

**Ireland: First and Second Reviews Under the Extended Arrangement and Request for Rephrasing of the Arrangement—Staff Report; Letter of Intent; Memorandum of Economic and Financial Policies; Technical Memorandum of Understanding; Letter of Intent and Memorandum of Understanding on Specific Economic Policy Conditionality (College of Commissioners); Staff Supplement; and Press Release on the Executive Board Discussion.**

In the context of the first and second reviews under the extended arrangement and request for rephrasing of the arrangement, the following documents have been released and are included in this package:

- The staff report for the First and Second Reviews under the Extended Arrangement and Request for Rephrasing of the Arrangement, prepared by a staff team of the IMF, following discussions that ended on April 15, 2011, with the officials of Ireland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 2, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- Letter of Intent sent to the IMF by the authorities of Ireland.
- Memorandum of Economic and Financial Policies by the authorities of Ireland.
- Technical Memorandum of Understanding.
- Letter of Intent and Memorandum of Understanding on Specific Economic Policy Conditionality (College of Commissioners).
- A staff supplement of May 11, 2011 updating information on recent developments.
- A Press Release summarizing the views of the Executive Board as expressed during its May 16, 2011 discussion of the staff report that completed the review.

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

International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) Internet: <http://www.imf.org>

Price: \$18.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

IRELAND

**First and Second Reviews Under the Extended Arrangement and Request for  
Rephrasing of the Arrangement**

Prepared by the European Department in Consultation with Other Departments

Approved by Ajai Chopra and Martin Mühleisen

May 2, 2011

**Executive Summary**

**Background.** A three-year EFF arrangement with access of SDR 19.5 billion was approved on December 16, 2010. Following elections on February 25, a new coalition government with a comfortable majority took office on March 9. In light of a delay in the first review made necessary by the early elections, the authorities request to combine the first and second program reviews and, given the smaller immediate external financing needs, also request a rephrasing of the arrangement.

**Mission.** Discussions were held in Dublin during April 5–15, 2011. The IMF team comprised A. Chopra (head), C. Beaumont, J. Mathisen, and B. Barkbu (all EUR), S. Abbas (FAD), D. Hawley and O. Stankova (EXR), B. Kelmanson (SPR), M. Luedersen (LEG), L. Cortavarria, and P. Bologna (MCM). Teams from the EC and ECB participated in the discussions. P. McGoldrick (OED) attended the meetings.

**Performance under the program.** Policy implementation is off to a strong start. All relevant performance criteria for the first and second reviews, and all but one of the structural benchmarks were observed. In particular, at end March the authorities announced comprehensive banking reform and recapitalization plans which were well received by financial markets and analysts.

**Program discussions.** The discussions focused on the implementation of the banking sector reforms and on fiscal consolidation. Specifically, focus was on (i) the schedule and sources of funding for recapitalizing the four guaranteed banks; (ii) timetables and steps for reorganizing domestic banks and the framework for the deleveraging of banks during 2011–13; and, (iii) ensuring that any adjustments in fiscal plans include compensating measures so that the program targets for 2011 and beyond remain achievable, while allowing the automatic stabilizers to operate.

**Program risks.** Risks to the program, already high at program approval, have increased in some respects while declining in others. Slower growth and higher unemployment, further ratings downgrades, and developments in other Euro Area crisis countries—have contributed to a rise in bond spreads that hinders Ireland’s prospects to regain market access on affordable terms in the near future.

**Policy recommendations.** The program risks must be actively managed with support from a more comprehensive European plan. Timely implementation of the banking strategy—recapitalization, reorganizing and deleveraging the viable banks, and resolving the non-viable banks—remains critical for program success in restoring the banking sector to healthy functionality so it can begin to contribute to renewed growth. This intensive effort must continue to be underpinned by fiscal consolidation and structural reforms to overcome doubts regarding the feasibility of the necessary fiscal adjustment and regarding growth prospects in the medium term.

## Contents

Page

I. Introduction .....	3
II. Recent Developments and Banking Reform Announcements .....	3
III. Macroeconomic Framework .....	10
IV. Program Discussions .....	13
A. Financial Sector Policies .....	13
B. Fiscal Policies and Structural Issues .....	17
V. Program Modalities and Risks .....	20
VI. Staff Appraisal .....	22
Tables	
1. Selected Economic Indicators, 2007–11 .....	25
2. Medium-Term Scenario, 2007–16 .....	26
3. General Government Finances, 2006–15 .....	27
4. Indicators of External and Financial Vulnerability, 2004–10 .....	28
5. Summary of Balance of Payments, 2008–13 .....	29
6. External Financing Requirements and Sources, 2008–13 .....	30
7. Monetary Statistics .....	31
8. Schedule of Reviews and Purchases .....	32
9. Indicators of Fund Credit, 2010–24 .....	33
10. Quantitative Performance Criteria and Indicative Targets Under the Economic Program for 2010–11 .....	34
11. Program Monitoring .....	35
12. Prior Action and Structural Benchmarks Under the Program for 2011 .....	36
Boxes	
1. New Data Show Reduced International Exposure to Irish Banks .....	5
2. Assessment of the Capitalization Needs for the Four Domestic Banks .....	6
3. Deleveraging the Irish Banks to Stabilize Their Funding Structure .....	7
4. Sovereign Debt: Recent Rating Actions and Market Developments .....	9
5. Competitiveness Trends—Compositional Effects and Export Sectors .....	12
6. Fiscal Reporting of Bank Support .....	14
Annex	
Debt Sustainability Analysis .....	37
Attachments	
I. Letter of Intent .....	43
II. Memorandum of Economic and Financial Policies .....	46
III. Technical Memorandum of Understanding .....	60
IV. Letter of Intent (College of Commissioners) .....	64
V. Memorandum of Understanding on Specific Economic Policy Conditionality .....	67

## I. INTRODUCTION

1. **A new coalition government entered office on March 9, 2011.** Early elections were held on February 25 after the collapse of the government led by the Fianna Fáil party which had held power since 1997. The new government—a coalition of the Fine Gael and Labour parties with a strong majority in the Dáil—has formulated its *Programme for Government* to promote national recovery, which includes committing to the fiscal consolidation agreed in the EU/IMF-supported program and to a fiscal deficit of 3 percent of GDP by 2015. At the end of March, after three weeks in office, the authorities announced comprehensive banking sector reforms and recapitalization, with the first steps to implement these reforms already taken. Among other forthcoming measures, the government is expected to present a fiscal package—the Jobs Initiative—in May 2011.

2. **Policy implementation has been determined and in line with the program.** The end December and March quantitative performance criteria for the primary cash balance as well as the continuous performance criterion on external debt arrears were met, as were the indicative targets for net central government debt (Table 10). All seven structural benchmarks were implemented, with the exception of the advance recapitalization of the banks scheduled for end-February, which was to have been an early confidence building measure (Table 11).<sup>1</sup>

3. **The program is on track, yet challenges remain and the external environment has become more adverse, hence steadfast policy implementation is key.** Although bond spreads declined significantly following the authorities' end March banking announcements, they have since risen to new highs and Ireland's sovereign and bank ratings have been further downgraded. Moreover, recent growth and unemployment developments have been worse than anticipated. Steadfast implementation of policies agreed under the program, coupled with support from a comprehensive European plan, is critical to regaining market access at affordable interest rates, which may take additional time in this challenging context.

## II. RECENT DEVELOPMENTS AND BANKING REFORM ANNOUNCEMENTS

4. **Recent weak growth and higher unemployment represent some setback to the recovery.** Real GDP fell by 1 percent in 2010, with a disappointing 1.6 percent fall in Q4 2010 partly due to bad weather and volatile net exports by multinationals. In addition, revised data show a 1 percentage point higher unemployment rate at end-2010, of 14.8 percent, which remained at 14.7 percent in March. Rising energy and food prices lifted annual HICP inflation to 1.2 percent in March, up from -1.6 percent on average in 2010.

---

<sup>1</sup> The outgoing Finance Minister considered it inappropriate to inject public resources with the Dáil dissolved for the February 25 elections. The new government decided to await the completion of the 2011 Prudential Capital Assessment Review (PCAR) at end March to determine the recapitalization needed. Staff considers this delay reasonable given the government's commitment to timely recapitalization based on the much deeper analysis undertaken in the 2011 PCAR.

5. **Although immediate financial stresses have stabilized, access to financial markets remains elusive.** Deposit outflows from domestic covered banks have slowed markedly from the latter part of 2010, although with a modest increase briefly in the run-up to the elections. Nonetheless, reliance on Eurosystem liquidity support has risen to about €145 billion at end-March 2011, including Emergency Liquidity Assistance (ELA) provided by the CBI, in part reflecting maturities of bank bonds. Despite the government's cash reserves and program financing, the government has not been able to reenter the short-term bill markets at this stage. Similarly, domestic banks have been unable to source term funding even with a government guarantee, and newly available data indicate that foreign exposure to the domestic banks has declined greatly (Box 1).

