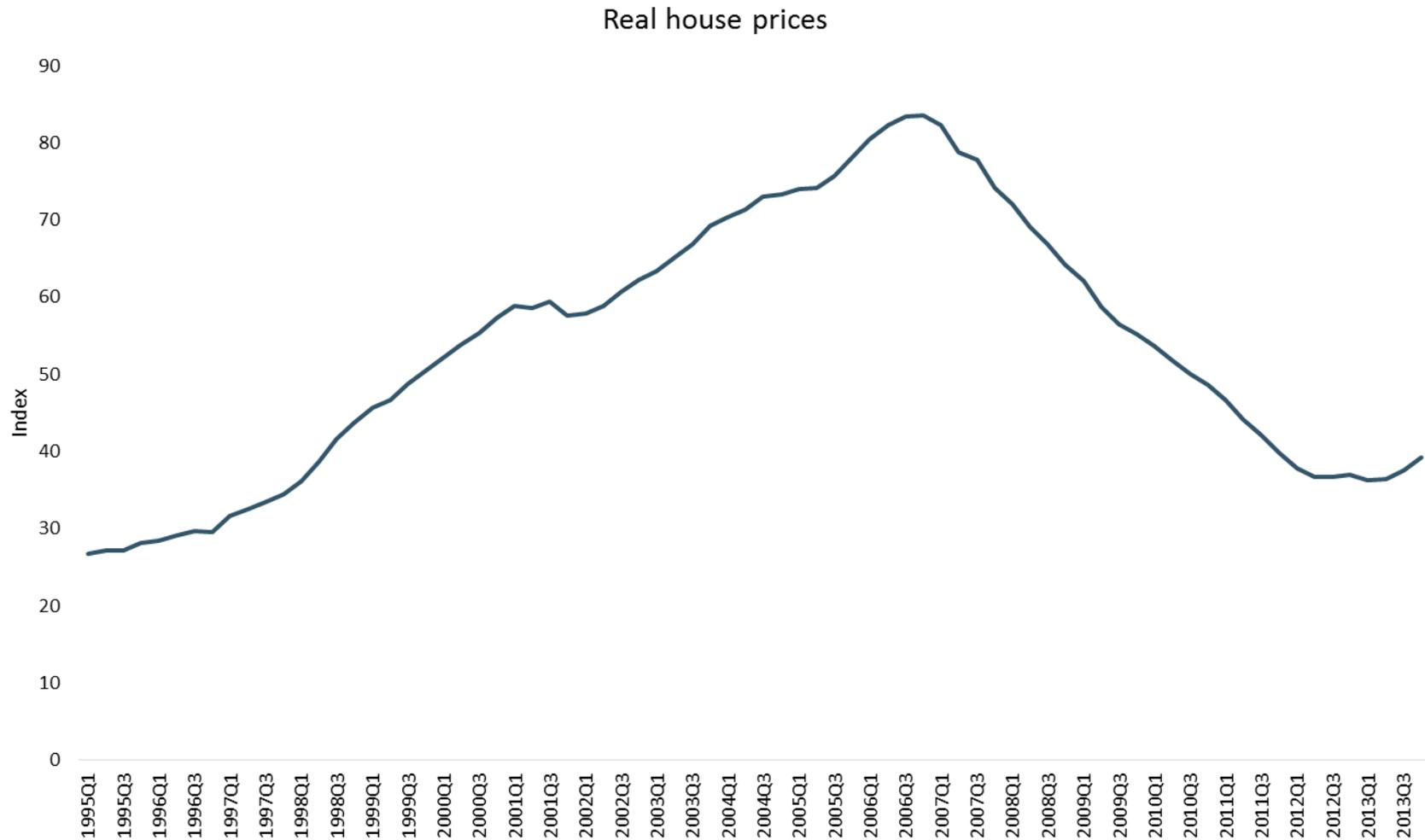
As part of our commitments to the Troika, the Central Bank will be publishing a report on the treatment of loans in arrears under the Code of Conduct for Business Lending to Small and Medium Enterprises aiming to provide standards for banks concerning their handling of past due loans of still viable entities, and where recovery appears feasible. Consultation has commenced and code will be in place in the autumn. The code will provide a framework within which the banks will deal with SMEs whose loans are in arrears. It is not about debt forgiveness for businesses.

John Trethowan, the head of the Credit Review Office published his fifth quarterly report earlier this week. He welcomed my decision to increase the threshold of credit refusals which can be reviewed to €500,000 and to hold the maximum fee charged at its limit of €250. He expects the volume of formal applications for review to increase on foot of those changes. Mr Trethowan thinks, and I agree with him, that the existence of the Credit Review Office, and its potential to review refusals of credit, is having a generally beneficial impact for all SME and farm borrowers in AIB and Bol.

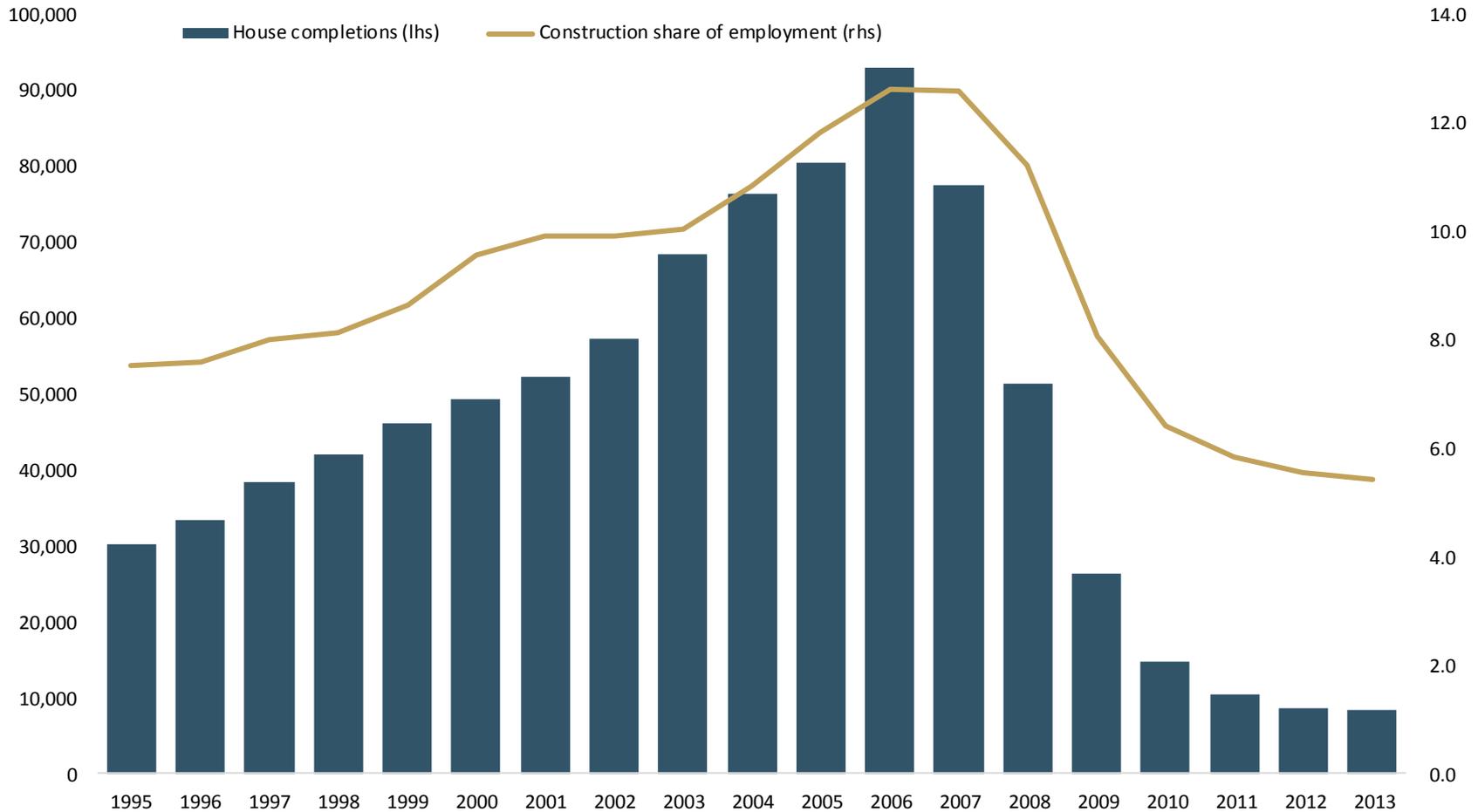
Massive increase in credit



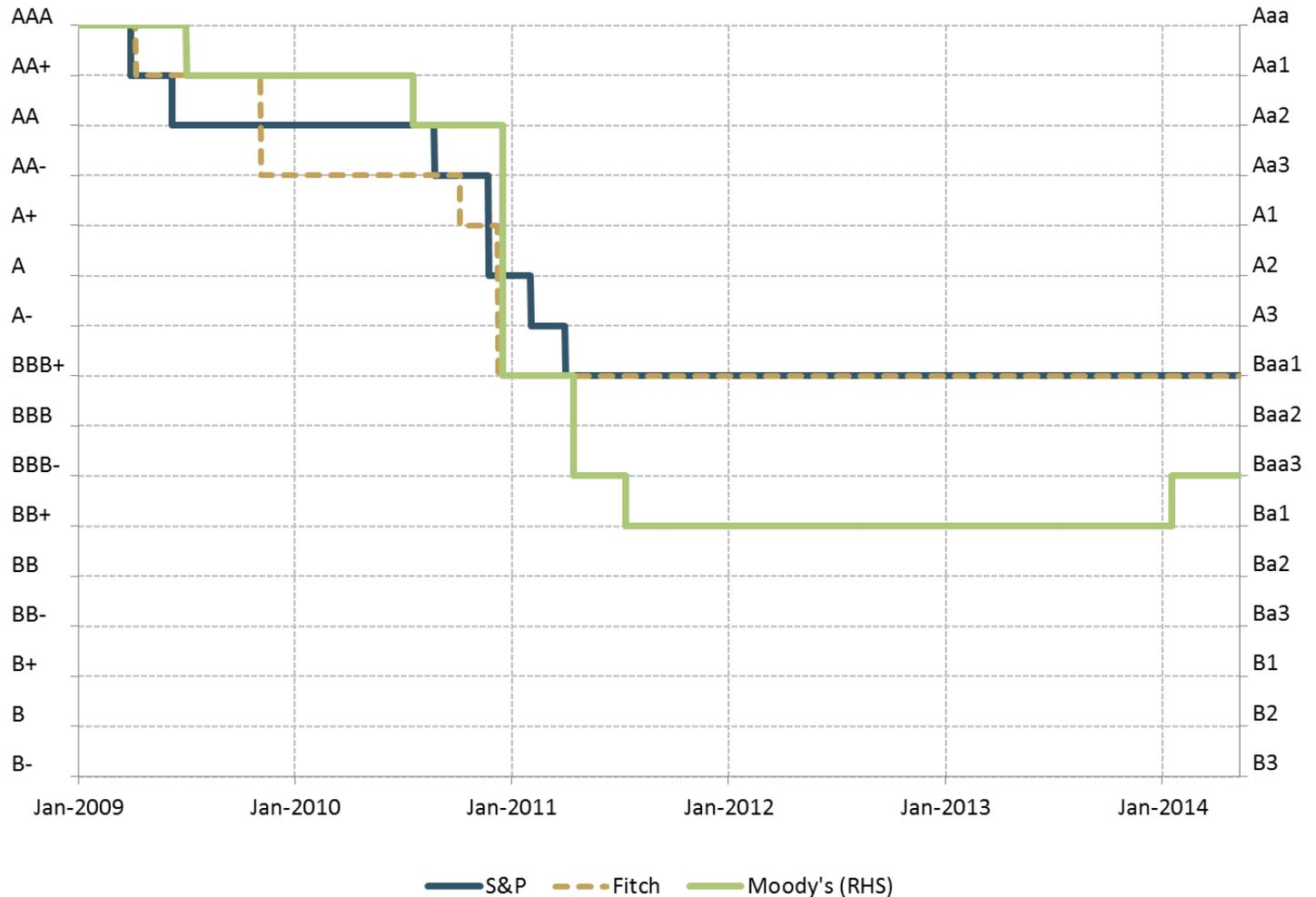
Accumulating imbalances



Mis-allocation of resources



Market access – now rated investment grade by all major CRAs



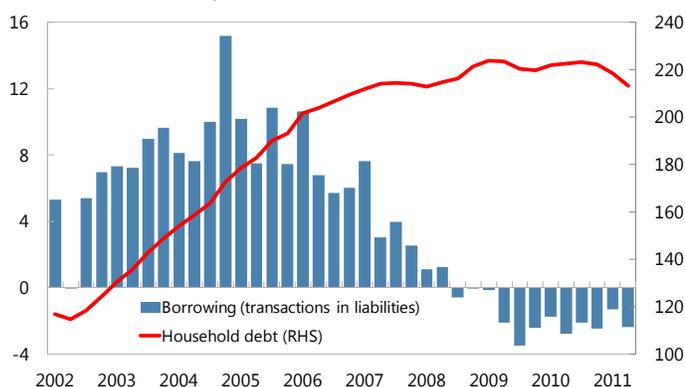
BACKGROUND—AN EXCEPTIONALLY DEEP BANKING CRISIS

1. The “Celtic Tiger” years came to an abrupt end in 2008. Suddenly, Ireland had to contend with an interlocking sovereign–banking–real economy crisis. As property prices collapsed, banks’ losses on real estate loans mounted and domestic demand fell sharply. Fiscal deficits gapped outwards and public debt catapulted from 25 percent of GDP in 2007 to over 90 percent by 2010. Deepening uncertainty about the ultimate scale of the banking sector losses, and hence growing doubts about public debt sustainability, drove a brutal switch in market sentiment in the Fall of 2010, cutting the sovereign off from market financing and compelling the authorities to resort to EU and IMF financial support.

2. The boom years stored up immense problems. Following a decade of export- and FDI-led growth supported by broad-based productivity gains, from about 2003 on the Irish economy embarked on a domestic boom underpinned by lax lending. Stiff competition for market share from foreign-owned as well as domestic banks pushed underwriting standards lower, and the feedback effect of rising collateral values fuelled the leveraging process. Rapidly rising property prices also drove high fixed investment in commercial and residential property, and a positive wealth effect fed private consumption, raising incomes and employment. Wages and prices rose, eroding competitiveness and compressing real interest rates. The integration of the Irish financial system into the broader euro area financial landscape, as well as the apparently strong fiscal position of the sovereign, gave Irish banks unfettered access to wholesale funding that turbocharged their asset expansion. In the five years to mid-2008 the net foreign liabilities of the Irish banking system jumped from about 20 percent to about 70 percent of GDP, and wholesale funding rose to 55 percent of assets. Regulators—and the IMF, in its surveillance role—failed to issue proper warnings as a vast commercial and residential property bubble inflated and bank assets grew to some 500 percent of GDP (see [Honohan report, May 2010](#), and [Nyberg report, March 2011](#)).

Household Borrowing and Debt

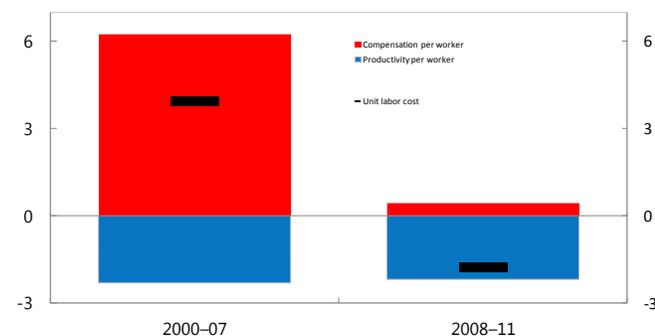
(Percent of household disposable income)



Sources: Central Bank of Ireland (CBI); and Central Statistical Office (CSO).

Unit Labor Cost Growth 1/

(Percent)



Sources: CSO; Eurostat; Haver; and IMF staff calculations.

1/ Average annual growth rates. Productivity gains depicted with negative sign.

Banks Recapitalisation

17. Deputy John Browne asked the **Minister for Finance** if he has presented to the ESM a formal case for retroactive recapitalisation of the continuing Irish banks; the timetable for the conclusion of efforts in this regard; and if he will make a statement on the matter. [41442/13]

Minister for Finance (Deputy Michael Noonan): The Deputy will be aware that the Euro-Area Heads of State or Government agreed on 29th June 2012 to break the vicious circle between banks and sovereigns, and that when a Single Supervisory Mechanism is in place involving the ECB, the European Stability Mechanism (ESM) could recapitalize banks directly. The Eurogroup meeting of 20th June 2013 agreed on the main features of the ESM's Direct Bank Recapitalisation instrument (DBR). The instrument will come into effect when the Single Supervisory Mechanism is in place. This is not expected to take place until at least mid-to-late 2014.

There is a specific provision for retrospective recapitalisation which states that "The potential retroactive application of the instrument should be decided on a case-by-case basis and by mutual agreement." The agreement, that we were active in negotiating, keeps open the possibility to apply to the ESM for a retrospective direct recapitalisation of the Irish banks, should we wish to avail of it. The Eurogroup has agreed that there will be strict eligibility criteria as well as a clear pecking order for the ESM DBR instrument.

Finally, it is a matter for the ESM Board of Governors (i.e. Euro area Finance Ministers) to decide on any application made for its facilities, including the DBR facility and its retrospective recapitalisation element. However, it will not be possible to make any application in respect of retroactive recapitalisation until the instrument is declared operational, which as I have said is expected to be in the second half of next year.

**Savings on the programme loans as a result of the now secured
reductions in the interest rates applying
20 September 2011
Speaking Points**

Total saving on the European funding

- Following the agreement secured at European level it is now calculated that the overall savings from the reductions in the margins applying to the EU related programme funding to be a total of about €9bn over the average life of 7½ years as originally envisaged for the loans.
- This saving of about €9bn represents 5.7% of the current forecasted level of GDP in 2011.
- In relation to the EU funding we are scheduled to receive:
 - €22.5 bn in funding from the EFSM;
 - €17.5 bn from the EFSF; and
 - €4.8 bn in bilateral loans (€3.8 UK, €0.6 Swe & €0.4 DK)
- The saving is made up of €4.9bn on the EFSM funding, €3.5bn on the EFSF funding and €0.57bn in relation to the UK bilateral loans. As the loans with Sweden and Denmark have yet to be finalised it is not possible to confirm the savings, but given the overall size of their bilateral loans the overall picture will not be materially altered.

Impact on the 2012 Budgetary position

- In terms of 2012 the NTMA now calculate that the savings on the EU funds as €875 million. All things being equal this will improve the budgetary position by this amount.
- As previously indicated the Department is currently working on a revised set of macroeconomic and fiscal projections and these will be brought to the Government's attention in October in the context of the Pre-Budget Outlook. In that context this interest rate development represents a significant positive impact but it will have to be factored in alongside the various other developments, both positive and negative.

Impact of the Extended Maturities

- In addition to considering the savings on the existing programme funding, there are also benefits to be gained from the decision to have longer term funding from the EU funds.
- While it is true to say that longer dated loans do cost more, the EU decisions now means that we will have funding available to us for a longer duration than an average life of 7½ years.

Interest rates on EU-IMF loan assistance

The Government agreed on 28 November 2010 to the provision of a €85 billion financial support programme for Ireland in the context of a joint EU-IMF Programme. The State's contribution to the programme will be €17.5 billion while the external support will amount to €67.5 billion.

The external assistance will be as follows

- €22.5 billion from the European Financial Stabilisation Mechanism (EFSM)
- €22.5 billion from the European Financial Stability Facility (EFSF) and bilateral loans from the UK, Sweden and Denmark.
- €22.5 billion from the IMF.

The average interest rate on the €67.5 billion available to be drawn from these three external sources under the EU-IMF programme is 5.82 per cent on the basis of market rates at the time of the agreement. The actual cost will depend on the prevailing market rates at the time of each drawdown. The average life of the borrowings, which will involve a combination of longer and shorter dated maturities, under each of these sources is 7.5 years and the interest rates applying to borrowings from each are set out below based on market rates at the time of the agreement.

EFSM

The EU has agreed that funds from the EFSM will be at a rate similar to the IMF funds i.e. 5.7%

The EFSM was established as part of a package of measures agreed in May 2010 to safeguard financial stability in the euro area.

Council Regulation (EC) No. 407/2010 of 10 May 2010 provides that the interest rate to be charged is based on IMF lending. The rate is made up of the cost of borrowing by the European Commission and a margin which is charged to the Member State concerned. The margin which has been agreed for the EFSM loan to Ireland is 2.925% within the overall interest rate of 5.7%.

EFSF

The interest rate on the EFSF loan is 6.05%

The EFSF borrows on the international capital markets on the strength of guarantees provided by Euro area countries (excluding Ireland and Greece). In order to obtain the top AAA rating from the credit rating agencies it was necessary for the EFSF to put in place certain enhancements in the form of collateral and the cost of this arrangement is reflected in the interest rate charged by EFSF on its lending.

IMF

The interest rate on the IMF loan is 5.7%



IRELAND

December 2013

TWELFTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND PROPOSAL FOR POST-PROGRAM MONITORING

In the context of Twelfth Review Under the Extended Arrangement and Proposal for Post-Program Monitoring, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on December 13, 2013, following discussions that ended on November 7, 2013, with the officials of Ireland on economic developments and policies underpinning the IMF Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 2, 2013.
- A **Staff Supplement** of December 12, 2013 updating information on recent developments.
- A **Press Release** including a statement by the Chair of the Executive Board.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Ireland*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

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IRELAND

TWELFTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND PROPOSAL FOR POST-PROGRAM MONITORING

December 2, 2013

KEY ISSUES

Steadfast policy implementation has been maintained through the final review of the program. Budget execution has once more been solid in 2013, with the fiscal deficit expected to remain within the Excessive Deficit Procedure ceiling. Budget 2014 targets a balanced adjustment path, with a primary balance in 2014 and an overall deficit below 3 percent of GDP in 2015. Efforts continue to address the high level of nonperforming residential mortgages and SME loans and key bank diagnostics have been completed.

Ireland has pulled back from a severe banking crisis with the support of the EU-IMF arrangements and broader European initiatives. Though below initial projections, growth has exceeded the euro area average and indicators suggest a recovery may be emerging. Banking reforms have supported financial stability. While the crisis and bank support led to a substantial rise in the deficit and a sharp increase in public debt, phased consolidation—initiated prior to the Fund arrangement but subsequently maintained—has significantly improved the fiscal position. Market access has been regained, also benefitting from EFSF/EFSM maturity extensions, the Promissory Notes transaction, and the broader easing in euro area market tensions.

Continued determined policy implementation is nonetheless needed on a range of fronts before Ireland can be judged to have fully recovered from the crisis:

- **Steady fiscal consolidation.** With the fiscal deficit still high and public debt very elevated, sizable further consolidation is needed in coming years to put debt firmly on a declining path and help ensure Ireland's return to market financing is lasting.
- **Addressing mortgage arrears and completing bank repairs.** Very slow progress in addressing mortgage arrears hinders a revival over time in lending that is needed for domestic demand recovery to become sustained. Intensified efforts are needed to ensure banks and mortgage borrowers in arrears conclude durable solutions. Banks also need to rebuild their profitability, although, in the context of low ECB policy rates, they face challenges from the structure of their assets.
- **Reducing high unemployment.** Efforts to improve employment services should continue, especially for the long-term unemployed, to ensure that they remain in the workforce and acquire marketable skills.

After wide consultation, the Irish authorities have decided to not seek a financing backstop after the conclusion of their current EU-IMF arrangements. Ireland concludes its Fund arrangement in a much strengthened position and the authorities intend to press on with addressing the significant challenges that remain. Nonetheless, continued European support, especially during Ireland's transition to the Single Supervisory Mechanism and the banking union, remains important.

Approved By
**Philip Gerson and
 Vikram Haksar**

C. Beaumont (head), A. Bhatia, A. Chailloux, J. Andritzky, and E. Jurzyk (all EUR); L. Jaramillo (FAD); M. Moore and J. Gutierrez (both MCM); and V. Chensavasdjai (SPR). P. Breuer (Res. Rep.) also participated.

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Acronyms

AIB	Allied Irish Banks
BoI	Bank of Ireland
BSA	Balance sheet assessment
CBI	Central Bank of Ireland
CCMA	Code of Conduct on Mortgage Arrears
DIRT	Deposit Interest Retention Tax
ECOFIN	Economic and Financial Affairs
EDP	Excessive Deficit Procedure
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ELG	Eligible Liabilities Guarantee
ESM	European Stability Mechanism
ESRI	Economic and Social Research Institute
HICP	Harmonized index of consumer prices
IBRC	Irish Bank Resolution Corporation
IFAC	Irish Fiscal Advisory Council
IFRS	International Financial Reporting Standards
IFSC	International Financial Services Centre
MART	Mortgage Arrears Resolution Targets
MTES	Medium Term Economic Strategy
NAMA	National Asset Management Agency
NFC	Nonfinancial corporation
NPL	Nonperforming loan
NTMA	National Treasury Management Agency
PCAR	Prudential Capital Assessment Review
PDH	Primary dwelling home
PMI	Purchasing managers index
PPNR	Pre provision net revenue
PTSB	Permanent tsb
REER	Real effective exchange rate
RWA	Risk weighted assets
SGP	Stability and Growth Pact
SME	Small or Medium Enterprise
SSM	Single Supervisory Mechanism

OVERVIEW

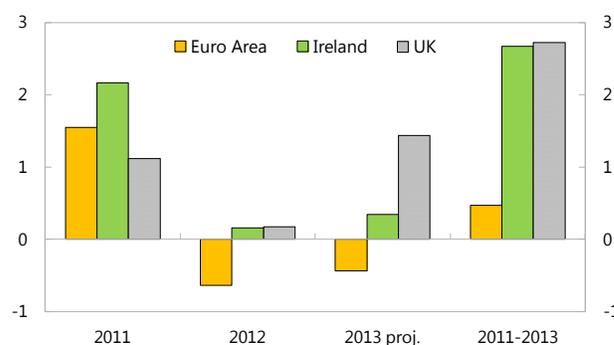
1. **The twelfth and final review of Ireland’s EU-IMF supported program found policy implementation remains on track but significant challenges remain ahead.** Discussions focused on fiscal policy and on the bank diagnostics. Following further discussions on a potential EU-IMF financing backstop the authorities [announced](#) their decision not to request such arrangements from the ESM and IMF. The authorities’ broader strategy to address remaining fiscal, financial sector and unemployment challenges and thereby ensure a durable return to market financing, as summarized in their attached Letter of Intent, was also discussed.

PROGRESS AND REMAINING CHALLENGES

2. **Ireland has pulled back from a severe banking crisis with the support of the EU-IMF program.** The [program](#) that began in December 2010 followed an exceptionally deep banking crisis, as described in the [staff report](#) for the 2012 Article IV consultation. Policy implementation has been steadfast although progress under the program has been mixed:

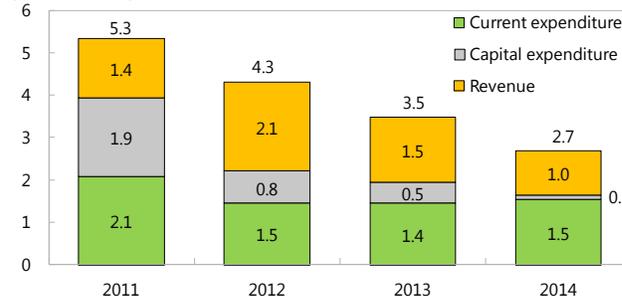
- Growth has been slower than projected, although exceeding the euro area average.** After an export-led expansion of 2.2 percent in 2011, real GDP growth slowed to 0.2 percent in 2012 and turned negative in H1 2013 as exports were hit by the “patent cliff” in pharmaceuticals and by slow trading partner recovery (Box 1). Expected cumulative growth in 2011–13 of about 2¾ percent falls short of the 5¼ percent originally projected. However, expected euro area growth of ½ percent in 2011–13 falls short of the October 2010 WEO projection of 5.2 percent to a greater extent. Ireland’s cumulative growth in 2011–13 is expected to match the UK.
- Phased consolidation effort has significantly improved the fiscal position.** Even before the start of the program, Ireland undertook substantial fiscal consolidation, reducing the structural primary deficit by 5¼ percent of GDP in 2009–10. Subsequently, every fiscal target under the program has been met. As a result, Ireland is expected to reduce its structural primary deficit to ½ percent of GDP in 2013, a cumulative

Real GDP Growth
(Percent)



Source: IMF WEO; and IMF Staff estimates.

Composition of Fiscal Consolidation 1/
(Billions of euro)



Source: IMF staff estimates.

1/ Of the €6 billion in measures included in Budget 2011, some €0.7 billion related to the sale of assets and debt service savings are not part of staff estimates of the consolidation effort. Revenues for 2012 include €0.5 billion in carryovers from the Universal Social Charge and other measures not envisaged under the original program, but implemented under Budget 2011. For 2014, the estimate of consolidation does not include additional deficit reductions of €0.45 billion identified in the Budget related to unemployment benefits, interest payments, and central bank dividends.

decline of around 4½ percentage points since 2010 and of 10 percentage points since the onset of the crisis. Fiscal measures implemented under the program total over €13 billion or 8 percent of GDP, two-thirds on the expenditure side.

- **The fiscal framework has been strengthened.** A general government budget balance rule and a general government debt rule were adopted as part of the [Fiscal Responsibility Act 2012](#), consistent with the Stability and Growth Pact (SGP). Budget 2012 introduced three-year aggregate and ministerial level expenditure ceilings, put on a statutory basis in the recently approved [Ministers and Secretaries \(Amendment\) Bill 2013](#). The Fiscal Responsibility Act also provides for the independence and adequate funding of the [Irish Fiscal Advisory Council](#) (IFAC). The Council is responsible for providing an *ex ante* endorsement of the macroeconomic forecasts underpinning the budget and for assessing the soundness of the government's budgetary projections and fiscal stance. Measures to enhance transparency include the authorities' action plan on fiscal reporting, forecasting and risk analysis (guided by the Fund's [fiscal transparency assessment](#)) and the launch of a quarterly [Government Finance Statistics](#) publication.

- **Financial stability has been supported by determined efforts.** These include a €24 billion (15 percent of GDP) top up of banks' capital in 2011, coupled with a significant [restructuring](#) of the system.¹ These PCAR banks reported an aggregate core tier 1 risk based capital ratio of 14.1 percent as of mid 2013 (although the balance sheet assessment indicates a somewhat lower ratio, 12.9). Provisions doubled between end 2010 and June 2013 to account for 90 percent of aggregate loan losses projected under the stress scenario of the 2011 stress test.² Domestic deposits have stabilized since mid 2011 even as deposit rates have declined. The loan-to-deposit ratio has come down from 190 percent at end 2010 to

Aggregate Balance Sheet of PCAR Banks 1/
(In billions of euro unless otherwise indicated)

Balance Sheet	Q4 2010	Q2 2013	Percent change
	€ bn.	€ bn.	
Cash & due from Eurosystem	6.3	9.1	42.9
Net loans	273.6	186.0	-32.0
o/w Mortgages (Ireland, gross)	95.3	90.0	-5.6
Due from banks	n.a.	8.7	n.a.
Securities & derivatives	58.9	64.7	9.7
Other assets	29.2	13.4	-54.1
Total assets	368.1	281.8	-23.4
Due to Eurosystem	90.1	33.7	-62.6
Due to banks	27.0	19.1	-29.5
Deposits	144.3	159.0	10.2
Debt & derivatives	72.1	37.9	-47.4
Other liabilities	19.3	11.0	-43.0
Net equity	15.3	21.1	37.7
Total liabilities & equity	368.1	281.8	-23.4
<i>Memorandum items:</i>			
Gross loans 2/	310.8	213.5	-31.3
Loan loss provisions	14.3	28.2	97.0
Gross NPLs	33.5	56.8	69.4
Gross NPLs to gross loans (%)	10.8	26.6	15.8
Provisions to gross NPLs (%)	42.7	49.7	6.9
Loans (net) to deposits (%)	189.7	117.0	-72.7

Sources: CBI; and IMF staff estimates.

1/ PCAR banks are Bank of Ireland, Allied Irish Banks, and Permanent tsb.

2/ Includes loans held for sale, classified on balance sheet as other assets.

¹ The 2011 Prudential Capital Assessment Review (PCAR) stress tested Allied Irish Banks (AIB), Bank of Ireland (BoI), and Permanent tsb (PTSB), together the PCAR banks. See the [Financial Measures Programme Report](#), March 2011, of the Central Bank of Ireland (CBI).

² In calculating this ratio, the PCAR loss estimate is increased by €3.9 billion to reflect the subsequent decision to not transfer smaller land and development loans to the National Asset Management Agency (NAMA).

117 percent in June 2013 and PCAR bank reliance on Eurosystem support is down from a peak of over €90 billion to about €31 billion. Bank support involved a heavy burden on the public sector, with gross costs of €64.1 billion (40 percent of GDP). Recovery of these costs is at an early stage, including through the sale of Irish Life and CoCos in BoI.

- **Financial regulation and supervision have developed further and improvements continue.** In October 2011 a special resolution regime for banks and credit unions was enacted and in July 2013 the [supervisory powers](#) of the CBI were strengthened.³ In December 2012 the new Personal Insolvency Act established three new essentially nonjudicial procedures for debt resolution and modernized the Bankruptcy Act 1988.⁴ In May 2013 the CBI reinforced its [Impairment Provisioning and Disclosure Guidelines](#), including clauses on loan modification and evergreening practices. The [Credit Reporting Bill](#), though delayed, is expected to be enacted by December 2013 to provide for a statutory Central Credit Register system operated by the CBI. The CBI has been strengthening banking supervision by increasing resources and operationalizing its new risk based supervisory approach. Reports on Ireland's observance of the Basel Committee *Core Principles for Effective Banking Supervision* and the IOSCO *Objectives and Principles of Securities Regulation* are due to be completed shortly, and the authorities are committed to continue making improvements in regulation and supervision.
- **Competitiveness is improving even as structural reform progress has been slower than hoped.** Competitiveness deteriorated during the boom but subsequent declines in the CPI and unit labor costs left Ireland with only a moderate degree of real effective exchange rate overvaluation, in the range of 5–10 percent (see [2012 Article IV Staff Report](#), Annex I). Flat nominal wages and low inflation suggest improvements in competitiveness will continue in coming years. Structural reforms have aimed to improve competition within the legal and medical services sectors, strengthen [competition enforcement](#) including by increasing resources, enhance [activation and training](#) of the unemployed, and facilitate [labor market adjustment](#) in sectors hit hard by the crisis, although the implementation of some reforms is yet to be completed.⁵
- **Market access has been regained.** Financial market conditions have improved markedly, reflecting a combination of the above policy efforts and European support through interest rate reductions, EFSF/EFSM maturity extensions, and the Promissory Notes transaction, together with the broader easing in euro area market tensions since mid 2012. Two government bond issues totaling €7½ billion in early 2013 were heavily subscribed by an investor base that was diversified by region and investor class. Spreads on Irish sovereign bonds have fallen to their lowest level since early 2010 and, since its issuance in March, the 10 year bond yield has fallen from 4.15 percent to about 3.5 percent recently, some 60 basis points below Italy and Spain.

³ On the resolution regime, see Box 2 in [Ireland: First and Second Reviews Under the Extended Arrangement](#).

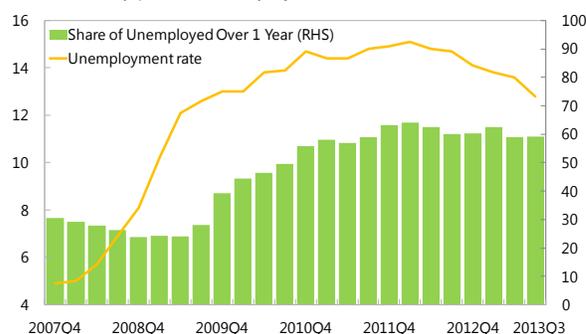
⁴ See Annex II, [Ireland—Ninth Review Under the Extended Arrangement](#).

⁵ For elaboration on these reforms, see ¶36 of [Ireland—Staff Report for the 2012 Article IV Consultation](#).