6. **The authorities announced on March 31 a comprehensive reform and recapitalization of the domestic banks,** with three main elements:

- **Recapitalization:** The *Financial Measures Programme* released by the CBI included the diagnostic evaluation of four domestic banks' assets carried out by an independent consultant, together with stringent stress tests (MEFP ¶6)—both end-March structural benchmarks.<sup>2</sup> These elements form the basis for the 2011 Prudential Capital Assessment Review (PCAR) which identified capitalization needs of €24 billion for the four domestic banks (Box 2). The net fiscal cost is to be mitigated by liability management exercises on subordinated debt assumed to be about €5 billion.<sup>3</sup>
- **Deleveraging:** The *Financial Measures Programme* also included a Prudential Liquidity Assessment Review (PLAR), which established targets for the domestic banks' liquidity positions, in particular a loan-to-deposit ratio of 122.5 percent by end 2013. The CBI completed the assessment of the banks' restructuring plans to meet those targets—also an end-March structural benchmark. These plans include the run-off and disposal of non-core assets, and the potential losses arising in a stress scenario from this process are integrated into the PCAR assessment of capital needs (Box 3).
- **Restructuring:** At the same time, the Finance Minister announced a reorganization of the domestic banks around two “pillar” banks (MEFP ¶8) with sound business models focused on serving the Irish economy's needs.<sup>4</sup>

---

<sup>2</sup> See <http://www.financialregulator.ie/industry-sectors/credit-institutions/Documents/The%20Financial%20Measures%20Programme%20Report.pdf>

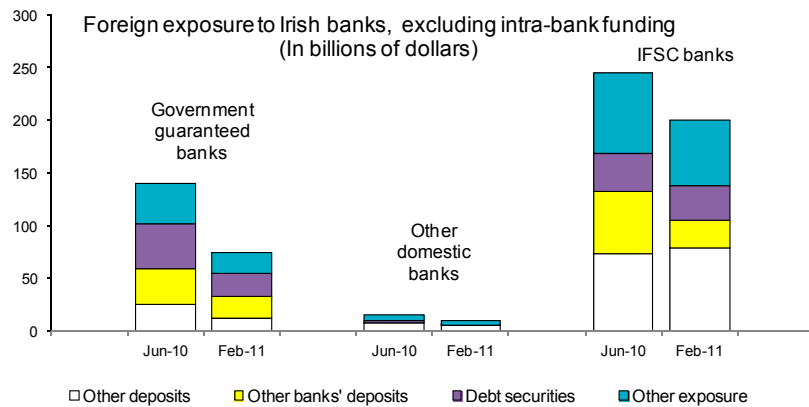
<sup>3</sup> Together with the €46.3 billion previously injected, this brings the use of public resources for recapitalization to about 42 percent of GDP. Only two banking crisis in the last four decades (Argentina in 1980 and Indonesia in 1997) are estimated to have had a significantly larger gross fiscal cost, see Laeven and Valencia (2008), “Systemic Banking Crises: A New Database”, IMF Working Paper WP/08/224.

<sup>4</sup> See <http://www.finance.gov.ie/viewdoc.asp?DocID=6749&CatID=79&StartDate=1+January+2011>

### Box 1. New Data Show Reduced International Exposure to Irish Banks

**Recently improved monetary statistics give a better and more accurate picture of international exposure to credit institutions based in Ireland.** A number of resident banks are principally engaged in financial transactions with nonresidents as part of the International Financial Center (IFSC) based in Ireland. The large size of the IFSC has complicated much of the past analysis of international exposures which applied to the whole Irish financial system. The improved statistics compiled by the Central Bank of Ireland have therefore been expanded to include: (i) positions vis-à-vis nonresidents with breakdown by type of financial instruments, maturity, and currency; and (ii) separate datasets for banks servicing the domestic market and those focusing on the nonresident market. The domestic banking system—comprising banks that focus on retail banking services to resident households and non-financial corporations—have been further separated into government guaranteed retail banks and non Irish owned retail banks.

**The new data show that foreign exposure to the Irish banking system has fallen sharply.** In terms of gross exposure of nonresidents to Ireland, nonresidents' claims on the six government guaranteed banks are now about €75 billion—only slightly more than one third than at the peak of the credit boom. Most of this reduction was related to loss in deposits (from both nonresident banks and other nonresidents), but also foreign holdings of debt securities issued by the domestic banking system fell sharply, to €23 billion at end February from €42 billion in mid-2010. IFSC banks have experienced a similar reduction in deposits from other banks, although other types of funding have held up relatively well.



Source: Central Bank of Ireland.

## Box 2. Assessment of the Capitalization Needs for the Four Domestic Banks<sup>1</sup>

**Stringent capital assessments show that €24 billion is needed to ensure the four banks have a strong capital base even in adverse circumstances.** These capital requirements will allow the banks to offset potential losses and still meet 10.5 percent and 6 percent of Core Tier 1 capital ratios in base and stress scenarios, respectively.

**The CBI used three complementary exercises to identify capital requirements:**

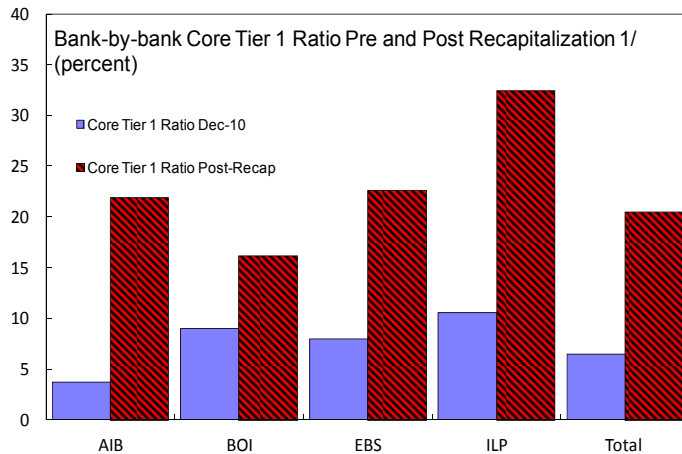
- Stress tests (PCAR 2011) calibrated to base and stress scenarios through 2013;
- Bank-specific deleveraging plans to meet loan-to-deposit ratios of 122.5 percent by end-2013; and
- In-depth review of banks' loan portfolios, adjusting the banks' estimated loan loss projections significantly upwards based on the independent BlackRock Solutions loss forecasts.

**The capitalization is doubling existing bank buffers against possible losses arising through 2013 and beyond.** Once the recapitalization is completed, the four domestic banks' Core Tier 1 capital ratios will be above 15 percent.

**The analysis includes a number of layers of prudence.** The independent loan loss forecasts use conservative assumptions wherever data gaps prevent more detailed analysis. The identified capital needs are based on stricter parameters than those of the upcoming 2011 European stress test run by the European Banking Authority, with higher thresholds for the capital ratio and a 3-year rather than 2-year period of stress. Finally, a significant capital buffer (€5.3 billion) is included for potential loan losses after 2013.

### Ireland: Calculation of 2013 Capital Requirements under Stress Scenario

<b>A. Buffers as of December 2010</b>	<b>23.2</b>
Core Tier 1 (CT1) capital	13.3
Stock of loan loss provisions	9.9
<b>B. Estimated net bank losses through 2013</b>	<b>(37.0)</b>
Operating profit before loan losses and leverage cost	3.9
3 year stress loss projections from BlackRock Systems	(27.7)
Loss on deleveraging under stress scenario	(13.2)
<b>C. Capital shortfall to meet 6 percent under stress scenario</b>	<b>18.7</b>
CT1 capital required for 6 percent CT1 ratio under stress scenario	8.4
- Estimated equity position before capital injection	(10.3)
Buffers after estimated bank losses through 2013 (A-B)	(13.8)
Capital increases within Q1 2011	3.5
<b>D. CBI capital requirements</b>	<b>24.0</b>
Capital shortfall to meet 6 percent CT1 ratio under stress (as per C)	18.7
Additional capital buffer for potential losses after 2013	5.3
Cash capital	2.3
Contingent capital	3.0



Source: Central Bank of Ireland; and IMF Staff Estimates.

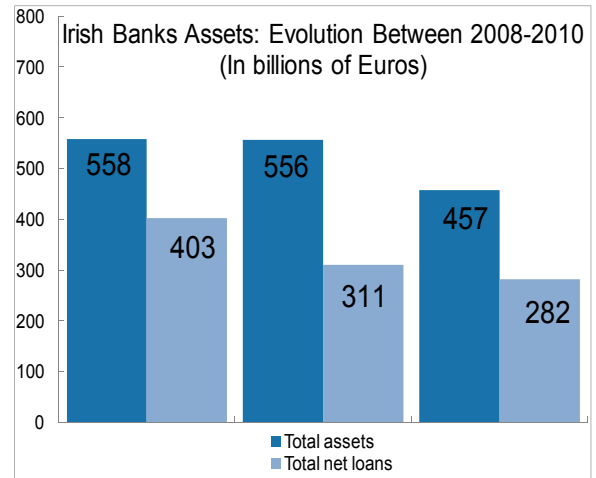
1/ The post recapitalization ratios are calculated as if the recapitalization would have been done from the December 2010 capital levels. The new ratios include also the capital raised in the first quarter of 2011.

<sup>1</sup> A detailed description of the stress scenarios, loan loss forecasts, and deleveraging plans is provided in <http://www.financialregulator.ie/industry-sectors/credit-institutions/Documents/The%20Financial%20Measures%20Programme%20Report.pdf>

### Box 3. Deleveraging the Irish Banks to Stabilize Their Funding Structure

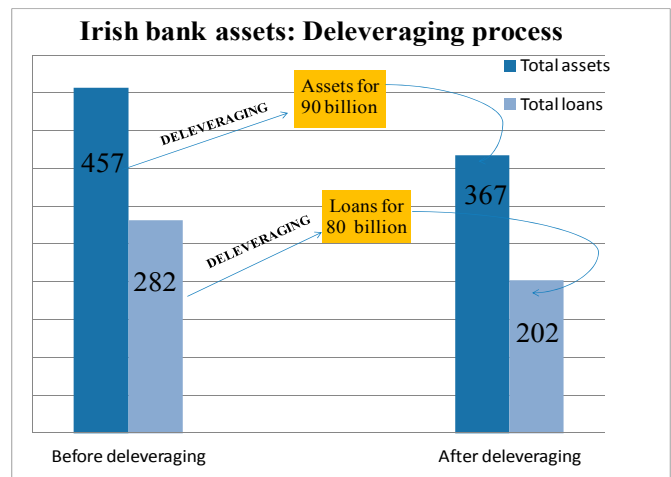
**In the period 2003–09, the six Irish domestic banks grew dramatically driving a booming property and construction sector.** Total assets and loans to GDP peaked in end-2009 at 348 percent and 194 percent, respectively, and the loan to deposit ratio (LDR) reached 138 percent.

**During 2010 the Irish banks and authorities took actions that reduced the size of the banking system, but LDRs remained high.** The two “pillar” banks were proactive in areas such as reducing international exposures, increasing loan loss provisioning, closing international offices, and disposing non-core operations. More fundamentally, net loans for about €30 billion (€71 billion in gross terms) were transferred from banks to NAMA in exchange for securities, guaranteed by the government. These actions led to a decline of assets and loans to 297 percent and 183 percent of GDP, respectively. However, due to persistent deposit outflows (especially from corporates and operations abroad) the LDR had increased to 168 percent by end-December 2010.



**Therefore, to further enhance the stability of bank funding and “right-size” the banks, the Irish authorities have taken bold measures on three fronts:**

- **The four fully operating institutions (AIB, BOI, EBS and ILP) have been directed to reduce their current LDRs by one third.** To this end, they have presented to the CBI plans to meet LDR of 122.5 percent by 2013 through the disposal and run-off of non-core assets; specific assets are identified totaling €73 billion, mainly comprised by loans held by subsidiaries in UK and the rest of the world.
- **To facilitate the implementation and monitoring of asset deleveraging the four banks will virtually split their balance sheet into core and non-core divisions.** A virtual split is seen as the best way to manage legal risk, capital implications and funding challenges. Non-core assets have been segregated by the banks on the basis of CBI guidelines and are to be managed under a Deleveraging Committee.
- **Anglo and INBS are to be merged into a single Government-owned bank focused on working out legacy commercial property and other loans within ten years.** During 2011 to 2013 Anglo/INBS assets are expected to decline by €17 billion with loans falling by €7 billion.



Provided that banks meet the target LDR of 122.5 percent by end-December 2013, and assuming that deposits are broadly unchanged, the size of the banking system measured on the basis of total bank assets and loans to GDP would decline to 221 percent and 122 percent, respectively, or about 70 percent and 55 percent of these ratios at the outset of the crisis.<sup>1</sup>

<sup>1</sup> These estimates do not include the effect on asset decline arising from likely further increases in loan loss provisioning.



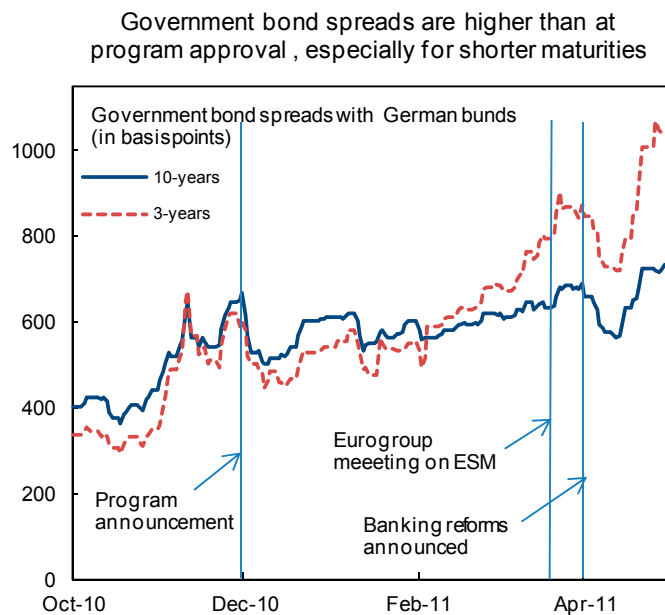
7. **Staffs of the EC, ECB, and IMF welcomed the Irish authorities' announcements as a major step toward restoring the Irish banking system to health which is crucial for sustained revival of growth and employment.**<sup>5</sup> The staff noted that the Central Bank, together with leading international consulting firms, had identified the banks' capital needs based on thorough and transparent valuations of bank assets and stringent stress tests conducted with an appropriately high minimum capital ratio, and strongly supported the authorities' plans to ensure that these capital needs are met in a timely manner. The ECB also stated the Eurosystem will continue to provide liquidity to banks in Ireland given the commitment of the Irish authorities to substantially strengthen the capital base of the banks, and it suspended the rating threshold for debt instruments of the Irish government for the purposes of the Eurosystem's credit operations.<sup>6</sup>

8. **Market sentiment improved notably after the end March banking announcements, but it has since deteriorated along with broader European developments.** After dipping briefly around the time of program announcement, Ireland's bond spreads trended upwards, especially at maturities of around 2–3 years, with this process accelerating during March when the European Stability Mechanism (ESM) was adopted. The authorities' comprehensive end

March banking announcement led to a notable decline in spreads in the following few weeks, with 10-year bond spreads declining by up to 120 basis points, as markets and commentators considered the PCAR/PLAR analysis credible, although there was some disappointment of expectations that the ECB may announce a medium-term funding facility for the banks. However, spreads have retraced more recently, in part reflecting developments in Portugal and concerns about Greece, as well as further rating downgrades.

Commentary by ratings agencies

refers to the potential for debt restructuring for countries receiving assistance under the forthcoming ESM, and to the potential for credit under the ESM to subordinate other sovereign debts, as factors contributing to the downgrades (Box 4).



Source: Bloomberg.

<sup>5</sup> See Press Release No. 11/105, <http://www.imf.org/external/np/sec/pr/2011/pr11105.htm>

<sup>6</sup> See press releases at: <http://www.ecb.int/press/pr/date/2011/html/pr110331.en.html>, [http://www.ecb.int/press/pr/date/2011/html/pr110331\\_2.en.html](http://www.ecb.int/press/pr/date/2011/html/pr110331_2.en.html)

### Box 4. Sovereign Debt: Recent Rating Actions and Market Developments

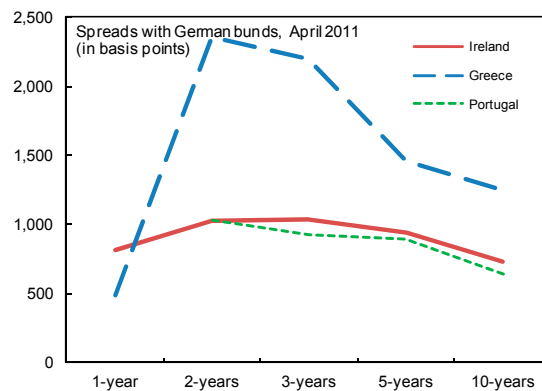
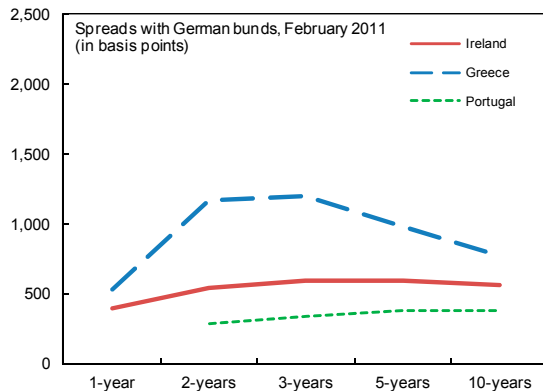
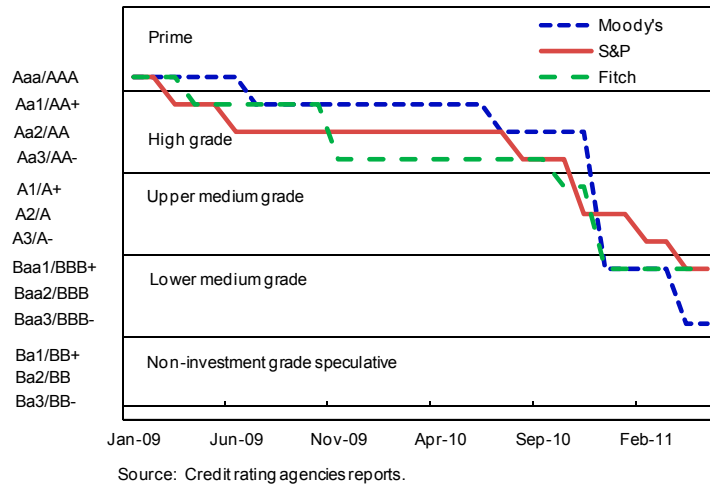
**Irish sovereign debt was downgraded sharply during 2009–10.** Ireland lost its AAA rating in 2009, followed by further downgrades reflecting the size of the banking sector problem, the scale of the fiscal consolidation need, uncertainties about the economic outlook, and, in late 2010, the loss of market access.

**Downgrades after program approval have left Ireland just a few notches above speculative grade.** Moody's cut their rating by five notches to Baa1 on December 17, and S&P downgraded by one notch to A- in February 2011. The initial reaction to the end March banking

announcements was modest, as S&P downgraded Ireland by a further notch to BBB+, and revised the outlook to stable, while Fitch affirmed its BBB+ rating and removed it from ratings watch negative but maintained a negative outlook.. However, in mid-April Moody's cut Ireland's rating by another two notches, to Baa3, one notch above speculative grade, and maintained its negative outlook.

**Rating agencies now also see European-wide developments as driving ratings.** Both Moody's and S&P view the recent announcement of the *Financial Measures Programme* as having a positive impact, by enhancing credibility and transparency about bank recapitalization needs. In explaining its downgrade, Moody's cites the weakening of the government's financial strength owing to additional bank support needs and slower growth outlook. It is notable that Moody's and S&P also motivate their downgrades by the uncertainties introduced by the proposed terms of the forthcoming European Stability Mechanism (ESM), including the solvency test and potential private sector burden sharing starting from 2013.

**Markets are also increasingly concerned about potential debt restructuring.** In February 2011, spreads were generally higher for longer maturities for Ireland, and Portugal. However, in March 2011, the spread curves became hump-shaped. For Greece, the hump-shape became more apparent, the spreads on 2- and 3-year bonds are now more than 1,000 basis points higher than for 10-year bonds. Spreads also peak at 2- and 3-year maturities in Ireland, in a pattern that appears to reflect concerns about debt sustainability coupled with the market expectations regarding the proposed ESM terms.