3. **Nonetheless, significant challenges remain that will require concerted action over the medium term before Ireland can be judged to have fully recovered from the crisis:**

- **Heavy private sector debts weigh on the level of domestic demand.** By boosting savings, households have reduced their nominal debts by 16 percent in the past 4½ years, but [debt burdens](#) remain high at 198.3 percent of disposable income in 2013 Q2 with saving likely to remain above normal levels for some time. SMEs face financing constraints on investment and job creation, often reflecting debt incurred for past property investments.⁶
- **Banks' progress in resolving high nonperforming loans (NPLs) has been very slow and weak profitability also hinders a revival of lending.** NPLs stand at 26½ percent of PCAR bank loans, led by commercial real estate loans (41 percent), Irish residential mortgages (34 percent) and business and SME loans (19 percent). This high share of NPLs raises the cost of market funding including through overcollateralization requirements and drains management resources that could be used for new lending. High unemployment and other shocks have led to [arrears](#) over 90 days on 12.9 percent of mortgages for principal dwellings, while the figure for mortgages on buy-to-let properties is 21.2 percent. However, banks' progress in resolving NPLs has been very slow, prompting the CBI to establish targets for the resolution of [residential mortgages](#) and SME loans.⁷ Even after significant profitability improvements in the first half of 2013—reflecting the removal of the Eligible Liabilities Guarantee (ELG) scheme, reductions in staffing and branch numbers made in 2012, and declines in deposit rates—bank profitability remains weak, limiting banks' capacity to generate the capital needed to sustain lending. The greatest challenge is faced by the smaller PTSB which is not expected to break even after provisioning expenses until 2017.
- **The fiscal deficit remains high and putting public debt firmly on a downward path requires sizeable further fiscal consolidation.** Despite the major primary adjustment under the program, a rising interest bill has kept the fiscal deficit at 6½ percent of GDP (excluding one-off guarantee payments related to the liquidation of the Irish Bank Resolution Corporation, IBRC), and with debt projected at 124 percent of GDP at end 2013 further consolidation is needed while allowing room for recovery.
- **High long-term unemployment, if unaddressed, could depress growth for years.** Reflecting a combination of job creation and emigration, unemployment eased from 15.1 percent in early 2012 to a still high 12.8 percent by Q3 2013. However, the long-term jobless constitute some 58.4 percent of all jobseekers, eroding labor force participation and work skills.

Unemployment Rate and Duration
(Quarterly, percent, seasonally adjusted)



Sources: Haver Analytics; and IMF staff calculations.

⁶ See Box 4 in [Ireland—Eleventh Review Under the Extended Arrangement](#).

⁷ Factors behind prolonged mortgage forbearance are outlined in ¶19 of the [Tenth Review](#).

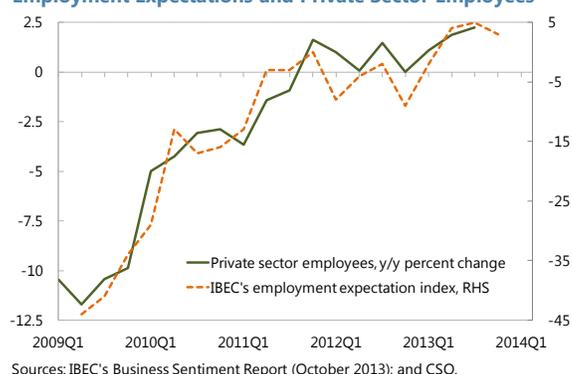
RECENT DEVELOPMENTS

4. **An output rise in Q2 2013 reversed only part of the sharp dip in Q1 but a range of indicators paint a more positive picture for the second half of the year:**

- **Real GDP grew by 0.4 percent q/q in Q2 but still contracted 1.2 percent y/y.** Exports rebounded in Q2 to increase 1 percent y/y, led by services export growth of 3.6 percent. Final domestic demand contracted 0.3 percent q/q in Q2, to be down by 1.1 percent y/y, as a 0.7 percent q/q rise in private consumption was outweighed by weak investment and public consumption. Nonetheless, fixed investment ex-aircraft grew 11.8 percent y/y, driven by equipment spending and construction.

- **Employment rose 3.2 percent y/y in Q3, the fastest increase in six years.** Job growth was recorded in 8 of 14 sectors, including construction, though public sector employment fell. Surveys of employers, together with the further decline in the unemployment rate in October, suggest that private sector job growth is continuing.

Employment Expectations and Private Sector Employees



- **Signals of a broad-based recovery are provided by high frequency indicators in the second half.** Goods exports rose 4.9 percent q/q in Q3. The [manufacturing PMI](#) continued to rise through October to 54.9, the [services PMI](#) reached its highest level since March 2007, and the [construction PMI](#) for October is now firmly in expansion territory, with the overall index increasing to 59.4, the highest level observed since January 2006. [Consumer sentiment](#) also reached the highest level in 6 years in October and although core retail sales were flat in October, they are up 0.3 percent y/y in the first ten months of 2013.

Purchasing Managers Indexes by Sector

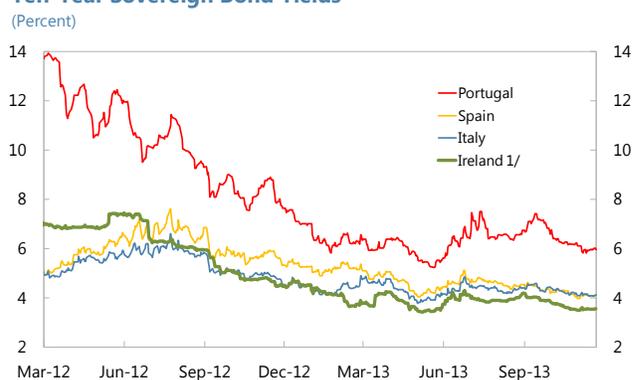


- **Inflation remains low.** Helped by falling energy prices, harmonized index of consumer prices inflation was essentially flat y/y in October (-0.1) and below euro area inflation of 0.7 percent y/y during the same period.
- **House prices are rising nationally, with strong growth in Dublin and increases emerging elsewhere, even as bank credit continues to contract.** Household credit outstanding shrank by 4.2 percent y/y in October and loans to nonfinancial corporations fell by 4.7 percent. Nonetheless, [mortgage draw downs](#) rose 12.5 percent y/y in Q3 and [mortgage approvals](#) increased 22.2 percent y/y in October. Residential property prices rose

6.1 percent y/y in October, led by a 15 percent y/y gain in Dublin while elsewhere house prices have edged up by 3.5 percent since March. Renewed house price increases and declining household indebtedness are contributing to a rebuilding of [household net worth](#), although it remains some 34 percent below peak levels.

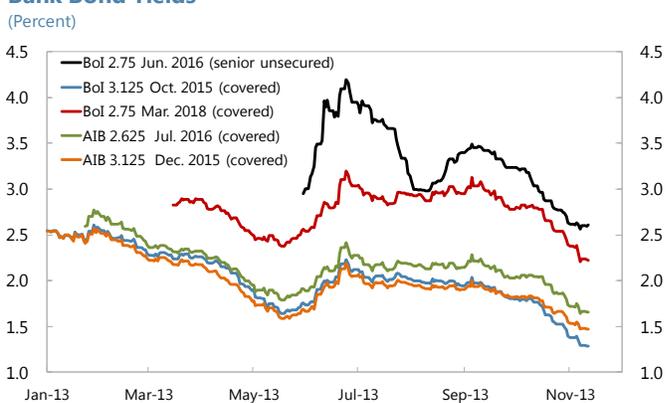
5. **Financial market conditions continued to improve, benefitting from international developments.** Yields eased following the Federal Reserve's postponement of the tapering, the German election outcome, and the recent ECB easing decision. In view of its relatively strong funding position, the National Treasury Management Agency (NTMA) decided to suspend its monthly Treasury bill auctions for the final quarter of 2013 and to defer consideration of any further medium/long-term bond issuance until early 2014.

Ten-Year Sovereign Bond Yields



6. **Funding conditions for banks have enjoyed a positive spillover from the strength of the Irish sovereign bond market in recent months.** Secondary market yields on three-year covered bonds from BoI and AIB have fallen by about 75 basis points since early September. Domestic banks have also issued €3 billion in bonds since September, with high bid-to-cover ratios and geographically diversified demand indicating strong investor interest.⁸ After declining significantly, bank deposit rates have stabilized below 1 percent in recent months. ECB borrowing by domestic banks fell from €39.6 billion at end March to €30.8 billion at end October.

Bank Bond Yields



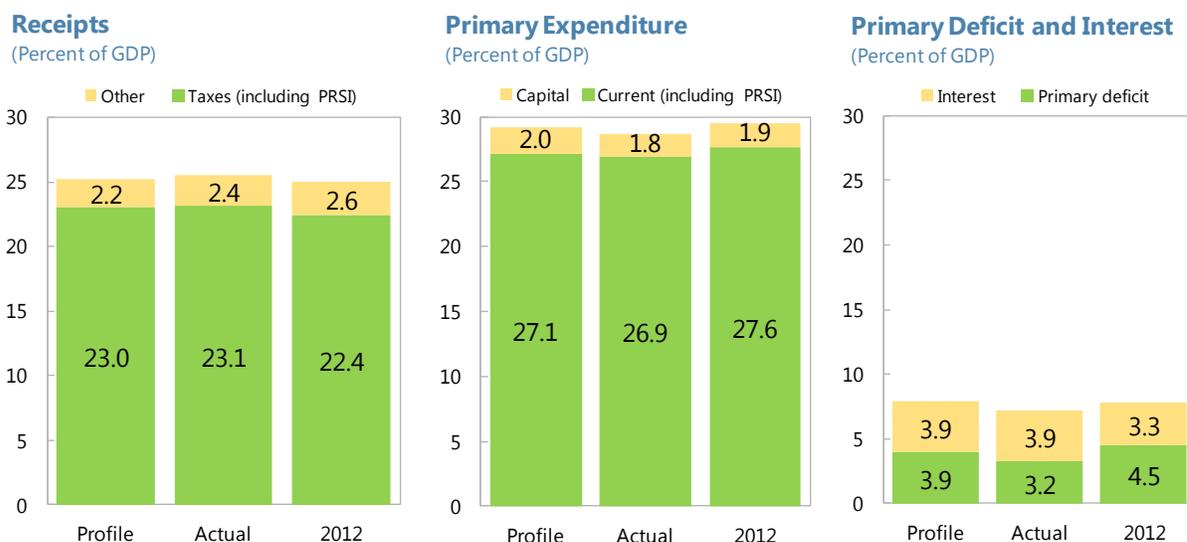
7. **NAMA continues to make progress towards its debt redemption targets and is preparing for the challenges of integrating IBRC loans.** In the year through mid-October NAMA generated cash receipts totaling €3.9 billion of which €2.9 billion was from asset disposals. From its inception, NAMA has generated total cash receipts of about €14.5 billion of which €9.7 billion was from asset disposals, helping to bring cumulative redemptions of its senior bonds to €7 billion to date out of a total of €30 billion by 2020. NAMA recorded a profit of

⁸ BoI and AIB issued €1.5 and €0.5 billion of covered bonds, respectively. AIB also issued €0.5 billion of senior unsecured debt. PTSB's €0.5 billion asset backed security issuance is the first of this type since 2007.

€53 million in the first half of 2013, notwithstanding cumulative impairment provisions of €3.6 billion (14½ percent of gross loans and receivables). To support asset sales, NAMA has advanced €375 million in vendor financing and has spent €500 million in capital investment to date. Preparations are being made to acquire IBRC loans up to the value of the €12.9 billion floating charge acquired as part of the Promissory Notes transaction in the event the Special Liquidator is unable to sell IBRC's assets to the market. Loan servicing previously conducted by IBRC on behalf of NAMA on debt with a principal of €41 billion is being migrated to a loan servicing company, and staff and IT systems from IBRC are being integrated.

8. **The exchequer deficit remained on track through end October.** Cumulative primary expenditure (excluding ELG payments linked to the Promissory Notes transaction) was 0.7 percent of GDP lower than in the same period of 2012 on account of lower outlays in social protection, health, and education. Both current and capital spending remained below the authorities' profile as well. Cumulative revenues (after adjusting for one-offs) were 0.7 percent of GDP higher than a year earlier. Revenues remain marginally above budget projections as over-performance on corporate income tax, Pay Related Social Insurance, and stamp duties offset shortfalls in VAT and excise duties that have until now been weighed down by weak domestic demand. The exchequer primary deficit at end October was 3.2 percent of GDP, 1.3 percent of GDP smaller than in the corresponding period of 2012, and the end September performance criterion was met by a margin of 0.8 percent of GDP (Table 12).

Cumulative Exchequer Outturn vs. Authorities' Profile, January–October 2013



Sources: Department of Finance; and IMF staff estimates.

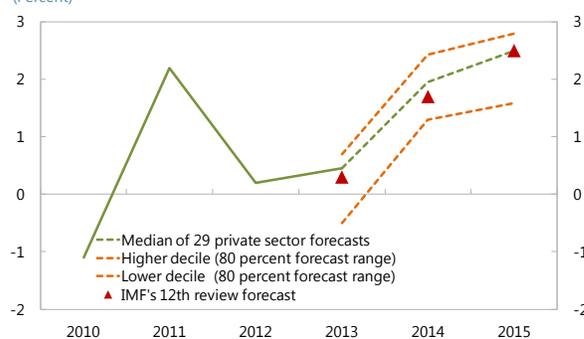
Note: To facilitate comparability: (i) 2012 tax revenues do not include the €251 million corporation tax payment delayed from December 2011; (ii) outlays in respect of Irish Life (€1.3 billion) and credit unions (€250 million) are excluded from 2012 capital spending; (iii) proceeds from the sale of Bank of Ireland contingent capital notes (€1 billion) and Irish Life (€1.3 billion) are excluded from 2013 other receipts; and (iv) Eligible Liabilities Guarantee scheme payments linked to the promissory note transaction of €1 billion are excluded from 2013 current expenditure.

MACRO-FINANCIAL OUTLOOK AND RISKS

9. **Drag from a weak first half implies lower growth in 2013 despite recent signals of recovery.** GDP growth in 2013 is revised to 0.3 percent, down from 0.6 percent at the eleventh review, yet experience indicates that a significant range of uncertainty remains owing to the potential for large data revisions when the annual GDP data for 2013 are released in mid-2014.⁹ Final domestic demand is forecast to contract 0.2 percent for the year, led by a 0.6 percent decline in private consumption. While investment is rising, the growth contribution is limited by its low share in GDP. Exports are expected to grow just 0.5 percent y/y owing to the weak first half, still outpacing import growth of 0.2 percent.

10. **Higher trading partner growth is a key driver of gradual recovery to 1.7 percent y/y growth in 2014.** Recent WEO projections show Ireland's trading partner growth picking up from 0.4 percent y/y in 2013 to 1.6 percent in 2014, which is expected to allow net exports to boost growth by just over 1 percentage point. Recent employment growth appears to be continuing and is expected to support household incomes and confidence, helping consumption growth turn modestly positive in 2014 at 0.5 percent y/y. Public consumption will contract at a faster pace than in 2013 owing to the implementation of the agreement on public sector wages.

Real GDP Growth—Private Sector Projections, October 2013
(Percent)



Sources: Bloomberg; and IMF staff estimates.

Macroeconomic Projections, 2009–15

(Percentage change unless indicated otherwise)

	2009	2010	2011	2012	2013	2014	2015
Real GDP	-6.4	-1.1	2.2	0.2	0.3	1.7	2.5
Final domestic demand	-9.7	-5.0	-3.0	-1.1	-0.2	0.4	1.0
Private consumption	-5.1	0.9	-1.6	-0.3	-0.6	0.5	1.0
Public consumption	-3.4	-6.9	-2.8	-3.7	-1.0	-2.8	-2.5
Fixed investment	-26.9	-22.6	-9.5	-1.0	2.9	4.4	5.4
Change in stocks 1/	-0.7	0.6	1.0	-0.4	0.2	0.0	0.0
Net exports 1/	4.6	3.0	5.7	1.6	0.3	1.4	1.7
Exports	-3.8	6.4	5.4	1.6	0.5	2.5	3.7
Imports	-9.8	3.6	-0.4	0.0	0.2	1.4	2.7
Nominal GDP (billions of euros)	162.3	158.1	162.6	163.9	165.4	169.5	175.4
GDP deflator	-3.8	-1.5	0.7	0.7	0.6	0.7	1.0
Current account (percent of GDP)	-2.3	1.1	1.2	4.4	4.2	4.6	4.7
Consumer Prices (HICP)	-1.7	-1.6	1.2	1.9	0.8	0.9	1.1
Unemployment rate (percent)	12.0	13.9	14.6	14.7	13.3	12.3	11.7
Household savings rate (percent of disp. income)	14.9	12.0	10.7	10.2	10.9	10.8	10.6
Household debt (percent of disp. income)	218	215	212	206	202	193	188
Credit to households and NFCs (eop)	-1.5	-3.4	-2.9	-4.0	-3.9	-1.9	0.2

Source: IMF staff projections.

1/ Contributions to growth.

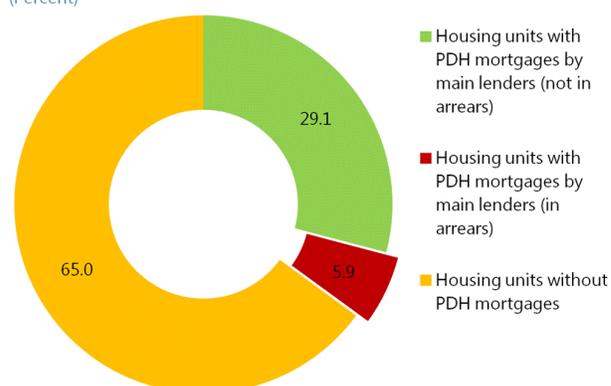
⁹ In 2011, initial estimates for real GDP growth of 0.7 percent were subsequently revised up to 2.2 percent, while initial estimates for growth in 2012 of 0.9 percent have since been revised down to 0.2 percent.

11. **Growth is projected to firm to 2½ percent from 2015 even as heavy private sector debt burdens imply a protracted domestic demand recovery.** Improvements in the external economic environment, less drag from fiscal consolidation, and a gradual revival of lending are key drivers. Export growth is projected to return to its long-term trend by 2015. Domestic demand recovers slowly, growing just 1 percent by 2015, amidst high household and SME indebtedness. Growth of 2½ percent is sustainable into the medium term as [demographic trends](#) support growth in the working age population of around 1 percent over the next ten years, as declines in unemployment allow a period of employment growth on the order of 1½ percent without igniting wage pressures, and as Ireland's productivity rises about 1 percent annually including as a result of continuing [FDI inflows](#).

12. **Mortgage restructuring needs to advance, yet also achieve durable solutions, to support economic recovery in the medium term.** Currently some 6 percent of households are

running arrears and others are struggling to uphold debt service. As discussed in Box 2, sustainable loan restructures will entail adjustments in consumption in some cases while providing relief in others. These direct near term effects on consumption are likely to be outweighed by the broader medium term benefit of improving banks' asset quality, thereby enabling banks to attract cheaper funding and facilitating a revival of mortgage lending. Furthermore, resolving nonperforming mortgages will ease fears around the "shadow housing inventory" from underwater mortgages, enhancing housing market turnover and reducing household uncertainty about wealth, altogether supporting domestic demand recovery. These benefits could however be reversed if widespread redefaults were to occur or debt service discipline were to weaken further.

Housing Units, Mortgages, and Arrears
(Percent)



Source: Department of Finance, "Mortgage restructures data", September 2013.

13. **Risks continue to surround recovery prospects, with near-term risks significant yet broadly balanced but risks tilt to the downside in the medium term:**

- **External environment.** Ireland's high degree of openness (exports account for around 110 percent of GDP) makes it vulnerable to trading partner growth fluctuations. Weak external recovery could also spill over to domestic demand through consumer and business confidence. Nonetheless, recent indicators in some of Ireland's main trading partners are relatively positive, providing scope for upside risk.
- **Domestic demand.** Consumption prospects hinge importantly on a continuation of recent employment gains, supporting incomes and reducing uncertainties. The ongoing house price recovery is yet to be tested by the depressive effects of a potential rise in disposals of

repossessed properties. Investment recovery is a potential upside risk given its low base (around 11 percent of GDP).

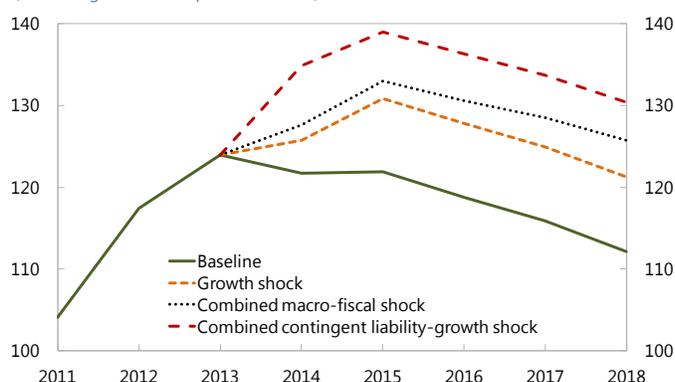
- **Financial conditions.** The revival in credit growth and investment needed to sustain recovery over the medium term would be hindered if current efforts to resolve NPLs and improve bank profitability were to fall short. If a later U.S. Federal Reserve tapering were to impact the euro area periphery more strongly there could be adverse impacts on banks' access to and costs of market funding and thus to credit availability.

14. **Public debt sustainability remains fragile (Annex I).** Declines in public debt are subject to risk from lower growth, contingent liabilities, or a combination of both. Under the baseline scenario, the public debt-to-GDP ratio is projected to peak at 124 percent at end 2013 and to decline to 112 percent by 2018 as the economic recovery gains traction. A temporary growth shock (with annual growth about 2 percentage points lower at -0.3 percent y/y in 2014 and 0.5 percent in 2015) would increase the debt-to-GDP ratio to 131 percent in 2015 before declining to 121 percent of GDP by 2018.

If slower growth in 2014–15 were compounded by a temporary primary balance shock during the same period (with a worsening of the primary balance by 1½ percentage points of GDP on average in each year) and by interest rates on newly contracted debt rising by 2 percentage points through the medium term, the debt ratio increases to 133 percent of GDP in 2015 and falls to 126 percent by 2018. As discussed in Annex I, a range of contingent liabilities remain in the financial sector, and without estimates of their potential realization, a scenario of a 10 percent of GDP shock is used. Such a shock, if combined with the above growth shock, would push gross public debt to 139 percent of GDP in 2015 before declining to 130 percent by 2018.

Public Debt Paths under Various Scenarios

(Nominal gross debt in percent of GDP)



Source: IMF staff estimates.

POLICY DISCUSSIONS

A. Fiscal Policy

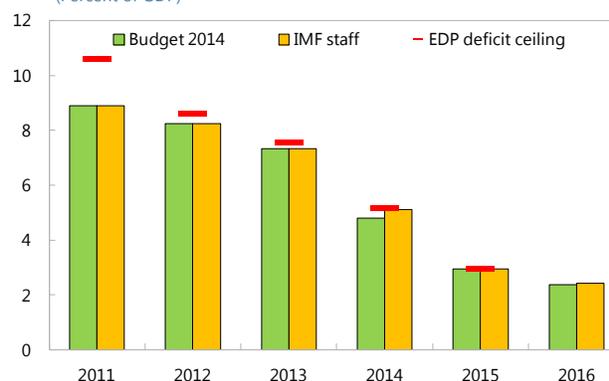
15. **The deficit for 2013 is expected to remain within the 7.5 percent of GDP ceiling under the Excessive Deficit Procedure (EDP).** Though revenue outturns are currently on track, they could fall short at end-2013 by some 0.2 percent of GDP if receipts from consumption related taxes continue to disappoint. Overall, expenditure is expected to remain within budget, as modest overruns in the health sector (0.1 percent of GDP) are expected to be offset by lower capital spending. However, the deficit would be raised if AIB dividend payments are reclassified

as capital transfers (0.2 percent of GDP).¹⁰ Nonetheless, the risks of exceeding the EDP deficit ceiling are limited as the budget will benefit from lower than expected interest payments and the later than expected recording of a telecom license sale.¹¹

16. **Budget 2014 targets primary balance in 2014 and the Irish authorities are firmly committed to reaching a fiscal deficit below 3 percent of GDP by 2015, which is sufficient to put debt on a declining trajectory.**¹² The corresponding structural benchmark is met:

- **The targets for the fiscal deficit in 2014–15 are in line with the nominal ceilings set out in the 2010 Council Recommendation under the EDP.** For 2014, the budget targets primary balance and an overall deficit of 4.8 percent of GDP, providing a buffer relative to the 5.1 percent of GDP ceiling under the EDP. Staff projects a deficit equal to the ceiling as revenues are expected to be somewhat lower in the context of more subdued domestic demand than budgeted. For 2015, the authorities target a deficit of 2.9 percent of GDP to meet the EDP target for a deficit below 3 percent of GDP. This would imply a primary surplus of 2 percent of GDP based on staff's forecast, above the debt stabilizing primary surplus in 2015 of 1 percent of GDP.

Overall Fiscal Deficit
(Percent of GDP)



Sources: Department of Finance; and IMF staff estimates.

- **The cumulative fiscal consolidation in 2014–15 is consistent with the fiscal effort set out in the 2012 Medium Term Fiscal Strategy and April 2013 Stability Programme.** The fiscal consolidation effort in 2014 is estimated at €2.7 billion (1.6 percent of GDP), including carryovers from measures implemented in previous years and 0.1 percent of GDP in higher dividends from state owned companies (Box 3).^{13, 14} For 2015, staff estimates under its

¹⁰ The deficit could also be affected with the ruling of Ireland's High Court on the amount that the state will have to pay out in compensation for lost pension benefits in the Waterford Crystal case. The net present liabilities to the state could amount to some 0.1 percent of GDP, spread out over the lifetime of the pensions.

¹¹ In consultation with Eurostat, the authorities are to record €0.7 billion from the telecom license sale that took place in 2012 in 2013 instead, as the license became operational only in February 2013. Similarly, €0.4 billion from the sale of the national lottery license that took place in 2013 will be recorded in 2014.

¹² In its recent [Fiscal Assessment Report](#) the IFAC assessed the Government's planned fiscal stance in Budget 2014 to be conducive to prudent economic and budgetary management. At the same time, it cautioned that the decision to reduce the planned fiscal adjustment in 2014 compared with the [April 2013 Stability Programme](#) had eliminated the previously existing margin of safety relative to the 3 percent of GDP deficit ceiling for 2015.

¹³ Consistent with European Commission practice, additional dividends from state owned enterprises are treated as a consolidation measure because the total dividend remains within historical profit generation, indicating that this measure is sustainable, and projections are for higher dividends to continue for a number of years.

¹⁴ This consolidation measure may be understated as it does not include the expenditure restraint needed to offset additional demographic pressures in a no policy change scenario, which the authorities estimate at €0.3 billion. The authorities identify additional deficit reductions of €0.45 billion from lower unemployment benefits, lower interest payments, and higher central bank dividends, for a total adjustment of €3.1 billion.

macroeconomic projections that €2.4 billion (1.4 percent of GDP) in fiscal measures would be needed to achieve the 2.9 percent of GDP target. This would bring the cumulative fiscal consolidation effort in 2014–15 to €5.1 billion (3 percent of GDP).¹⁵ This pace of fiscal adjustment is appropriately slower than in 2012–13 (4¾ percent of GDP), recognizing the need to reduce drag on economic recovery and the credibility built up by the authorities.

- ***The fiscal effort projected for 2016 is in line with the authorities' national fiscal rules and SGP.*** Expenditure growth is expected to be contained at 1 percent in nominal terms, which would keep it within the expenditure benchmark under the SGP. This would result in a 0.5 percent of GDP improvement of the structural balance (based on the authorities' calculations), complying with the authorities' national fiscal rule.¹⁶ This pace of improvement is sufficient to raise the primary balance to almost 4 percent of GDP by 2018, reinforcing the decline in the debt to GDP ratio while avoiding undue drag on economic growth.

17. **Firm implementation will remain critical to achieve the 2014 fiscal target, with the main risk stemming from possible disappointment in domestic demand growth.** The Finance and Social Welfare Bills needed to implement all the new measures announced in the budget have been published and are expected to be adopted by year end once approved by Parliament. The authorities noted that some of health overruns in 2013 were related to delayed implementation of some measures (such as approval of the Haddington Road Agreement and charging of private patients for use of public beds), which have already been resolved. They also indicated that close monitoring of the sector will continue. Hence, risks from potential spending pressures in the health sector are not expected to be substantial, but may require contingency measures to keep spending within allocations. More broadly, the main risk to the budget is that domestic demand is weaker than budgeted. The authorities acknowledged this risk, but also pointed to possible upsides, as recent reforms to broaden the tax base are likely to result in larger elasticities that could lead to stronger revenue performance if economic activity is robust.

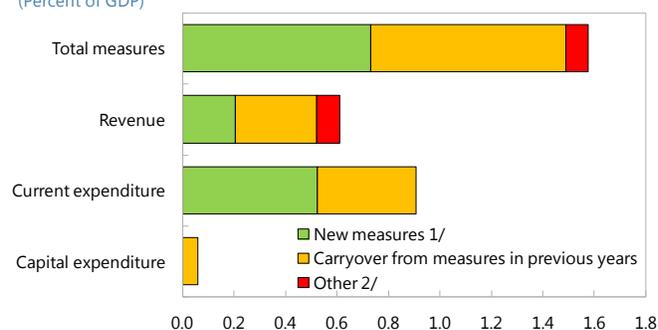
18. **Expenditure savings will be achieved through measures with a durable impact, although they do not tackle costly universal payments nor advance structural reform.** The budget reduces or eliminates some untargeted social support schemes (see Box 3). The reduction in the unemployment benefit rate for those 22 to 25 years of age is intended to provide greater incentive for the transition to work through a reduction in the reservation wage and by encouraging access to education and training where the benefit rate is significantly higher. Nonetheless, measures to better target costly universal supports and subsidies (such as the child benefit, medical cards, and subsidies on college fees) were not part of the budget package, which fails to address the schemes likely to be subject to strong demographic pressures. Furthermore,

¹⁵ Staff's estimate of a structural primary balance rise of 3¼ percent of GDP in 2014–15—an alternative measure of fiscal adjustment—is consistent with the calculated scale of the cumulative fiscal consolidation effort.

¹⁶ The authorities' structural balance figures differ modestly from staff estimates due to differences in macroeconomic forecasts and the methodologies used, including for calculation of the output gap.

the budget does not develop structural measures to reform key public services.¹⁷ The authorities underscored that universal supports were reduced in past budgets, and there was currently no political appetite for changing the principal of universality. They also indicated that some of these issues would be taken up in the context of the Comprehensive Review of Expenditure and review of the Capital Investment Framework to be launched next year.

Composition of 2014 Consolidation
(Percent of GDP)



Sources: Department of Finance; and IMF staff estimates.

1/ Includes lower proceeds due to retention of 9 percent reduced VAT rate for the tourism sector of (€0.3 billion).

2/ Includes high dividend dividends from state-owned companies.

19. **Revenue measures both increase rates and broaden bases, but new collections would be partly offset by the extension of the reduced VAT rate in the tourism sector.** Base broadening measures included the introduction of a bank levy and reduction of some personal income tax exemptions. Such measures, including the bank levy – which is comparable to levies in place in several European countries such as France, Germany and the UK – can help pay for the direct fiscal cost of any future government support to the sector. The impact on banks is expected to be somewhat mitigated by the lifting of the restriction on the use of deferred tax assets for losses incurred when banks transferred loans to NAMA. Looking ahead, if the levy is retained beyond its initial 3-year period, it could be refined to reflect institutions' riskiness and contributions to systemic risk. The budget also raises rates on the deposit interest retention tax (DIRT) and excise duties. However, the reduced VAT rate of 9 percent in the tourism industry will not be allowed to expire at end-2013, with an estimated negative impact of €0.3 billion. The authorities considered that the reduced VAT rate has had a significant positive impact in the sector and on employment, and did not want to cause a setback to the sector before it is on stronger footing.

20. **The distributional impact of Budget 2014 is uncertain given the composition of measures.** The tax-benefit model used by the [Economic and Social Research Institute](#) (ESRI) to assess the distributional impact of the budget each year is not equipped to deal with indirect taxes or taxes on wealth, such that it covers less than 20 percent of the total consolidation package in Budget 2014. On the taxation side, the reduction in tax relief for high valued pensions, the increase in DIRT, and restriction on tax relief for health insurance premia are expected to have a broadly progressive impact. By contrast, the ESRI's SWITCH model indicates that the full year impact of the indicative but not final version of the local property tax to be felt in 2014 would have likely been regressive. Also, the reduction in unemployment payment rates for those aged 22

¹⁷ Staff recommendations on reform of key public services such as health, education, and social protection, are outlined in the [2012 Article IV Staff Report](#).

to 25 could have a more severe impact on individuals in low income households, though this will depend in the availability of suitable training which would provide a higher payment.

21. **Recent institutional reforms came into effect in Budget 2014.** Aggregate exchequer and ministerial level expenditure ceilings were set through to 2016, with spending growth to remain within the SGP expenditure benchmark. The authorities indicated that the upward revision to the 2014 ceiling as compared to Budget 2013 by €0.4 billion was in compliance with the recently issued circular, which stipulates that changes are permissible if compensatory discretionary measures are introduced. The budget also announced that the number of public service employees would not decline in 2014 as anticipated under the previous employment control framework target but the authorities emphasized their commitment to the existing wage bill envelope. Staff underscored the need to keep employment numbers in check, as spending pressures could mount once the freezes on automatic increments expire at end 2016. The authorities considered that the moratorium on new hires since 2008 was affecting the provision of public services and there was a need to recruit frontline staff. They also indicated that this issue would be assessed as part of the next Comprehensive Review of Expenditure in 2014. The process by which the [IFAC](#) provided the *ex ante* [endorsement](#) of the macroeconomic forecast underpinning the budget went smoothly. The slight revision to the growth forecast after IFAC endorsement due to a change in the policy stance was within the expectations of IFAC. Staff suggested that a trigger be considered beyond which a modification to the macroeconomic forecast would need to be consulted with IFAC.

B. Financial Sector Policy

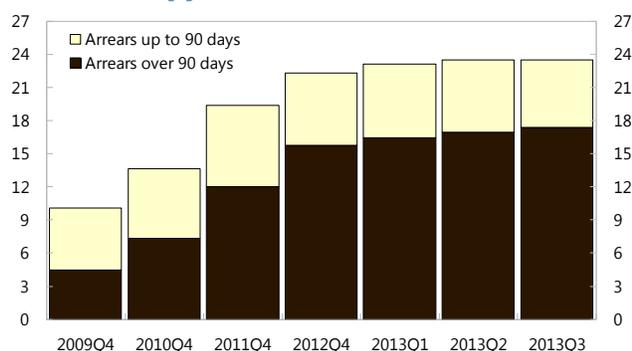
22. **The twelfth review focused on NPL resolution and bank diagnostics.** The mission reviewed ongoing initiatives to drive forward arrears resolution on residential mortgages and SME loans. The mission also consulted on the Balance Sheet Assessment (BSA), reviewing both the process and findings, and discussing the policy actions to follow. It assessed the authorities' recent reviews of bank operating profits and tracker funding solutions that will help inform the development of options to bolster bank profitability, which are especially relevant for PTSB.

Resolving NPLs

23. **The rise in mortgage [arrears](#) appears to be slowing and the personal insolvency reforms have become operational.** Mortgages on primary dwelling homes (PDH) in arrears for more than 90 days rose from 15.8 percent of the total value of PDH mortgages outstanding at end 2012 to 17.4 percent at end September, a slower increase than in recent years. The stabilization of house prices and decline in unemployment likely contributed and banks' improved collection efforts also appear to be containing early arrears cases. A small initial number of Debt Settlement and Personal Insolvency

Mortgages in Arrears on Primary Dwellings

(Percent of total mortgage value)



Source: Central Bank of Ireland.

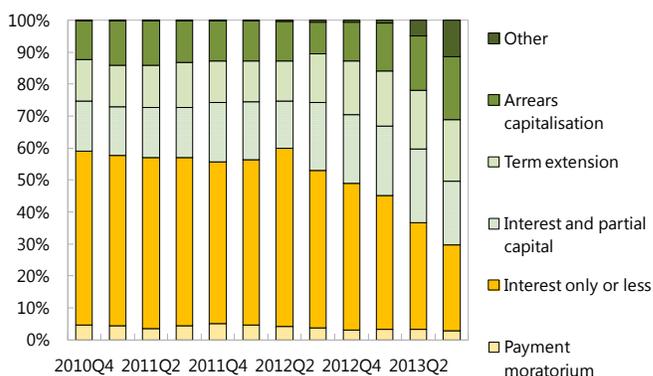
Arrangements are being processed, and the Insolvency Service expects the case load to increase, complementing the other options for case-by-case resolution (Box 4).

24. **Banks are reporting progress in line with the CBI’s [Mortgage Arrears Resolution Targets](#) (MART) framework yet the use of solutions that are not expected to be durable needs to be averted.**¹⁸ The CBI [announced](#) that banks reported they have met the end September target for proposing solutions to 30 percent of mortgages with arrears over 90 days. Proposed solutions involving a loss in ownership for PDH became less prominent, while the portion of long-term loan modifications increased. A third-party audit commissioned by the CBI has reviewed banks’ solutions proposed until June, including an analysis of a sample of arrears cases relative to CBI guidelines on sustainable solutions.¹⁹ The audit identified some instances where the proposed situations were not considered sustainable, e.g., a short-term solution was proposed without tangible evidence to expect an improvement in a borrower’s debt servicing capacity. The CBI will follow up with lenders on the issues identified by the audit and develop further guidance for future targets, including for solutions concluded. Staff recommends that future audits also assess debt service sustainability.

25. **Overcoming inadequate engagement between banks and borrowers is critical to move from proposals to conclusions in a timely manner.** Banks now face targets to conclude solutions in 15 and 25 percent of mortgage arrears cases by end December 2013 and March 2014, respectively. Banks’ improving loan workout efforts are reflected in a lower share of short term forbearance in mortgage restructurings. While roughly half of borrowers seeking loan modifications have no arrears or arrears of less than 90 days, banks note that a large portion of borrowers with longer term arrears are not cooperating, even in cases where repossession has been threatened. A recent initiative by one bank to provide free advice from an independent consumer advocate is a welcome step to promote reengagement. Nonetheless, creating a clear expectation among borrowers that repossession is a consequence for a lack of engagement toward resolution also remains important.²⁰

Restructured Mortgages by Type

(Percent of total restructured mortgages on principal dwelling houses)



Sources: CBI; and IMF staff calculations.

¹⁸ The MART framework from March 2013 is described in the staff reports for the [Tenth](#) and [Eleventh](#) Reviews.

¹⁹ Amendments to the CBI’s [guidelines](#) on sustainable mortgage arrears solutions allow a significant change in the payment structure for an extended period—such as concessional interest rates for seven years—and remove constraints on the warehoused portion of split mortgages.

²⁰ In the four years to September 2013, repossessions and voluntary surrenders have totaled 2,384 or just 1.8 percent of all PDH mortgages with arrears over 90 days, which is very low relative to the UK and US.

26. **The authorities are examining the repossession system and procedures to ensure they are efficient and timely and have decided not to proceed with two staff proposals at this time.**²¹ Efficient repossession proceedings encourage borrowers to continue debt service or engage constructively when encountering debt distress. The authorities have therefore instituted an expert group to review by year end the length, predictability, and cost of proceedings, and propose appropriate measures to be brought forward quickly where necessary. A new monitoring system for the case load and processing times of repossession cases is being considered in this context. In the interim, the authorities assessed two options proposed by staff, but they decided to not proceed at this time:

- **Assigning Specialist Judges to also deal with repossession cases.** The authorities' assessment notes synergies with judicial consideration of personal insolvency proposals and the potential to increase judicial capacity to deal with repossessions. But it deems the measure untimely as the case load is still manageable and recourse to repossession may be contained by the comprehensive set of recent reforms to facilitate loan modification.
- **Introducing tight deadlines on plenary proceedings for non-principal private residences.** Under this proposal, procedures would be further streamlined, building on the positive experience with expedited proceedings in the Commercial Court. While such rules could be established under the powers of the court's Rules Committees, the authorities do not deem this measure necessary unless bottlenecks within the courts system are being expected.

27. **Staff considers that intensified efforts are needed to reach the goal of largely completing sustainable solutions for mortgage arrears by end 2014.** In late 2013, the CBI is expected to announce end June 2014 targets, where targets may need to be adapted to allow an increased focus on completions. On the bank side, incentives to offer durable restructurings should be reinforced by introducing rules-based policies on the accounting for provisions, charge-offs, and interest accrual for unstructured loans with prolonged arrears at end 2014. Where a bank falls materially behind targets, more directive supervisory guidance on resolution or outsourcing of workouts may be needed, where staff supports any needed strengthening of CBI powers. Measures to strengthen borrowers' engagement toward sustainable solutions are needed, combining information and incentives. Implementation of measures to be developed by the expert group on repossession is critical and lenders should have in place a strategy to address potential shortfalls from voluntary surrenders of collateral. For cases where a loss of ownership is unavoidable, enhanced support for mortgage to rent solutions would help contain social costs.

28. **The workout of SME arrears is also progressing and staff urges consideration of streamlining procedures for SME examinership.** SME loan restructuring is progressing with the number of loan restructures substantially exceeding cases of legal enforcement. Both banks that dominate SME lending have met their end June and September workout targets set by CBI. The

²¹ For background on enhancing the efficiency of the repossession regime, see Box 4 in the [Ninth Review](#).

CBI remains closely involved in assessing progress and reviewing banks' operational effectiveness in SME loan workouts. To permit small businesses to apply for examinership in Circuit Courts, where legal fees are generally lower, the authorities intend to fast track recently [published amendments](#) to the Companies Bill with the aim to enact them before the end of 2013. This is a welcome step forward, yet further gains could be realized by further streamlining the role of Courts in examinership, drawing on experience with the Insolvency Service for households.

Bank Diagnostics

29. **The BSA has been implemented by the authorities and independently validated yet uncertainties remain, including owing to limited resolution experience in Ireland.** Focused on the three PCAR banks, the BSA analyzed the adequacy of provisions on an IFRS incurred loss basis and the appropriateness of internally generated Basel risk weights, which fed into a point-in-time assessment of capital as of June 2013 (Box 5). As envisaged, the CBI-led exercise engaged private sector contractors in project execution and a consulting firm for oversight and independent validation. EC/ECB/IMF staff were consulted on the methodology and updated on its implementation. The BSA took time to get underway, however, and with the second round of loan file reviews still in progress, the preliminary BSA report provided at end October was not complete. The analysis was completed during November and has been independently validated as having followed an appropriate, conservative and robust process in line with its terms of reference. Nonetheless, such analysis is by its nature subject to uncertainties, which may be more acute in this case given the lack of experience in Ireland with recovery of loan collateral—including as a result of past unintended legal impediments to repossessing residential property—together with risks to the durability of ongoing residential and SME loan modifications, for which there is also limited experience. The authorities will undertake further analysis in close cooperation with the ECB, as the ECB conducts its Comprehensive Assessment.

30. **The BSA finds a significant increase in provisioning is appropriate but this analysis does not imply an immediate need for capital.** The finding that higher provisioning levels are appropriate in some portfolios primarily reflects issues with collateral valuation and lack of seasoning for restructured loans that are now more appropriately classed as impaired, consistent with the May 2013 update of the CBI's [Impairment Provisioning and Disclosure Guidelines](#). At the same time, standardized probabilities of default and recovery values indicate somewhat higher risk weighted assets for some of the banks. Nonetheless, given the higher reported average capital ratio of 14.1 percent as of June 2013, the BSA results do not imply a capital need, with the point-in-time assessment of capital adequacy estimated to remain above the regulatory floor of 10.5 percent on a core tier 1 basis. Nonetheless, these BSA results are on an incurred loss basis, and do not exclude the potential for a capital need to be identified in the forward looking part of the [Comprehensive Assessment](#) being conducted by the ECB in 2014, though some buffer is provided by the 8 percent common equity tier 1 capital floor announced for the AQR.

31. **Banks need to use the BSA results to guide a reallocation of their risk buffers from capital to provisions, which will also encourage more timely loan resolution.** The BSA will inform the CBI's continuing supervisory dialogue with each of the banks on the adequate level of provisioning at year end. Considering the evidence provided by the loan file reviews and

provisioning model reviews that take account of the updated CBI provisioning guidelines, banks will need to consider the BSA results carefully when preparing their end 2013 financial statements, and will be aware that the CBI will also use the BSA results as a benchmark in its annual ex post review of provisioning adequacy. In relation to risk weighted assets, the CBI will issue risk mitigation actions to banks as needed for implementation by end December 2013. The CBI will also draw on the qualitative findings of the BSA to guide its supervisory focus.

32. **The needed strengthening in bank profitability is sensitive to the macroeconomic outlook, including any recovery in credit demand.** The CBI completed its review of bank operating profits at end September (structural benchmark).²² Both BoI and AIB show steady improvements in net operating income, whereas PTSB is not expected to achieve positive net operating income until 2014 and positive net income after provisioning expenses until two years later. The analysis highlighted the sensitivity of the improvement in bank profitability to prospects for new business volume, repricing of loans, and funding costs—each of which will depend on the macroeconomic environment and progress in balance sheet repair. A key weakness in the analysis owing to banks' data deficiencies is the failure to assess revenue contributions from nonperforming, modified, and forbore loans, as the banks continue to accrue and capitalize an unspecified amount of interest income that is not actually paid.

33. **The review of options to fund tracker mortgages at a lower cost identified significant implementation challenges.** In aggregate the PCAR banks hold €48 billion in tracker mortgages in Ireland and a further €21 billion in the UK, with an average margin of 100 basis points over the policy rates of the ECB and Bank of England respectively. Declines in these policy rates had outpaced reductions in bank funding costs, resulting in a significant cost of carry for tracker mortgages, although the profitability drag has eased somewhat with recent declines in deposit and market funding rates. Further technical analysis by the authorities of options to lower these funding costs explored the potential to pool loans indexed to policy rates into government-guaranteed asset backed security structures for repurchase with various counterparties. The analysis suggested that maximizing net income benefits would require the inclusion all of these assets in the repurchase structure. However, attracting funding from private counterparties at sufficiently low rates will be challenging.

34. **PTSB still needs external support to become a sustainable source of lending in support of Ireland's recovery.** PTSB is projected to run persistent losses until 2017 owing to high NPLs and tracker mortgages exceeding half of total assets. With assets of €38 billion or 23 percent of GDP, and a heavy market discount on its loan book, resolution would have a large fiscal cost. Accordingly, PTSB's restructuring plan, yet to be approved by the European Commission, envisages a split—in anticipation of which the bank has been internally separated into a core retail banking and an asset workout unit and a non-core unit. Executing this planned legal separation requires an affordable funding solution for the workout operation. European

²² The analysis does not reflect the Budget 2014 levy on banks—both domestic and foreign owned—which is expected to total some €150 million annually.

support could take the form of official funding or guarantees to facilitate low cost market funding—both of which would hasten the bank’s return to profitability, thereby enabling it to rebuild its market position and eventually attract private investor interest.

C. Structural Reforms

35. **The authorities are advancing steps to combat high unemployment and staff continued to urge stronger engagement with the long-term unemployed:**

- ***To enhance employment services the authorities are rolling out Intreo offices, redeploying staff, and tendering for private sector providers.*** Some 43 Intreo offices providing integrated employment services will be opened by end 2013, in line with the target set by the [Pathways to Work](#) plan. Of the doubling in front-line case officers, all have been identified and about half have been reassigned, in line for reaching the target of 300 staff redeployed by year end. Preparations have continued for the tender for private sector employment service providers expected in early December, with it envisaged that payments for activation services for the long-term unemployed will be outcome-based. However, initial targets for one-on-one engagement with job-seekers for Q3 were slightly missed, and staff urged more ambitious targets for individual and group engagement with jobseekers.
- ***Staff welcomed the strategic priorities set out by the review of Further Education and Training policies and emphasized the need for timely implementation.*** Better aligning training services provided with the needs of prospective employers will improve benefits for the long-term unemployed. This requires (i) better local labor market intelligence and data collection; (ii) more systematic involvement of private sector parties in the design and delivery of the training program; and (iii) more flexible provision of shorter duration work placements and on the job training involving private sector providers. The review also emphasized the need to strengthen the strategic cooperation between SOLAS, local Education and Training Boards and local Intreo offices.
- ***Sanctions for uncooperative jobseekers have been reviewed but their application should be strengthened.*** Legislation enacted in July 2013 extended the form of sanctions and the range of circumstances in which sanctions could be applied, allowing social payments to be reduced incrementally for job seekers failing to engage with activation activities. Following an increase in the number of sanctions, attendance at group and individual engagements had increased. Nonetheless, staff noted that the number of penalties applied overall remained small and encouraged more effective steps to maximize jobseekers engagement.

36. **Preparations for the disposal of up to €3 billion in state assets are proceeding yet an initial transaction was not concluded.** The sale process for Bord Gáis Energy attracted significant interest from a broad range of potential international acquirers. However, the authorities determined that none of the final bids received were at an acceptable value, noting that current conditions in the power and commodity markets were not favorable. The authorities indicate that they will continue developing the Bord Gáis Energy business and will review options for its future. EBS has sold its 50 percent stake in a UK-based company and the sale of its stake in a Spanish company is expected in early 2014. The growth enhancing projects to be funded with up to half of the resulting sales proceeds via public-private partnerships are under preparation,

with 6 out of the 9 projects announced due to be tendered in the coming months. The €150 million in budget resources assigned to these investments will be spent on road construction, school buildings and retrofitting of public buildings.

37. **Initiatives to improve the financing conditions for the SME sector are being rolled out.** In anticipation of the establishment of the Ireland Strategic Investment Fund, the National Pension Reserve Fund has committed, in partnership with private sector players, up to €950 million in investments dedicated to providing equity financing and new lending to SMEs. A large number of potential transactions are at various stages of underwriting. Separately, the [Credit Review Office](#) will now be able to review loan applications rejected by banks for amounts up to €3 million rather than €0.5 million.

PROGRAM MODALITIES AND FINANCING

38. **All end September quantitative performance criteria were met but performance related to the structural benchmarks was mixed** (Tables 11–13). The January–September exchequer primary deficit of €2.3 billion was well within the adjusted target of €3.7 billion.²³ The indicative target on the stock of central government net debt was also met with a margin. The end September benchmark on conducting a forward-looking analysis of PCAR banks' operating profits was partially observed due to a significant shortfall in relation to the analysis of revenue contributions from nonperforming, modified, and forbore loans owing to weaknesses in banks' information systems. The authorities published Budget 2014 by October 15 in line with the corresponding structural benchmark. A preliminary BSA of the PCAR banks was provided at end October, although it was not complete, but the structural benchmark was observed by late November.

39. **The significant volume of funding activity earlier this year helped build a sizeable cash buffer and Ireland remains comfortably financed through 2014.** Syndicated bond sales in January and March totaled €7.5 billion and the disposal of Irish Life and BoI contingent capital notes generated a further €2.3 billion. End-year cash buffers are projected at some €20 billion, covering more than 12 months of prospective financing needs. In light of the NTMA's relatively strong cash position, in October the authorities decided to suspend monthly Treasury bill auctions for the remainder of 2013 and to defer consideration of any further bond issuance until 2014. Looking ahead, the authorities indicate long-term bond issuance in 2014 of €6–10 billion taking into account an exchequer funding need of about €9½ billion, while the cash buffer could be partially drawn down, especially to meet a €6.9 billion bond redemption in January 2014.

40. **Recognizing the significant challenges remaining, the authorities are preparing a Medium Term Economic Strategy (MTES) for 2014–20.** The MTES is intended to provide a robust framework to ensure that policy efforts are consistent and are aligned in a manner that

²³ Adjustments reflected the underperformance of revenues, ELG payments related to the Promissory Notes transaction, and proceeds from the sale of BoI contingent convertible notes and Irish Life.

will provide financial market stability and also underpin consumer and business confidence for investment. The strategy will focus on three pillars: macro-fiscal, structural, and financing. A macro-fiscal pillar will analyze possible economic policy measures and the conduct of fiscal policy under SGP requirements, and within these constraints consider how revenue and expenditure policies can best promote economic growth. The structural pillar will focus on raising potential growth, including through policies in relation to industry/innovation, labor markets including the long-term unemployed, education and skills, competition and taxation. A sectoral element will address growth impediments and provide a framework within which existing sectoral strategies operate. Broad consultation on the MTES is ongoing with a view to completing it before the end of 2013. As a strategy of the government, the MTES is expected to be monitored and reported to the government over time.

41. **After wide consultation, the Irish authorities have decided to not seek a financing backstop after the expiry of their current EU-IMF arrangements.** Given uncertainties remaining for Irish and European prospects, and in the global economy more broadly, staff noted that such a backstop could cushion financing against a range of potential risks in the immediate post-program period. While recognizing these potential insurance benefits, the authorities also took note of their strong cash buffer and reasonable terms for market access, their reduced financing needs owing to the extension of EFSF/EFSM loan maturities and the Promissory Notes transaction, and their intention to signal their commitment to steadfastly address remaining challenges through their MTES. On balance, the authorities consider that this combination of safeguards will ensure a durable return to market financing, but they also take comfort from the evolution of the European framework in recent years including the establishment of the ESM.

42. **Though subject to significant risks, the exceptional access criteria continue to be met:**

- **Debt sustainability and the systemic risk exception.** Under the baseline macroeconomic framework, debt sustainability is expected to be maintained over the medium term, although it continues to be subject to significant risks if growth does not strengthen as anticipated or if further contingent liabilities materialize. Crucially, this relies on ongoing steadfast policy implementation, along with European policymakers' delivering on their commitments to reduce strains in countries facing stress and ensure financial stability in the euro area. As debt sustainability is not assured with a high probability, the program continues to be justified on the basis of the systemic international spillover risks posed by Ireland. Given Ireland's strong financial and

Correlation of 10-year Yields of Ireland with Other Countries
(Three-month moving average of 7-day correlation)



Sources: Bloomberg; and IMF staff calculations.

trade interlinkages, most notably with the euro area and UK, the risk of significant potential spillovers should Ireland face financing pressures remains, especially as Ireland is perceived in markets as having performed well under its EU-IMF supported program. Such spillover risks would be heightened in period of international financial volatility, when linkages for spillovers can strengthen—this was evident most recently during the period of uncertainty around tapering by the US Federal Reserve.

- **Adequate prospects to retain and expand market access.** In view of Ireland’s strong program performance and commitments and its regained market access, there are adequate prospects to retain and expand access to private capital markets within the timeframe over which Fund resources will remain outstanding, yet this access remains at some risk over time:
 - **On a range of indicators Ireland currently has gained solid market access.** Since mid 2012, Ireland has issued debt ranging from Treasury bills to bonds at 5 year, 8 year, and 10 year maturities, and has also sold longer-term amortizing bonds designed for the domestic pensions industry. The 10 year benchmark issue on March 13, 2013 raised €5 billion on the back of total bids of €13 billion from about 400 investors, the majority of whom were European, especially UK, German, Nordic and French, with further uptake by Irish residents and US investors. Investors included fund managers, banks, pension funds, and insurance companies. Ireland enjoys yields significantly below those of Italy and Spain which have strong market access.
 - **Market access is expected to be retained, subject to risks linked to the fragility of debt sustainability.** The volume of market financing needed appears manageable in 2014–15, and while these requirements increase from 2016 onward they are still not a major share of the debt stock. It appears reasonable to expect Ireland to retain market access in the baseline scenario of declining debt ratios, while recognizing that the risks to debt sustainability from growth and contingent liabilities also imply risks to market access. In particular, there is a risk of inadequate European support for potential remaining challenges in Ireland’s financial sector during the ECB’s Comprehensive Assessment in 2014, despite the availability of the ESM direct recapitalization instrument under the November 15 ECOFIN Council statement, which would weaken the assurances of adequate and durable market access given Ireland’s public debt vulnerabilities.
- **Sound policies.** Ireland’s policy program is sound and adjustment is being delivered, providing reasonable prospects for success. More effective policy action and delivery on commitments at the European level is needed to strengthen prospects for success.

STAFF APPRAISAL

43. **Steadfast policy implementation has been maintained through the final review of Ireland’s program and signs of nascent recovery are emerging.** The first half of the year was characterized by mixed signals, with weak GDP figures partly related to the “patent cliff” affecting pharmaceutical exports occurring alongside significant growth in private sector employment.

More recently a range of indicators signal that Ireland is completing its EU-IMF supported program with the potential for a more sustained recovery.

44. **Significant risks to Ireland's growth prospects and to debt sustainability remain nonetheless, requiring concerted policy implementation progress.** Setbacks to the recoveries in major trading partners would hurt exports, with adverse effects on confidence and domestic demand. Sustaining a recovery into the medium term will increasingly depend on a revival of lending to households and SMEs, which would be at risk if banks fail to address high nonperforming loans and weak profitability. High nonperforming loans imply that contingent liabilities in the financial sector remain a risk to debt sustainability and these risks rise in an environment of weak growth owing to declining loan performance and collateral values. Accordingly, as recognized by the authorities' ongoing preparation of a Medium Term Economic Strategy, Ireland must maintain determined efforts to address its high public debt and deficit levels, heavy private sector debt burdens, financial sector repair needs, and substantial long-term unemployment before it can be judged to have fully recovered from the crisis.

45. **Steady fiscal consolidation, which has been a hallmark of the program and key to restoring Ireland's policy credibility, needs to continue.** Budget execution has once more been solid in 2013, including the smooth introduction of the local property tax and the social cohesion demonstrated by reaching the Haddington Road agreement on public sector pay and pensions. Budget 2014 sets out a path with a balanced pace of adjustment in coming years that is expected to put public debt on a declining trajectory, though subject to risks from growth prospects and contingent liabilities. Continued sound implementation of fiscal consolidation will be especially critical after the completion of the program. Looking to the medium term, the further consolidation needed should be centered on reforms of health, education, and social protection spending that realize durable savings while protecting core services and the most vulnerable. Revenue increases should focus on broadening the tax base.

46. **Intensified efforts are needed to reach the goal of largely completing sustainable solutions for mortgage arrears by end 2014.** Although the rise in mortgage arrears appears to be slowing, the stock of distressed mortgages remains unacceptably high. The initiation of operations by the Insolvency Service is a welcome step to create new resolution options and establish useful precedents for solutions. Banks report they are meeting CBI targets for proposing solutions, yet there are concerns that a portion will not prove sustainable. Moreover, after a prolonged period of forbearance, restarting the engagement between banks and borrowers needed to conclude solutions is proving difficult. Making progress will involve both providing supervisory guidance to ensure that banks adjust their solutions to address household's circumstances in a lasting manner, while also providing households and buy-to-let investors with appropriate information and incentives to engage. In particular, timely and predictable repossession procedures are needed to help promote engagement on loan modifications and also help ensure that such modifications can provide lasting resolution at manageable cost. For cases where retaining ownership is not sustainable, enhanced support to facilitate mortgage to rent and other solutions that contain social costs is appropriate.

47. **The quantitative and qualitative findings of the bank BSA should inform the CBI's supervisory work and banks' preparations for the ECB's upcoming Comprehensive Assessment.**

The Balance Sheet Assessment independently assessed loan classification, quantified incurred loan losses, and reviewed risk weights. It is vital that the CBI ensures that banks increase provisioning for some portfolios in line with the findings of the assessment, which will also improve incentives for loan workout. Nonetheless, uncertainties remain, including owing to the limited experience with loan resolution in Ireland and also with respect to the potential findings of a forward-looking assessment of profitability and loan losses. Given Ireland's still fragile debt sustainability, an ESM direct recapitalization backstop to the ECB's Comprehensive Assessment would be desirable to protect market confidence and financial stability.

48. **Reviving lending in coming years remains important to sustain a recovery in domestic demand, where external support could play a critical role.**

Encouragingly, the two larger domestic banks appear to be returning to the profitability needed to support lending, although risks remain to their profitability prospects. However, PTSB is not expected to break even after provisioning expenses until 2017 given its heavy exposure to tracker mortgages, limiting its potential to rebuild its market position and attract private investment. With other banking systems in the euro area also facing challenges that hinder credit expansion, a European solution to better align bank funding costs with official interest rates would facilitate recovery in the euro area as well as Ireland.

49. **Reducing high unemployment must remain an overarching policy priority.**

Initiatives to promote credit to SMEs, with the support of European partners, are positive for investment and job creation. Yet it is also important to ensure SMEs are creditworthy through banks completing resolution of SME loans in arrears and also by facilitating SME restructuring where needed, including by considering further streamlining the role of courts in SME examinership. Efforts to strengthen employment services for jobseekers should continue in order to achieve adequate engagement, with further redeployment of staff needed in addition to bringing in private sector providers. Timely initiatives to achieve the strategic priorities set out in the review of Further Education and Training are critical to better align training with the needs of the economy and especially to ensure the long-term unemployed gain skills enabling them to return to work.

50. **On the basis of the progress made under Ireland's program, staff supports the authorities' request for completion of the twelfth review.**

Staff also recommends that Ireland be brought back to the standard 12-month consultation cycle for Article IV consultations upon expiration of the Extended Arrangement. In accordance with Executive Board Decision No. 14747(10/96), Ireland shall be placed on a 12-month consultation cycle because it currently has an outstanding Fund credit exceeding 200 percent of quota. In light of the amount of the outstanding credit, and given that the authorities have decided not to request a successor arrangement from the Fund, the Managing Director also recommends the initiation of post-program monitoring.

Box 1. The Impact of the “Patent Cliff” Revisited

Ireland is a leading exporter of pharmaceutical products and the sector accounts for a quarter of total exports. Nine out of the top ten pharmaceutical companies are located in Ireland, and seven of ten blockbusters (global benchmark products generating annual sales over 1 billion) were [produced in Ireland in 2011](#).

The global pharmaceutical industry had an exceptional year for patent expiry in 2012. [Accenture](#) evaluated the impact of patent expiry in terms of global lost sales at US\$38 billion in 2012 compared with around US\$20 billion per annum thereafter, highlighting 2012 as an exceptional year relative to a yearly run-off in the US\$10-20 billion range.

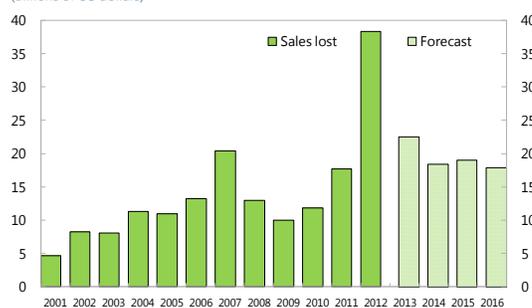
Ireland’s pharmaceutical exports have registered a significant contraction since mid-2012 as a set of blockbuster drugs manufactured locally went off patent. This “patent cliff” resulted in a 6.7 percent y/y contraction of pharmaceutical exports in value over the first nine months of 2012. While some slowdown in contraction was visible in H1 2013, the year-on-year decline resumed again in value terms in Q3 2013.

Uncertainty remains as to the overall economic impact of these developments. Preliminary analysis suggested that the impact on net trade should be dampened by the high import content of blockbuster drugs (in the form of royalties paid to the mother company as well as other chemical imports for intermediate consumption), and by the comparatively small contribution of the sector to total employment in Ireland. More recent analysis by [Department of Finance](#) staff provides illustrative simulations based on the overall estimation of the remaining impact of patent expiry for the industry. In case pharmaceutical exports decline 4 percent annually through 2014, they estimate a cumulative GDP loss of 2 percent over 5 years, while if the pace of decline is 8 percent annually, the cumulative GDP loss is 4 percent.

Moreover, the national accounts impacts are affected by firm’s accounting models. Research by [ESRI](#) illustrates how the national accounts impacts are affected by whether pharmaceutical firms booking their profits locally versus making royalty payments to their multinational parent. When the patent expiry impacts royalty payments, the offsetting changes in exports and imports yield little net effect on GDP. When profits are booked locally the patent expiry reduces exports, net trade, and GDP but the fall in profit outflows dampens the impact on GNP and the current account. Irrespective of the accounting treatment used patent expiries are unlikely to have a large effect on GNP, as the sector is dominated by foreign-owned companies.

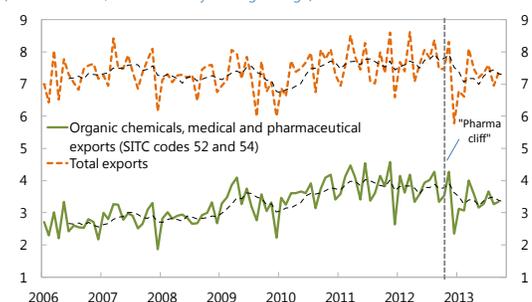
Although patent expiry is a drag on prospects for the pharmaceutical sector, investments in new areas signal opportunities for expansion. Ireland’s competitiveness in the sector is underpinned by a stable regulatory environment, strong human capital and efforts made to improve the investment climate, notably for R&D. Irish based subsidiaries are being gradually refocused towards higher-value “niche” products like biopharmaceuticals, where Ireland already has 10 large scale biopharmaceutical facilities. Biopharmaceuticals, though more R&D intensive, have shorter development and testing cycles, and in some cases faster regulatory approval. Investment plans total €2 billion over the next three years after €1 billion over the last three years. The industry expects these “nichebusters” (for global sales between US\$½-1 billion) should help improve pharmaceutical company business models in the long run through a more diversified supply of drugs, and a lesser reliance on blockbuster revenues.

Global Pharmaceutical Sales Lost Due to Patent Expiry
(Billions of US dollars)



Source: Accenture.

Monthly Pharmaceutical Exports and Total Exports
(Billions of euros, with 6-monthly moving average)



Sources: CSO; and Haver Analytics.

Box 2. Mortgage Arrears Resolution and Consumption

In considering the implications of mortgage loan restructuring for household consumption, it is important to distinguish the effects of high household debt from those of arrears. In Ireland, many households are highly indebted and are saving to reduce their debts, which has a first order impact on aggregate consumption. The vast majority of these households will not have access to any form of resolution as their adjustment in living standards is sustainable. Resolution efforts affect about 6 percent of households in arrears and possibly some other households in distress that are not yet in arrears, but—consistent with the slowing in new arrears cases—these are not expected to be substantial relative to the stock already in arrears.

The net direct impact of mortgage restructuring depends on the status of the households affected, especially whether they are already receiving forbearance:

- **Relief of debt overhang.** For households making significant payments under strain a restructuring that reduces due debt service in line with affordability may reduce uncertainties and raise consumption. [CBI analysis](#) suggests that households with debt problems spend 18 percent less on consumption controlling for other characteristics, though there is the possibility that this finding is driven by unobserved factors.
- **Unwinding of forbearance.** Widespread forbearance, including temporary restructures, helped some households to smooth consumption at a time when incomes were falling sharply.¹ Converting households back into paying borrowers according to a sustainable debt service schedule could reduce income available to consume, even where the total debt being serviced is cut significantly.

Estimates suggest that the aggregate near term direct impact on consumption is likely to be small.

A rough estimate of the impact of the flow of arrears plus debt service savings provided by temporary restructures is €1.2 billion (1½ percent of consumption). The portion of this forbearance that would be expected to be paid under sustainable loan terms is difficult to estimate, but even if it were as high as one-third or one-half, the drag on consumption would not be large, and would be counter balanced to some extent by other households in distress receiving some debt relief.

In the medium term, any direct impact from loan resolution on consumption is expected to be outweighed by second round benefits from reducing uncertainties for borrowers and lenders:

- **Resolving household NPLs could improve confidence in banks' balance sheets.** The extent and the depth of mortgage arrears—one third of defaulted loans have not been serviced for two years or longer—in part explains banks' less favorable funding conditions, as reflected in the pricing of covered bond issues and the high degree of over collateralization required. Durably reducing mortgage NPLs could improve market confidence in the quality of banks' loan books, in turn reducing market funding cost and making a restart of bank lending a profitable proposition.
- **Reducing non performing mortgage loans could also support housing demand.** While repossessions may add to housing supply over time, resolving unsustainable mortgage loans could reduce concerns about a large "shadow inventory" from underwater mortgages that deters potential buyers. As three-quarters of Irish households own their homes, reduced uncertainty around the value of these assets could support consumption by reducing precautionary saving.

¹ The [CBI](#) reports that for distressed borrowers, debt service represents a remarkably small portion of current income for a relatively high fraction of borrowers, with available income after living expenditures sufficient to meet all debt service in 17 percent of distressed households.

Box 3. Fiscal Measures in Budget 2014

Achieving the 2014 deficit target entails the implementation of €2.7 billion in total consolidation.

This includes €1.2 billion in new measures, €1.3 billion in carryovers from policies implemented in previous years (most notably the additional yield in 2014 from the local property tax and the reduction in the standard fund threshold for pensions, together with additional savings from the Haddington Road Agreement), and €0.2 billion in the form of higher dividends from state-owned enterprises. Two-thirds of the total consolidation effort will fall on spending.

Revenue measures include both the broadening of the tax base and rate increases. However, some of the proceeds will be offset by the retention of the reduced VAT rate in labor intensive services mainly in tourism of 9 percent that was to expire at end-2013 (0.2 percent of GDP). The package also includes measures to stimulate the economy through tax relief targeted at the tourism, agri-food, construction and property sectors and startups. The cost of these measures is expected to be modest based on preliminary estimates, with the impact mostly felt in 2015. Base broadening steps include: (i) the introduction of a levy on financial institutions, while removing the restriction on the use of deferred tax assets for losses on assets transferred to NAMA; (ii) making the tax credit for single parents available only to the principal carer of the child; and (iii) restricting the tax relief for medical insurance. Rate increases include: (i) the introduction of an additional pension fund levy of 0.15 percent for 2014 and 2015; (ii) raising rates on the deposit income retention tax to 41 percent; and (iii) increasing excise duties on tobacco and alcohol.

Savings from New Revenue Measures in Budget 2014

	€ million	Base	Rate
Income tax	216		
One-parent family tax credit	18	↑	
Medical Insurance tax relief	94	↑	
Deposit income retention tax	105		↑
Stamp duties	285		
Bank levy	150	↑	
Pension levy	135		↑
VAT	-313		
Retention of 9 percent reduced VAT rate	-290	↓	
Other	-23		↓
Excise duties	132		
Air travel tax	-28		↓
Alcohol and tobacco	161		↑
Other	29		
Total	350		

The package for current expenditure collects a range of measures, mainly in health and social protection. Savings in the health sector (€0.4 billion excluding pay-related savings) are to be achieved through a reduction in drug costs, the enforcement of medical card eligibility requirements, and an increase in prescription charges, among others. While protecting basic social welfare rates, measures in social protection (€0.3 billion) include the elimination of certain schemes (telephone allowance, bereavement grant, and mortgage interest supplement for new applicants) and the reduction of some benefits (maternity benefits maximum rate, jobseeker's allowance for certain recipients aged 22-25, and illness benefit). To support service delivery, additional staffing will be recruited for schools, hospitals and front-line services, but the wage bill is expected to remain within its envelope.

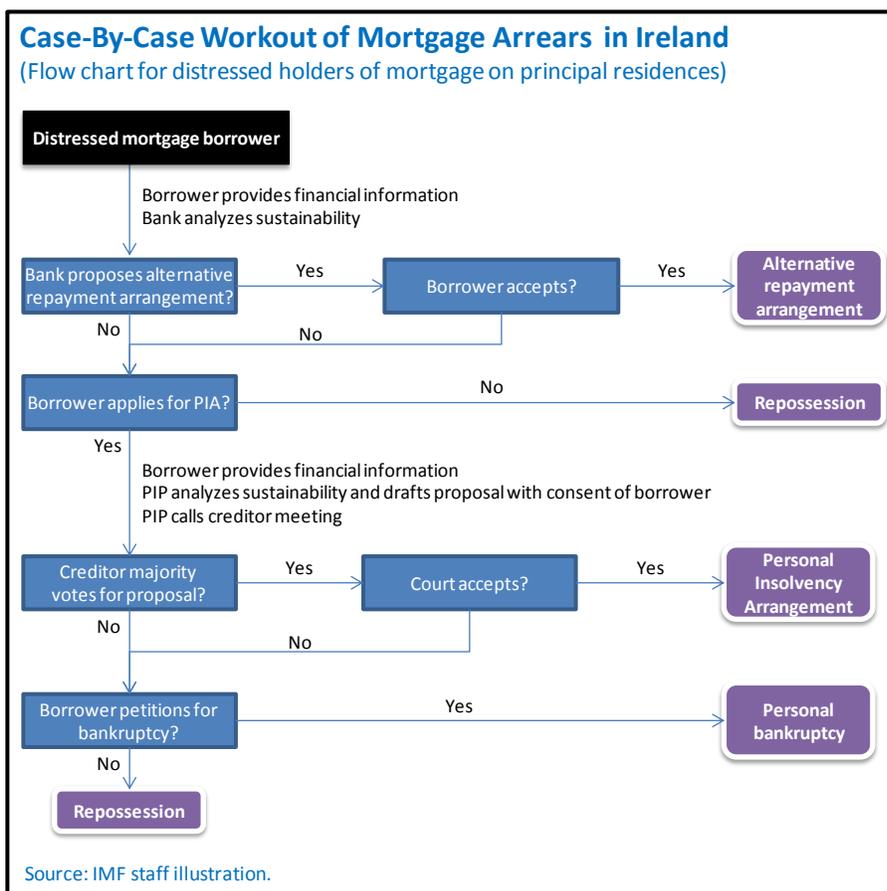
Along with the budget, a [new international tax strategy](#) was published. The government's strategy will be to remain active and supportive of the work of the EU and OECD on international tax matters. In addition, changes are to be implemented to ensure that Irish registered companies cannot be "stateless" in terms of their tax residency. The authorities estimate that a limited number of companies have made use of this loophole, so they do not expect any direct budget impact.

Box 4. Case-by-Case Restructuring of Mortgage Loans in Ireland

Resolving distressed mortgage debts is guided by a two-step approach to facilitate case-by-case loan modifications before banks can pursue a change in ownership. Borrowers in mortgage distress on personal dwelling homes are protected by the CBI's [Code of Conduct on Mortgage Arrears](#) (CCMA), which sets out a clear process towards a bilateral arrangement to address debt servicing difficulties between borrowers and lenders. If the bilateral approach does not succeed, borrowers can apply for a Personal Insolvency Arrangement (PIA) to settle secured debt of up to €3 million. In case neither leads to an acceptable solution or the borrower is uncooperative, lenders can pursue a change in ownership, including repossession. For mortgages on buy-to-let properties, lenders can appoint rent receivers to re-direct rental payments to lenders or pursue repossession.