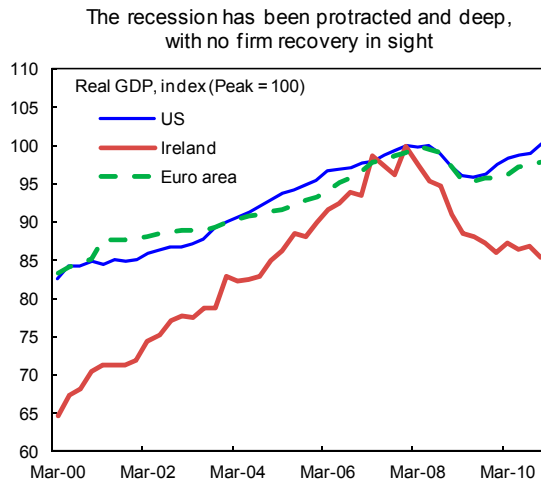
### III. MACROECONOMIC FRAMEWORK

9. **The 2011 growth outlook is moderately weaker than at program approval.** Real GDP fell by 1 percent in 2010, with domestic demand falling by 5½ percent, while strong exports—rising by more than 9 percent—remained the only source of growth. Domestic demand will continue to face headwinds from fiscal adjustment and correction in private sector balance sheets in 2011, as well from as outward migration. Higher-than-anticipated unemployment suggests weaker disposable income, contributing to a downward revision to domestic demand, now expected to decline by 3½ percent. Export growth of about 6 percent will continue to be the main driver of GDP growth, which is now projected at 0.6 percent in 2011, down from 0.9 percent at program approval.

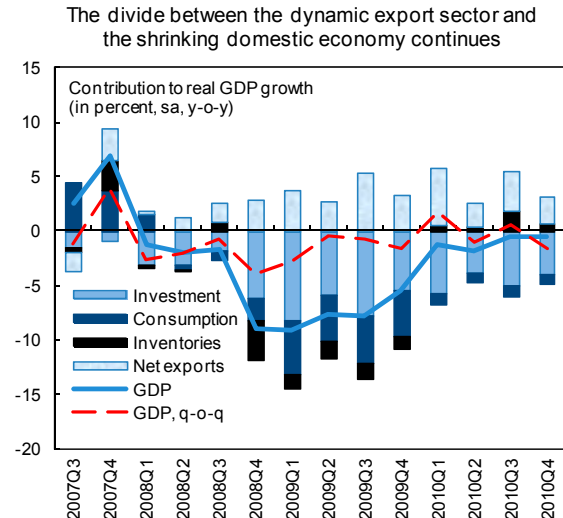
Ireland - Macroeconomic Projections (percentage change, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015
		Prog.	Prel.				
Real GDP	-7.6	-0.2	-1.0	0.6	1.9	2.4	2.9
Real domestic demand	-13.9	-4.1	-5.6	-3.5	0.1	0.8	1.4
Private consumption	-7.0	-1.4	-1.2	-1.6	0.1	0.8	1.2
Public consumption	-4.4	-2.0	-2.2	-4.4	-1.9	-1.5	-1.5
Fixed investment	-31.0	-21.1	-27.8	-13.5	3.1	4.0	6.0
Change in stocks 1/	-1.4	1.1	0.9	0.2	0.0	0.0	0.0
Net exports 1/	3.8	3.5	3.4	3.5	1.8	1.8	1.9
Exports	-4.1	5.8	9.4	6.0	5.2	4.9	4.9
Imports	-9.7	2.2	6.6	3.0	4.2	4.0	4.9
Current account (in percent of GDP)	-3.0	-2.4	-0.7	0.5	1.2	0.7	0.5
Consumer Prices (HICP)	-1.7	-1.6	-1.6	1.0	0.6	1.4	1.3
Unemployment rate (in percent)	11.8	13.5	13.6	14.5	13.9	13.2	11.3

1/ Contributions to growth

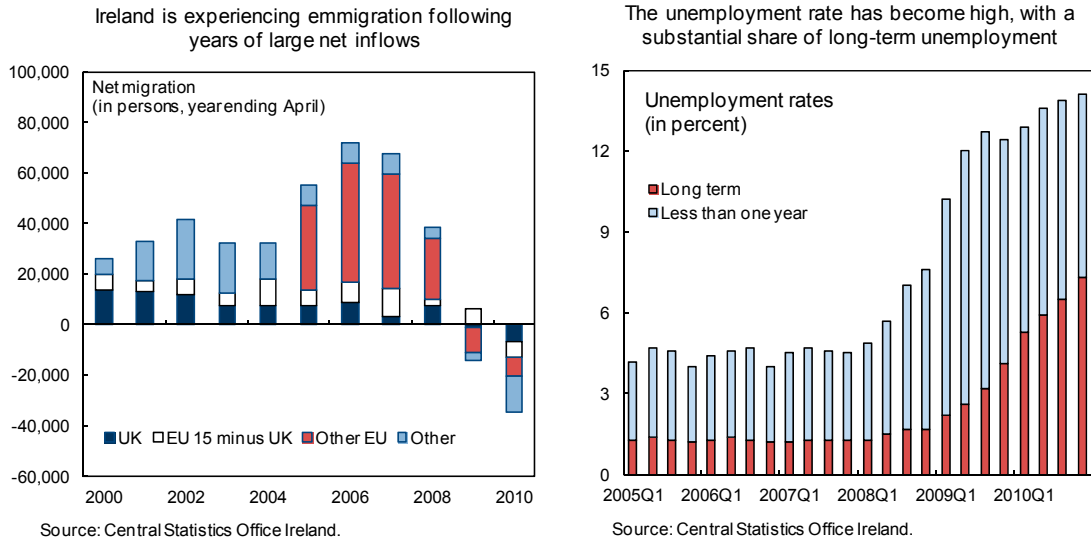


Source: NBER, Eurostat, and Central Statistics Office Ireland.



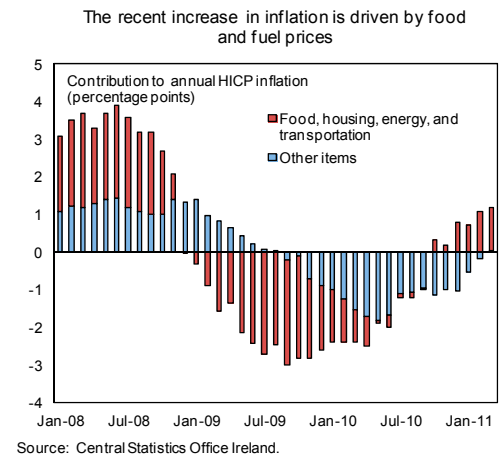
Source: Central Statistics Office Ireland.

10. **The pace of economic recovery is expected to remain modest over the program period, with high unemployment increasingly becoming long-term.** Growth is projected to average 2¼ percent over 2012–13, in line with the original program, but this modest recovery is subject to considerable downside risks. The impact of continued fiscal consolidation, household debt overhangs, and emigration outflows could be greater than anticipated. Low growth rates are expected to keep unemployment elevated in the medium term, and the share of long-term unemployed has risen to just over half, especially affecting younger men formerly working in the construction sector.



11. **The authorities share similar views on the 2011 outlook and the composition of the recovery, but are somewhat more optimistic about medium-term growth prospects.** Over 2012–13, the authorities expect a larger contribution from net exports, reflecting competitiveness gains (Box 5), and in line with the continued strong performance of Irish exports over the past years. They expect domestic demand to recover gradually starting in 2012, in line with Fund staff projections.

12. **Energy and food prices are lifting inflation despite weak domestic price pressures.** Staff now projects HICP inflation of 1 percent in 2011, up from -½ percent at program approval, with the bulk of the revision reflecting changes in energy and food price prospects. Domestic price pressures remain weak given the continued slack in the economy, although CPI inflation is likely to be significantly higher than HICP inflation due to hikes in mortgage interest rates. The projected HICP inflation of ½ percent in 2012 reflects an expected stabilization in consumer demand.

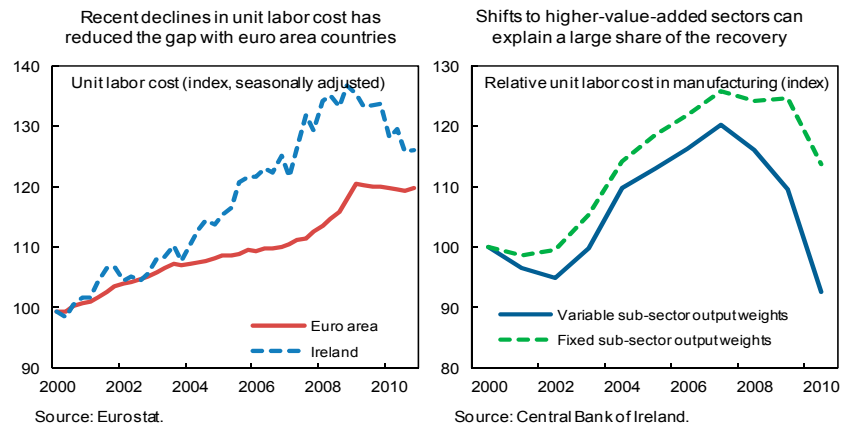


### Box 5. Competitiveness Trends—Compositional Effects and Export Sectors

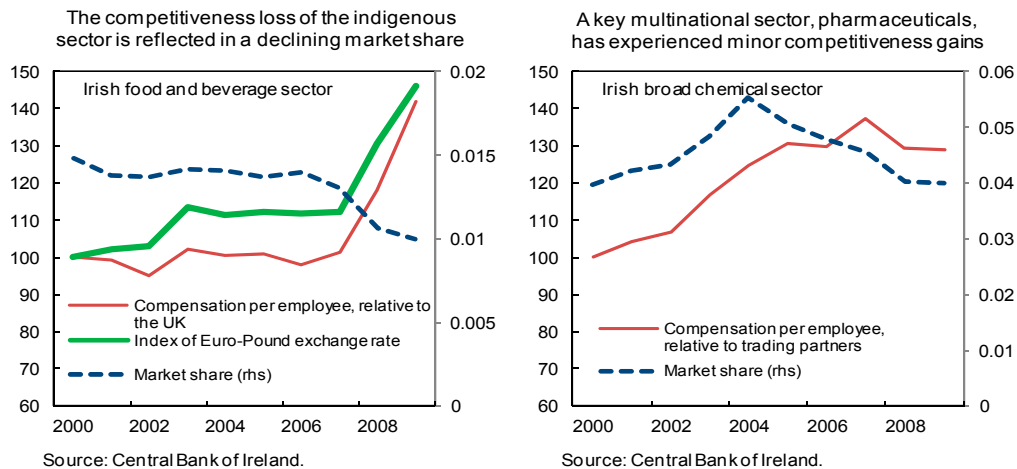
#### Unit labor costs have fallen in Ireland, narrowing the competitiveness gap that developed since 2000.