The terms of loan restructurings are determined by households' current debt servicing capacity after applying ceilings on common expenditure categories. The Insolvency Service Ireland (ISI) has issued detailed [guidelines](#) for reasonable household expenditures which provide ceilings for typical spending categories conditional on borrowers' circumstances during the five-to-six year duration of the Arrangement. Banks apply similar internal guidance for determining the terms for bilateral arrangements.

Repossession or a voluntary change in ownership remain as last resort. Given limited scope for schemes such as mortgage-to-rent, which converts repossessed residences into social housing, repossession or voluntary sales remain as last resort to unsustainable borrowers. The full recourse nature of mortgage loans means that banks can collect any shortfall between outstanding loan amount and collateral value. In this case, borrowers can apply for a debt settlement for unsecured debt under the new personal insolvency framework, or avail of personal bankruptcy with a charge off period of three years.



Box 5. Balance Sheet Assessment Methodology

In the second half of 2013 the Central Bank of Ireland undertook a BSA of the three PCAR banks.

The exercise assessed the capital adequacy of the banks as of June 30, 2013 on a point-in-time basis, in preparation for the [Comprehensive Assessment](#) for the SSM in 2014. To this end, the CBI analyzed banks' loan classification, provisioning, and risk weighted assets and calculated new point-in-time capital ratio. To augment its in-house capacity, the CBI contracted independent consultants to perform loan file reviews and provisioning analysis while a separate independent third party was tasked with guiding the project and validating the exercise as a whole. The main areas of work were:

- **Loan file reviews.** Combined with tests of data integrity, a two-phased testing of loan files was conducted. It aimed to assess whether banks correctly classify loans by risk characteristics and whether provisions are consistent with IFRS and the CBI's [Impairment Provisioning and Disclosure Guidelines](#) as amended at end May 2013. The first phase of reviews covered about 3,500 loan files, including 1,800 residential mortgages and 1,650 commercial connections (commercial real estate, corporate, and SME loans). Issues identified in the first phase guided a second phase of examining 850 additional loans. Both the Irish and the UK loans were included, and the biggest loans within cohorts were examined separately. On average, 93 percent of total loans and receivables are within the scope of the exercise through extrapolation, with only small and highly provisioned portfolios excluded.
- **Provision estimation.** Using cohorts identified for the loan file review purposes, estimation of any point-in-time provisioning shortfall was performed based on a two part process that considered (i) review of models that determine provisions for collectively assessed loans (e.g., for mortgages); and (ii) sample and extrapolation of reassessed provisioning for individually assessed loans (e.g., the commercial loans).
 - **Collectively assessed loans.** Independent consultants reviewed banks' collective provisioning models and also developed their own independent frameworks for benchmarking purposes. Such benchmarking used a range of parameter sets including (i) the parameters in the banks models; (ii) common parameters set across banks (emergence period, house price index and peak-to-trough fall, fire-sale discounts, time to work-out, total work-out costs, cure rates) while keeping default probabilities bank-specific. These were compared with banks' own provisioning estimates, accounting for any revisions due to misclassifications and the transition process to full compliance with the CBI provisioning and disclosure guidelines (due at end December). Sensitivity analysis was also performed to determine impact of changes in model parameters.
 - **Individually assessed loans.** The independent consultants determined differences between their assessment of provisioning and those of the bank for each loan in a sample of individually reviewed loans. Taking into account outliers, the sample results were subsequently extrapolated to the rest of each cohort.
- **A review of risk weights and risk weighted assets.** The CBI reviewed the appropriateness of banks' risk weighted asset (RWA) calculations based on the Internal Risk Based models for regulatory capital purposes, including key model inputs like Probability of Default or Loss Given Default and other assumptions. The aim of the exercise was to extrapolate changes in risk classification from the review of asset quality to estimate the overall impact on RWAs. Sensitivity analysis with respect to main parameters was also performed.

The results of the review of loan file classification, provisioning, and risk weighted assets were combined to produce a point-in-time capital assessment of each of the three PCAR banks.

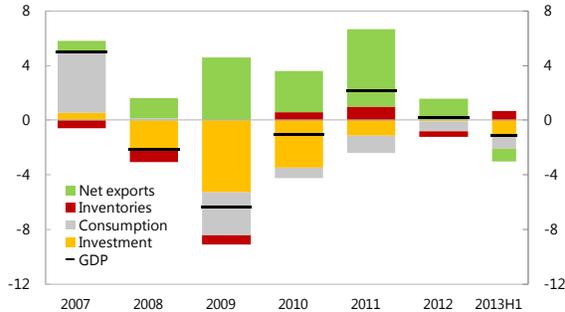
Figure 1. Ireland: Real Sector and Inflation Indicators, 2006–13

Net exports became a drag on growth as the “patent cliff” impacted pharmaceutical exports...

...but high frequency indicators suggest stronger domestic demand with consumer sentiment at its highest level since mid 2007.

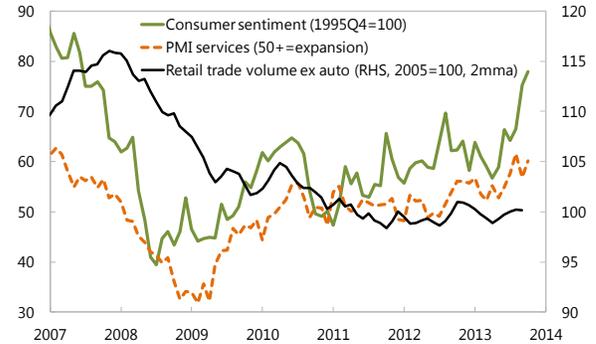
Contributions to Real GDP Growth

(Percent y/y)



Sources: CSO; and IMF staff calculations.

Retail Trade and Sentiment Indicators

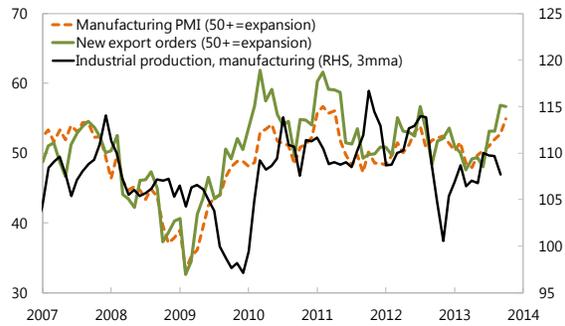


Sources: ESRI; NCB Stockbrokers/Markit; CSO; and Haver Analytics.

Export orders are strong and the manufacturing PMI is now firmly into expansion territory.

The current account surplus remained strong in H1 as net exports outweighed income outflows.

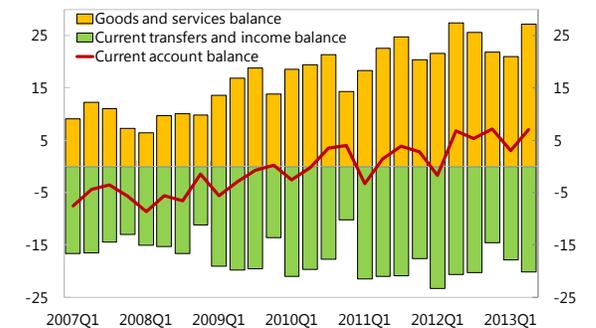
Export Indicators and Industrial Production



Sources: CSO; NCB; and Haver Analytics.

Current Account Balance Composition

(Percent of nominal GDP)



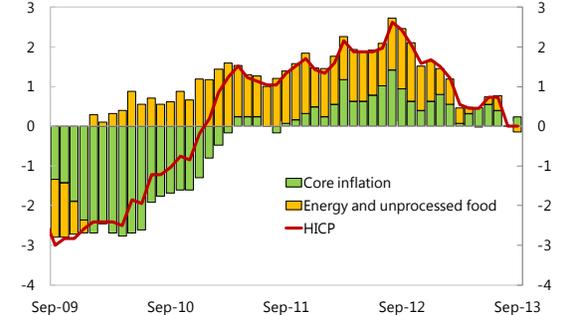
Sources: CSO; and Haver Analytics.

Inflation was absent during August-October owing to falling goods prices possibly due to euro appreciation.

Unemployment eased to 13.7 percent in Q2, with youth unemployment increasing towards 29.6 percent.

Contribution to Annual HICP Inflation

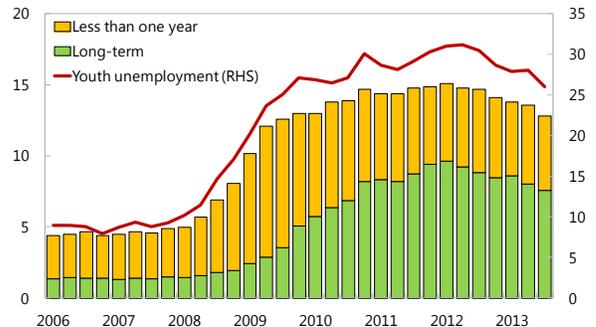
(Percentage points)



Sources: CSO; and IMF staff calculations.

Unemployment Rates

(Percent, s.a.)



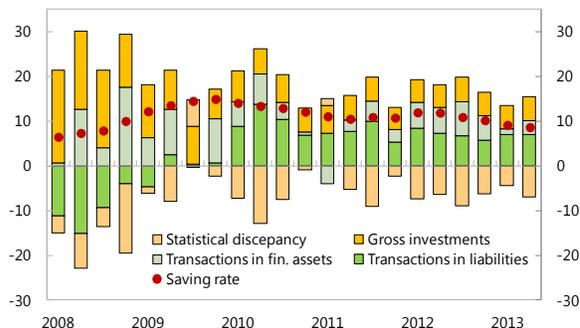
Sources: CSO; and Haver Analytics; and IMF staff calculations.

Figure 2. Ireland: Household Finance and Housing Developments, 2003–12

Household savings remain elevated, with three-quarters of savings devoted to debt reduction since 2010...

Decomposition of Household Savings

(Percent of Gross disposable income)

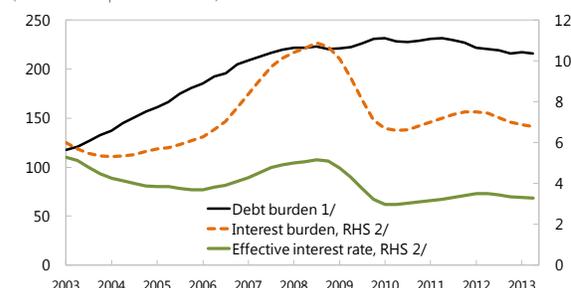


Sources: CBI; Eurostat; Haver Analytics; and IMF staff calculations.

...but household balance sheets remain burdened with high debt, although interest payments are low.

Household Debt and Interest Payments

(Percent of disposable income)



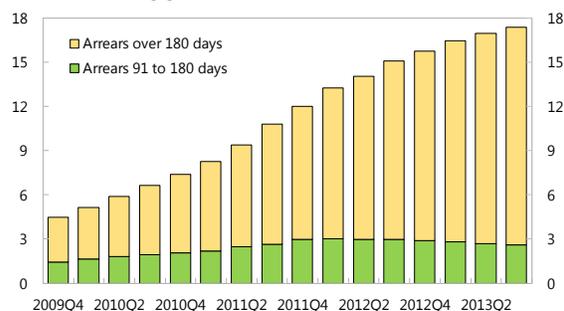
Sources: CBI; Haver Analytics; and IMF staff calculations.

1/ Total household liabilities in percent of four-quarter gross disposable income.
2/ Four quarter interest payments (excluding FISIM adjustment) in percent of four-quarter gross disposable income or previous quarter's total household liabilities, respectively.

Mortgage arrears continue to increase, although the flow of new arrears is abating.

Mortgages in Arrears on Primary Dwellings

(Percent of total mortgage value)

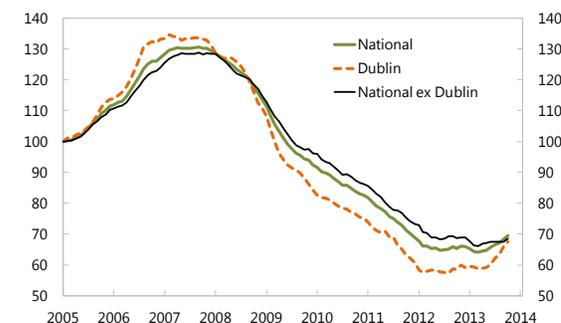


Source: Central Bank of Ireland.

Nationwide property prices are rising driven primarily by strong gains in the Dublin market while prices in the rest of the country have been edging up since March.

Residential Property Prices

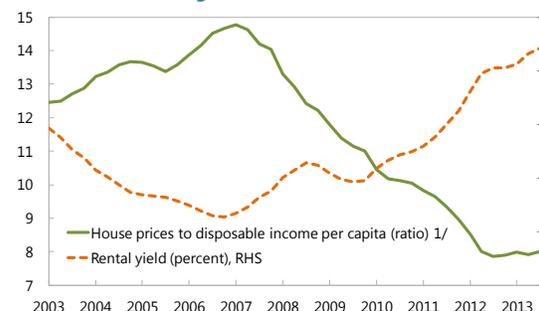
(2005M1=100)



Sources: CSO; and Haver Analytics.

Rental yields stand at their highest level in ten years, suggesting favorable housing valuation.

Indicators of Housing Valuation Levels



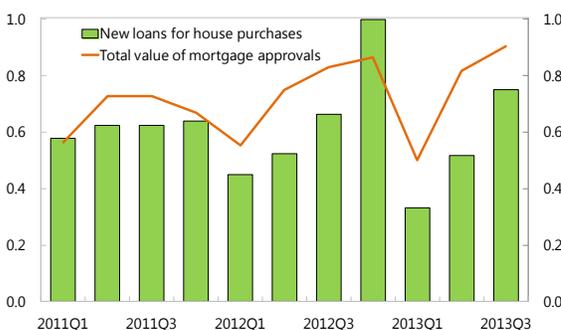
Sources: PTSB/ESRI; CSO; and Haver Analytics.

1/ Average house prices divided by moving 4-quarter adjusted GDI per capita.

New mortgage lending rose in Q3 to be up 12.5 percent y/y. (The expiry of mortgage interest tax relief at end 2012 affects data for late 2012 and early 2013).

Housing Loans and Mortgage Approvals

(Billions of euros)

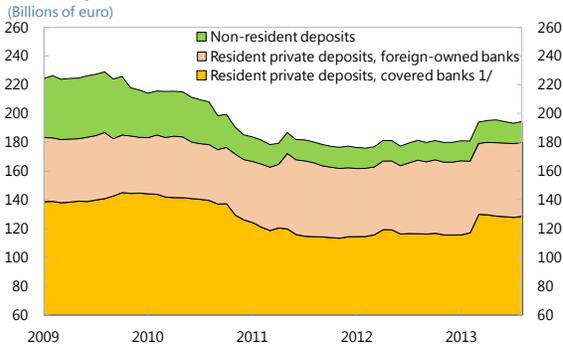


Source: Irish Banking Federation.

Figure 3. Ireland: Credit Developments, 2003–13

The level of private sector deposits has stabilized...

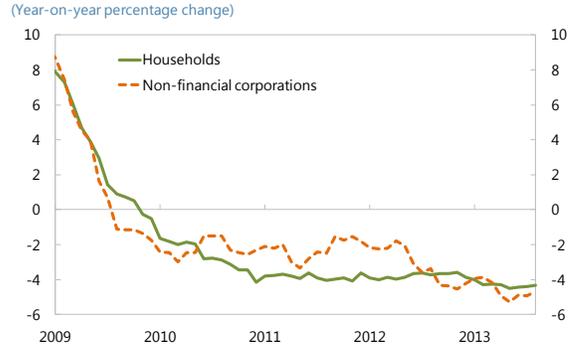
Bank Deposits



Source: Central Bank of Ireland.
1/ Credit institutions covered by the Irish Government Eligible Liabilities Guarantee Scheme.

...but deleveraging continues and credit to households and corporations continue to contract at a 4 percent y/y rate.

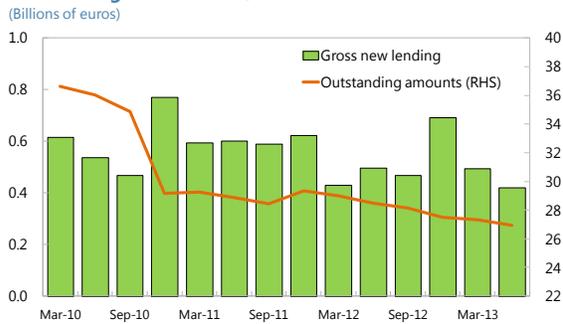
Loans Outstanding to Irish Residents



Source: Central Bank of Ireland.

Total SME outstanding credit is steadily declining...

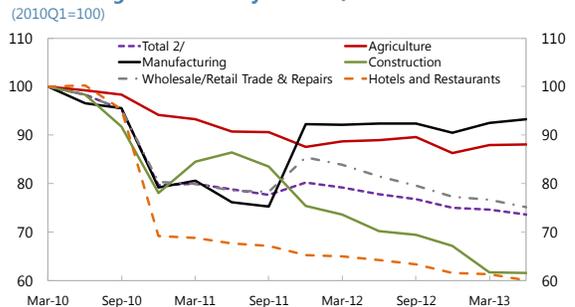
Outstanding SME Credit 1/



Source: Central Bank of Ireland.
1/ All resident credit institutions, excluding real estate and financial intermediation.

...across all sectors, though to a lesser extent in manufacturing and agriculture.

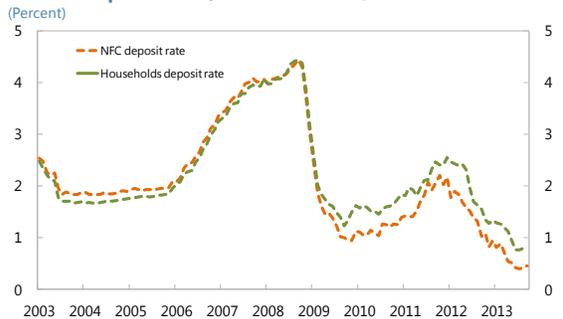
Outstanding SME Credit by Sector 1/



Source: Central Bank of Ireland.
1/ All resident credit institutions.
2/ Excludes real estate and financial intermediation.

New deposit rates have started to stabilize at much reduced levels this summer...

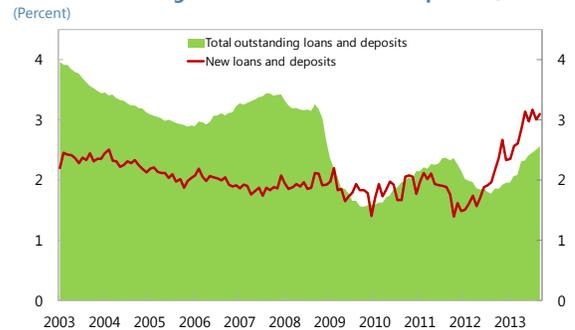
Median Deposit Rates, New Business 1/



Source: Central Bank of Ireland.
1/ Data relate to new business conducted through resident offices of a sample of banks and include IBRC. Refers to median deposit rates (excludes overnight). Last observation July 2013.

...but average margins between loans and deposits keep improving as long-term deposits roll-off.

Interest Rate Margins Between Loans and Deposits 1/



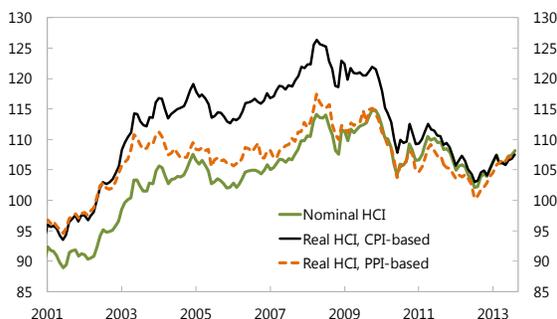
Source: Central Bank of Ireland.
1/ Weighted average loan rate minus weighted average deposit rate.

Figure 4. Ireland: Competitiveness Indicators, 1996–2013

Appreciation of the euro in the recent months slowed the improvement in competitiveness indicators.

Harmonized Competitiveness Indicators (Monthly)

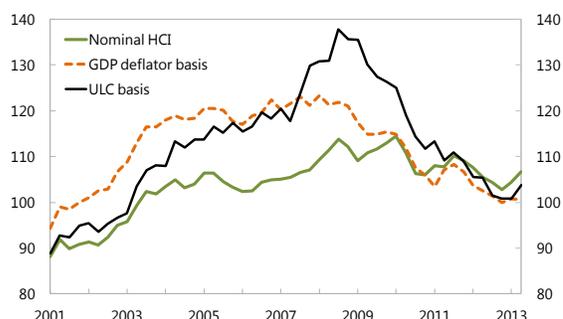
(1999Q1=100)



Sources: CBI; and Haver Analytics.

Harmonized Competitiveness Indicators (Quarterly)

(1999Q1=100)



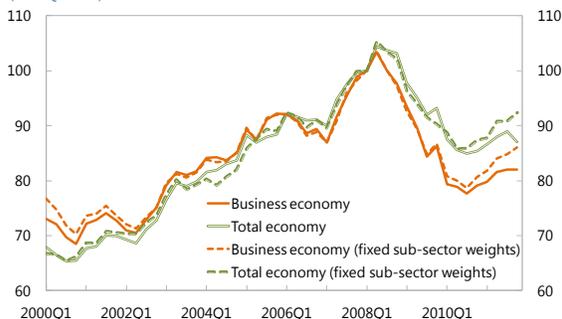
Sources: CBI; and Haver Analytics.

Though part of that earlier improvement reflects a shift to higher value-added sectors.

Private wages have been broadly flat in recent years, while growth has continued in the euro area...

Real Effective Exchange Rates on a ULC Basis

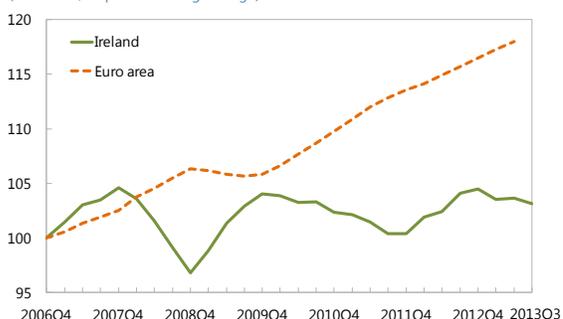
(2008Q1=100)



Source: Bruegel.

Hourly Labor Costs in Manufacturing

(2006=100; 4-quarter moving average)



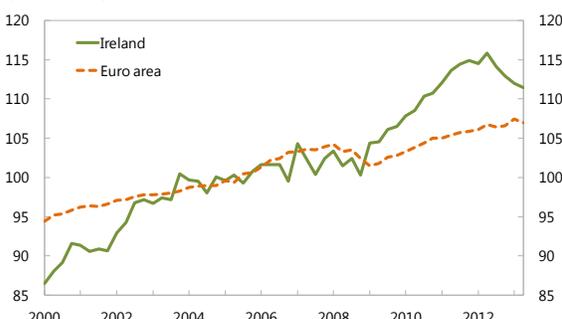
Sources: CSO; Eurostat; Haver Analytics; and IMF staff calculations.

...while labor productivity continues to outpace the euro area, this gap has narrowed recently as employment data showed gains while output in the high-productivity pharmaceutical sector stalled due to patent expiry.

As yet, competitiveness improvements have not been reflected in rising market shares, with the impact of patent expiry on the goods market share evident.

Real Labor Productivity

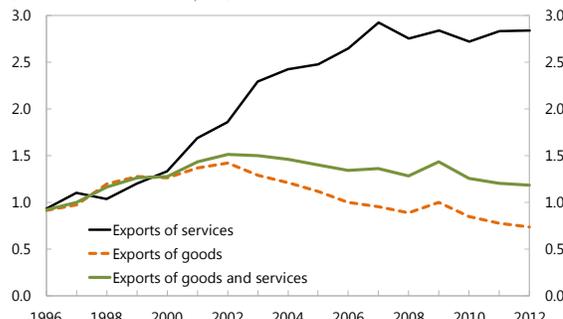
(2005=100, SA)



Source: Eurostat.

Export Shares

(Percent of world non-oil imports)



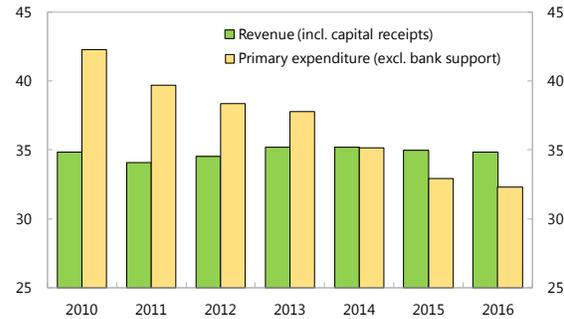
Sources: IMF WEO; and IMF staff calculations and projections.

Figure 5. Ireland: Selected Trends in General Government Finances, 2007–16

Of an 11 percent of GDP primary balance improvement (2010–16), more than half is expected by 2013.

Revenues and Primary Expenditure

(Percent of GDP)

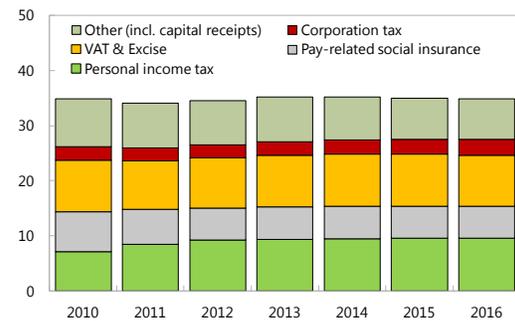


Sources: Department of Finance; and IMF staff estimates.

Given the weaker recovery in nominal domestic demand, tax measures will only modestly raise revenues as a share of GDP.

Revenue Composition

(Percent of GDP)

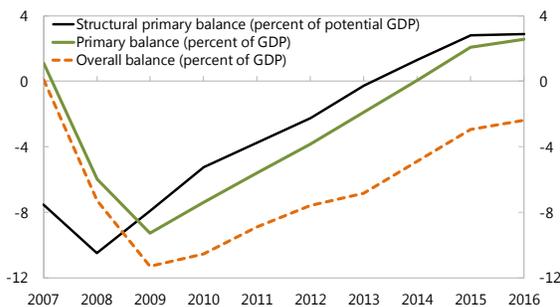


Sources: Department of Finance; and IMF staff estimates.

An overall deficit below 3 percent of GDP is targeted for 2015, with a primary balance targeted for 2014.

Headline, Primary and Structural Balance 1/

(Percent of GDP)

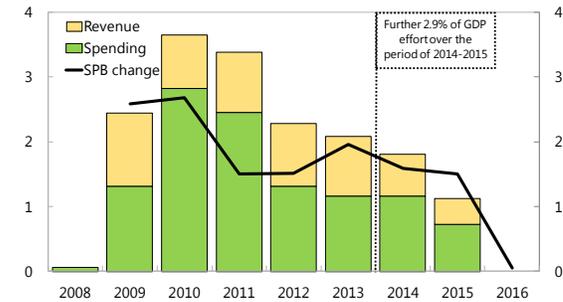


Sources: Department of Finance; and IMF staff estimates.
1/ Excluding bank support; for 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

Fiscal consolidation is programmed to moderate over time and is expenditure-led.

Composition of Fiscal Consolidation

(Percent of GDP)

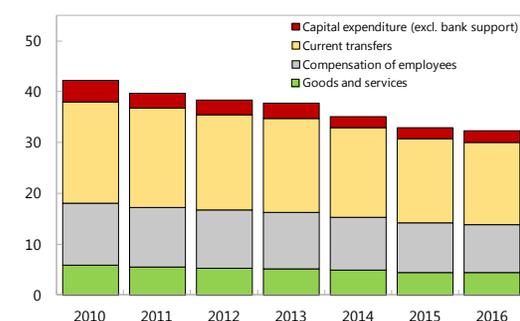


Source: IMF staff estimates.
SPB denotes structural primary balance ratio.

Primary expenditures will fall by 10 percent of GDP, reflecting evenly spread durable savings.

Primary Expenditure Components

(Percent of GDP)

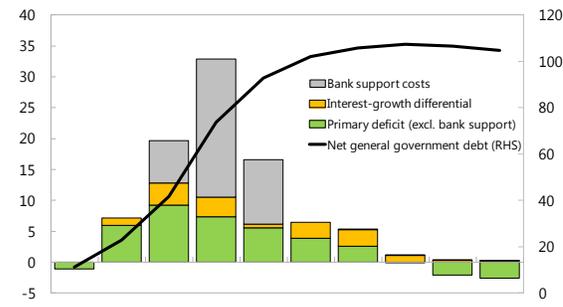


Sources: Department of Finance; and IMF staff estimates.

It will take time to unwind the increase in net debt, half of which arose from bank support costs.

Sources of Increase in Net Debt-to-GDP Ratio

(Percent of GDP)



Sources: Department of Finance; and IMF staff estimates.

Table 1. Ireland: Selected Economic Indicators, 2008–14

(Annual percentage change unless indicated otherwise)

	2008	2009	2010	2011	2012	2013	2014
						Proj	
National accounts (constant prices)							
Real GDP	-2.2	-6.4	-1.1	2.2	0.2	0.3	1.7
Final domestic demand	-2.2	-9.7	-5.0	-3.0	-1.1	-0.2	0.4
Private consumption	0.1	-5.1	0.9	-1.6	-0.3	-0.6	0.5
Public consumption	0.6	-3.4	-6.9	-2.8	-3.7	-1.0	-2.8
Gross fixed investment	-9.6	-26.9	-22.6	-9.5	-1.0	2.9	4.4
Net exports 1/	1.5	4.6	3.0	5.7	1.6	0.3	1.4
Exports of goods and services	-1.1	-3.8	6.4	5.4	1.6	0.5	2.5
Imports of goods and services	-3.0	-9.8	3.6	-0.4	0.0	0.2	1.4
Real GNP	-1.8	-9.1	0.5	-1.6	1.8	0.2	1.3
Gross national saving (in percent of GDP)							
Private	16.3	13.8	13.3	11.8	15.1	15.2	15.7
Public 2/	18.4	21.3	20.4	18.3	21.4	20.7	19.3
Gross investment (in percent of GDP)	-2.0	-7.6	-7.1	-6.4	-6.4	-5.5	-3.5
Private	22.0	16.1	12.2	10.6	10.6	10.9	11.2
Public	16.7	12.3	8.7	8.1	8.8	9.1	9.6
Public	5.3	3.7	3.5	2.5	1.9	1.8	1.6
Prices, wages and employment (annual average)							
Harmonized index of consumer prices	3.1	-1.7	-1.6	1.2	1.9	0.8	0.9
Average wage, whole economy	5.8	0.0	-1.9	-0.5	0.5	0.5	0.8
Employment	-0.7	-7.8	-4.0	-1.8	-0.6	1.6	1.5
Unemployment rate (in percent)	6.4	12.0	13.9	14.6	14.7	13.3	12.3
Money and credit (end-period) 3/							
Irish resident private sector credit 4/	8.8	-1.5	-3.4	-2.9	-4.0	-4.6	...
Financial and asset markets (end-period) 3/							
Three-month interbank rate	2.9	0.7	1.0	1.4	0.2	0.2	...
Government bond yield (in percent, 10-year) 5/	4.4	4.9	9.2	8.5	4.5	3.5	...
Annual change in ISEQ index (in percent)	-47.3	28.8	5.1	5.2	16.3	25.6	...
House prices	-12.4	-18.6	-10.5	-16.7	-4.5	3.6	...
Public finance (in percent of GDP)							
General government balance (excl. bank support) 6/	-7.3	-11.3	-10.6	-8.9	-8.2	-7.3	-5.1
Primary balance (excl. bank support)	-6.0	-9.3	-7.4	-5.6	-4.5	-2.7	-0.3
General government gross debt	44.2	64.4	91.2	104.1	117.4	123.9	121.7
General government net debt		38.6	70.4	85.1	92.8	99.1	101.8
External trade and balance of payments (percent of GDP)							
Balance of goods and services	9.0	15.8	18.4	21.5	24.1	24.3	25.4
Balance of income and current transfers	-14.6	-18.1	-17.3	-20.3	-19.7	-20.1	-20.8
Current account	-5.6	-2.3	1.1	1.2	4.4	4.2	4.6
Effective exchange rates (1999:Q1=100, average) 3/							
Nominal	111.6	112.5	107.8	108.6	105.1	107.3	...
Real (CPI based)	123.1	121.0	111.6	110.2	105.3	106.6	...
Memorandum items:							
Population (in millions)	4.5	4.5	4.6	4.6	4.6	4.6	4.6
GDP per capita (in euros)	40,189	35,797	34,710	35,542	35,752	35,857	36,520
GDP (in billions of euros)	180.2	162.3	158.1	162.6	163.9	165.4	169.5

Sources: Bloomberg; Central Bank of Ireland; Department of Finance; International Financial Statistics; and IMF staff estimates

1/ Contribution to growth.

2/ Excludes bank restructuring costs.

3/ Data refers to end-June for private sector credit, end-May for interbank rate, end-June for house prices and effective exchange rate, and end-July for other indicators.

4/ Adjusted growth rate of credit to households and non-financial corporations.

5/ Since mid-2012, 8 year government bond yield is shown as no 10 year benchmark exists.

6/ General government balance per ESA95 definition. For 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

Table 2. Ireland: Medium-Term Scenario, 2009–18

(Annual percentage change, unless indicated otherwise)

	2009	2010	2011	2012	2013	2013	2014	2015	2016	2017	2018
					11 th Review			Proj.			
Real GDP	-6.4	-1.1	2.2	0.2	0.6	0.3	1.7	2.5	2.5	2.5	2.5
Domestic demand	-10.4	-4.4	-1.8	-1.6	0.0	0.0	0.4	1.0	1.8	2.0	2.2
Final domestic demand	-9.7	-5.0	-3.0	-1.1	0.0	-0.2	0.4	1.0	1.8	2.0	2.2
Private consumption	-5.1	0.9	-1.6	-0.3	-0.3	-0.6	0.5	1.0	1.3	1.6	1.6
Public consumption	-3.4	-6.9	-2.8	-3.7	-0.6	-1.0	-2.8	-2.5	0.3	0.0	0.5
Gross fixed investment	-26.9	-22.6	-9.5	-1.0	2.0	2.9	4.4	5.4	6.0	6.0	6.5
Change in stocks 1/	-0.7	0.6	1.0	-0.4	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Net exports 1/	4.6	3.0	5.7	1.6	0.6	0.3	1.4	1.7	1.2	1.1	0.9
Exports of goods and services	-3.8	6.4	5.4	1.6	1.1	0.5	2.5	3.7	4.1	4.2	4.2
Imports of goods and services	-9.8	3.6	-0.4	0.0	0.6	0.2	1.4	2.7	3.9	4.3	4.4
Real GNP	-9.1	0.5	-1.6	1.8	0.3	0.2	1.3	2.1	2.1	2.1	2.2
Current account 2/	-2.3	1.1	1.2	4.4	2.3	4.2	4.6	4.7	4.5	3.8	2.9
Gross national saving 2/	13.8	13.3	11.8	15.1	13.1	15.2	15.7	16.2	16.2	15.7	15.2
Private	21.3	20.4	18.3	21.4	19.0	20.7	19.3	17.7	17.1	16.1	15.1
Public	-7.6	-7.1	-6.4	-6.4	-5.9	-5.5	-3.5	-1.5	-1.0	-0.4	0.1
Gross investment 2/	16.1	12.2	10.6	10.6	10.8	10.9	11.2	11.5	11.6	11.9	12.3
Private	12.3	8.7	8.1	8.8	9.1	9.1	9.6	10.0	10.2	10.5	11.0
Public	3.7	3.5	2.5	1.9	1.6	1.8	1.6	1.5	1.4	1.4	1.3
Prices											
Harmonized index of consumer prices	-1.7	-1.6	1.2	1.9	1.0	0.8	0.9	1.1	1.2	1.7	1.7
GDP deflator	-3.8	-1.5	0.7	0.7	1.0	0.6	0.7	1.0	1.0	1.6	1.6
Average wage, whole economy	0.0	-1.9	-0.5	0.5	0.4	0.5	0.8	0.5	1.4	1.5	1.2
Labor market											
Employment	-7.8	-4.0	-1.8	-0.6	0.6	1.6	1.5	1.2	1.2	1.7	1.7
Unemployment rate (in percent)	12.0	13.9	14.6	14.7	13.7	13.3	12.3	11.7	11.3	10.9	10.4
Public finance											
General government balance 2/ 3/	-11.3	-10.6	-8.9	-8.2	-7.5	-7.3	-5.1	-2.9	-2.4	-1.8	-1.2
General government gross debt 2/	64.4	91.2	104.1	117.4	123.3	123.9	121.7	121.9	118.8	115.8	112.2
General government net debt 2/	38.6	70.4	85.1	92.8	105.5	99.1	101.8	102.8	100.9	98.7	95.7
Output gap	-3.0	-3.8	-1.6	-1.6	-1.8	-1.9	-1.3	-0.4	0.1	0.3	0.4
Nominal GDP (in billions of euros)	162.3	158.1	162.6	163.9	166.6	165.4	169.5	175.4	181.7	189.2	197.2

Sources: Central Statistics Office; Department of Finance; and IMF staff estimates.

1/ Contributions to growth.

2/ In percent of GDP, excludes bank restructuring costs. For 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

3/ General government balance per ESA95 definition.

Table 3. Ireland: General Government Statement of Operations, 2009–18
(consistent with GFSM 2001; in billions of Euros)

	2009	2010	2011	2012	Projections 1/					
					2013	2014	2015	2016	2017	2018
Revenue	56.0	55.1	55.4	56.5	58.5	60.4	62.6	64.3	66.4	68.9
Taxes	35.9	34.8	37.6	39.5	41.4	43.3	45.2	46.8	48.7	50.7
Personal income tax	11.8	11.3	13.8	15.2	15.7	16.3	17.0	17.6	18.3	19.1
Corporate income tax	3.9	3.9	3.8	4.0	4.4	4.7	5.1	5.5	5.7	6.0
Value-added tax	10.7	10.1	9.7	10.2	10.4	10.5	10.8	11.2	11.6	12.0
Excise tax	4.7	4.7	4.7	4.7	4.7	4.9	5.1	5.3	5.5	5.7
Other 2/	4.8	4.9	5.6	5.4	6.2	6.9	7.1	7.3	7.6	7.9
Social contributions 3/	12.0	11.5	10.3	9.7	9.9	10.3	10.6	10.9	11.2	11.5
Other revenue 4/	8.1	8.8	7.5	7.4	7.2	6.8	6.8	6.6	6.5	6.7
Expenditure (excl. fin. sector support)	74.4	71.8	69.9	70.0	70.7	69.0	67.8	68.6	69.8	71.4
Expense (excl. fin. sector support)	68.3	66.3	65.8	67.0	67.7	66.4	65.2	66.0	67.2	68.7
Compensation of employees	20.7	19.3	19.1	18.8	18.7	18.4	17.7	17.7	18.0	18.3
Use of goods and services	10.4	9.3	8.9	8.4	8.3	8.1	8.2	8.3	8.3	8.7
Interest	3.3	5.0	5.3	6.1	7.6	8.2	8.8	9.2	9.5	9.8
Subsidies	0.9	0.9	0.6	1.5	1.3	1.3	1.3	1.3	1.3	1.3
Social benefits 3/	28.3	28.2	28.8	29.0	28.4	27.9	26.6	26.8	27.3	27.7
Other expense (excl. fin. sector support) 5/	4.7	3.6	3.1	3.1	3.3	2.5	2.7	2.6	2.8	2.8
Gross fixed capital formation	6.1	5.5	4.0	3.1	3.0	2.6	2.6	2.6	2.6	2.7
Financial sector support costs	4.0	31.6	6.8	0.0	0.0	0.1	0.1	0.1	0.0	0.0
Net lending/borrowing (excl. fin. sector support)	-18.4	-16.7	-14.4	-13.5	-12.1	-8.6	-5.2	-4.3	-3.4	-2.5
Net lending/borrowing (incl. fin. sector support)	-22.4	-48.3	-21.3	-13.5	-12.2	-8.7	-5.3	-4.4	-3.4	-2.5
Primary balance (excl. fin. sector support)	-15.1	-11.7	-9.1	-7.4	-4.5	-0.4	3.6	4.9	6.1	7.4
Net financial worth, transactions	-22.4	-48.3	-21.3	-13.5	-12.2	-8.7	-5.3	-4.4	-3.4	-2.5
Net acquisition of financial assets	2.6	-8.1	3.2	5.2	0.8	-7.3	-0.3	-1.0	0.0	0.0
Net incurrence of liabilities	24.9	40.1	24.4	18.7	12.9	1.5	5.0	3.4	3.4	2.5
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items (in percent of GDP, unless indicated otherwise)</i>										
Revenue	34.5	34.9	34.1	34.5	35.4	35.6	35.7	35.4	35.1	35.0
Taxes and social contributions 3/	29.5	29.3	29.4	30.0	31.0	31.6	31.8	31.8	31.6	31.6
Other revenue 4/	5.0	5.6	4.6	4.5	4.3	4.0	3.9	3.6	3.5	3.4
Expenditure (excl. fin. sector support)	45.8	45.4	43.0	42.7	42.7	40.7	38.6	37.8	36.9	36.2
Current primary (excl. fin. sector support) 5/	40.1	38.8	37.2	37.1	36.3	34.3	32.2	31.3	30.5	29.9
Interest	2.0	3.1	3.3	3.7	4.6	4.8	5.0	5.1	5.0	5.0
Gross fixed capital formation	3.7	3.5	2.5	1.9	1.8	1.6	1.5	1.4	1.4	1.3
Net lending/borrowing (excl. fin. sector support)	-11.3	-10.6	-8.9	-8.2	-7.3	-5.1	-2.9	-2.4	-1.8	-1.2
Net lending/borrowing (incl. fin. sector support)	-13.8	-30.5	-13.1	-8.2	-7.3	-5.2	-3.0	-2.4	-1.8	-1.2
Primary balance (excl. fin. sector support)	-9.3	-7.4	-5.6	-4.5	-2.7	-0.3	2.0	2.7	3.2	3.7
Net financial worth, transactions	-13.8	-30.5	-13.1	-8.2	-7.3	-5.2	-3.0	-2.4	-1.8	-1.2
Net acquisition of financial assets	1.6	-5.1	1.9	3.2	0.5	-4.3	-0.2	-0.5	0.0	0.0
Net incurrence of liabilities	15.4	25.4	15.0	11.4	7.8	0.9	2.8	1.9	1.8	1.2
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural balance	-10.2	-8.6	-7.1	-6.2	-5.3	-4.2	-2.3	-2.3	-2.0	-1.7
Structural primary balance 6/	-7.9	-5.3	-3.8	-2.5	-0.6	0.6	2.6	2.8	3.0	3.2
General government gross debt	64.4	91.2	104.1	117.4	123.9	121.7	121.9	118.8	115.8	112.2
General government net debt	38.6	70.4	85.1	92.8	99.1	101.8	102.8	100.9	98.7	95.7
Output gap (percent of potential GDP)	-3.0	-3.8	-1.6	-1.6	-1.9	-1.3	-0.4	0.1	0.3	0.4
Nominal GDP (in billions of euros)	162.3	158.1	162.6	163.9	165.4	169.5	175.4	181.7	189.2	197.2

Sources: Department of Finance; and IMF staff estimates.

1/ Projections are consistent with the adjustment path set out in Budget 2014.

2/ Includes stamp duty, capital taxes, property tax and other taxes.

3/ Includes imputed social insurance contributions. The 2011 downward jump in the series reflects the integration of health levy receipts into the universal social charge (now part of income tax).

4/ Includes property income, sales of goods and services, current transfer revenue and capital transfer revenue.

5/ For 2013, includes exchequer outlays for guarantees paid out under the ELG scheme in the context of the liquidation of IBRC.

6/ In percent of nominal potential GDP.

Table 4. Ireland: Indicators of External and Financial Vulnerability, 2009–13

	2009	2010	2011	2012	2013 7/
External indicators					
Exports (annual percent change, value in euros)	-2.5	8.0	6.1	5.8	1.5
Imports (annual percent change, value in euros)	-9.9	6.8	2.9	3.9	1.5
Terms of trade (goods, annual percent change)	1.7	-1.6	-2.7	0.4	-0.3
Current account balance (in percent of GDP)	-2.3	1.1	1.2	4.4	4.2
Capital and financial account balance (in percent of GDP)	-2.2	3.8	5.9	-0.8	-4.4
<i>Of which:</i>					
Inward portfolio investment	13.8	47.8	18.2	44.7	41.2
Inward foreign direct investment	11.4	20.4	10.4	18.2	18.4
Other investment liabilities	-53.3	-39.2	-51.2	-67.5	-45.5
U.S. dollar per euro (period average)	1.40	1.32	1.40	1.29	1.32
U.K. pound per euro (period average)	0.89	0.86	0.87	0.81	0.86
Financial markets indicators					
General government debt (in percent of GDP)	64.4	91.2	104.1	117.4	123.9
Government bond yield (in percent, 10-year, end-period) 1/	4.9	9.2	8.5	4.5	3.5
Spread of government bond yield with Germany (in percent, end of period)	1.3	6.0	6.5	3.2	1.7
Real government bond yield (in percent, 10-year, period average, based on HICP)	6.9	7.6	8.4	4.1	3.1
Annual change in ISEQ index (in percent, end of period)	28.8	5.1	5.2	16.3	25.6
Personal lending interest rate (in percent)	11.1	11.4	11.6	11.6	11.6
Standard variable mortgage interest rate (in percent)	3.3	4.0	4.2	4.3	4.4
Financial sector risk indicators					
Annual credit growth rates (to Irish resident private sector, in percent) 2/	-1.5	-3.4	-2.9	-4.0	-4.6
Personal lending as a share of total Irish resident credit (in percent)	35.6	35.5	30.0	33.0	33.4
<i>Of which:</i>					
House mortgage finance	30.1	30.7	25.4	28.7	29.2
Other housing finance	0.2	0.4	0.3	0.3	0.3
Other personal lending	5.3	4.8	4.6	4.3	4.2
Irish resident household mortgage debt annual growth rates (in percent) 3/	-3.9	-9.0	-19.3	5.6	4.4
Foreign-currency denominated assets (in percent of total assets)	34.3	30.3	29.4	28.4	28.1
Foreign-currency denominated liabilities (in percent of total liabilities)	31.1	25.8	26.3	25.4	25.6
Non-performing loans (in percent of total loans) 4/	9.0	8.6	9.1	11.3	11.5
Total provisions for loan losses (in percent of total loans)	4.0	4.2	4.8	5.4	4.5
Regulatory capital to risk-weighted assets of domestic banks (in percent)	10.9	10.4	17.7	16.6	15.9
Bank return on assets (before tax, in percent)	-1.6	-3.1	-0.8	-0.8	...
Bank return on equity (before tax, in percent)	-40.6	-67.6	-16.9	-14.1	...
Deposits to M3 ratio 5/	1.3	1.5	1.2	1.3	1.4
Loan-to-deposit ratio vis-à-vis Irish residents 6/	2.1	2.1	2.1	1.9	1.7
vis-à-vis total 6/	2.2	2.1	2.1	1.9	1.7
Concentration ratios in the banking sector					
No. of banks accounting for 25 percent of total assets	2.0	2.0	2.0	2.0	2.0
No. of banks accounting for 75 percent of total assets	13.0	13.0	14.0	14.0	14.0
Share of state-owned banks in total assets (in percent)	6.0	8.0	18.0	19.1	15.8
Share of foreign-owned banks in total assets (in percent)	65.0	65.0	61.6	57.6	61.3
Sources: Bloomberg; Central Bank of Ireland; International Financial Statistics; and IMF staff estimates.					
1/ Since mid-2012, 8 year government bond yield is shown as no 10 year benchmark exists.					
2/ Adjusted growth rate of credit to households and non-financial corporations.					
3/ Including securitisations.					
4/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.					
5/ Deposits vis-à-vis Irish and nonresidents. The M3 compilation methodology has been amended in line with Eurosystem					
6/ Nongovernment credit/nongovernment deposits ratio.					
7/ For 2013, staff projections for macroeconomic variables and debt, end-July 2013 for bond yields and stock market index, and end-June 2013 for other indicators. Financial sector indicators cover all credit institutions licensed in Ireland except for personal lending rate, which is calculated based on a sample of retail banks, and a mortgage interest rate, which is calculated excluding IFSC.					

Table 5. Ireland: Summary of Balance of Payments, 2009–18

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Proj.					
	(In billions of euros)									
Current account balance	-3.8	1.8	2.0	7.3	7.0	7.8	8.3	8.2	7.1	5.7
Balance of goods and services	25.6	29.1	35.0	39.6	40.2	43.1	47.1	49.7	52.2	54.6
Trade balance	32.5	35.8	36.7	36.4	35.0	35.8	37.5	39.4	41.5	43.7
Exports of goods	77.6	82.6	85.0	85.9	83.7	85.5	88.8	92.7	96.9	101.3
Imports of goods	-45.2	-46.9	-48.3	-49.5	-48.8	-49.7	-51.4	-53.3	-55.4	-57.6
Services balance	-6.9	-6.6	-1.7	3.2	5.2	7.3	9.6	10.2	10.7	10.9
Credit	67.6	74.3	81.5	90.3	95.1	99.2	104.7	110.9	117.6	124.7
Debit	-74.5	-81.0	-83.2	-87.1	-89.9	-91.9	-95.1	-100.6	-106.8	-113.9
Income balance	-27.9	-25.9	-31.8	-31.1	-32.0	-34.1	-37.3	-39.9	-43.5	-47.0
Credit	55.1	57.1	57.1	57.2	57.2	57.3	57.2	58.0	58.5	59.3
Debit	-83.0	-83.0	-88.9	-88.4	-89.2	-91.4	-94.5	-97.9	-102.0	-106.3
Current transfers (net)	-1.4	-1.4	-1.2	-1.2	-1.2	-1.2	-1.5	-1.5	-1.6	-1.8
Capital and financial account balance	-2.3	6.6	-24.7	-22.3	-17.9	-8.6	-8.3	-8.2	-7.1	-5.7
Capital account balance	-1.3	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Financial account	-1.1	7.3	-24.4	-22.1	-17.7	-8.3	-8.0	-7.9	-6.8	-5.4
Direct investment	-0.6	15.4	17.8	15.4	15.9	16.1	16.2	16.9	17.6	18.3
Portfolio investment	22.6	86.0	26.9	-0.2	2.4	-0.7	-0.3	3.2	14.5	26.7
Other investment	-23.1	-94.1	-69.4	-35.5	-30.1	-20.4	-19.2	-19.9	-21.5	-28.6
Change in reserve assets 1/	0.1	0.0	0.3	0.0	-5.8	-3.3	-4.7	-8.2	-17.3	-21.8
Net errors and omissions	6.1	-8.4	-11.8	-6.2	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	34.5	21.3	11.0	0.8	0.0	0.0	0.0	0.0
Program financing	0.0	0.0	34.5	21.3	11.0	0.8	0.0	0.0	0.0	0.0
IMF	0.0	0.0	12.6	6.4	3.5	0.0	0.0	0.0	0.0	0.0
EU	0.0	0.0	21.9	14.8	7.5	0.8	0.0	0.0	0.0	0.0
	(In percent of GDP)									
Current account balance	-2.3	1.1	1.2	4.4	4.2	4.6	4.7	4.5	3.8	2.9
Balance of goods and services	15.8	18.4	21.5	24.1	24.3	25.4	26.8	27.3	27.6	27.7
Trade balance	20.0	22.6	22.6	22.2	21.1	21.1	21.4	21.7	21.9	22.2
Services balance	-4.3	-4.2	-1.0	2.0	3.2	4.3	5.5	5.6	5.7	5.5
Income balance	-17.2	-16.4	-19.6	-19.0	-19.3	-20.1	-21.3	-22.0	-23.0	-23.8
Current transfers (net)	-0.9	-0.9	-0.7	-0.7	-0.7	-0.7	-0.8	-0.8	-0.8	-0.9
Capital and financial account balance	-1.4	4.2	-15.2	-13.6	-10.8	-5.1	-4.7	-4.5	-3.8	-2.9
<i>Of which:</i>										
Direct investment	-0.4	9.8	10.9	9.4	9.6	9.5	9.3	9.3	9.3	9.3
Portfolio investment	13.9	54.4	16.5	-0.1	1.4	-0.4	-0.2	1.8	7.6	13.6
Other investment	-14.2	-59.5	-42.7	-21.6	-18.2	-12.0	-11.0	-11.0	-11.4	-14.5
Change in reserve assets 1/	0.0	0.0	0.2	0.0	-3.5	-1.9	-2.7	-4.5	-9.2	-11.1
Net errors and omissions	3.7	-5.3	-7.3	-3.8	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	21.2	13.0	6.6	0.5	0.0	0.0	0.0	0.0
Program financing	0.0	0.0	21.2	13.0	6.6	0.5	0.0	0.0	0.0	0.0
IMF	0.0	0.0	7.7	3.9	2.1	0.0	0.0	0.0	0.0	0.0
EU	0.0	0.0	13.5	9.0	4.5	0.5	0.0	0.0	0.0	0.0
Memorandum items:										
Current account balance excluding undistributed profits 2/	-3.3	-2.1	-2.3	-0.1						

Sources: Central Bank of Ireland; Central Statistics Office; and IMF staff estimates.

1/ Includes financing need to build reserves for bank support.

2/ Undistributed profits of redomiciled firms, as estimated by FitzGerald (2013).

Table 6. Ireland: Monetary Survey, 2009–13
(In billions of euros, unless otherwise indicated; end of period)

	Dec-09	Dec-10	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Jul-13
Aggregate balance sheet of domestic market credit institutions										
Assets	801	747	639	614	610	571	550	498	487	484
Claims on Central Bank of Ireland	12	8	4	5	6	7	2	2	3	2
Claims on Irish resident Other MFIs	129	123	92	86	81	55	53	50	50	50
Claims on Irish resident non MFIs	364	359	340	338	333	331	326	292	288	287
General government	9	43	42	44	45	47	47	19	20	20
Private sector	355	316	298	294	288	285	279	274	269	267
Households	47	26	55	58	57	79	73	59	55	54
Non-Financial Corporations	177	159	143	144	144	145	147	160	159	159
Non-Bank Financial Intermediaries	131	132	99	92	87	60	59	55	54	53
Claims on non-residents	243	209	150	141	143	132	122	112	105	105
Other assets	54	48	52	44	46	46	47	42	41	41
Liabilities	801	747	639	614	610	571	550	498	487	484
Liabilities to Eurosystem 1/	58	95	72	75	78	71	59	44	39	37
Liabilities to Irish resident Other MFIs	131	132	99	92	87	60	59	55	54	53
Deposits of Irish resident non MFIs	180	162	146	147	147	148	153	169	172	173
General government	3	3	2	2	3	3	6	10	13	13
Private sector	177	159	143	144	144	145	147	160	159	159
Deposits of non-residents	230	140	100	93	91	84	76	77	74	77
Debt securities	98	64	52	44	41	40	38	34	29	27
Capital and reserves	53	72	91	93	97	97	98	94	94	94
Other liabilities (incl. Central Bank of Ireland)	50	83	79	70	69	71	66	24	25	24
Money and credit 2/										
Net foreign assets	-421	-480	-340	-34	-23	-15	-14	-9	...	...
Central Bank of Ireland 3/	-37	-128	-101	-76	-77	-67	-62	-42	...	...
Commercial banks	-384	-352	-239	42	54	52	48	33	31	33
Net domestic assets	629	652	509	203	191	185	183	194	...	...
Public sector credit	10	43	43	44	46	47	48	19	20	20
Private sector credit	375	335	324	319	313	309	302	297	292	287
Other	244	274	143	-160	-167	-171	-166	-122	...	...
Irish Resident Broad money (M3) 4/	208	173	169	169	168	170	170	185	189	189
Irish Resident Intermediate money (M2) 4/	188	173	167	167	166	168	168	182	183	182
Irish Resident Narrow money (M1)	100	97	90	89	89	90	92	105	109	109
	(percent of GDP)									
Public sector credit 5/	5.3	27.6	27.0	27.9	28.4	29.0	29.4	11.5	12.2	12.2
Private sector credit 5/	221.0	202.4	190.1	186.9	180.7	177.3	173.5	170.4	167.4	166.3
	(y-o-y percentage change)									
Broad money - Irish contribution to euro area M3 6/	-6.6	-19.6	1.3	-3.3	-10.2	-7.5	-7.3	-0.5	6.1	6.1
Irish Public sector credit 6/ 7/	176.9	369.4	1.5	11.0	15.3	8.5	8.5	-58.6	-57.1	-57.3
Irish Household and non-financial corporations credit 6/ 7/	-1.5	-3.4	-2.9	-3.2	-3.4	-4.0	-4.0	-4.2	-4.6	-4.6
Memorandum items: 8/										
Credit to deposits (in percent) 9/	200.5	199.2	207.6	204.0	199.7	195.9	189.9	171.1	168.5	167.6
Deposits from Irish Private Sector (y-o-y percent change)	42.5	-16.4	-11.7	-18.8	-24.9	-25.2	-26.1	-31.2	-34.4	-34.9
Wholesale funding (billions of euros)	59	31	22	18	16	15	15	15	12	10
Deposits from MFIs	12	10	8	7	7	7	8	8	7	6
Debt securities	47	21	14	10	8	8	8	7	6	4
Wholesale funding (y-o-y percent change) 10/	-19.0	-48.9	-28.1	-34.8	-39.7	-35.3	-30.8	-15.1	-21.0	-32.7
Wholesale funding (percent of assets) 10/	7.4	4.4	3.4	2.9	2.6	2.7	2.8	3.0	2.5	2.1

Sources: Central Bank of Ireland; and staff estimates.

1/ Relating to Eurosystem monetary policy operations.

2/ Including banks in the International Financial Service Centre (IFSC).

3/ Sourced from quarterly IIP statistics.

4/ Differs from the M3 (M2) Irish contribution to euro area as only liabilities vis-a-vis Irish residents are used.

5/ Refers to credit advanced by domestic market credit institutions.

6/ Includes IFSC.

7/ Growth rates adjusted for valuation, reclassification, derecognition/loan transfer to non-MFIs, and exchange rates.

8/ Excludes IFSC.

9/ Domestic market credit institutions' private sector credit to deposits.

10/ Includes resident and non-resident MFI deposits, and debt securities issued.

Table 7. Ireland: General Government Financing Requirements and Sources, 2008–13
(In billions of euros)

	2008	2009	2010	2011	2012	2013 <i>Proj.</i>
Gross borrowing need	15.9	63.4	71.4	45.3	29.8	27.8
Exchequer cash deficit 1/	12.7	24.6	18.7	19.1	17.1	11.3
Amortization	3.1	27.7	17.3	9.7	11.1	16.5
Medium-and long-term	0.1	5.1	1.2	4.8	6.8	6.2
Short-term 2/	3.0	22.6	16.2	4.9	4.4	10.2
Official creditors	0.0	0.0	0.0	0.0	0.0	0.0
European Union	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0	0.0
Bank recapitalization	0.0	11.0	35.3	16.5	1.6	0.0
Gross financing sources 3/	15.9	63.4	71.4	10.8	8.5	16.8
Market financing (incl. retail) 4/	34.9	53.3	23.2	1.4	10.1	18.4
Net retail funding	1.3	1.8	3.4	1.4	1.3	1.6
Other market financing	33.6	51.6	19.8	0.0	8.8	16.8
Promissory notes	0.0	0.0	30.9	0.0	0.0	0.0
Bond placement for Promissory notes 5/				...	3.5	...
Cash drawdowns 6/	-19.0	10.0	17.3	9.4	-5.2	-0.8
Financing gap	0.0	0.0	0.0	34.5	21.3	11.0
EFSM/EFSF	0.0	0.0	0.0	21.5	12.3	5.6
Bilateral EU	0.0	0.0	0.0	0.5	2.5	1.9
IMF	0.0	0.0	0.0	12.6	6.4	3.5
<i>Memorandum items</i>						
Exchequer cash balance	22.0	21.8	12.3	13.0	19.3	20.1
General government debt 7/	79.6	104.5	144.2	169.2	192.5	205.0
Official creditors	0.0	0.0	0.0	34.5	56.0	66.6
European Union	0.0	0.0	0.0	21.9	37.1	44.1
IMF	0.0	0.0	0.0	12.6	18.9	22.5
Other	79.6	104.5	144.2	134.7	136.5	138.4
Treasury bills, bonds and retail	72.0	96.3	110.4	101.6	104.2	131.2
Promissory notes	0.0	0.0	30.9	28.3	25.3	0.2
Other	7.6	8.4	2.9	4.8	7.0	7.0
General government debt (in percent of GDP) 7/	44.2	64.4	91.2	104.1	117.4	123.9
Official creditors	0.0	0.0	0.0	21.2	34.1	40.3
European Union	0.0	0.0	0.0	13.5	22.6	26.6
IMF	0.0	0.0	0.0	7.7	11.5	13.6
Other	44.2	64.4	91.2	82.8	83.3	83.7
Treasury bills, bonds and retail	39.9	59.3	69.8	62.5	63.6	79.3
Promissory notes	0.0	0.0	19.5	17.4	15.4	0.1
Other	4.2	5.1	1.9	2.9	4.3	4.2

Sources: Department of Finance; National Treasury Management Agency; and IMF staff estimates.

1/ Includes allowance for amortization of Promissory notes and contingency for collateral on hedging transactions.

2/ Gross amortization of Treasury bills, Exchequer notes, and commercial paper, including intra-year rollovers.

3/ Includes stock-flow adjustment arising from the March 2012 payment of Promissory notes.

4/ Gross issuance including rollovers.

5/ Placement of a bond for the March 2012 payment of Promissory notes to IBRC.

6/ Forecast includes cash outflow for posting collateral.

7/ Includes local debt, other national debt, and other general government debt on consolidated level.

Table 8. Ireland: Schedule of Reviews and Purchases

Review	Availability Date	Action	Purchase	
			SDRs	Percent of quota
	December 16, 2010	Board approval of arrangement	5,012,425,200	399
First and Second Reviews	May 16, 2011	Observance of end-March 2011 performance criteria, completion of First and Second Reviews	1,410,000,000	112
Third Review	August 15, 2011	Observance of end-June 2011 performance criteria, completion of Third Review	1,319,000,000	105
Fourth Review	December 14, 2011	Observance of end-September 2011 performance criteria, completion of Fourth Review	3,309,000,000	263
Fifth Review	February 15, 2012	Observance of end-December 2011 performance criteria, completion of Fifth Review	2,786,000,000	222
Sixth Review	June 13, 2012	Observance of end-March 2012 performance criteria, completion of Sixth Review	1,191,000,000	95
Seventh Review	September 5, 2012	Observance of end-June 2012 performance criteria, completion of Seventh Review	758,000,000	60
Eight Review	December 12, 2012	Observance of end-September 2012 performance criteria, completion of Eight Review	758,000,000	60
Ninth Review	March 15, 2013	Observance of end-December 2012 performance criteria, completion of Ninth Review	831,000,000	66
Tenth Review	June 15, 2013	Observance of end-March 2013 performance criteria, completion of Tenth Review	831,000,000	66
Eleventh Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of Eleventh Review	681,000,000	54
Twelfth Review	November 15, 2013	Observance of end-September 2013 performance criteria, completion of Twelfth Review	579,374,800	46
Total			19,465,800,000	1,548

Source: IMF staff projections.

Table 9. Ireland. Indicators of Fund Credit, 2010–23 1/
(In millions of SDR)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Fund credit														
Disbursement	-	11,050	5,493	2,922	-	-	-	-	-	-	-	-	-	-
Stock 2/	-	11,050	16,543	19,466	19,466	18,931	16,757	13,862	10,617	7,373	4,129	1,420	349	-
Obligations	-	109	332	346	647	1,211	2,803	3,427	3,653	3,521	3,389	2,748	1,083	351
Repurchase	-	-	-	-	-	535	2,173	2,896	3,244	3,244	3,244	2,709	1,071	349
Charges	-	109	332	346	647	676	630	532	409	277	144	39	12	3
Stock of Fund credit														
In percent of quota	-	879	1,315	1,548	1,548	1,505	1,332	1,102	844	586	328	113	28	-
In percent of GDP	-	7.7	12.0	13.4	12.9	12.0	10.2	8.1	5.9	3.9	2.1	0.7	0.2	-
In percent of exports of goods and services	-	7.5	11.1	12.4	11.8	10.9	9.1	7.2	5.2	3.5	1.9	0.6	0.1	-
Obligations to the Fund														
In percent of quota	-	9	26	27	51	96	223	273	290	280	269	219	86	28
In percent of GDP	-	0.1	0.2	0.2	0.4	0.8	1.7	2.0	2.0	1.9	1.7	1.4	0.5	0.2
In percent of exports of goods and services	-	0.1	0.2	0.2	0.4	0.7	1.5	1.8	1.8	1.7	1.5	1.2	0.4	0.1

Source: IMF staff estimates.

1/ Calculated based on existing credit and full disbursements of the prospective available amounts under the extended arrangement under the Extended Fund Facility.

2/ End of period.

Table 10. Ireland: PCAR Banks' Aggregated Summary Financial Statements, H1 2012–H1 2013 1/

(In billions of euro unless otherwise indicated)

Balance Sheet	H1 2012	H1 2013	H1/H1 change		Profit and Loss Account	H1 2012		H1 2013	
	€ bn.	€ bn.	€ bn.	%		€ bn.	% of TAA	€ bn.	% of TAA
Cash & due from Eurosystem	17.2	9.1	-8.1	-47.3	Interest income	4.7	2.9	4.1	2.8
Net loans	208.2	186.0	-22.2	-10.6	Interest expense	-3.4	-2.1	-2.5	-1.7
Due from banks	17.5	8.7	-8.8	-50.3	Net interest margin	1.3	0.8	1.5	1.1
Securities & derivatives	64.1	64.7	0.5	0.8	Net fee income	0.4	0.3	0.4	0.3
Other assets	13.9	13.4	-0.5	-3.8	Net trading gains	-0.2	-0.1	0.1	0.0
Total assets	320.9	281.8	-39.1	-12.2	Other nonrecurrent items	0.0	0.0	-0.1	-0.1
Total average assets (TAA)	322.5	292.0	-30.5	-9.5	Gross operating income	1.5	0.9	1.9	1.3
Due to Eurosystem	64.1	33.7	-30.4	-47.5	Operating expenses	-2.1	-1.3	-1.8	-1.2
Due to banks	16.1	19.1	3.0	18.5	o/w: administration & other	-0.9	-0.5	-0.8	-0.5
Deposits	155.5	159.0	3.6	2.3	o/w: staff	-1.3	-0.8	-1.0	-0.7
Debt & derivatives	51.6	37.9	-13.8	-26.6	Preprovision profits (PPP)	-0.7	-0.4	0.1	0.1
Other liabilities	8.4	11.0	2.7	32.1	Loan loss & NAMA provisions	-2.5	-1.5	-1.9	-1.3
Total liabilities	295.7	260.7	-35.0	-11.8	Loss on derecognized assets	-0.1	0.0	0.4	0.3
Net equity	25.2	21.1	-4.2	-16.4	Net income before tax	-3.2	-2.0	-1.5	-1.0
Total liabilities & equity	320.9	281.8	-39.1	-12.2	Tax effects & other 3/	0.3	0.2	0.1	0.1
					Net income	-2.9	-1.8	-1.4	-0.9
<i>Memorandum items:</i>									
Gross loans 2/	233.7	213.5	-20.2	-8.6	PPP net of other nonrecurrent items	-0.7	-0.4	0.2	0.2
Loan loss provisions	25.4	28.2	2.8	11.1	Return on equity		-21.2		-12.4
Gross NPLs	51.8	56.8	5.0	9.6	Provisions to gross loans		10.9		13.2
Gross NPLs to gross loans (%)	22.2	26.6		4.4	Risk weighted assets (RWA)	157.8	48.9	138.9	47.6
Provisions to gross NPLs (%)	49.0	49.7		0.7	Core tier 1 capital (CT1) and CT1 to RWA (%)	25.7	16.3	19.5	14.1
Net NPLs to net equity (%)	104.7	135.5		30.8	CT1 to total assets = leverage ratio (%)		8.0		6.9

Sources: CBI; and IMF staff estimates.

1/ PCAR banks are Bank of Ireland, Allied Irish Banks, and Permanent tsb.

2/ Includes loans held for sale, classified on balance sheet as other assets.

3/ Includes profits from discontinued operations of €1.6 billion and tax credits of €1.5 billion in 2011.

Table 11. Ireland: Program Monitoring

Measure	Date	Status
Quantitative Performance Criteria		
Cumulative exchequer primary balance	End-June 2013	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-June 2013	Observed
Continuous Performance Criteria		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
Structural Benchmarks		
Define the criteria to run stringent stress tests scenarios.	End-December 2010	Observed
Agree on terms of reference for the due diligence of bank assets by internationally recognized consulting firms.	End-December 2010	Observed
The Central Bank will direct the recapitalization of the principal banks (AIB, BoI and EBS) to achieve a capital ratio of 12 percent core tier 1.	End-February 2011	Not observed ^{1/}
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed ^{2/}
The Central Bank to complete the assessment of the banks' restructuring plans.	End-March 2011	Observed
Complete the diagnostic evaluation of banks' assets.	End-March 2011	Observed
Complete stress tests (PCAR 2011).	End-March 2011	Observed
Complete a full assessment of credit unions' loan portfolios	End-April 2011	Observed
Finalize plans for the recapitalization of Irish Life and Permanent.	End-May 2011	Observed
Establish a Fiscal Advisory Council.	End-June 2011	Observed
Complete the recapitalization of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society.	End-July 2011	Observed
Submit the Supervision and Enforcement Bill to Oireachtas.	End-July 2011	Observed
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society.	End-September 2011	Observed
Publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight.	End-October 2011	Observed ^{3/}
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book.	End-December 2011	Observed
Finalize a strategy to guide the development of broader legal reforms around personal insolvency, including significant amendments to the Bankruptcy Act 1998 and the creation of a new structured non-judicial debt settlement and enforcement system.	End-December 2011	Observed
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets.	2012 Budget day in early December 2011	Observed
Updated restructuring plan for the PTSB detailing the actions needed to ensure viability of its core businesses.	End-June 2012	Observed
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence	End-September 2012	Observed

Table 11. Ireland: Program Monitoring (concluded)

Measure	Date	Status
Publish legislation to strengthen the regulatory framework for credit unions, including making legislative provision for effective governance standards and prudential requirements.	End-September 2012	Observed
Approve regulations to establish a charge levied across credit institutions to recoup over time the costs of resolving vulnerable institutions.	End-September 2012	Observed
Request an external BCP assessment in support of efforts to strengthen financial supervision and regulation.	End-March 2013	Observed
Publish an update, where necessary, of the 2011 Impairment Provisioning and Disclosure Guidelines.	End-May 2013	Observed
Undertake a review of progress in addressing mortgage arrears.	End-June 2013	Observed
Conduct a forward looking analysis of PCAR banks' operating profits.	End-September 2013	Partially observed
Publish 2014 Budget.	October 15, 2013	Observed
Complete a preliminary balance sheet assessment of PCAR banks.	End-October 2013	Observed with delay
<p>1/ Central Bank directions were issued within the required timeframe. However, completion of the capital injections required was postponed by the Minister for Finance until after the General Election. These directions are now superseded by the Central Bank's PCAR directions of 31 March 2011.</p> <p>2/ In practice this was submitted to the Seanad as discussed in paragraph 21 of the MEFP, as the Dáil was dissolved owing to the elections.</p> <p>3/ Effective end-October 2011 and posted on November 8, 2011.</p>		

**Table 12. Ireland: Quantitative Performance Criteria and Indicative Targets
Under the Economic Program for 2011–13**

	31-Dec-11		31-Mar-12		30-Jun-12		30-Sep-12		31-Dec-12		31-Mar-13		30-Jun-13		30-Sep-13	
	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target1/	Outcome
(In billions of euro)																
	Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion	
1. Cumulative exchequer primary balance 2/	-22.3	-21.0	-6.9	-5.7	-9.6	-8.7	-11.4	-10.1	-13.2	-12.3	-3.2	-1.8	-4.0	-2.2	-3.7	-2.3
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 3/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
	Indicative Target		Indicative Target		Indicative Target		Indicative Target		Indicative Target		Indicative Target		Indicative Target		Indicative Target	
3. Ceiling on the stock of central government net debt	117.2	115.7	125.0	123.0	130.1	128.2	132.5	130.0	135.8	133.7	167.9	161.8	171.1	164.6	171.0	165.4
1/ Adjusted. For details on the adjustments, see Annex II in Ireland—Eleventh Review Under the Extended Arrangement .																
2/ Measured by the exchequer balance excluding interest payments. Cumulative from the start of the relevant calendar year.																
3/ Applies on a continuous basis.																

Annex I. Debt Sustainability Analysis

This Annex presents the public and external debt sustainability analysis (DSA) based on staff's medium-term macroeconomic framework and the Irish authorities' fiscal consolidation plan.