Ireland started from a competitive position in 2000, but rapidly rising unit labor costs eroded competitiveness over time. However, unit labor costs have fallen by 8 percent since its peak in 2007, and by 11 percent relative to the euro area average in that time.

However, this development partly reflects a shift to higher value-added sectors.<sup>1</sup> As relatively low productivity sectors such as construction have contracted most, average productivity has been raised. Compositional shifts have also taken place within export-producing sectors, e.g., shifts from indigenous sectors, such as food and beverages to higher value-added sectors, such as chemicals that are dominated by multinational pharmaceutical firms. If sector weights are held at the 2000 level, unit labor costs in Irish manufacturing have declined by 10 percent during 2007-10 compared with trading partners, significant but notably less than the 23 percent decline allowing for the shift in production shares.



**Sectoral developments in competitiveness are less encouraging.** The largest indigenous sector - food and beverages – has experienced an increase in the compensation per employee, partly reflecting exchange rate developments with its key export market, the United Kingdom. As a result, market shares have declined. For the pharmaceutical industry, compensation per employee has declined somewhat compared to competitors, but not enough to reverse previous years' increase or the loss in market share.



<sup>1</sup> The analysis of compositional effects is based on work by Derry O'Brien, see *Compositional Effects in Recent Trends in Irish Unit Labor Cost* in the January 2011 Quarterly Bulletin of the Central Bank of Ireland, and *Assessing the Cost Competitiveness in Irish Manufacturing Sectors* in the April 2011 Quarterly Bulletin.

13. **The export-led recovery will lift the current account balance into a modest surplus.** The current account deficit narrowed by 5 percentage points of GDP during 2008-10 to a deficit of 0.7 percent of GDP. A small surplus of ½ percent of GDP is expected in 2011. Given the large role of multinational companies in exports, the rise in net exports will be partly offset by factor income outflows, diminishing the overall impact on the current account position and the spillover to domestic demand.

#### IV. PROGRAM DISCUSSIONS

14. **Discussions focused on the implementation of the banking sector reforms and fiscal consolidation.** Specifically, the focus was on (i) the schedule and sources of funding for recapitalizing the four guaranteed banks; (ii) timetables and steps for reorganizing domestic banks and the framework for the deleveraging of banks during 2011-13; and, (iii) ensuring that any adjustments in fiscal plans includes compensating measures so that the program targets for 2011 and beyond remain achievable, subject to allowing the automatic stabilizers to operate.

15. **Safeguarding the sovereign from further spillovers from the financial sector continues to be a top priority.** As noted in the original program request, risks to debt sustainability stem from the high debts incurred for bank recapitalization and the associated sensitivities to the growth outlook and interest rate developments (Box 6). In that regard, the authorities' policies on recapitalization and reform of the banking system are important to reduce uncertainties around potential fiscal costs, and it is beneficial that the €24 billion additional bank capital needs identified by the PCAR analysis are significantly less than the €35 billion set aside in the program. At the same time, this leaves a sizable buffer of financing available should contingencies arise.

##### A. Financial Sector Policies

16. **Completion of the PCAR and PLAR is a critical milestone towards restoring banking sector viability.** The results framed the discussions on the refinement and implementation of the banking sector strategy. They provided the analytical foundation for decisions on: (i) restructuring; (ii) deleveraging; (iii) recapitalization; and, (iv) strengthening the banking sector framework.

##### Restructuring

17. **The program puts emphasis on ensuring that only banks with viable business models remain operating in the domestic banking system** (MEFP ¶8). The authorities have decided to fundamentally restructure the domestic banks around two pillar banks, centered on Allied Irish Banks (AIB) and Bank of Ireland (BoI). Regarding the remaining non-pillar banks, the authorities have decided that EBS Building Society (EBS) will be merged into AIB, initially as a subsidiary, while plans for the future of the banking operations of Irish Life and Permanent Group (ILP) will be finalized by end-July, 2011.

### **Box 6. Fiscal Reporting of Bank Support**

**The authorities' extensive support has been vital to address financial stability concerns, but at a considerable fiscal cost.** The fiscal reporting of the banking support has been determined on the basis of international and Eurostat guidelines.

**Direct bank recapitalization costs amounted to €46.3 billion (30 percent of GDP) over 2009-10.** Of this, €10.7 billion represent investments by the National Pension Reserve Fund (NPRF), €4.7 billion have been provided in cash, and the remaining €30.9 billion have been issued in promissory notes. The fiscal reporting of these injections depend on whether they create an effective claim on the bank by the government:

- An intervention that results in an increase in the government's claims on banks commensurate to its intervention and for which the government expects to get returns (equity injections) or be repaid (loans to a solvent bank) is recorded as a financing operation. It changes the composition of the government's assets and liabilities, but does not change the government's net worth. The injections financed by the NPRF are considered as investments in this category.
- An unrequited intervention is treated as an expense, as it results directly in a reduction in government net worth. This is, in particular, the case for the recapitalization of a bank that does not translate in new claims for the government (thus amounting to an unrequited transfer). The injections financed by cash and promissory notes are considered as unrequited interventions, and are recorded as expenditure in the budget, and giving rise to an increase in gross and net debt.

**The guarantees of covered domestic banks' liabilities and the bonds of the National Asset Management Agency (NAMA) give rise to contingent liabilities:**

- In line with EU state aid rules, the Irish government charges for the provision of a guarantee, which counts as a benefit to the operating balance. Under statistical reporting standards (GFSM 2001 and ESA95) the guarantees represent contingent liabilities that are not considered liabilities until the contingency materializes, and therefore they need not be recorded in the fiscal report as a liability/expense until then. The outstanding amount under the government guarantee was €113 billion (73½ percent of GDP) at end-December 2010.
- NAMA buys banks' distressed commercial and property development assets in exchange for government-guaranteed securities. NAMA is, however, a majority privately-owned special purpose vehicle, and consistent with a Eurostat decision (July 15, 2009), is recorded outside the general government sector, despite the bulk of its costs being funded with government guaranteed debt. As of end-December 2010, NAMA has issued bonds totaling €30.2 billion, of which 95 percent or €28.7 billion (18.6 percent GDP) are government guaranteed.

18. **Action is being taken to run down the nonviable banks in a timely and orderly manner** (MEFP ¶9). The authorities have developed time bound plans to resolve Anglo-Irish Bank (Anglo) and the Irish Nationwide Building Society (INBS), and managers will be subject to strict performance targets to implement these plans expeditiously. Analysis

released in September 2010 estimated Anglo's capital requirements at €29.3 billion in a base case, which have been covered through capital injections in 2009–10. An independent advisor is in the process of validating the methodologies used in that analysis, and is also conducting a loan-loss forecasting exercise for the much smaller INBS. The authorities do not expect that significant additional needs will be identified, but should additional capital be required at that point, the Government will then consult with the EC, ECB and IMF on the timeframe and means of recapitalizing those institutions at minimum cost to the taxpayer, having regard to the financial stability impacts in Ireland and abroad.

19. **The authorities are also addressing vulnerabilities in credit unions, although their assets are less than 3 percent of domestic banking system assets** (MEFP ¶10). The authorities are completing an extensive analysis of about 400 credit unions, and will on this basis prepare a plan to address any undercapitalized institutions, where they envisage consolidation will result in a smaller but stronger sector. Staff noted that this process will need to preserve incentives for credit unions to minimize credit losses while fully meeting the state's obligations to depositors.

### **Deleveraging**

20. **The authorities are establishing a framework to deleverage the banks over time.** They consider that improving the funding structure of the banks is critical to regaining the stable access to market-based funding, so renewed lending can underpin sustained growth, and are therefore targeting reducing loan-to-deposit ratios to 122.5 percent by end 2013 (MEFP ¶11). The deleveraging plans to meet this goal identify €73 billion in non-core assets—often relatively high quality foreign assets—which are to be run-off or disposed of over time. To underpin the execution of these plans, the authorities are developing a framework involving incentives for managers focused on non-core assets, oversight by a bank-specific Board committee (Deleveraging Committee), and close official monitoring (MEFP ¶12). Progress towards achieving the 6-monthly interim targets for liquidity ratios, and banks' plans to reach future targets, will be a topic for future program reviews.

21. **Progress with deleveraging will take into account the need to avoid fire sales.** While up to €13 billion in losses from deleveraging have been allowed for in the PCAR, the authorities note these losses are estimated in a stress scenario, and in most circumstances the losses should be expected to be smaller. To help guide decisions on the acceptability of asset prices, the authorities are preparing objectives for the Deleveraging Committee and consistent performance benchmarks for managers of non-core assets (MEFP ¶12). These metrics will need to be well adapted to the illiquidity of some of these assets, for which only a small group of interested parties exists and where sales opportunities may not always be available.

22. **The government does not currently intend that NAMA will further assist with the deleveraging process.** It considers that the banks are better placed to deal with smaller



land and development loans (less than €20 million) as these loans are often cross-guaranteed by SMEs. To offset the implied reduction in deleveraging, AIB and BoI will provide contingency plans to meet the deleverage targets by alternative means (MEFP ¶14).

### **Recapitalization**

23. **The process to recapitalize four domestic banks has started and is expected to conclude by end-July** (MEFP ¶15–17).<sup>7</sup> Of the total need for €24 billion, the authorities expect to meet a significant portion (assumed to be about €5 billion) through liability management exercises (LMEs) on subordinated bank debt.<sup>8</sup> On April 14, a court order was issued that will facilitate an LME for AIB’s subordinated debt, and similar orders will be sought for the other banks.<sup>9</sup> The LME itself will take some weeks to conclude. Once completed, the authorities will instruct the banks to raise the remaining capital needs within a defined timeframe, after which public funds will be injected. Absent significant delays from legal challenges, the process is expected to be completed by the end of July. In the case of ILP, the injection of public funds will take into account the expected profits from asset sales.

### **Strengthening the Banking Sector Framework**

24. **Responding to the crisis has created an opportunity to address remaining weaknesses in the financial system:**

- **Governance.** The authorities are acting to improve governance within banks, and to strengthen the framework through which the government exercises its ownership rights (MEFP ¶18). The Finance Minister recently announced that banks will provide plans for the renewal of boards and management, so as to ensure the skills of board members and managers are fully adequate, and that senior managers will be capable of meeting the CBI’s new fitness and probity standards, which, where relevant, will assess their track record in the period leading up to the financial crisis.<sup>10</sup>
- **Banking supervision.** The authorities are preparing legislative proposals to address weaknesses in supervisory and enforcement powers of the Central Bank identified in the aftermath of the crisis (MEFP ¶19). In particular, these proposals would authorize broad access for the Central Bank to information through “authorized officers,” enhance administrative sanctions, clarify aspects of the new “fit and proper” requirements, and introduce a whistleblower regime. An action plan to strengthen

<sup>7</sup> These four are Bank of Ireland, Allied Irish Banks, EBS Building Society, and Irish Life and Permanent.

<sup>8</sup> The government has not proposed restructuring of senior debt for these banks, keeping in mind knock-on effects and facilitating positive relationships with counterparties.

<sup>9</sup> Legal challenges were initiated by some AIB bondholders, with a hearing scheduled in early May.

<sup>10</sup> See <http://www.finance.gov.ie/viewdoc.asp?DocID=6803&CatID=79&StartDate=1+January+2011>

supervisory practices is also being prepared, with progress to be monitored at future reviews and later by an independent assessment against the Basel Core Principles.<sup>11</sup> Going forward, a comprehensive review of the currently fragmented legislation for bank regulation and supervision is recommended.

- **Credit practices and information.** The CBI will also promote improved bank practices in relation to provisioning, recognition of arrears and loan losses, capacity for measuring financial risks, and the availability of credit information (MEFP ¶19).
- **Mortgage restructuring and personal insolvency regime** (MEFP ¶20). The authorities are developing reform proposals that would address the treatment of unsustainable debt burdens incurred by financially responsible individuals while targeting only those borrowers most in need to limit moral hazard. Staff welcomed this work, while noting the need to also assess the impact on banks' balance sheets.
- **Crisis preparedness** (MEFP ¶21). Substantial progress has been made towards establishing a special resolution regime for banks. The draft legislation grants powers to the CBI to seek a court order for (i) imposing official administration on a bank and (ii) initiating the transfer of assets and liabilities to another institution, including a bridge bank. Necessary resources for facilitating resolution measures, including the capitalization of a bridge bank, would be provided by the new resolution fund to be funded by the banks, and backed by public resources. Staff emphasized that the legislation should include provisions and clarifications to (i) ensure that the appointment of a special manager for a bank will be as short as possible to minimize the risk of an ongoing need for public support; (ii) explicitly limit the use of the bridge bank tool to circumstances involving systemic risk; (iii) increase transparency in the pricing and valuation mechanism for transfers of assets and liabilities; and (iv) set out the respective roles of the new resolution fund and the limited deposit guarantee scheme.

## **B. Fiscal Policies and Structural Issues**

25. **The fiscal program is on track.** The quarterly performance criterion on the exchequer primary balance was met for end-December 2010 and end-March 2011, as were the indicative targets for central government net debt (Table 10).<sup>12</sup> An overperformance in the exchequer primary balance in the last two months of 2010 was mainly on account of higher corporation tax payments. The quarterly exchequer out-turn through end-March 2011 shows

<sup>11</sup> Past failings in banking supervision are identified in the recently published report of the Commission of Investigation into the Banking Sector, *Misjudging Risk: Causes of the Systemic Banking Crisis In Ireland*, which is available at <http://www.finance.gov.ie/viewdoc.asp?DocID=6798>

<sup>12</sup> In line with program definitions, the end-December-2010 performance criterion was adjusted for bank support, reflecting the €525 million (0.3 percent of GDP) injection into EBS on December 14, 2010 (Box 6).

current voted spending (the bulk of government expenditure) lower than profiled, but revenues broadly in line with program. There was, however, a discernible deviation from the programmed composition of revenues, with personal income tax and VAT underperforming and corporation and excise taxes doing better than expected. These developments highlight the importance of maintaining adequate tax administration resourcing to contain risks to tax compliance while implementing changes in tax policy.

26. **Staff projects the 2011 general government deficit at about 10½ percent of GDP.** Budget 2011 delivered €6 billion in consolidation measures, and the Finance Act, a key step in implementing the fiscal program, was approved on January 29.<sup>13</sup> The new government has committed to aggregate fiscal adjustment consistent with the EU/IMF-supported program for 2011 and 2012. The original program projection for 2011 remains feasible; as although economic growth has been marked down and unemployment is projected to be higher, the adverse consequences for taxes and social spending are largely offset by favorable base effects due to the better-than-expected 2010 out-turn.

27. **The government will announce a fiscally neutral Jobs Initiative in May 2011** (MEFP ¶23). The Initiative, which will be presented to the Dáil, is expected to feature reductions in the lower tier VAT and employer PRSI rates till end-2013 to help support labor-intensive domestic services sectors.<sup>14</sup> Spending commitments will include new training positions for the unemployed, and a fiscally neutral reorientation of capital spending toward “shovel-ready” local and regional infrastructure projects. The government will specify offsetting measures at the time of the Jobs Initiative. The fiscal neutrality of the package, both in 2011 and in the period until 2014, is a prior action for the completion of this review.

28. **The authorities’ focus on job creation supports the goal of renewed growth, although close monitoring of the efficacy and targeting of the underlying measures will be essential.** In particular, it would be important that the jobs training programs provide good value-for-money, the investment outlays do not entail permanent spending commitments, and the tax incentives result in an increase in labor demand, rather than creative wage contracts designed for tax avoidance.<sup>15</sup> Staff also encouraged the authorities to ensure that the offsetting measures are high-quality.

---

<sup>13</sup> The Finance Act gave effect to the taxation measures announced in the 2011 budget with some minor modifications. The abolition of the property related tax expenditure will now likely take effect in 2012, following the preparation and publication of an economic impact assessment. For medical card holders, the universal social charge will be reduced from 7 percent announced in the budget to 4 percent, to be offset by increasing the rate paid by self-employed taxpayers from 7 to 10 percent on incomes above €100,000. However, the overall budget consolidation objectives are respected.

<sup>14</sup> The PRSI rate reduction is also aimed at partly neutralizing the impact of reversing the recent €1 per hour cut in the minimum wage which is expected to be announced together with the Jobs Initiative.

<sup>15</sup> The halving of the lower-tier PRSI rate will imply a large step-increase (of 2.5 times) in the employers’ PRSI liability when moving above the minimum wage level of €356/week.

29. **The authorities are undertaking a comprehensive review of expenditure to underpin their fiscal consolidation effort beyond 2011, while also protecting those most in need** (MEFP ¶22 and ¶24). *The Programme for Government* commits to the previously-agreed fiscal consolidation of €3.6 billion for 2012 and to meeting the 3 percent of GDP deficit target by 2015. The policy mix for the 2012 consolidation and the adjustment path beyond 2012 will be decided in the context of Budget 2012 and Budget 2013, respectively. To ensure that the consolidation in public finances is least burdensome on taxpayers and predicated on the most efficient use of resources, and to take a fresh look at government service delivery, the authorities have initiated a comprehensive review of expenditure, to be completed by end-September 2011. Moreover, to ensure that fiscal consolidation does not undermine social support to the most vulnerable, the Department of Social Protection will produce a comprehensive program of reforms to better target social spending, while removing inactivity and poverty traps (MEFP ¶24).

30. **The authorities are also implementing a strong set of institutional fiscal reforms to support and sustain fiscal consolidation** (MEFP ¶25). A Fiscal Advisory Council, mandated to provide an independent assessment of public finances, will be established by June 2011. In the context of Budget 2012, the authorities will introduce binding medium-term expenditure ceilings, informed by the conclusions of the comprehensive review of expenditure. These reforms, as well as a set of fiscal rules aimed at credibly anchoring budgetary discipline over the cycle, will receive legislative backing in a Fiscal Responsibility Bill by the end of the year. Important pension reforms being legislated later this year will materially strengthen Ireland's long-term public finances (MEFP ¶26).