Public Debt Sustainability Analysis

1. **Public debt sustainability risks remain largely unchanged from the eleventh review (IMF Country Report No. 13/305).** Since the last review, Ireland's debt trajectory has developed in line with staff projections, and principal risks to debt sustainability have not changed substantially. Under the baseline scenario, public debt is projected to peak this year at 124 percent of GDP before declining to 112 percent in 2018 as the fiscal deficit narrows and economic recovery gains traction. Gross financing needs are forecast to remain below 15 percent of GDP over the medium term, providing a mitigating factor for the risks associated with the debt level. The downward trajectory of Ireland's public debt remains fragile given its vulnerability to lower growth and contingent liabilities, mainly from the financial sector.
2. **A heat map and fan charts indicate that Ireland faces high risks to debt sustainability (Figure 1).** The debt burden benchmark for advanced economies of 85 percent of GDP is already exceeded, which suggests that Ireland's debt level is highly vulnerable under all scenarios regardless of the extent to which a shock increases debt. Gross financing needs are only vulnerable to the contingent liability shock, as the benchmark of 20 percent of GDP is only exceeded under this stress test. The debt profile is also subject to high risks from external financing requirements (excluding debts of the IFSC) and public debt held by non-residents which exceed the upper risk assessment benchmarks for these indicators.¹ It is useful to note, however, that a large proportion of external financing requirements reflects non-IFSC private sector debt and trade operations. The fan charts illustrate the possible evolution of the debt-to-GDP ratio over the medium term, based on both a symmetric and an asymmetric distribution of risks. The asymmetric fan chart (where only negative shocks to the primary balance are considered) is more relevant given the large planned fiscal adjustment and shows that risks to the debt outlook are skewed to the upside.
3. **There is no evidence of a systematic projection bias in the baseline assumptions for key macroeconomic variables** (Figure 2). Ireland's forecast track record is comparable to that of all other countries with Fund-supported programs. The median forecast errors for real GDP growth and the primary balance during 2004–12 are below 1 percent and in line with other countries. Individual large forecast errors for growth, primary balance, and inflation mostly arise during the crisis period, especially for the primary balance where there were very large unforeseen bank recapitalization costs.

¹ Note that Irish government bonds held by non-residents are considered to be external debt for this analysis.

4. **Reflecting the sizable fiscal effort, Ireland's fiscal adjustment is projected to improve its primary balance to above its debt stabilizing threshold** (Figure 2). The estimated change in the cyclically adjusted primary balance of 4½ percent of GDP over three years during the projection period is in the top quartile of fiscal adjustments observed in advanced and emerging market countries with debt greater than 60 percent of GDP. While sizable, this projected adjustment is consistent with Ireland's track record of steadfast efforts under its program, and is further underpinned by Ireland's commitments under the Excessive Deficit Procedure and fiscal rules entrenched in the Fiscal Responsibility Act. Nonetheless, the baseline debt path remains vulnerable in the event of a primary balance shock.

5. **Under the baseline macroeconomic projection, Ireland's debt ratio will enter a declining path from 2014** (Figures 3 and 4). Ireland's primary surplus is projected to rise above its debt-stabilizing threshold in 2015, while the planned reduction in the large cash buffer after a major debt amortization in January 2014 allows gross public debt to decline from 2014. Automatic debt dynamics arising from the interest rate-growth differential will on average add 3 percentage points per year to the debt-to-GDP ratio in 2013–14, before stronger growth takes hold from 2015.

6. **The projected decline in public debt remains fragile, vulnerable to both lower growth and contingent liabilities, which could compound each other** (Figure 5). Key risk factors include:

- **Growth shock.** Slower growth remains the principal risk to debt sustainability. If projected real GDP growth rates for 2014–15 are lowered by 0.5 standard deviation (implying annual growth about 2 percentage points lower at -0.3 percent y/y in 2014 and 0.5 percent in 2015), the debt-to-GDP ratio peaks at 131 percent in 2015 (compared with 122 percent under the baseline) before declining.²
- **Interest rate shock.** An interest rate shock does not pose a significant risk given that a 200 basis point increase on new borrowing affects the debt trajectory only marginally.³ The baseline is built on conservative interest rate projections, which have not taken into account the full extent of recent declines in spreads, thus including a safety margin. In the medium term, Ireland is shielded from a rise in interest rates by its still-high share of fixed rate and official borrowing. While the swapping of the fixed coupon promissory note against €25 billion of floating-rate long-term bonds reduces the share of fixed-rate borrowing, there is an option to exchange a portion of them against fixed-rate bonds at the time the CBI is

² A one-half standard deviation shock, instead of a default one standard deviation shock, is applied to the growth rate to adjust for the exceptionally volatile growth rates during the recent boom-bust years.

³ A 200 basis point interest rate shock, instead of a larger shock derived from the difference between average real interest rate level over the projection period and maximum real historical level (equivalent to 514 basis points), appears more appropriate given the exceptionally high interest rates during the crisis years (2008–10).

selling them in the market. The CBI will make such sales subject to a minimum disposal schedule and if financial stability conditions permit.

- **Macro-fiscal shock.** If slower growth in 2014–15 were compounded by a primary balance shock⁴ and by an increase in interest rates on new borrowing by 2 percentage points, the debt ratio rises to 133 percent of GDP in 2015 and falls to 126 percent by 2018. In this scenario, gross financing needs increase by about 2½ percentage points of GDP on average over the medium term compared with the baseline.
- **Contingent liability shock.** Potential sources of financial sector contingent liabilities include: (i) shortfalls in the crystallized value of NAMA assets (including those acquired in February 2013 from the liquidated IBRC);⁵ (ii) any further bank capital needs identified in the 2014 Comprehensive Assessment that could not be sourced in the market or through ESM direct recapitalization; and (iii) costs related to the ongoing restructuring of the credit union sector, although these are contained by the size of the sector, with net loans being only 2½ percent of GDP. Without estimates of the potential realization of these contingencies, a scenario assuming a 10 percent of GDP shock is used.⁶ Such a shock, if combined with the above growth shock, would push gross public debt to 135 percent of GDP and 139 percent in 2014 and 2015, respectively, before declining to 130 percent by 2018.

7. **Debt reductions from asset sales present an upside risk.** Current baseline assumptions do not incorporate proceeds from state asset disposals of up to €3 billion (around 1¾ percent of GDP) in the areas of energy generation and aviation, at least half of which are to be used for debt reduction. Similarly, no allowance is made for further transactions reducing the cost incurred in supporting the banking system beyond the sales of interests in BoI and Irish Life earlier this year.

⁴ A shock equivalent to one-half of the planned fiscal adjustment over the medium term is used, instead of a larger temporary shock derived from baseline primary balance minus one-half of the 10-year historical standard deviation, given the exceptionally high primary balances (reflecting bank recap costs) during the crisis years.

⁵ Based on the progress to date in preparing and valuing portfolios for sale, and the extent of interest evident in the initial sales process, the authorities do not anticipate a significant call on the budget will arise from the liquidation of IBRC assets during the remainder of 2013 and early 2014.

⁶ A 10 percent of GDP shock is used, instead of a default shock of 10 percent of banking sector assets (equivalent to around 30 percent of GDP), taking into account the 40 percent of GDP of financial sector support already incurred.

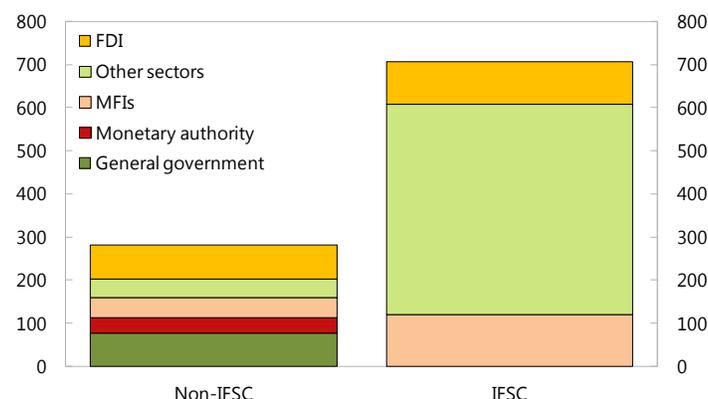
External Debt Sustainability Analysis

8. **External debt excluding the IFSC sector stood at 282 percent of GDP at the end of Q2 2013, while the total external debt (IFSC and non-IFSC) amounted to 990 percent of GDP:**

- Compared with end 2012, the non-IFSC debt declined by 17 percentage points of GDP while total external debt increased by 6 percentage points of GDP. Net international investment liabilities in Q2 2013 stood at 108 percent of GDP, which was mostly accounted for by the non-IFSC sector. Since end-2012, total external debt has fallen by 10 percentage points of GDP, while the non-IFSC debt declined by around 17 percentage points of GDP.

External Debt Composition, 2013-Q2

(Percent of nominal projected 2013 GDP)



Sources: Central Statistics Office Ireland; and IMF staff calculations.

Ireland: Net International Investment Position

(In percent of GDP)

	2005	2006	2007	2008	2009	2010	2011	2012	2013 Q2
Assets	1,032	1,133	1,197	1,267	1,493	1,680	1,650	1,718	1739
Direct investment abroad	54	52	54	67	126	161	149	165	189
Portfolio investment abroad	615	693	706	701	833	922	881	971	988
Other investment abroad	362	388	437	498	533	595	619	581	561
Reserve assets	0	0	0	0	1	1	1	1	1
Liabilities	1,057	1,138	1,216	1,342	1,586	1,768	1,744	1,814	1847
Direct investment to Ireland	85	67	73	75	107	135	120	138	168
Portfolio investment to Ireland	630	689	701	711	903	1,055	1,061	1,157	1182
Other investment to Ireland	342	382	442	557	576	578	563	519	497
Net investment position	-25	-5	-19	-76	-92	-88	-94	-96	-108
Direct investment, net	-31	-15	-19	-8	19	26	30	28	21
Portfolio investment, net	-15	4	5	-9	-69	-133	-180	-186	-193
Other investment, net 1/	20	6	-5	-59	-44	18	56	62	63
Reserve assets	0	0	0	0	1	1	1	1	1
Memorandum items									
Net IIP of the IFSC	32	35	44	4	-1	-1	15	-2	1
Net IIP of the non-IFSC	-56	-41	-63	-79	-91	-87	-108	-94	-110

Source: Central Statistics Office.

1/ Includes valuation changes and errors and omissions.

- The non-IFSC debt is largely comprised of official external liabilities of the general government and the central bank (around 40 percent of the total), which increased six-fold as a result of the crisis. This portion of the external debt is likely to decline gradually in line with the public debt profile and with the ongoing reduction of the Target II liability of the Central Bank of Ireland. Around 28 percent of the non-IFSC debt is accounted for by FDI-related liabilities, which are not usually considered to be a source of vulnerability given their intra-company nature. The minority remaining is split between foreign liabilities of domestic financial institutions and other sectors.

9. **By end 2018, total external non-IFSC debt is expected to decline to 219 percent of GDP, though significant risks surround this projection** (Table 1). This revised debt projection is around 3.5 percentage points of GDP higher than at the 11th Review. Risks to the debt outlook remain (Figure 6). With growth remaining at historical averages, in 2018 debt would be over 55 percentage points of GDP higher than under the baseline, though it would remain on a declining path. A permanent $\frac{1}{2}$ standard deviation shock to growth, implying a contraction of around $\frac{1}{4}$ percent in 2014 (about 2 percentage points below the baseline) and slow growth of $\frac{1}{2}$ percent annually thereafter, would raise the debt-to-GDP ratio to 245 percent, 26 percentage points above the baseline. A permanent $\frac{1}{2}$ standard deviation shock to the non-IFSC current account (excluding interest payments) would raise debt by around 21 percentage points of GDP above the baseline. A combined shock of $\frac{1}{4}$ of the standard deviation to the current account balance, real interest rate, and GDP growth rate would increase medium-term debt to 251 percent of GDP.

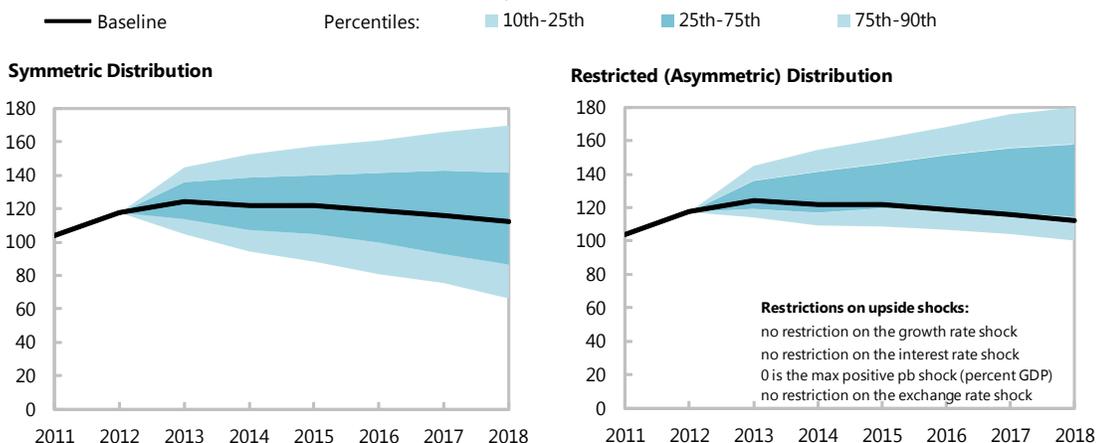
Annex I. Figure 1. Ireland Public DSA—Risk Assessment

Heat Map

Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

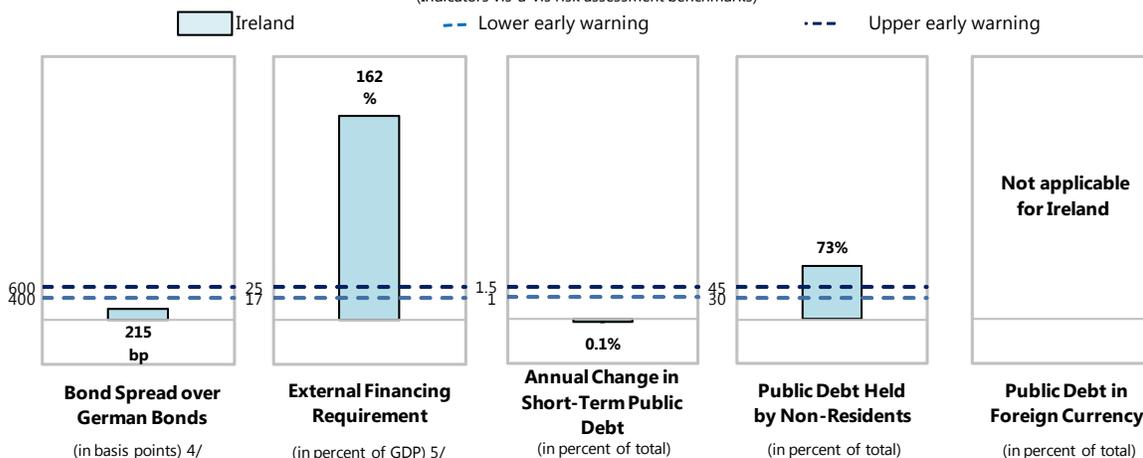
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85 percent of GDP is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20 percent of GDP is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

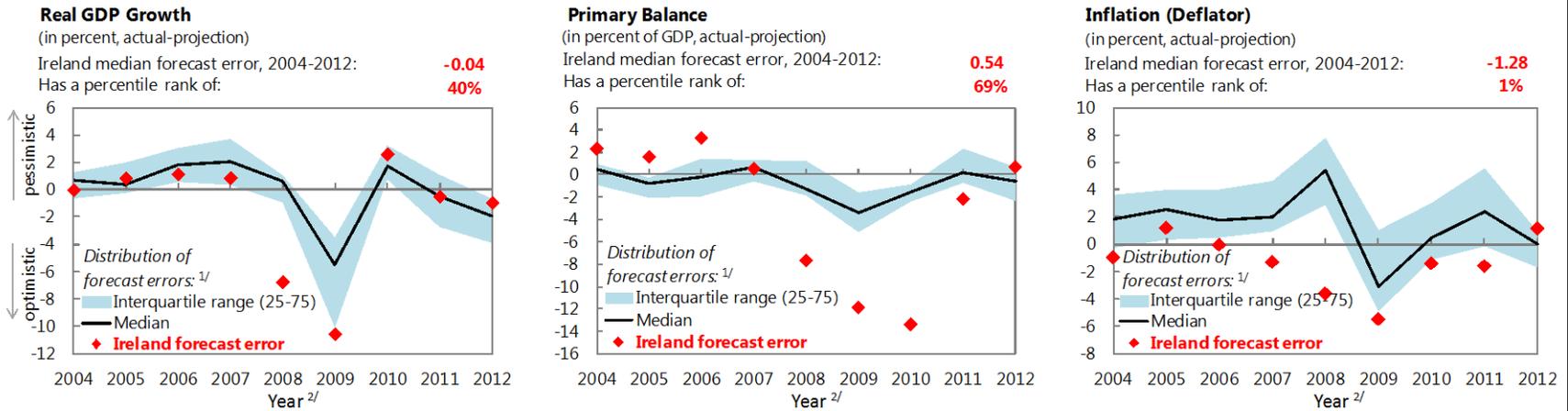
400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

4/ Average over the last 3 months, 06-Jul-13 through 04-Oct-13.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

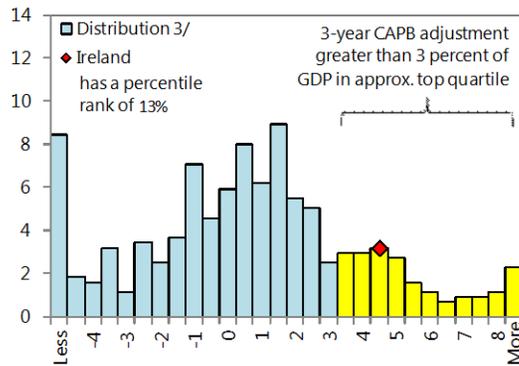
Annex I. Figure 2. Ireland Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus program countries

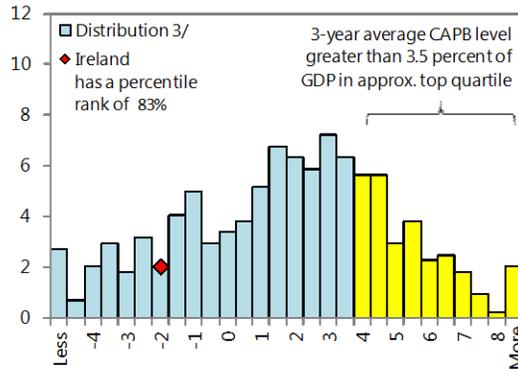


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

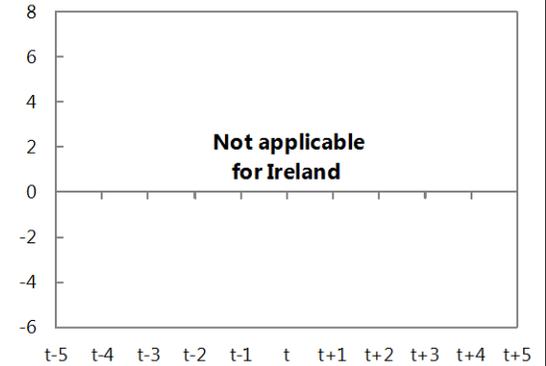


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis

Real GDP growth
(in percent)



Source : IMF staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex I. Figure 3. Ireland Public DSA—Baseline Scenario

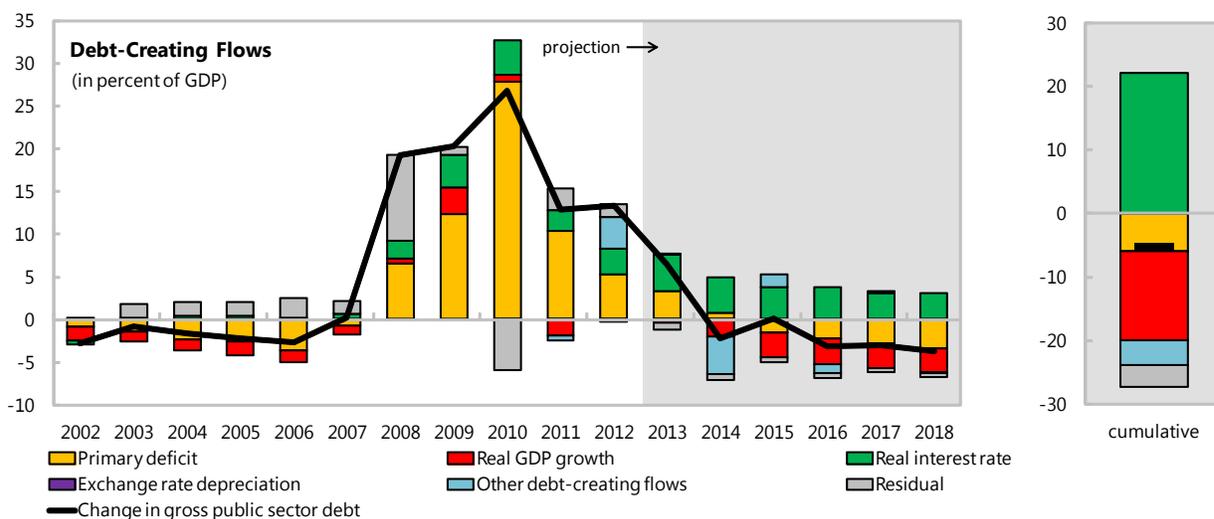
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of November 27, 2013		
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018	Sovereign Spreads		
Nominal gross public debt	41.0	104.1	117.4	123.9	121.7	121.9	118.8	115.8	112.2	Spread (bp) 2/ 180		
Public gross financing needs	...	19.0	15.7	13.5	10.6	6.8	11.6	9.0	12.3	CDS (bp) 121		
Real GDP growth (in percent)	2.3	2.2	0.2	0.3	1.7	2.5	2.5	2.5	2.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.2	0.7	0.7	0.6	0.7	1.0	1.0	1.6	1.6	Moody's	Ba1	Ba1
Nominal GDP growth (in percent)	3.6	2.8	0.8	0.9	2.5	3.5	3.6	4.1	4.2	S&Ps	BBB+	BBB+
Effective interest rate (in percent) ^{3/}	4.4	3.7	3.6	4.2	4.1	4.2	4.2	4.4	4.4	Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{7/}
	2002-2010	2011	2012	2013	2014	2015	2016	2017	2018		
Change in gross public sector debt	6.3	12.9	13.3	6.5	-2.2	0.2	-3.1	-2.9	-3.7	-5.2	0.0
Identified debt-creating flows	4.8	10.4	11.8	7.2	-1.7	0.6	-2.7	-2.6	-3.4	-2.6	0.0
Primary deficit	3.9	10.4	5.2	3.3	0.8	-1.5	-2.3	-2.9	-3.4	-5.9	0.0
Revenue and grants	34.8	33.5	33.7	34.8	35.1	35.2	35.0	34.8	34.6	209.5	
Primary (noninterest) expenditure	38.7	43.9	39.0	38.1	35.9	33.7	32.7	31.9	31.2	203.5	
Automatic debt dynamics ^{4/}	0.8	0.5	2.9	3.6	1.8	0.7	0.6	0.1	0.2	7.2	
Interest rate/growth differential ^{5/}	0.8	0.5	2.9	3.8	2.0	0.9	0.8	0.2	0.3	8.0	
Of which: real interest rate	1.3	2.5	3.1	4.2	4.1	3.8	3.7	3.1	3.1	22.0	
Of which: real GDP growth	-0.4	-1.9	-0.2	-0.4	-2.1	-2.9	-3.0	-2.9	-2.8	-14.1	
Other identified debt-creating flows	0.0	-0.5	3.7	0.2	-4.3	1.4	-1.1	0.1	-0.2	-3.9	
Drawdown of deposits (negative)	0.0	-5.7	3.2	0.5	-4.3	-0.2	-0.5	0.0	0.0	-4.5	
Other, incl. stock-flow adjustment	0.0	5.2	0.6	-0.3	-0.1	1.6	-0.6	0.1	-0.2	0.7	
Residual, incl. interest revenue ^{6/}	1.5	2.5	1.5	-0.8	-0.7	-0.6	-0.5	-0.4	-0.4	-3.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Bond Spread over German Bonds.

3/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).5/ The real interest rate contribution is derived from the numerator in footnote 4 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

6/ Includes asset and exchange rate changes.

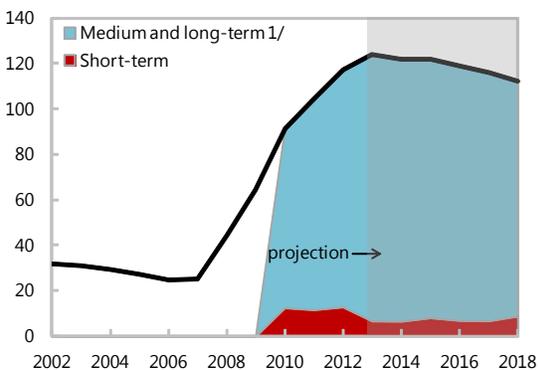
7/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Annex I. Figure 4. Ireland Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

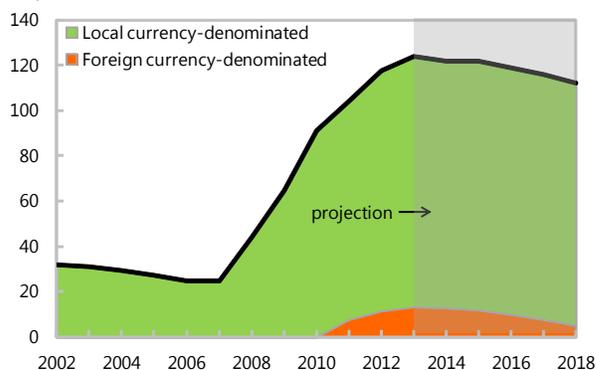
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

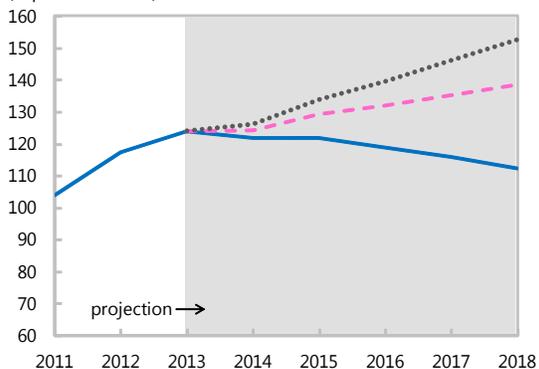


Alternative Scenarios

— Baseline Historical - - - - - Constant Primary Balance

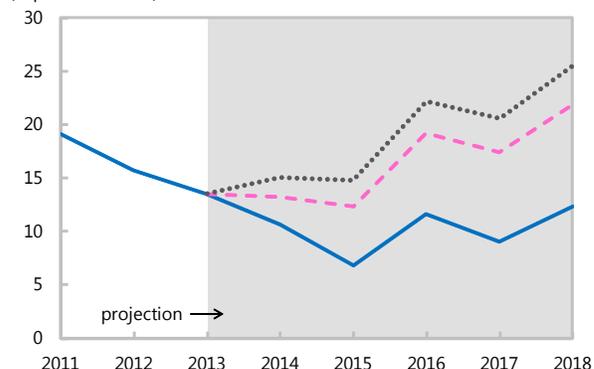
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	0.3	1.7	2.5	2.5	2.5	2.5
Inflation	0.6	0.7	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-0.8	1.5	2.3	2.9	3.4
Effective interest rate	4.2	4.1	4.2	4.2	4.4	4.4

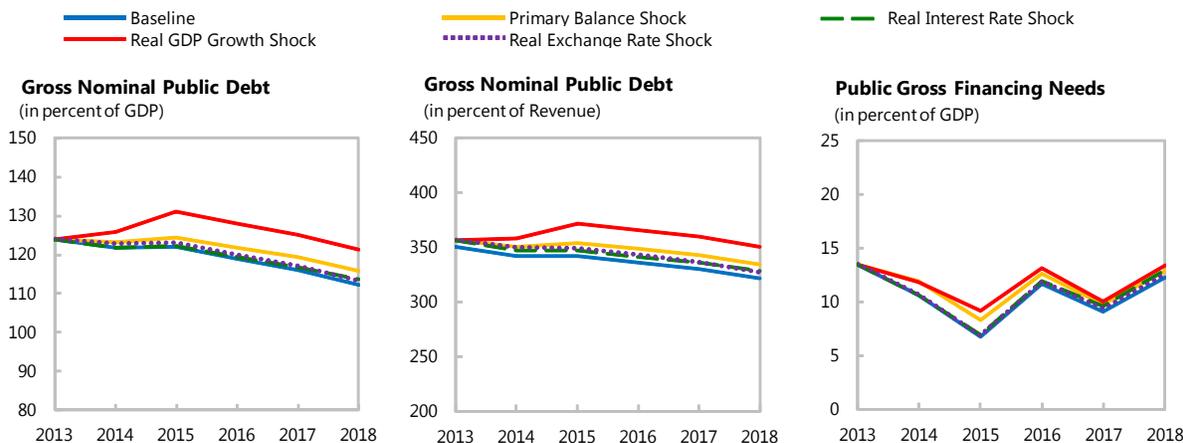
Constant Primary Balance Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	0.3	1.7	2.5	2.5	2.5	2.5
Inflation	0.6	0.7	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Effective interest rate	4.2	4.1	4.2	4.3	4.4	4.5

Historical Scenario	2013	2014	2015	2016	2017	2018
Real GDP growth	0.3	1.7	1.7	1.7	1.7	1.7
Inflation	0.6	0.7	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-5.2	-5.2	-5.2	-5.2	-5.2
Effective interest rate	4.2	4.1	4.3	4.4	4.5	4.7

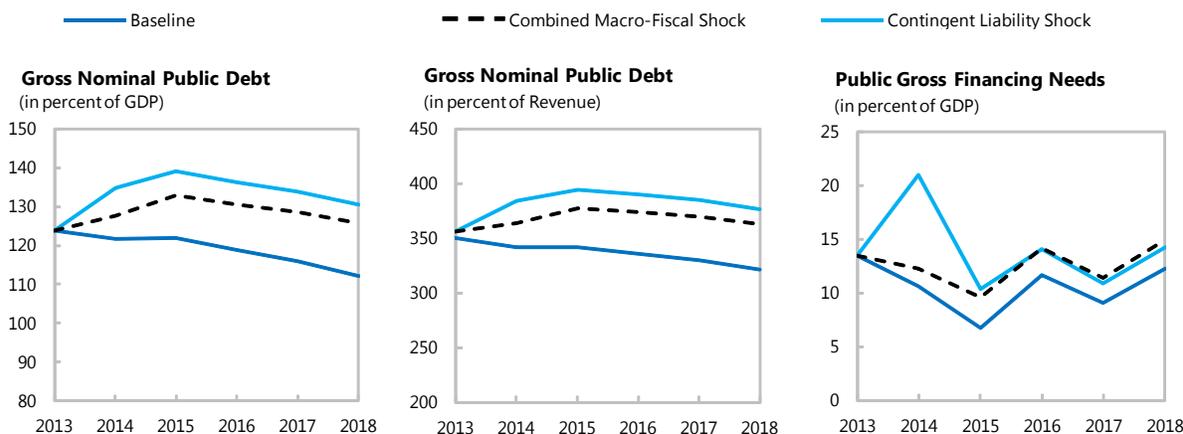
Source: IMF staff.
1/ Includes retail debt.

Annex I. Figure 5. Ireland Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests

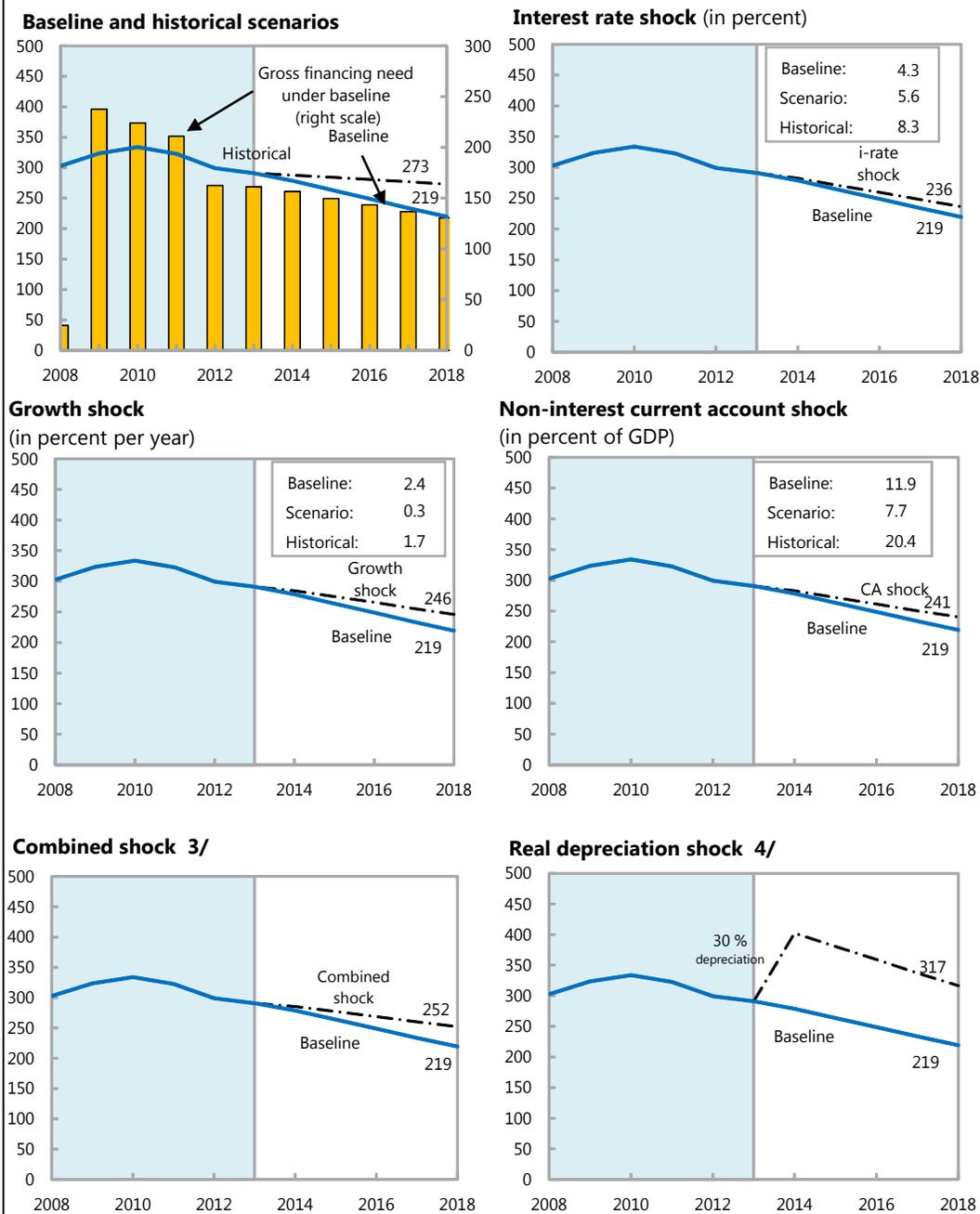


Underlying Assumptions (in percent)

	2013	2014	2015	2016	2017	2018
Primary Balance Shock						
Real GDP growth	0.3	1.7	2.5	2.5	2.5	2.5
Inflation	0.6	0.7	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-2.1	0.4	1.9	2.6	3.2
Effective interest rate	4.2	4.1	4.2	4.3	4.4	4.5
Real Interest Rate Shock						
Real GDP growth	0.3	1.7	2.5	2.5	2.5	2.5
Inflation	0.6	0.7	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-0.8	1.5	2.3	2.9	3.4
Effective interest rate	4.2	4.1	4.3	4.5	4.7	4.9
Combined Macro-Fiscal Shock						
Real GDP growth	0.3	-0.3	0.5	2.5	2.5	2.5
Inflation	0.6	0.2	0.5	1.0	1.6	1.6
Primary Balance	-3.3	-2.1	-0.2	1.9	2.6	3.2
Effective interest rate	4.2	4.2	4.4	4.5	4.8	5.0
Real GDP Growth Shock						
Real GDP growth	0.3	-0.3	0.5	2.5	2.5	2.5
Inflation	0.6	0.2	0.5	1.0	1.6	1.6
Primary Balance	-3.3	-1.7	-0.2	2.3	2.9	3.4
Effective interest rate	4.2	4.1	4.2	4.3	4.4	4.5
Real Exchange Rate Shock						
Real GDP growth	0.3	1.7	2.5	2.5	2.5	2.5
Inflation	0.6	1.1	1.0	1.0	1.6	1.6
Primary Balance	-3.3	-0.8	1.5	2.3	2.9	3.4
Effective interest rate	4.2	4.2	4.2	4.3	4.4	4.4
Contingent Liability Shock						
Real GDP growth	0.3	-0.3	0.5	2.5	2.5	2.5
Inflation	0.6	0.2	0.5	1.0	1.6	1.6
Primary Balance	-3.3	-10.8	1.5	2.3	2.9	3.4
Effective interest rate	4.2	4.2	4.5	4.5	4.6	4.7

Source: IMF Staff.

Annex I. Figure 6. Ireland: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
 3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 4/ One-time real depreciation of 30 percent occurs in 2014.