31. **A number of structural reforms to boost medium-term growth potential are being pursued as envisaged in the program** (MEFP ¶27–29). Measures to tighten the regulation of sheltered sectors, reduce entry barriers, cap exemptions from the Competition Law, and strengthen the Competition Authority should help raise competitiveness and consumer purchasing power. To enhance job creation, the authorities will follow-up on the recommendations of an independent review of sectoral wage agreements. Finally, to increase the efficiency of state enterprises, especially energy and transport companies, the authorities are deliberating on the recommendations of the recently concluded *Review of State Assets and Liabilities*, which outlines the scope for privatization and associated reforms.<sup>16</sup>

---

<sup>16</sup> The first wave of privatization in Ireland started in the early 1990s and ended in 2006, generating receipts of €8.3 billion (much of it accounted by the €6.3 billion sale of Eircom over 1996-99). The net asset value of the major remaining state commercial companies was also estimated at €8.3 billion (in book value terms) at end-2009. The Report of the Review Group on State Assets and Liabilities identifies €5 billion of these for potential privatization, comprising, in the main, non-transmission assets in the electricity and gas sectors, the government's 25 percent share in Aer Lingus, and the non-forest land assets of Coillte (the forestry and renewable energies company). The Report recommends that asset sales be undertaken in a phased manner and after appropriate regulatory structures are in place, especially in the energy sector, where monopoly concerns are relevant; and be used for reducing public debt. It also proposes a number of governance and cost-cutting

(continued...)

## V. PROGRAM MODALITIES AND RISKS

### 32. **Program monitoring for 2011 has been updated:**

- The program will continue to be monitored based on quarterly and continuous performance criteria, an indicative target, structural benchmarks and quarterly reviews. It is proposed that the third and fourth reviews be completed on or after August 15 and December 14, 2011, respectively.
- Quantitative performance criteria are proposed for end-June 2011 and end-September 2011 (Table 10). The indicative target for end-2011 on the exchequer primary balance has been modified in line with the revised fiscal deficit projection for 2011, while the quarterly path has been adjusted to account for the better-than-programmed end-March outcome. The indicative targets for the ceiling on the stock of central government net debt have been modified accordingly.
- Several new structural benchmarks are proposed in support of program objectives (Table 12). The financial sector benchmarks relate to the schedule and process for recapitalizing the four guaranteed banks (MEFP ¶8 and ¶17), strengthening the legal framework for banking supervision (MEFP ¶19), and restructuring the domestic banking system (MEFP ¶8 and ¶9). The prior action aims to ensure that the Jobs Initiative is consistent with the fiscal targets for 2011 and beyond (MEFP, ¶23). The deadline for introduction of a medium-term expenditure framework has been moved to end 2011 to allow the expenditure ceilings to be informed by the recently announced comprehensive review of expenditure.

33. **The Fund and the EU have disbursed €17.8 billion (11.4 percent of GDP) since the extended arrangement was approved.** The Fund disbursed SDR 5 billion (€5.8 billion) on January 18; one third of total financing disbursed so far. From the European Financial Stability Mechanism (EFSM), Ireland obtained €5 billion in January, at 5-year maturity with a cost of 5.5 percent, and €3.4 billion in March, at 7-year maturity and 6.2 percent. The European Financial Stability Facility (EFSF) launched a €5 billion 5-year benchmark issue on January 25, resulting in a €3.6 billion disbursement to Ireland at 5.9 percent. Regarding the remaining program financing, a bilateral agreement has been concluded with the United Kingdom, and finalization of discussions on similar agreements is ongoing with Denmark and Sweden.

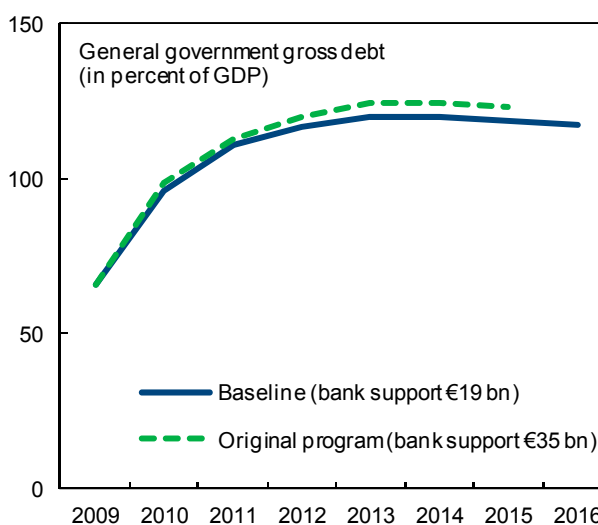
34. **The schedule of IMF and EU disbursements was reviewed in light of new information on the scale and timing of external financing needs.** The immediate financing

---

reforms in state-owned enterprises, including a review of remuneration levels. The Report is accessible at <http://www.finance.irg.gov.ie/documents/publications/reports/2011/stateassets.pdf>.

need is lower than previously assumed, primarily reflecting a smaller net recapitalization expense in cash terms than provided for in the original schedule. The proposed phasing reflects this lower immediate need, the timing of fiscal financing and debt amortization requirements, and also allows for potential delays in regaining access to market financing. Accordingly, it is proposed that total EU/IMF disbursements through end-2011 be reduced by some €4.5 billion, offset by higher access later in program. The Fund's disbursement schedule would continue to be half that of the EU (Table 8). With total access unchanged, and a similar medium-term economic outlook, Ireland's capacity to repay the Fund is little changed from at the time of program approval.

35. **The debt outlook, however, remains fragile.** Debt is projected to peak at 120 percent of GDP in 2013, and to then decline gradually. The debt path is below the one projected in the initial program by about 5 percentage points of GDP, primarily because the recapitalization cost (net of LMEs) is now assumed to be about €19 billion, less than the program's contingency funding for banks of €35 billion. Debt would reach about 117 percent of GDP by 2016 under the planned fiscal consolidation path. Higher market interest rates and downsides to medium-term growth prospects represent key risks to putting the debt ratio on a downward path (Annex). Responding to downside shocks by accelerating the already substantial fiscal adjustment that has been programmed in the medium term would not mitigate these risks as it would further retard growth in an already weak economic environment.



Source: Staff projections.

36. **Program risks remain high despite generally good policy implementation, with risks rising in some areas, especially access to market funding, while declining in others.** An update to the key program risks identified at the approval of the program is as follows:

- **Growth:** recent GDP and unemployment data were disappointing, pointing to larger downside risks to growth, although the period since the program was approved has been subject to unusual uncertainties. Nonetheless, export prospects remain strong, but these remain sensitive to growth in partner countries including the euro area, and robust export growth does not necessarily translate into strong domestic demand. For now, staff have not revised the medium-term outlook, but a weaker recovery would impact financial sector health, revenue, and debt dynamics.

- **Fiscal:** the program is on track in this respect, and the new government is committed to the consolidation targets for 2011 and 2012, and the comprehensive expenditure review is expected to find scope for savings. Nonetheless, revenue performance going forward will bear close monitoring.
- **Financial:** the comprehensive banking announcements have credibly served to specify the fiscal costs from the banking sector in a stress scenario, and immediate liquidity pressures on domestic banks appear to have eased. But contingencies could still arise, and implementation of reforms may face legal and other challenges.
- **Political:** the elections brought in a coalition government with strong ownership of the goals and key elements of the EU/IMF-supported program, much reducing these risks compared with the time of program approval. Yet the capacity to sustain fiscal adjustment and other reforms will depend on signs of concrete results in time.
- **Access to market funding:** this has been the clearest set-back since program approval, where despite strong policy implementation in both the financial and fiscal areas, the availability of cash and program financing, and the resolution of political uncertainty, ratings have been downgraded to the bottom tier of investment grade, spreads have widened, and access to markets has not been regained. A continued inability to regain market access for the sovereign, and hence for the banks, would impede growth, and, if prolonged, would result in a rising share of official financing in total public debt that could itself lead to wider spreads and undermine the ability to regain market access. In this context, deepening financial stress for other euro area periphery countries presents a critical yet largely exogenous risk that needs to be addressed through a more comprehensive European plan.

37. **The safeguards assessment of the CBI has been completed.** The assessment concluded that the CBI has a relatively strong safeguards framework in place, underpinned by its participation in the Eurosystem and good governance practices. Recommendations were made to address heightened risks emanating from the financial crisis, notably in relation to ELA lending, and to strengthen the CBI's financial autonomy. Considering that the planned €24 billion recapitalization of the domestic banks will shape the risks identified, the Government will discuss these recommendations after that process is completed. In the interim the authorities are preparing draft amendments to clarify certain aspects of the CBI Act, taking into account best practices in the Eurosystem.

## VI. STAFF APPRAISAL

38. **In the face of challenges, program implementation is off to a strong start.** The authorities' implementation of the program has been resolute, despite the period of political change and an uncertain external environment. The new government, through its *Programme*

*for Government* and its decisive approach to banking sector reforms, has also taken full ownership of the goals and key elements of the EU/IMF-supported program.

39. **The comprehensive reform and recapitalization of domestic banks announced on March 31 is a major step towards restoring the Irish banking system to health.** The integrated approach to restructure and deleverage the domestic banks, and to strengthen their capital base, is crucial for enabling these banks to become a driver of economic recovery. The credibility of the capital needs assessment was reflected in positive market reaction and favorable commentary by financial analysts. The intention to seek a contribution from holders of banks' subordinated debt will help execute bank recapitalization while limiting the burden on the taxpayer. A far-reaching and intensive implementation agenda to advance toward the goal of a healthy and fully privately owned banking system has now been designed.

40. **As the banking reforms switch from an analytical and design phase to a more complex implementation phase, continued rigorous management of the process will be essential to meet these goals.** In particular, the deleveraging of bank balance sheets will need to strike an appropriate balance between improving liquidity and containing losses; greater confidence in the availability of ECB financing in the medium term could maximize the benefits of these efforts for the banks' ability to regain market-based funding. In addition, the authorities will need to ensure that banks focus on strengthening the quality of their balance sheet by working out problem loans on the basis of best international practices.