Annex 1. Table 1. Ireland: External Debt Sustainability Framework, 2008-2018

(In percent of GDP, unless otherwise indicated)

	Actual					Projections							Debt-stabilizing non-interest current account 6/
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018		
Baseline: External debt	302.7	323.6	334.0	322.7	299.2	291.1	278.7	263.2	248.2	233.1	218.9	-2.6	
Change in external debt	45.1	20.8	10.4	-11.3	-23.5	-8.2	-12.4	-15.4	-15.0	-15.1	-14.2		
Identified external debt-creating flows (4+8+9)	15.1	31.9	11.6	-9.1	-5.1	-6.6	-10.1	-12.4	-11.9	-11.2	-10.5		
Current account deficit, excluding interest payments	-26.6	-20.6	-22.9	-35.8	-16.1	-13.6	-12.2	-12.0	-11.4	-11.9	-11.8		
Deficit in balance of goods and services	-137.8	-143.9	-158.2	-161.4	-167.7	-165.7	-166.8	-167.6	-169.6	-171.5	-173.5		
Exports	71.4	77.5	85.9	89.0	93.0	91.8	92.3	93.2	94.4	95.4	96.4		
Imports	-66.4	-66.4	-72.3	-72.3	-74.7	-73.9	-74.5	-74.4	-75.2	-76.1	-77.1		
Net non-debt creating capital inflows (negative)	0.4	-1.9	3.1	0.6	-1.6	-4.3	-4.3	-4.2	-4.2	-4.2	-4.1		
Automatic debt dynamics 1/	41.2	54.4	31.3	26.1	12.5	11.3	6.4	3.8	3.7	4.9	5.4		
Contribution from nominal interest rate	27.8	20.9	22.7	35.4	15.2	12.3	11.3	10.4	10.2	10.9	11.0		
Contribution from real GDP growth	5.9	21.5	3.5	-7.0	-0.5	-1.0	-4.9	-6.7	-6.4	-6.0	-5.7		
Contribution from price and exchange rate changes 2/	7.6	12.0	5.0	-2.2	-2.1	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	30.0	-11.1	-1.2	-2.2	-18.4	-1.6	-2.3	-3.0	-3.2	-3.9	-3.7		
External debt-to-exports ratio (in percent)	423.9	417.7	388.7	362.4	321.6	317.0	301.9	282.3	262.9	244.4	227.1		
Gross external financing need (in billions of euro) 4/	44.4	385.8	354.3	342.8	266.2	266.7	265.3	262.1	260.6	259.0	257.6		
in percent of GDP	24.7	237.7	224.1	210.8	162.4	10-Year 161.2	10-Year 156.5	149.2	143.0	136.4	130.3		
Scenario with key variables at their historical averages 5/						291.1	287.8	284.4	280.8	277.0	273.0	16.1	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Real GDP growth (in percent)	-2.2	-6.4	-1.1	2.2	0.2	1.7	4.0	0.3	1.7	2.5	2.5	2.5	
GDP deflator (change in percent)	-2.9	-3.8	-1.5	0.7	0.7	0.7	2.6	0.5	0.8	1.1	1.2	1.6	
Nominal external interest rate (in percent)	10.3	6.2	6.8	10.9	4.7	8.3	2.6	4.2	4.0	3.9	4.0	4.6	
Growth of exports (in percent)	-1.2	-2.3	8.0	6.6	5.4	4.2	4.3	-0.5	3.1	4.6	5.1	5.2	
Growth of imports (in percent)	0.0	-10.0	6.0	3.0	4.1	2.9	6.5	-0.3	3.4	3.4	5.0	5.3	
Current account balance, excluding interest payments	26.6	20.6	22.9	35.8	16.1	20.4	8.4	13.6	12.2	12.0	11.4	11.9	
Net non-debt creating capital inflows	-0.4	1.9	-3.1	-0.6	1.6	-0.4	2.1	4.3	4.3	4.2	4.2	4.1	
1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.													
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).													
3/ For projection, line includes the impact of price and exchange rate changes.													
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.													
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.													
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.													

Annex II. Fund Relations

(As of October 31, 2013)

Membership Status: Joined August 8, 1957; Article VIII

General Resources Account:	SDR Million	Percent of Quota
Quota	1,257.60	100.00
Fund holdings of currency	19,885.41	1,581.22
Reserve position in Fund	258.66	20.57

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	775.42	100.00
Holdings	647.56	83.51

Outstanding Purchases and Loans:	SDR Million	Percent of Quota
Extended Arrangements	18,886.43	1,501.78

Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
EFF	12/16/10	12/15/13	19,465.80	18,205.43

Projected Payments to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Principal			535.20	2,173.15	2,895.74
Charges/Interest	124.11	627.09	654.38	607.96	509.42
Total	124.11	627.09	1,189.58	2,781.11	3,405.16

Exchange Rate Arrangement and Exchange Restrictions:

Ireland's currency is the euro, which floats freely and independently against other currencies. Ireland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

Safeguards Assessment:

The safeguards assessment of the Central Bank of Ireland (CBI) was finalized in March 2011. The safeguards assessment of the Central Bank of Ireland (CBI) found that the CBI has a relatively strong safeguards framework in place. Its financial statements are audited in

accordance with international standards and published. Governance and control systems adhere to good practices. The assessment recommended measures to address heightened risks emanating from the financial crisis, notably liquidity lending, and to improve transparency. Recommendations were also made to strengthen the de-jure autonomy of the central bank. Progress has been made in implementing these recommendations: the CBI has strengthened internal governance and control procedures for ELA; brought forward the publication dates for its audited financial accounts; clarified its accounting framework for areas not covered by ECB guidelines; and formally approved revised investment guidelines. The CBI and DoF are considering how to strengthen the arrangements for financial autonomy of the CBI, which may require changes to central bank legislation and changes in other related regulations, which would be prepared in consultation with the ECB.

Article IV Consultations:

The last Article IV consultation was concluded on September 5, 2012 (IMF Country Report No. 12/264). Article IV consultations with Ireland are on the 24-month cycle.

Twelfth Review Under the Extended Arrangement:

Discussions were held in Dublin during October 29–November 7, 2013. The IMF team comprised Craig Beaumont (head), Ashok Bhatia, Alexandre Chailloux, Jochen Andritzky, and Emilia Jurzyk (all EUR); Laura Jaramillo (FAD); Michael Moore and Joaquin Gutierrez Garcia (both MCM), and Varapat Chensavadijai (SPR). Teams from the EC and ECB as well as Mary O’Dea and Michael Hough from the Executive Director’s office participated in the discussions. The mission met with the Minister for Finance, the Minister for Public Expenditure and Reform, the Governor of the Central Bank and the Deputy Governor for Financial Regulation, the Chief Executive of the National Treasury Management Agency, the Chief Executive of the National Asset Management Agency, and senior officials from these institutions. The mission also met with representatives of the Fiscal Council; the Department of Jobs, Enterprise and Innovation; the Department of Justice and Equality; the Department of Social Protection; Central Statistics Office; the Economic and Social Research Institute; banks and market analysts.

Technical Assistance:

Department	Purpose	Date
STA	Balance of Payments Statistics	January 2011
STA	Monetary and Financial Statistics	January 2011

Resident Representative:

Mr. Peter Breuer assumed his post in September 2011.

Appendix I. Ireland: Letter of Intent

Dublin, 29 November 2013

Ms. Christine Lagarde
 Managing Director
 International Monetary Fund
 Washington, D.C. 20431

Dear Ms. Lagarde:

1. **Our economic programme has achieved its main objectives and has underpinned Ireland's emergence from the crisis.** The key objectives of our programme were to address financial sector weaknesses, to put Ireland's economy on a path of sustainable growth, to strengthen our public finances, to boost job creation, and to fully regain international capital market access. Now, as we approach the conclusion of our programme we are beginning to reap the rewards of our sustained efforts. Economic growth has returned, albeit at a slower pace than was anticipated at the start of the programme. The public finances have been put on a sustainable footing and unemployment is declining slowly but steadily. Importantly, we have also successfully returned to financial market funding. The financial sector has undergone significant restructuring since the beginning of the crisis and we will continue to progress this agenda. All of this has been achieved by steadfast implementation and delivery of our commitments under the programme and complemented by European decisions that led to a reduction of the interest rates on the EU sourced loans and an extension of the maturities of the EFSF and EFSM loans. This effort has encompassed the completion of over 260 actions to date. Looking ahead we intend to maintain our momentum and press on with our reform agenda. We are preparing a Medium-Term Economic Strategy (MTES), which will articulate the key principles that will underpin economic policy for the period to 2020. It will address the key policy areas such as education and training, labour market activation, industrial/innovation, access to credit, competition and budgetary policy. Through this strategic, medium-term perspective, the MTES will not duplicate – but will complement – the necessarily more short-term focus of other related policy efforts such as the *Action Plan for Jobs*. Although the Extended Fund Facility arrangement is ending we will keep our close dialogue with the Fund and will consult with it semi-annually under the usual Post-Program Monitoring.

I. MACROECONOMIC OUTLOOK

2. **Economic growth has resumed and has supported programme objectives.** Real GDP is forecast to grow by a modest 0.2 per cent this year. The impact of the patent cliff is weighing on pharma-chem activity, given its large weight in Irish output and exports. Developments in the domestic economy have been considerably more favourable though. Employment returned to

year-on-year growth of nearly 2 per cent in the second quarter, and unemployment, while still high, is continuing to fall. High-frequency indicators for the third and fourth quarters are also positive. Purchasing managers' indices have recorded some multi-annual highs, tourism numbers are up substantially and house prices have shown consistent growth since early in the year. 2014 GDP is forecast to grow by about 2 per cent. Net exports are expected to make a positive contribution to growth again, as the fast-growing service export sector offsets some drag from pharma-chem activity. Expectations for trading partner growth are also supportive as are continuing strong inflows of foreign direct investment. Domestic demand is expected to expand modestly, as increased employment and incomes spill over into real activity and construction output continues to rise from very low levels. The recovery is expected to strengthen with GDP growth set to average 2½ per cent over 2015 and 2016.

II. FISCAL POLICY

3. **In each year of the programme we have met or exceeded the fiscal headline targets.** The level of consolidation is significant with Budget 2011 to Budget 2014 achieving consolidation of over €16.4 billion. This is equivalent to 9.6 per cent of the forecast GDP for 2013, and approximately 90 per cent of the consolidation required in the period 2011 to 2015. All of this was achieved against a background of much lower growth than was projected when the programme started. We have also introduced important structural changes to the management of our public finances with the enactment of the Fiscal Responsibility Act 2012, the establishment of the Irish Fiscal Advisory Council on a statutory basis, the introduction of regular wide-scale reviews of public spending (the next Comprehensive Review of Expenditure to take place in advance of Budget 2015), and the implementation of multi-annual expenditure budgeting and Ministerial expenditure ceilings. The improved fiscal frameworks that have been put in place over recent years are testament to the commitment of the Government to ensuring that the mistakes of the past will not be repeated.

4. **The 2013 Budget position remains on track and we will ensure the 2013 fiscal deficit target of 7.5 per cent of GDP is met.** Building on the actions taken since mid-2008, which were designed to yield savings around €28 billion, *Budget 2014* introduced a set of adjustment measures aimed at reducing the deficit next year to 4.8 per cent of GDP, below the 5.1 per cent of GDP requirement under the Excessive Deficit Procedure (EDP). The measures are also intended to achieve a primary balance or a small surplus next year. Broadening the revenue base, reforming the health sector, and targeting social supports towards the most vulnerable will help achieve the further fiscal consolidation needed in a durable and growth-friendly manner.

5. **A clear focus on reducing the deficit below 3 per cent of GDP in 2015 has been the cornerstone on which budgetary planning over recent years has been anchored.** The Government remains steadfast in its commitment to meet this deficit target and will do whatever is necessary to achieve this. Beyond 2015, Ireland will be subject to the conditions of the stability and growth pact which necessitates continued fiscal prudence and structural improvement over the medium term.

III. FINANCIAL SECTOR

6. **Confidence in the Irish banks is beginning to return and has helped reduce their reliance on Eurosystem funding, which is now a fraction of what it was at the beginning of the programme.** As part of the 2011 Financial Measures Programme Irish banks were recapitalised to meet a capital requirement identified at €24 billion which was sourced from the private market, burden sharing with subordinated bondholders and from the State. The banking system has been restructured including deleveraging undertaken as part of the Financial Measures Programme and the merger of Allied Irish Banks with EBS. Exceptional Liquidity Assistance (ELA) has been removed from the system following the liquidation of IBRC. NAMA has maintained a strong financial position, generating considerable cash, leaving it on track to redeem €7.5 billion of bonds by the end of this year. Private capital has been introduced to the banking system including the sale of equity (in 2011) and contingent capital notes (in 2013) in Bank of Ireland and the sale of Irish Life (in 2013).

7. **We will press ahead with further restructuring of the banking sector.** We have prepared a preliminary assessment of the balance sheets of the PCAR banks. A rigorous review is being performed incorporating an assessment of impairment provisions and a review of the appropriateness of risk weights for regulatory capital purposes. The review has the benefit of extensive sampling of loan files by independent third parties and engagement with staff of the EC, ECB and IMF on an ongoing basis on progress, methodology, inputs, outputs and findings. The review will inform the continuing supervisory dialogue with each of the banks on the adequate level of provisioning at year end, in line with the Central Bank's guidelines. We will agree restructuring plans for AIB and PTSB with the European Commission and these plans will be implemented along with the already agreed restructuring plan for Bank of Ireland. Returning the banks to profitability will continue to be a key focus. The legacy banking assets now housed in NAMA will be run down over time together with assets that will be transferred to it from the liquidated IBRC. We will continue our policy of exiting our banking investments in a manner that maximises the proceeds to be returned to taxpayers. The main Irish banks will undergo a comprehensive risk assessment, including a stress test in 2014, in the context of the upcoming euro area-wide exercise prior to the establishment of the SSM.

8. **Building on the recommendations of the 2011 Inter-Departmental Mortgage Arrears Working Group, we have put in place a broad suite of measures to address the problem of mortgage arrears in a way that seeks to maintain credit discipline while providing appropriate relief to borrowers who are experiencing genuine repayment difficulty.** We have significantly reformed and updated our personal insolvency law and practice and also made changes to vindicate the legitimate rights of creditors. The Personal Insolvency Act 2012 introduced new insolvency resolution frameworks and also modernised the judicial bankruptcy system. The Land and Conveyancing Law Reform Act 2013 removed an uncertainty regarding the rights of some secured creditors. We have also put in place a process to require mortgage lenders to resolve, on a sustainable basis, cases of mortgage arrears. In particular, performance targets have been set for six credit institutions requiring them to propose and conclude sustainable mortgage solutions for their mortgages which are more than 90 days in arrears.

9. **Financial sector repair will continue with a view to ensuring that significant progress is made in the resolution of mortgage and SME difficulties in 2014.** The ongoing work on durable resolution of mortgages in arrears will reduce uncertainties that weigh on economic recovery. The Mortgage Arrears Resolution Targets process will be implemented in a resolute manner with a view to addressing most mortgages in arrears by the end of next year. The Insolvency Service of Ireland is now fully operational and will process insolvency applications from insolvent debtors in a fair and efficient way. In addition, we are continuing to address the SME distressed portfolios (which include considerable property-related exposures) through targets which require the banks to implement sustainable long-term debt resolution strategies for all distressed SME loans. Overall, we will continue to monitor and assign a high priority to the resolution of the arrears problem. Ensuring an adequate flow of credit for SMEs remains a priority and active consideration is being given to alternative provision of non-bank financing for the enterprise sector.

IV. STRUCTURAL REFORM

10. **Structural reform focusing on improved competitiveness has also been progressed.** This included the enactment of the Competition (Amendment) Act (2012) (to support the Competition Authority in the investigation and prosecution of anti-competitive practices) and the implementation of Sectoral Wage Reforms. As a result, over the last three years, we have won back much of the competitiveness we lost during the boom. Having seen significant erosion in competitiveness during the boom years, the European Commission is now estimating a 22 per cent improvement in unit labour costs in Ireland vis-à-vis the euro area over the period 2008-2014. The economic path for the years ahead will be directed by the Medium Term Economic Strategy 2014-2020 which we are preparing (see paragraph 1 also).

11. **There has been significant reform in the Health Sector, with significant reduction in the cost of drugs to the State.** The implementation of generic substitution and reference pricing has been prioritised by the Department, the Health Service Executive and the Irish Medicines Board. Reference pricing is expected to deliver at least €50 million savings in 2014. The Health (Pricing and Supply of Medical Goods) Act 2013 also includes a process for the review of existing prices outside of reference pricing. Each medicinal product, which was on the Reimbursement List when the legislation was commenced, must be reviewed by the HSE within three years to determine whether it should remain on the List and, if so, the price that should apply.

12. **Structural reform in other areas including labour market activation is well underway.** The labour activation effort will prioritise the reduction and prevention of long-term unemployment, combatting youth unemployment and helping to reduce the number of jobless households; this will involve greater engagement on job seeking activity and appropriate referral to activation or further education and training programmes. We also intend to deliver a Strategic Implementation Plan for Further Education and Training that will draw on the analysis and

recommendations of the FET Strategic Review carried out under the Programme this year. Legal services reform is also being advanced. The Legal Services Regulation Bill has completed Second Stage and commenced Committee Stage in July 2013. The resumption of Committee Stage is expected in early 2014 with a view to the Bill's earliest enactment and the expedited establishment of the new Legal Services Regulatory Authority. Water sector reforms are also continuing at pace. The Water Services Bill is progressing and is expected to be published shortly.

V. FUNDING

13. **Strong policy implementation of the programme has improved funding conditions even as domestic challenges and external uncertainties remain.** Ireland remains on course to end the year with a cash buffer sufficient to cover more than 12 months of Exchequer financing needs. The 7-year extension in EFSM/EFSD maximum average maturities and the February IBRC Promissory Note transaction significantly reduce funding needs in the coming years. These positive developments strengthen Ireland's ability to access long-term market funding on sustainable terms. The NTMA is guiding for €6 billion to €10 billion of market issuance in 2014 by way of pre-funding for 2015. In the context of euro area sovereign issuance requirements this is relatively modest. The NTMA looks forward to normalised engagement with the debt markets, following an exit from the EU-IMF programme, through 2014 and beyond using the standard issuance mechanisms, such as bond auctions and syndications.

14. **In light of our strong performance and the policies outlined in this letter, we request the completion of the twelfth review under the Extended Arrangement.** This would complete the disbursements of international assistance under the programme. We request the drawdown of the remaining programme funding in an amount equivalent to SDR 579.3748 million at the time of the completion of the review.

15. **We authorise the IMF to publish this Letter of Intent and the related staff report.**

This letter is being copied to Messrs. Draghi, Dijsselbloem, Rehn, and Šadžius.

Sincerely,

_____/s/
Michael Noonan, T.D.
Minister for Finance

_____/s/
Patrick Honohan
Governor of the Central Bank of Ireland



IRELAND

TWELFTH REVIEW UNDER THE EXTENDED ARRANGEMENT AND PROPOSAL FOR POST-PROGRAM MONITORING—SUPPLEMENTARY INFORMATION

December 12, 2013

Prepared By

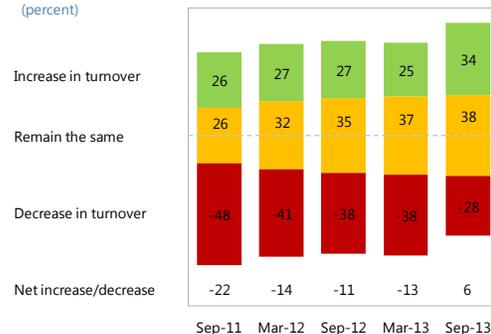
European Department

This supplement provides information that has become available since the issuance of the staff report on December 2, 2013. The information does not alter the thrust of the staff appraisal.

Recent high-frequency indicators continue to signal stronger economic growth in H2. The [unemployment rate](#) eased to 12.5 percent in November, its lowest reading since June 2009. Although PMIs for manufacturing, services, and construction all eased in November, they all remained significantly above the 50 mark signifying expansion. In November, the [KBC Ireland/ESRI consumer confidence index](#) retreated from a six-year high reached in the prior month, perhaps reflecting the impact of Budget 2014, but the index level remained relatively high. HICP inflation edged up to 0.3 percent y/y in November as increases in excise duties in Budget 2014 came into effect.

A [survey](#) of Small and Medium Enterprises found a significant improvement in trading conditions in Q2-Q3 along with a rise in credit approvals rates. The survey found 34 percent of SMEs experienced an increase in turnover, up from 25 percent in the previous six months, turning the net increase in turnover positive for the first time since the survey's inception in 2011. Trading conditions improved for all sizes of SME, with micro and small-sized companies gaining most. Although fewer SMEs sought credit, they report 80 percent of applications were approved in full or partially (excluding pending applications), an improvement of

Irish SMEs Business Turnover in the Last 6 Months
(percent)



Sources: RedC survey; and DoF.

4 percentage points. To further improve financing conditions for SMEs, the Department of Jobs, Enterprise, and Innovation will follow up on the expert review of the SME Credit Guarantee Scheme, which proposes several amendments to increase its take-up and future performance.

November exchequer figures suggest the general government deficit target for 2013 will be achieved with a more comfortable margin. Budget outturns for November showed strong revenues while spending remained within allocations. Cumulative revenues (after adjusting for one-offs) through end November were slightly above budget projections, as corporate tax, Pay Related Social Insurance, and stamp duties continued to over-perform, and earlier shortfalls on VAT and excise duties narrowed somewhat, indicative of rising consumer spending. Cumulative primary expenditure (excluding ELG payments stemming from the liquidation of IBRC) was 0.4 percent of GDP below the authorities' profile, though some of this underspending is likely to unwind by year end. The cumulative exchequer primary deficit through end November was 1.9 percent of GDP, 0.5 percent of GDP below the authorities' profile. Overall, these figures suggest a general government deficit closer to 7 percent of GDP in 2013, somewhat below the staff report estimate of 7.3 percent of GDP, resulting in a larger buffer relative to the target of 7.5 percent of GDP for 2013.

Cumulative Exchequer Out-Turn vs. Authorities' Profile,
January to November 2013
(Percent of GDP)

	Out-turn Nov-13	Authorities' Profile Nov-13	Out-turn Nov-12
Revenue	29.7	29.6	28.9
Tax revenue	27.4	27.1	26.3
Other revenue	2.4	2.5	2.6
Expenditure	35.7	36.1	36.0
Current primary	29.6	29.7	30.4
Interest payments	4.1	4.1	3.5
Capital	2.0	2.3	2.1
Overall balance	-6.0	-6.5	-7.1
Primary balance	-1.9	-2.4	-3.7

Sources: Department of Finance; and IMF staff estimates.

Note: To facilitate comparability: (i) 2012 tax revenues do not include the €251 million corporation tax payment delayed from December 2011; (ii) outlays in respect of Irish Life (€1.3 billion) and credit unions (€250 million) are excluded from 2012 capital spending; (iii) proceeds from the sale of Bank of Ireland contingent capital notes (€1 billion) and Irish Life (€1.3 billion) are excluded from 2013 other receipts; and (iv) Eligible Liabilities Guarantee scheme payments linked to the promissory note transaction of €1 billion are excluded from 2013 current expenditure.

Balance sheet assessment (BSA) results had limited impact on financial markets.

The CBI finalized intensive work on bank diagnostics in late November as scheduled, and communicated the results to each of the three banks covered by the assessment. Banks in turn made short announcements. Secondary market yields on three-year covered bonds from BoI and AIB as well as Irish government bond yields remained stable. BoI's share price declined about 3 percent on the day of its [announcement](#) of the BSA results.

Soon afterwards, the government recouped its investment in BoI preference shares made to inject capital in 2009. The transaction consisted of two components: (i) BoI placed €580 million of new ordinary shares, repaying the state €537 million (at par) after expenses; and (ii) the government sold the remaining €1.3 billion of preference shares to private investors. The transaction reduces the government's stake in BoI by about one percentage point to 14 percent. The authorities have recouped around €2.05 billion from the transaction, consisting of €1.837 billion in principal value, a profit of €62 million, and accumulated interest of €151 million. The CBI confirmed that, in line with EBA's Q&A decision of October 31, 2013, BoI will be able to include €1.3 billion of preference shares sold to private investors in its common equity tier 1 calculations under Basel III grandfathering rules until end 2017. However, it is not BoI's intention to retain the 2009 preference shares as regulatory common equity tier 1 capital after July 2016, provided the capital buffer remains adequate.

NAMA has met its target to redeem a quarter of its outstanding senior bonds by end 2013. On December 4, NAMA [announced](#) the redemption of €500 million in senior bonds, reaching its goal of €7.5 billion in total, while also holding a cash balance of €3 billion. To guide its asset disposal and other activities, the NAMA Board has set a target of redeeming another €7.5 billion in senior bonds by end 2016 and expects to redeem all €30.2 billion by 2020. NAMA also announced the redemption of €200 million in the senior bonds which had been issued following its purchase of the IBRC floating charge from the CBI when IBRC was put into liquidation in February 2013, bringing the total redemption of these bonds to €500 million.

Recent [statistics on mortgage arrears](#) show a stabilization in overall arrears in Q3 but longer dated arrears continue to rise. In relation to mortgages on primary dwellings, the value of mortgages in arrears remained stable at about 23.6 percent of the total in Q3. There was a change in the composition of these arrears, with mortgages in arrears of less than 90 days past due declining 6.5 percent by value in Q3. In contrast, mortgages in arrears of 90 days or more rose by 1.8 percent, with this increase entirely driven by rising arrears of over 720 days. For buy-to-let mortgages, the flow of mortgages into early arrears also slowed, but the share of mortgages in arrears by value edged up further, from 35.7 percent at end June to 36.2 percent at end September.

Loan modifications increased in Q3 with a continued shift away from short-term forbearance and a sharp rise in legal proceedings. For primary dwelling mortgages, 23,776 new restructuring arrangements were agreed in Q3, representing 3.1 percent of mortgage contracts. The share of short term forbearance modifications on primary dwelling mortgages, under which debtors pay interest only or less, declined further, from 37 percent of total restructurings at end June to 30 percent at end September. The share of restructured loans on which payments are meeting the terms of the arrangement improved slightly to 78.9 percent. Following the removal of the unintended legal barriers to certain repossession proceedings in July, legal proceedings to enforce collateral on primary dwelling mortgages were issued in 1,830 cases in Q3, up sharply from 270 in Q2.

On December 5 the CBI published its [Mortgage Arrears Resolution Targets \(MART\) for end June 2014](#). Each bank is subject to targets for proposed solutions of 75 percent of arrears cases over 90 days by end June 2014, and for concluded solutions of 35 percent of cases. As the banks have made substantial progress in initiating proposed solutions, the CBI intends to shift its supervisory focus to conclusions of solutions and their durability. Considering that empirical experience with concluded solutions under the MART framework is still limited, the Q2 2014 targets appear to strike a reasonable balance between the challenging goal of largely completing sustainable solutions by end 2014 and the need for solutions to be durable if they are to have the benefits intended.

Residential Mortgage Arrears Resolution Targets

Targets 1/	2013			2014			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Sustainable solutions proposed (percent of customers 90+ days in arrears)	20	30	50	70	75	2/	2/
Arrangements concluded (percent of customers 90+ days in arrears)	No target	No target	15	25	35	2/	2/
Terms being met (percent of arrangements concluded)	No target	No target	No target	75	75	75	75

Source: CBI.

1/ The targets cover ACC Bank, AIB, BoI, KBC Bank Ireland, PTSB, and Ulster Bank.

2/ Announced on a rolling quarterly basis.

The reform of personal bankruptcy has become effective, shortening the automatic discharge period from 12 years to 3 years. The long discharge period under the original Bankruptcy Act 1988 had resulted in very little use of bankruptcy to address financial distress. Under the 2012 statutory amendments, borrowers must attest to having been unable to agree other insolvency solutions, such as a Personal Insolvency Arrangement, before pursuing bankruptcy. Once debtors are declared bankrupt, the court may require them to enter into payment plans for up to five years under which income in excess of that required to meet reasonable living expenses is distributed to creditors. Alternatives such as Debt Relief Notices and Personal

Insolvency Arrangements provided for under Ireland's new personal insolvency framework may help contain the number of bankruptcies, as was the case following the introduction of Debt Relief Orders in the United Kingdom. To ensure smooth processing, the Insolvency Service has increased its staff resources and published [detailed guidance](#). With this step, Ireland's reformed personal insolvency framework has become fully operational.



Press Release No. 13/507
FOR IMMEDIATE RELEASE
December 13, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Twelfth and Final Review Under the Extended Fund Facility Arrangement for Ireland

The Executive Board of the International Monetary Fund (IMF) today completed the twelfth and final review of Ireland's performance under an economic program supported by a three-year arrangement under the Extended Fund Facility (EFF). The completion of the review enables the disbursement of an amount equivalent to SDR 0.579 billion (about €0.65 billion, or about US\$0.89 billion), bringing total disbursements under the EFF to the equivalent of SDR 19.4658 billion (about €21.81 billion, or about US\$29.94 billion) or the equivalent of 1,548 percent of Ireland's IMF quota.

The arrangement for Ireland, approved on December 16, 2010 (see [Press Release No. 10/496](#)), was part of a financing package amounting to €85 billion (about US\$116.68 billion), also supported by the European Financial Stabilisation Mechanism and European Financial Stability Facility, bilateral loans from Denmark, Sweden, and the United Kingdom, and Ireland's own contributions.

This is the last review under the EFF arrangement, which will expire on December 15. Owing to steadfast policy implementation by the authorities, the EU-IMF supported program has been completed successfully. Ireland has pulled back from an exceptionally deep banking crisis, significantly improved its fiscal position, and regained its access to the international financial markets. Growth, though slower than initially projected, has exceeded the euro area average. Key policy actions have included necessary bank support, restructuring and downsizing, improvements in bank supervision and regulation, fiscal consolidation measures totaling some 8 percent of GDP and improvements in the institutional framework for fiscal policy. These and other efforts leave Ireland in a much strengthened position and a range of economic indicators suggest a recovery is emerging in the second half of 2013.

Yet important challenges remain. Public debt is projected to reach 124 percent of GDP this year, although this partly reflects Ireland's strong cash buffer. The fiscal deficit is expected at about 7 percent of GDP, within the target of 7.5 percent of GDP, yet still high. Banks remain weighed down by low-yielding indexed mortgages and by 26.6 percent of loans being

nonperforming, including some 17.4 percent of the total values of mortgages in primary residences being in arrears for over 90 days. Unemployment, though significantly below its peak of 15.1 percent in early 2012, remains unacceptably high at 12.5 percent in November, with almost 60 percent of job seekers out of work for over a year

After the expiration of the EFF arrangement, Ireland and the IMF will continue to maintain a constructive policy dialogue. In accordance with Fund policy, Post-Program Monitoring (PPM)¹ will now be initiated.

Following the Executive Board's discussion, Ms. Christine Lagarde, Managing Director and Chair, said:

“With today's approval of the 12th review Ireland has successfully completed its EU-IMF supported program. Steadfast policy implementation by the Irish authorities has underpinned the achievement of core program objectives: stabilizing the financial sector, significantly improving the fiscal position, and regaining market access. Renewed job creation and a range of positive indicators signal an emerging recovery. As a result, Ireland is now in a much stronger position than when its program began.

“Yet Ireland still faces significant economic challenges. Unemployment is too high, public debt sustainability remains fragile, and heavy private sector debts and banks' slow progress in resolving nonperforming loans weigh on domestic demand. Continued concerted policy implementation is therefore necessary for Ireland to recover fully from the crisis.

“Steady fiscal consolidation has been a hallmark of Ireland's program with deficit targets again expected to be met in 2013. Budget 2014 sets out a balanced pace of adjustment in coming years, as needed to put public debt on a declining trajectory. To limit the drag on growth, revenue increases should focus on further broadening the tax base, and reforms of health, education, and social protection spending should be undertaken while protecting core public services and the most vulnerable.

“To help revive lending and sustain a recovery in demand, efforts to resolve mortgages in arrears should be intensified. The recent bank balance sheet assessment—an intensive analysis conducted by the Central Bank—found additional provisioning to be appropriate. Results should inform banking supervision and banks' preparations for the Comprehensive Assessment in 2014, for which an ESM recapitalization backstop is desirable.

¹ The central objective of PPM is to provide for closer monitoring of the policies of members that have substantial Fund credit outstanding following the expiration of their arrangements. PPM is discussed in more detail in this [factsheet](#).

“Reducing unemployment is a central priority, requiring improved employment services and training for jobseekers, together with steps to promote credit to SMEs, where the support of European partners is welcome.

“The government’s decision not to request a successor program is welcome. Ireland’s track record within its EU-IMF supported program bodes well for its success in tackling these remaining challenges and the Fund looks forward to continued constructive engagement with the Irish authorities.”



EUROPEAN CENTRAL BANK
EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Mr Brian Cowen
Taoiseach
and Prime Minister
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010

L/JCT/10/1438

Dear Prime Minister,
Please find attached a copy of the letter I sent today to Mr Lenihan.

With kind regards

Encl. Letter to Minister Lenihan dated 19 November 2010



EUROPEAN CENTRAL BANK
EUROSYSTEM

Secret

Jean-Claude TRICHET
President

Mr Brian Lenihan
Tánaiste and
Minister of Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

Frankfurt, 19 November 2010

L/JCT/10/1444

Dear Minister,

As you are aware from my previous letter dated 15 October, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other national central bank of the Eurosystem, is closely monitored by the Governing Council of the European Central Bank (ECB) as it may interfere with the objectives and tasks of the Eurosystem and may contravene the prohibition of monetary financing. Therefore, whenever ELA is provided in significant amounts, the Governing Council needs to assess whether it is appropriate to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the prohibition of monetary financing, it is essential to ensure that ELA recipient institutions continue to be solvent.

As I indicated at the recent Eurogroup meeting, the exposure of the Eurosystem and of the Central Bank of Ireland vis-à-vis Irish financial institutions has risen significantly over the past few months to levels that we consider with great concern. Recent developments can only add to these concerns. As Patrick Honohan knows, the Governing Council has been asked yesterday to authorise new liquidity assistance which it did.

But all these considerations have implications for the assessment of the solvency of the institutions which are currently receiving ELA. It is the position of the Governing Council that it is only if we receive in writing a commitment from the Irish Government vis-à-vis the Eurosystem on the four following points that we can authorise further provisions of ELA to Irish financial institutions:

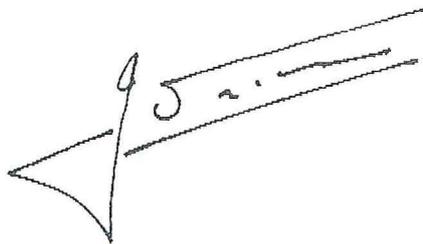
- 1) The Irish government shall send a request for financial support to the Eurogroup;
- 2) The request shall include the commitment to undertake decisive actions in the areas of fiscal consolidation, structural reforms and financial sector restructuring, in agreement with the European Commission, the International Monetary Fund and the ECB;

- 3) The plan for the restructuring of the Irish financial sector shall include the provision of the necessary capital to those Irish banks needing it and will be funded by the financial resources provided at the European and international level to the Irish government as well as by financial means currently available to the Irish government, including existing cash reserves of the Irish government;
- 4) The repayment of the funds provided in the form of ELA shall be fully guaranteed by the Irish Government, which would ensure the payment of immediate compensation to the Central Bank of Ireland in the event of missed payments on the side of the recipient institutions.

I am sure that you are aware that a swift response is needed before markets open next week, as evidenced by recent market tensions which may further escalate, possibly in a disruptive way, if no concrete action is taken by the Irish government on the points I mention above.

Besides the issue of the provision of ELA, the Governing Council of the ECB is extremely concerned about the very large overall credit exposure of the Eurosystem towards the Irish banking system. The Governing Council constantly monitors the credit granted to the banking system not only in Ireland but in all euro area countries, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks and the collateral they provide to the Eurosystem. The assessment of the Governing Council on the appropriateness of the Eurosystem's exposure to Irish banks will essentially depend on rapid and decisive progress in the formulation of a concrete action plan in the areas which have been mentioned in this letter and in its subsequent implementation.

With kind regards



Cc.: Mr Brian Cowen, Prime Minister



EUROPEAN CENTRAL BANK

EUROSYSTEM

Strictly Confidential

Jean-Claude TRICHET
President

Mr Brian Lenihan
Tánaiste and
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2
Ireland

COPY

Frankfurt, 15 October 2010

L/JCT/10/1280

Dear Minister,

I refer to our last phone conversation. As you know the ECB greatly appreciates the recent commitment of the Irish government to develop, in close cooperation with the Commission in liaison with the ECB, a multi-annual economic and fiscal adjustment strategy. Given Ireland's convincing track-record in fiscal adjustment, I am confident that your medium-term strategy will be successful in restoring fiscal sustainability and financial sector soundness.

In this context, I would like to draw your attention to a number of issues arising from the *extraordinarily large provision of liquidity by the Eurosystem to Irish banks* in recent weeks. The participation in Eurosystem credit operations is subject to rules. These include the requirement for the Eurosystem to base its lending operations with market participants on adequate collateral. Moreover, the General Documentation on Eurosystem monetary policy instruments and procedures requires our counterparties to be financially sound. In this context, the Eurosystem may limit, exclude or suspend counterparties' access to monetary policy instruments on the grounds of prudence and may reject or limit the use of assets in the Eurosystem credit operations by specific counterparties. The Governing Council indeed carefully monitors the Eurosystem credit granted to the banking system, in the Irish as well as in all other cases, and in particular the size of Eurosystem exposures to individual banks, the financial soundness of these banks, and the collateral they provide to the Eurosystem. The assessment by the Governing Council of the appropriateness of its exposures to Irish banks depends very much on progress in economic policy adjustment, enhancing financial sector capital and bank restructuring.

Moreover, the provision of *Emergency Liquidity Assistance (ELA)* by the Central Bank of Ireland, as by any other National Central Bank of the Eurosystem, is closely monitored by the ECB's Governing Council as it may interfere with the objectives and tasks of the Eurosystem and the prohibition of monetary financing under the Treaties. Therefore, if ELA is provided in significant amounts, the Governing Council will assess whether there is a need to impose specific conditions in order to protect the integrity of our monetary policy. In addition, in order to ensure compliance with the monetary financing prohibition, it is essential to ensure that the ELA recipient institution continues to be solvent.

Against the background of these principles, I would like to re-emphasize that the current *large provision of liquidity by the Eurosystem and the Central Bank of Ireland to entities such as Anglo Irish Bank should not be taken for granted as a long-term solution*. Given these principles, the Governing Council cannot commit to maintaining the size of its funding to these institutions on a permanent basis.

As I told you, a key element of the monitoring by the Governing Council of Eurosystem exposure to the Irish banking system, and the related decisions the Governing Council may take, will be its assessment of *progress in implementing the four-year economic strategy* that the Irish government envisages to announce in early November. This is not only because significant parts of the Irish banking systems are partially or fully Government owned, but also because an important share of the Eurosystem exposure to Irish credit institutions is collateralised with securities issued or guaranteed by the Irish Government. I trust that the four-year strategy will target a fiscal deficit of below 3% in 2014 and a decline in the public debt-to-GDP ratio from 2012/13 onward, based on cautious real growth forecasts, as well as a strong structural reform programme. Future decisions by the Governing Council of the ECB regarding the terms of liquidity provision to Irish banks will thus need to take into account appropriate progress in the areas of fiscal consolidation, structural reforms and financial sector restructuring.

With my best regards,



Cc.: Mr Olli Rehn, EU Commissioner for Economic and Monetary Affairs
Mr Joaquín Almunia, EU Commissioner for Competition



National Treasury Management Agency

Mr. Brian Lenihan TD
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2

21st November 2010

Dear Minister

I refer to the ongoing discussions with the IMF, the European Commission and the ECB regarding the stressed liquidity conditions affecting Ireland. The NTMA recognises that the liquidity conditions of the banking system are now so stressed that there is a serious risk of a collapse of the system. Given the close links between the State and its banking system the financial stability of the State itself is now in question.

To address these issues and, based on the information available to us, the NTMA recommends that an application be made to the external authorities for appropriate financial assistance. It is envisaged that such assistance will provide for a capital strengthening of the banking system and, although likely to be expensive, will also provide for a sizeable funding facility to the State. Appropriate support from the ECB would be a necessary complement to a decision to apply to the external authorities.

Yours sincerely

John C Corrigan

Chief Executive 



An Roinn Airgeadais
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21 November 2010

Mr Jean-Claude Juncker
Eurogroup President

Mr Didier Reynders
European Union Presidency

Dear Sirs,

On behalf of the Irish Authorities, I am writing to formally apply for financial assistance in the context of a joint EU-IMF programme. The external assistance sought is made under the terms of the European Financial Stabilisation Mechanism, the European Financial Stability Facility and the IMF assistance programme.

I welcome the statement by the Eurogroup and ECOFIN Ministers which concurred with the EU Commission and the ECB that providing assistance to Ireland is warranted to safeguard financial stability in the EU and in the euro area.

The Irish Authorities will cooperate fully in the preparation of the joint EU-IMF programme of assistance to the Irish State that will now be required to be developed.

Yours faithfully,

Brian Lenihan TD
Minister for Finance

cc Mr Olli Rehn, Commissioner on Economic and Monetary Affairs, European Commission
Mr Dominique Strauss-Kahn, Managing Director, IMF
Mr Jean-Claude Trichet, President, European Central Bank



IMF Reaches Staff-level Agreement with Ireland on €22.5 Billion Extended Fund Facility Arrangement

Press Release No. 10/462
November 28, 2010

Mr. Dominique Strauss-Kahn, Managing Director of the International Monetary Fund (IMF), issued the following statement today on Ireland: "The Irish authorities have today proposed a clear and realistic package of policies to restore Ireland's banking system to health and put its public finances on a sound footing. Immediate actions to tackle vulnerabilities in the banks and continued strong fiscal adjustment are set in a multi-year policy framework for sustained growth and job creation.

"In recent years, Ireland has resolutely carried out bold policies in a very challenging environment, and I have confidence in its ability to implement this new program. Supported by substantial financing, this program can underpin market confidence and bring Ireland's economy back on track. "The strategy for the financial system rests on twin pillars: deleveraging and reorganization; and ample capitalization. A fundamental downsizing and reorganization to restore the viability of the system will commence immediately.

"At the end of this process, a smaller, more robust, and better capitalized banking system will emerge to effectively serve the needs of the Irish economy. The transition to this goal will be buttressed by substantial recapitalization based on higher capital standards and stringent stress tests and asset valuation to accurately determine the quality of banks' loan portfolios. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability.

"On the fiscal side, the program incorporates a comprehensive National Recovery Plan that covers a period of four years. The plan will form the basis for the 2011 budget and also details fiscal consolidation measures through 2014. The process of budget formation will be reformed to safeguard these gains and bring greater sustainability to public finances.

"The fiscal plan strikes an appropriate balance between revenue and spending measures, and maintains Ireland's due regard to a social safety net.

"To restore strong sustainable growth the program includes a strategy to remove potential structural impediments to enhancing competitiveness and creating new employment opportunities. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, thereby supporting growth and reducing long-term unemployment.

"A financing package of €85 billion (about US\$113 billion) will support Ireland's effort to get its economy back on track. Of this, the European Union and bilateral European lenders have pledged a total of €45.0 billion (about US\$60 billion). The Irish authorities have decided to contribute €17.5 billion to this effort from the nation's cash reserves and other liquid assets. The Fund's contribution would be through a three-year SDR 19.5 billion (about €22.5 billion; or US\$30 billion) loan, representing about 2,320 percent of quota, under the Extended Fund Facility (EFF). The IMF has activated its fast-track procedures for consideration of Ireland's funding request, and I expect the EFF will go to the IMF Executive Board for approval in December."

The choice of an EFF offers Ireland a facility with a longer repayment period, with repayments to the Fund starting after four and a half years and ending after 10 years. The IMF charges member countries a uniform interest rate on nonconcessional loans, which is a floating rate based on the SDR interest rate, which is updated weekly. (The SDR interest rate is a weighted average of yields on three-month Treasury bills for the United States, Japan, and the United Kingdom, and the three-month Europe rate.) For amounts up to 300 percent of quota, the lending interest rate is currently 1.38 percent, while the lending rate on amounts over 300 percent of quota includes a surcharge that is initially 200 basis points and rises to 300 basis points after three years. At the current SDR interest rate, the average lending interest rate at the peak level of access under the arrangement (2,320 percent of quota) would be 3.12 percent during the first three years, and just under 4 percent after three years.

Ends

Statement by Minister for Finance, Brian Lenihan T.D. on the
EU/IMF Programme for Ireland and the National Recovery Plan
2011 to 2014

A Cheann Comhairle, amid the sometimes hysterical and contradictory reaction to the external assistance programme on which the Government concluded agreement last weekend, one quintessential point has been overlooked. It is this: without this Programme, our ability to fund the payments to social welfare recipients, the salaries of our nurses, our doctors, our teachers, our Gardai, would have been extraordinarily limited and highly uncertain.

Fifty billion of the €67.5 billion we are receiving from our European partners and from the IMF will go to fund those vital public services over the next three years. In those circumstances, the only responsible course of action for any government was to accept the EU/IMF financial assistance fund.

Nonetheless, we enter this Programme not as a delinquent State that has lost fiscal control. We enter it as a country that is funded until the middle of next year; as a State whose citizens have shown remarkable resilience and flexibility over the last two years in facing head on, an economic and financial crisis the severity of which has few modern parallels internationally.

The team with whom we have negotiated has acknowledged our success in stabilising our public finances and they have endorsed our banking

strategy. They have also accepted our four year Plan for National Recovery and have built their prescribed Programme around that Plan.

This needs to be emphasised because it shows that we do have the capacity to get out of our difficulties and that we have already made considerable progress in that respect. The fact is our economy is showing signs of recovery. As I have already reminded this house last week

- GDP will record a very small increase this year based on strong export growth.
- Exports are expected to grow by about 6% in real terms this year, driven by improvements in competitiveness and a strengthening of international markets.
- Conditions in the labour market are also beginning to stabilise.

The outlook for next year is much improved. As forecast in the Plan growth is expected to be around 1 $\frac{3}{4}$ per cent next year again driven by a remarkably robust export performance.

The Fine Gael leader referred to the European Commission's less optimistic forecasts in the Dail yesterday which he suggested had undermined our Four Year Plan. He ignored the substantial upward revision of the Commission's forecast on international trade which will benefit a small open economy like ours in which growth, by common consent, will be export led.

It is also the case that, under the Programme, we have been given an extra year to reach the deficit target of 3% of GDP precisely to take account of the Commission's lower growth forecast. I welcome this step but it does

not alter our budgetary plans as set out in the Plan. In other words the target of €15 billion of adjustments by 2014, remains but there is further room for manoeuvre in the event that growth is lower than expected. In the later years, the Commission's growth forecasts are similar to my Department's. It is also the case that others - such as the ESRI for example - believe that the Department of Finance forecast is too pessimistic.

The Programme has adopted in its entirety the measures set out in the National Recovery Plan as a roadmap to return our economy to sustainable growth. The adjustment of €15 billion by 2014 has been accepted as has the breakdown of €10 billion in spending reductions and €5 billion in revenue raising measures. The details of the first €6 billion of this adjustment will be contained in the budget which I will present to the House next Tuesday.

The programme of structural and labour market reform aimed at improving our competitiveness has also been endorsed by the Programme. It set out a detailed quarterly schedule for the achievement of the agreed measures.

The negotiations on the Programme which took place over a ten day period were intense and at times difficult. They were conducted under my direction and that of the Governor of the Central Bank by the most senior

officials from my Department, the Central Bank and the Financial Regulator, the National Treasury Management Agency and the Office of the Attorney General.

There has been the usual barrage of criticism of the outcome accompanied by the personal abuse of those involved that has become common place in our debased public discourse. But none of the critics explains how we could have secured the funds we require at less cost to the State.

Indeed the arguments put forward have been patently wrong. For example, it has been claimed that we are paying a higher interest rate than Greece even though Greece is now seeking our terms. The interest on Greek loans is 5.2% for 3 year loans. Ireland's interest rate will be 5.8% for loans that are on average for 7½ years. A basic fact of sovereign borrowing is that the longer a country borrows money, the higher the interest rate paid.

Germany can borrow at 2½% but the remainder of the EU member states are borrowing at either far closer to 5% or higher than 5% and they must cover their costs.

Of course, if at any time during the three years of the Programme, it emerges that we could borrow at a lower rate in the markets, there is nothing to stop us from doing so.

I want to clarify the position of the €85 billion funding package and its impact on our debt levels. Of the total, €50 billion is to provide the normal budget financing: in other words, it is money we would have had

to borrow over the next three years in any event. The Programme provides these funds at a much lower rate than currently available to us in the market. This level of funding is already included in the plan. Of the remaining €35 billion - €10 billion is for immediate additional bank recapitalisation and the remaining €25 billion is to be used as a contingency fund, only to be drawn down if required

Furthermore, the State is in the happy position of being able to contribute €17.5 billion towards the €85 billion from its own resources, including the National Pension Reserve Fund. It can do this without prejudicing the commitments in the four year plan to use funds from the NPRF for projects such as the water metering programme and retrofitting.

This use of the NPRF has provoked the most bewildering criticism of all from parties who, having for years fundamentally disagreed with the very existence of the Fund, have now become its most ardent protectors. And on this point the arguments make absolutely no sense. Why would we borrow expensively to invest in our banks when we have money in a cash deposit earning a low rate of interest? And how on earth can we ask tax payers in other countries to contribute to a financial support package while we hold a sovereign wealth fund? We have a large problem with our banks which has forced us to seek this external assistance. In these circumstances, it is surely appropriate that our cash reserves should be deployed to help solve that problem.

The reason we had to seek external assistance is because the problems in our banking system simply became too big for this State to handle on its

own. Our public finance problems are serious but we were well on the way to solving them. The combination of the two sets of difficulties in circumstances where the entire Eurozone was under pressure was beyond our capacity.

So the primary aim of the Programme agreed last weekend is to support the recovery and restructuring of our banking system.

It has been clear for some time that our banks were facing serious challenges in terms of their liquidity position. Lingering concerns in the market regarding their capital position led to negative market sentiment.

This was despite the substantial transfer of the banks' riskiest loans to NAMA and the detailed capital adequacy assessment made by the Financial Regulator in the summer as well as the significant recapitalisation measures that flowed from that.

But the Programme does not propose any departure from existing policy: its prescription is an intensification and acceleration of the restructuring process already being undertaken for the Irish banks. A key objective is to ensure that the size of the domestic banking system is proportionate to the size of the economy and is appropriately aligned with the funding capacity of the banks overall taking into account stable sources of deposit and wholesale funding.

The programme also seeks to demonstrate the capacity of the banks to accommodate very significant further deterioration in asset quality so as

to rebuild market confidence in the robustness and financial resilience of the banking system overall.

The Central Bank is requiring the banks to meet a Core Tier 1 capital ratio of 12% - a key measure of capital strength. If the banks cannot source it themselves, the State will inject the necessary capital. For that purpose, €10bn can be drawn down immediately from the overall Programme fund. A further remaining 25 billion euro will be available on a contingency basis.

The Central Bank will also carry out an updated capital assessment exercise or PCAR review of the capital position of the banks in early 2011 based on stringent stress testing and detailed reviews of asset quality and valuation. This exercise will ensure that over the coming years, the banks' capital ratio do not fall below 10.5% - this is a high standard in international terms and should give significant confidence to the market that our banks will be in a strong financial position. This in turn will provide the necessary reassurance to allow the banks to attract greater market funding in due course.

The Government will also undertake a process of significant restructuring and right-sizing of the banks to reduce their balance sheets. In this context, all land and development loans below €20m in Bank of Ireland and AIB will be transferred to NAMA.

Further work will be undertaken in the short-term with the banks to identify how the sector can be reorganised to ensure that we have a viable and financially strong banking system which meets the needs of the real economy and has the confidence of international markets. This strategy, developed in collaboration with the various international organisations

and endorsed by them, builds on the measures adopted by the Government over the past two years to resolve our serious banking difficulties.

The Programme allows for an integrated approach to the restructuring of Anglo Irish bank and Irish Nationwide Building Society, building on the proposed Asset Recovery Bank structure to seek to maximise value from their loan books.

Revised restructuring plans for the two institutions will be submitted to the European Commission in early 2011 detailing the resolution of the institutions, in particular the arrangements for working out of assets over an extended period of time

I would like to reiterate that all deposits held with the domestic banking system are safe and covered by the Deposit Protection Scheme for sums up to €100,000. In addition, deposits are covered under the Eligible Liabilities Guarantee Scheme for sums over €100,000 for the full term of the deposit up to five years providing they are made prior to 30 June 2011.

There has been much commentary about the need for senior bondholders to accept their share of the burden of this crisis. I certainly raised this matter in the course of the negotiations and the unanimous view of the ECB and the Commission was and is that no Programme would be possible if it were intended by us to dishonour senior debt. The strongly held belief among our European partners is that any move to impose burden sharing on this group of investors would have an enormous ripple effect throughout the Euro system. That was confirmed by Professor

Honohan in an interview last Monday when he said there was no enthusiasm in Europe for this course of action.

There is simply no way that this country, whose banks are so dependent on international investors, can unilaterally renege on senior bondholders against the wishes of the ECB. Those who think we could do so are living in fantasy land. Worse still, those who know we cannot do so but who nonetheless persist with the line are damaging this country and its financial system: and all for the sake of a cheap headline. It is a case of politics as usual even at this most difficult time.

It is estimated that around 84% of Ireland's bonds are held by international investors. Whether guaranteed by the State or not, a decision to default on these bond obligations would seriously compromise the standing of the whole of the Irish financial system. That is the advice of the Governor of the Central Bank; that is the advice of the National Treasury Management Agency; that is the advice of the Attorney General.

The idea that is out there that somehow there are no costs associated with default is entirely incorrect. Ireland is hugely dependent on Foreign Direct Investment. These companies have large funds and investments in Ireland and directly and indirectly employ a quarter of million people in this economy. Any default on senior debt and the uncertainty that would cause would undoubtedly impact on the future investment decisions of these companies.

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Subordinate Bonds

Subordinated debt holders are in a different position. As I said in my statement on the 30th of September last, there will be significant burden sharing by junior debt holders in Irish Nationwide and Anglo Irish Bank. These two institutions had received very substantial amounts of State assistance and it was only right that this should be done.

My Department has been working with the Office of the Attorney General to draft appropriate legislation to achieve this and this is near finalisation. Parallel to this Anglo Irish Bank has run a buyback operation which will offer these bondholders an exchange of new debt for old but at a discount of 80%. This process is still underway and will be concluded shortly.

Obviously this approach will also have to be considered in other situations where an institution receives substantial and significant State assistance in terms of capital provided to maintain their solvency ratios. I hope to be in a position soon to announce this legislation.

We need a properly functioning banking system for this country. As I have indicated in the past we need to shift to a banking system commensurate with the economy but one that is strong and capable of meeting our needs. That has been the overriding objective of all our efforts since this crisis began two years ago. I believe the considerable funds provided by this Programme, will enable us to bring this crisis to an

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end and to secure the future of the Irish banking system so that it can play its full role in supporting the development of this country.

Conclusion:

We have been through a traumatic two years. Of course, we would have preferred to avoid resort to external assistance. But we can emerge from it a stronger and fitter economy. The attributes that brought us the boom: the quality of our workers, our entrepreneurship, our pro-business environment; all of these remain in tact. During the boom we built a top class transport infrastructure, sport and cultural facilities and educational sector. Over the last two years, we have won back much of the competitiveness we lost during the boom.

This 3 year EU/IMF Programme will provide the basis for funding us through our current difficulties. It provides the funding to restructure and recapitalise our banking system. And it will guide us through the implementation of the necessary budgetary and reform strategies set out in the National Recovery Plan. A Cheann Comhairle, we have every reason to be confident about the future of this economy.



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Dublin, 3 December, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

1. Ireland faces an economic crisis without parallel in its recent history. The problems of low growth, doubts about fiscal sustainability, and a fragile banking sector are now feeding on each other, undermining confidence. To break this vicious circle, we are proposing a strong, wide-ranging, reform programme, backed by a substantial international financing package, to restore confidence and return the economy to a path of sustained growth and job creation.
2. At the root of the problem is a domestic banking system, which at its peak was five times the size of the economy, and now is under severe pressure. The Irish owned banks were much larger than the size of the economy. The fragility of the banking sector is undermining Ireland's hard-earned economic credibility and adding a severe burden to acute public finance challenges. Decisive actions to restore the strength of the financial sector and re-establish fiscal credibility are needed now.
3. The Irish authorities have already undertaken major steps to address these challenges. For the financial sector, these include measures to facilitate funding of banks, separate good assets from bad, asset disposals, and bank recapitalisation. On the fiscal side, we have pursued a large consolidation programme since 2008 and have announced a National Recovery Plan that accelerates the process of putting public finances on a sound footing.
4. But we recognise that more needs to be done. A fundamental downsizing and reorganisation of our banking system is essential. We are immediately undertaking several bold measures to achieve a robust, smaller, and better capitalised banking system that will effectively serve the needs of the economy. Restoring the banks to viability will also help insulate public finances from further pressures. We are mindful that the transition to a healthy banking sector will need to be actively managed to avoid fire sales of assets and



reduce market uncertainty. We are, therefore, expeditiously raising capital standards, stepping up efforts that will ensure that banks' losses are promptly recognised, and creating a mechanism to inject needed capital into the banks. We are also strengthening the banking resolution framework to promote financial stability.

5. In addition, we are also pressing ahead with our commitment to achieving a sustainable budget position. The National Recovery Plan lays out our strategy for staying the course of needed reform in a way that is socially fair and protects the most vulnerable. Recognising that Ireland already has put in place a business-friendly environment, our Plan also lays out a range of structural reforms that will be implemented to underpin economic stability, and enhance growth and job creation.

6. We are turning to our international partners for support as we implement these far-reaching objectives. Our estimate is that the financing need would be up to €85 billion until the end of 2013. We therefore request that the Fund support our policy programme through an arrangement under the Extended Fund Facility which can be drawn over a period of 36 months in the amount of SDR 19.4658 billion (€22.5 billion). This arrangement, along with support of €45 billion from the European Financial Stability Mechanism/European Financial Stability Facility including bilateral loans from the United Kingdom, Sweden and Denmark, and the judicious use of our own resources (€17.5 billion), will help ensure financial stability as we restore market confidence and return to durable growth.

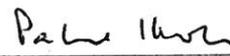
7. The attached Memorandum of Economic and Financial Policies outline the economic and financial policies that the Irish authorities will implement during the remainder of 2010 and the period 2011–13. We are confident that the policies set forth in this memorandum are adequate to achieve the objectives under the programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. As is standard under Fund-supported programmes, we will consult with the Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter.

8. This letter is being copied to Messrs. Juncker, Reynders, Rehn, and Trichet.

Sincerely,



Brian Lenihan
Minister for Finance



Patrick Honohan
Governor of the Central Bank of Ireland

Government's Negotiation of Programme of Assistance and Interest Rate Savings

- The Government has successfully negotiated several key changes to the programme of assistance in series of phases:
 1. The MoU was amended also to allow for the jobs initiative, the restoration of the minimum wage and also to provide that no further loans were transferred to NAMA.
 2. The Government has successfully renegotiated the interest rate which will give rise to significant savings for the state. This in turn will improve our debt sustainability and reduce the cost of the bailout to taxpayers. This is very welcome news.
- As pointed out by Minister Noonan in Poland we have achieved significant clarity in our favour on interest since July and over the last week.
- The annual saving based on the full drawdown of the €45 billion available from the EU and bilateral loans are set out in the tables below. They set out the calculation of the original estimates (from July) and the more recent estimates based on last week's discussions.

Initial Illustrative Calculation – based on initial illustrative assumptions of 2% reduction:

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.00%	17.7	354
EFSM	2.00%	22.5	450
Bilaterals	2.00%	4.8	96
Total		45	900 ¹

Updated NTMA estimates reflecting last week's announcements – EFSF rate reduction is approx. 2.6% and EFSM rate reduction is just under 3%

	Percentage reduction in the interest rate	Total available loans (€bn)	Annual Interest Savings in €m
EFSF	2.6%	17.7	450
EFSM	2.925%	22.5	650
Bilaterals	2.00% (not yet finalised)	4.8	100 (to be finalised)
Total		45	1,200 ²

¹ Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.

² Figure only valid when all €45 billion has been drawn down and for as long as this amount remains outstanding.

- In addition, the cost of our IMF loans will reduce as a result of recent and forthcoming increases in our IMF quota. The NTMA has calculated the overall benefit of this interest rate reduction at some €1.9 billion. Some €30 million of this arises in 2012 and is included in the overall estimate of €900 million of interest savings for next year.
- Based on the above estimates for the changes to the EU and IMF elements of the loans, the overall saving based on the initial lifetime of the programme (which will be extended) would be over €10 billion.
- For 2012 the changes in the EU and bilateral loans combined with the impact of IMF quota changes amount to some €900 million.
- The average maturities of the loans will be extended – this has the effect, as pointed out by Commissioner Rehn on Friday of improving our debt sustainability and also of improving liquidity for Ireland.
- Furthermore Minister Noonan pointed out that it has been agreed at the weekend meeting that Ireland will get a prepaid margin of €600m on the EFSF returned in 2016. This had not been clear beforehand. While it is important to note that this margin return is already factored into the interest savings figures once all the programme funding is drawdown it does give rise to a €600m capital receipt in 2016 directly to the Exchequer.

Impact of interest rate reduction on adjustment for 2012

- These actions are very positive for Ireland and improve our debt sustainability but there is a need for us to be realistic as there are a lot of difficult decisions still to be made. Indeed, we only get the benefit of the interest rate reductions if we continue to meet our programme commitments. The Commission, when announcing the proposed change to our EFSM, rate cited the fact that Ireland is meeting its programme.
- This Government is committing to making these difficult decisions and restoring our sovereignty but we will continue to negotiate key elements of our programme, as appropriate.



National Treasury Management Agency

Mr Brian Lenihan TD
Minister for Finance
Government Buildings
Upper Merrion Street
Dublin 2

28 November 2010

Dear Minister

I refer to my letter of 27 November 2010 regarding the proposed programme of external financial assistance and the subsequent discussion on it at last night's Government meeting at which I was in attendance. I am writing, as requested, to elaborate on a number of issues which arose.

I learnt during the course of the discussion that the external authorities and the European Central Bank (at board or equivalent level) had taken the view that burden sharing with unguaranteed bank senior bond holders was "not on the table". It is unfortunate that, notwithstanding the fast moving pace of recent events, I was not made aware of this outcome.

Recognising that burden sharing involving unguaranteed bank senior bond holders is no longer a potential cost mitigant, it is all the more important that the costs to the State of recapitalising the banks are kept to the minimum consistent with restoring a viable banking system. In this context I referred last night to the need to manage carefully the pace of deleveraging the banks' balance sheets so as to limit drawings on the €35 billion bank capital contingency.

As indicated in my letter, the NTMA is of the view that the estimated average cost of the facility, at 5.8%, is not unreasonable. The rates underlying that average are based on long standing IMF formulae and precedent lending. The estimated average rate is comparable with the 6.02% paid on Ireland's most recent Government bond auction (September 2010) which was for an 8 year maturity. Our credit rating has, of course, moved down sharply since that auction.

As I also indicated in my letter, the NTMA accepts that the adoption of the programme is the best course of action. I would, however, emphasise again the immediate need for a clear statement from the ECB underpinning ongoing liquidity support for the Irish banks if the programme is to succeed.

Yours sincerely

A handwritten signature in black ink that reads "John C. Corrigan".

John C. Corrigan
Chief Executive



BAIL-IN STRATEGY WITH HOLDERS OF SENIOR AND SUBORDINATED DEBT

NATIONAL TREASURY MANAGEMENT AGENCY

STRICTLY PRIVATE AND CONFIDENTIAL

28 MARCH 2011



Introduction

Due to the levels of support that have been provided to the Irish banking sector to date and the impending results of the current PCAR/PLAR exercise, the issue of burden sharing with senior as well as subordinated debt holders has been raised as a method to mitigate to the cost for the State of providing further capital support to the banking sector.

Burden sharing with debt holders either through debt write downs, the conversion of debt into equity or conversion of liabilities into contingent capital instruments will create capital gains for the Irish banks which, depending on the eventual level of haircut applied to the senior unsecured unguaranteed debt (senior debt) and subordinated debt, could give rise to a capital saving to the State of approximately €14.9¹ billion. While this amount would not be sufficient to fully offset the cost to the State of providing capital to the banks it would provide a significant contribution to the costs to the State of the capitalisation of the banks.

However, to take the approach of burden sharing with holders of senior debt appropriate legislation will need to be implemented and the support of the external authorities would, unless the Government decides to proceed without the support of the external authorities, be critical to any final position to be taken by the Government on this matter.

Debt Sustainability

Ireland is currently three notches above sub-investment grade with Moody's and Fitch and four notches above sub-investment grade with S&P. The rating agencies have stated that the maintenance of this rating will be contingent on (but not guaranteed by) the level of capital committed by the State following the announcement of the capital figures on 31 March 2011. A downgrade will almost inevitably follow if the capital cost to the State is over €10 billion, in the case of S&P and Fitch and €20 billion in the case of Moody's. If burden sharing keeps the cost under those respective limits prescribed by the rating agencies, there is a chance of avoiding a downgrade on that issue alone. But other issues such as the new ESM structure may cause a downgrade independent of the PCAR/ PLAR/ restructuring.

The primary impacts of a downgrade to sub-investment grade for the Irish State would be:

- significant adverse effects for the ability of the banks and the State to source funding,
- delay the eventual return of the State to the public bond markets,
- material impairment of the ability of the State to source foreign direct investment, and
- material impairment of the ability of the State to fund ongoing public infrastructure projects.

Each of these impacts would augment the financial difficulties of the State and the State's requirement for funding from the ECB and the other external authorities.

The markets have already priced in a possible restructuring of senior debt and there appears to be a greater number of hedge funds holding senior Irish bank debt. AIB senior bonds are trading at a level that shows a possible average 20% haircut, this is 15-20% in the case of Bank of Ireland and 40% in the case of Anglo.

¹ This figure is based on the assumed haircut levels contained in the below tables. The actual figure gained would depend on the actual haircuts negotiated with the debt holders.



Mitigation

Burden sharing across both senior and subordinated would increase the probability of preventing a Sovereign credit rating downgrade following the PCAR/ PLAR announcement. The rating agencies have publicly issued assumptions about the expected final cost to the State from the PCAR/PLAR. Burden sharing would help to keep the final cost to the State within the bounds outlined by the rating agencies. It would therefore be problematic for the rating Agencies to justify a downgrade on the PCAR/ PLAR issue alone. However, notwithstanding the rating issue, the possible return from this exercise would significantly mitigate the direct cost to the taxpayer of bank capitalisations following the announcements on 31 March 2011.

Proposed Approach

To enable a write down of senior debt it is imperative that there is an appropriate legislative structure in place to enable such an action to take place. The legislation currently in place provides the platform for the write down of subordinated debt only. Critical to any restructuring action would be the ability to rely on legislation to prevent the ability of the banks contractual counterparties to call events of default. Without this legislation in place the risks of events of default and other adverse actions being triggered by debt counterparties are materially heightened.

The Attorney General is examining the legal issues relating to the development of legislation to enable the implementation of burden sharing with senior debt.

The proposed approach involves a contemporaneous meeting with the senior and subordinated bondholders to determine the level of haircuts to be applied to the various classes of debt in the various institutions. Once agreed, the practical implementation (to respect legal issues relating to debt priorities) would, first involve a material write down of subordinated debt (this would not include debt held by the State or other Irish banks) followed by action to restructure senior debt.

It was proposed that legislation would be in place prior to any approach on this matter to the external authorities, however given the timing issues it is unlikely that this will now be the case. The case for burden sharing would be presented to the external authorities together with a statement of intent to introduce enabling legislation as soon as possible. Depending on the position of the external authorities the Government would then have three choices:

- (a) pursue a policy of burden sharing by senior debt holders with the approval of the external authorities,
- (b) the policy of burden sharing by holders of senior debt is abandoned and burden sharing is conducted solely with subordinated debt holders,
- (c) whether due to debt sustainability issues and other matters relevant to the State it is decided to progress with the broad burden sharing policy without the approval of the external authorities, or
- (d) the policy of burden sharing with holders of senior debt is only implemented with debt holders in Anglo and INBS.

The potential outcomes of each of these approaches can only determined following discussions with the external authorities.



If the decision is taken to progress with burden sharing by both senior and subordinated debt the State would need, with the legislative backdrop, to develop a strategy with the banks to implement a consistent approach for the sector. The banks would then engage with the creditors to negotiate the restructuring options, come to a final negotiated position and then implement the negotiated transaction to enable the return for the banks. In the case of AIB, Bank of Ireland, EBS and ILP (assuming following PCAR that it is decided not to immediately commence the wind down or transfer of ILP and EBS) it is assumed that this process would be completed by end September 2011. In the case of Anglo and INBS due to the fact that these entities are being wound down and as highlighted below, a different approach is being taken it is assumed that this process would be completed in July 2011.

Possible Gains

AIB/BOI/EBS/ILP

We have set out below a table of potential haircuts for senior and subordinated debt in each of AIB, Bank of Ireland, EBS and ILP. The haircuts to be applied are indicative only and are subject to negotiations with creditors. However if there is to be any burden sharing with the holders of senior debt, subordinated liabilities will need to be effectively wiped out in the first instance. In determining the approach to be taken with each of the institutions cognisance will need to be taken of the relative position of each institution and the level of State support provided. This is reflected in the below table.

Bank	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
	Senior Unsecured € m	Junior € m	% Senior	% Junior	Amount Senior € m	Amount Junior € m	Total Amount € m
AIB	5,864	2,600	60%	90%	3,518	2,340	5,858
BOI	5,198	2,581	45%	80%	2,339	2,065	4,404
EBS	520	150	60%	90%	312	135	447
ILP	1,156	1,203	60%	90%	694	1,083	1,777
Total	12,738	6,534			6,863	5,623	12,486

Source: AIB/BOI/EBS/ILP, Lazard Frères and Central bank of Ireland

Anglo/INBS

In respect of Anglo and INBS the approach will be different. There is approximately €3.6 billion of senior unsecured unguaranteed bonds and €0.1 billion of subordinated liabilities that would be targeted for burden sharing in these institutions. There may be further impairment charges on the loan portfolios of Anglo and INBS which would generate possible future capital shortfalls.

Due to the fact that the merged entity comprising Anglo and INBS is currently fully capitalised to meet any future contingent capital needs of the merged entity it is proposed to exchange senior debt instruments for contingent capital instruments at a discount. These contingent capital instruments would convert into equity should the merged entity have any additional capital requirements in the future. As part of this process it is proposed to extend the maturities (there is €15 billion falling due by 2013) of those instruments to improve



the merged entity’s liquidity position. If the contingent capital requirement never arises the additional capital raised will not impact the level of capital to be provided by the State following the 31 March 2011 announcement

Bank	Debt Eligible for Restructuring		Haircut Levels		Haircut Amounts		
	Senior Unsecured € m	Junior € m	% Senior	% Junior	Amount Senior € m	Amount Junior € m	Total Amount € m
Merged Anglo/INBS	3,629	141	63%	90%	2,286	127	2,413

Source: Anglo/INBS and Lazard Frères

AIB/BOI Views on Burden Sharing

Both AIB and Bank of Ireland were approached for their informal views on the merits of the burden sharing with holders of senior debt. Both were of the view that it would have material adverse implications for each bank. Both institutions were of the view that burden sharing with senior debt should only apply to the non-viable institutions.

The primary implications outlined were as follows:

- continued close out from the funding markets;
- triggering of credit default swaps;
- withdrawal of market counterparties (e.g. hedging and repo counterparties);
- events of default triggered.

Bank of Ireland also stated that they have been reviewing capital raising options and that they envisage that they could raise €1 billion through a liability management exercise on their subordinated debt and possibly raise €0.5 billion to €1 billion through private equity initiatives. Bank of Ireland stated options would be undermined by burden sharing with holders of senior debt and/or the elimination of subordinated debt

While the NTMA recognises these concerns, the NTMA is of the view that the highlighted adverse effects of a burden sharing strategy with senior debt would be ameliorated where burden sharing with senior debt was conducted system wide with the benefit of supporting legislation. In addition we are of the view that a more aggressive approach (as highlighted above) could be taken with the holders of subordinated debt to generate more than the €1 billion suggested by Bank of Ireland.

Risks

Taking the approach of burden sharing with holders of senior debt will have a number of risks the primary risks are as follows:

- there could be a wider negative European impact, including possible ratings downgrades and adverse funding issues for the European banks,
- counterparties prepared to engage in off balance sheet transaction are likely to withdraw their support. This would be likely to increase the cost of balance sheet management,



- if there is a successful constitutional challenge to any legislation implemented to enable burden sharing this could undermine the whole strategy for burden sharing with senior debt. However, until legislation has been drafted it is not possible to assess the likelihood of a successful challenge,
- the ability to legally differentiate the treatment of unsecured, unguaranteed bondholders from deposits and other categories of senior debt will be challenging,
- the ability to treat Irish institutions holding senior debt and subordinated debt in the covered institutions differently to other debt holders will be legally challenging, and
- it will be difficult to identify credit unions and other Irish institutions holding secondary market acquired debt. While we expect that the amount of debt held by credit unions and other Irish institutions to be immaterial relative to the overall level of debt the holdings could be material at an individual level for a particular credit union or institution.

Communications

It is imperative that any messaging in respect of burden sharing with senior debt makes it clear which classes of debt are included and which classes of debt are excluded, in particular depositors.

Recommendation

Given the:

- Unprecedented debt sustainability issues for the State;
- ability of the State to limit the cost to the taxpayer of the huge capital costs arising from the current PCAR/PLAR exercise;
- fact that the banks are currently unable to access market funding; and
- fact that the markets are expecting and have priced in burden sharing with subordinated and senior debt,

it is the recommendation of the NTMA that, subject to a view being taken by Government on the potential implications of an adverse reaction from the external authorities and the implementation of an appropriate legal framework, immediate steps should be taken following the announcement of the PCAR/PLAR results to enable burden sharing with both senior and subordinated debt.

The implementation of the burden sharing should be undertaken prior to the implementation of any other capital raising initiatives arising from the PCAR/PLAR results. The implementation of other capital raising initiatives prior to burden sharing with debt holders will reduce the cost mitigating benefits of such actions for the State.