41. **On the fiscal front, the program is on track, institutional frameworks are being strengthened, and it is appropriate for the program to reflect the authorities' policy priorities.** Fiscal targets were met by a comfortable margin in March, and the deficit remains on track for 2011. It is welcome that the new government has affirmed their strong commitment to the fiscal consolidation agreed in the EU/IMF-supported program, as well as to a deficit of 3 percent of GDP in 2015. The authorities' plan to adopt a Jobs Initiative in the near-term does not undermine these fiscal consolidation goals. The feasibility of reaching these ambitious goals is reinforced by the commitment to implement a Fiscal Advisory Council, a comprehensive review of expenditure to guide medium-term expenditure ceilings, and fiscal responsibility legislation. To further strengthen the credibility of these fiscal consolidation goals, it will be important to identify a set of high-quality measures to underpin fiscal consolidation in 2012 and beyond at forthcoming reviews.

42. **Risks to the program, already high at approval, have risen in some respects.** The combination of slower growth and higher unemployment rates, together with higher bond spreads and rating downgrades, have increased downside risks, especially risks to regaining market access. At the same time, some risks, such as those from the financial sector and political uncertainty would appear to have diminished. But these positive elements have had limited or temporary benefits in a context where external developments, such as the introduction of the forthcoming European Stability Mechanism or developments in other



eurozone periphery countries, drive financial markets and the perception of the probability of default.

43. **Staff support the authorities' requests for completion of the first and second program reviews and rephasing of the arrangement.** The authorities recognize the risks ahead, but are determined to bring about a recovery of the Irish economy. Restoring confidence will take time and sustained policy implementation efforts given the depth of the crisis and the extent of the debt overhangs. In this respect, the authorities have kept the program on track in challenging times and are committed to do so going forward, across the scope of banking reforms, fiscal consolidation, and supporting structural reforms. This decisive approach to program implementation, which should be supported by a more comprehensive European plan, offers the best prospect to overcome market doubts, regain market access, reduce the threat of spillovers, and restore growth.

Table 1. Ireland: Selected Economic Indicators, 2007–11  
(Annual change unless otherwise stated)

	2007	2008	2009	Prog. 2010	Prel. 2010	Proj. 2011
National accounts (constant prices)						
GDP	5.6	-3.5	-7.6	-0.2	-1.0	0.6
Domestic demand	5.4	-5.1	-13.9	-4.1	-5.6	-3.5
Private consumption	6.4	-1.5	-7.0	-1.4	-1.2	-1.6
Public consumption	6.9	2.2	-4.4	-2.0	-2.2	-4.4
Gross fixed investment	2.8	-14.3	-31.0	-21.1	-27.8	-13.5
Net exports 1/	0.8	1.5	3.8	3.5	3.4	3.5
Exports of goods and services	8.2	-0.8	-4.1	5.8	9.4	6.0
Imports of goods and services	7.8	-2.9	-9.7	2.2	6.6	3.0
Gross national saving (in percent of GDP)	21.7	16.4	11.5	10.0	10.6	12.2
Private	18.6	24.2	33.3	24.7	30.6	30.5
Public	2.7	-7.8	-21.8	-14.8	-20.0	-18.3
Gross investment (in percent of GDP)	27.3	22.3	14.1	11.8	10.8	10.8
Private	22.5	16.8	9.9	7.0	7.0	7.9
Public	4.8	5.5	4.2	4.7	3.8	2.9
Prices, wages and employment						
Harmonized Index of Consumer Prices (annual average)	2.9	3.1	-1.7	-1.6	-1.6	1.0
Average wages, all economy	5.2	3.5	-1.0	-3.7	-2.2	-1.2
Employment	3.6	-1.1	-8.1	-4.5	-4.2	-1.4
Unemployment rate (in percent)	4.6	6.3	11.8	13.5	13.6	14.5
Money and credit (end-period)						
Irish contribution to euro area money supply: M3	12.1	-0.6	-5.9	...	-19.6	...
Irish resident private sector credit 2/	17.0	7.3	-7.6	...	-5.3	...
Financial and asset markets (end-period)						
Three-month interbank rate	4.6	3.0	0.6	...	0.9	...
10-year government bond	4.5	4.4	4.9	...	9.2	...
ISEQ index	-26.3	-66.2	27.0	...	-3.0	...
House prices (permanent tsb index/ESRI)	-6.9	-8.8	-18.5	...	-10.8	...
Public finance (in percent of GDP)						
General government balance	0.1	-7.3	-14.3	-32.0	-32.4	-10.6
Primary balance	0.9	-6.3	-12.2	-29.0	-29.2	-6.7
General government debt	25.0	44.4	65.5	98.9	96.2	111.1
External trade and balance of payments						
Balance of goods and services (percent of GDP)	9.9	9.0	15.0	19.0	18.6	21.0
Current account (percent of GDP)	-5.3	-5.6	-3.0	-2.4	-0.7	0.5
Effective exchange rates (1999:Q1=100, annual average)						
Nominal	107.2	112.0	113.1	...	108.4	...
Real (CPI based)	119.2	123.8	121.9	...	112.5	...
Memorandum items:						
Population (in millions)	4.3	4.4	4.5	4.5	4.5	4.5
GDP per capita (in euros)	43,645	40,702	35,801	35,014	34,433	34,969

Sources: Department of Finance; Central Bank of Ireland; IFS; Bloomberg; and Fund staff calculations.

1/ Contribution to growth. However, the data for exports and imports of goods and services are annual growth rates.

2/ Adjusted change, which includes the effects of transactions between credit institutions and non-bank international financial companies and valuation effects arising from exchange rate movements.

Table 2. Ireland: Medium-Term Scenario, 2007–16  
(Percentage change, unless otherwise indicated)

	2007	2008	2009	2010		2011	2012	2013	2014	2015	2016
				Prog.	Prel.						
Real GDP	5.6	-3.5	-7.6	-0.2	-1.0	0.6	1.9	2.4	2.9	3.3	3.3
Real domestic demand	5.4	-5.1	-13.9	-4.1	-5.6	-3.5	0.1	0.8	1.4	2.8	2.9
Real final domestic demand	5.5	-4.3	-12.4	-5.3	-6.5	-3.9	0.1	0.8	1.4	2.8	2.9
Private consumption	6.4	-1.5	-7.0	-1.4	-1.2	-1.6	0.1	0.8	1.2	2.2	2.2
Public consumption	6.9	2.2	-4.4	-2.0	-2.2	-4.4	-1.9	-1.5	-1.5	0.0	0.0
Fixed investment	2.8	-14.3	-31.0	-21.1	-27.8	-13.5	3.1	4.0	6.0	9.0	9.0
Change in stocks 1/	0.0	-0.8	-1.4	1.1	0.9	0.2	0.0	0.0	0.0	0.0	0.0
Net exports 1/	0.8	1.5	3.8	3.5	3.4	3.5	1.8	1.8	1.9	1.2	1.2
Exports	8.2	-0.8	-4.1	5.8	9.4	6.0	5.2	4.9	4.9	4.9	4.9
Imports	7.8	-2.9	-9.7	2.2	6.6	3.0	4.2	4.0	4.0	4.9	4.9
Current account 2/	-5.3	-5.6	-3.0	-2.4	-0.7	0.5	1.2	0.7	0.5	0.0	-0.1
Gross national saving 2/	21.7	16.4	11.5	10.0	10.6	12.2	12.2	11.9	12.0	11.9	12.4
Private	18.6	24.2	33.3	24.7	30.6	30.5	26.2	23.3	18.4	17.4	17.4
Public	2.7	-7.8	-21.8	-14.8	-20.0	-18.3	-14.0	-11.4	-6.5	-5.5	-5.0
Gross investment 2/	27.3	22.3	14.1	11.8	10.8	10.8	10.8	11.0	11.2	11.7	12.3
Private	22.5	16.8	9.9	7.0	7.0	7.9	8.1	8.3	8.8	9.4	9.9
Public	4.8	5.5	4.2	4.7	3.8	2.9	2.7	2.6	2.4	2.4	2.4
Prices											
Consumer prices	2.9	3.1	-1.7	-1.6	-1.6	1.0	0.6	1.4	1.3	1.7	1.7
Wages	5.2	3.5	-0.1	-3.7	-2.2	-1.0	-0.1	0.7	0.7	1.1	1.2
Labor market											
Employment	3.6	-1.1	-8.1	-4.5	-4.2	-1.4	0.8	1.8	2.0	2.0	1.7
Average unemployment rate	4.6	6.3	11.8	13.5	13.6	14.5	13.9	13.2	12.3	11.3	10.5
Public finance											
General government balance 2/	0.1	-7.3	-14.3	-32.0	-32.4	-10.6	-8.9	-7.4	-4.9	-4.4	-4.2
General government structural balance 3/	-7.3	-11.5	-9.8	-8.8	-8.9	-6.7	-5.7	-4.8	-3.0	-3.1	-3.1
General government gross debt 2/	25.0	44.4	65.5	98.9	96.2	111.1	116.7	120.1	119.8	118.7	117.4
Output gap 3/	6.5	2.2	-5.6	-6.3	-6.6	-6.4	-5.1	-3.7	-2.4	-1.1	0.0

Sources: CSO; Department of Finance; and IMF staff calculations.

1/ Contributions to growth.

2/ In percent of GDP.

3/ In percent of potential output.

Table 3. Ireland: General Government Finances, 2006-15 1/  
(In billions of euros)

	Actual				Prog.	Prel.	Projections 1/				
	2006	2007	2008	2009	2010		2011	2012	2013	2014	2015
Current balance	11.5	8.9	-2.1	-12.0	-13.0	-12.8	-11.9	-9.0	-7.5	-4.1	-3.4
Current revenue	62.4	65.6	59.9	52.9	52.3	52.3	52.8	55.5	58.2	61.0	64.6
Tax revenue (incl. taxes on capital)	48.1	49.7	43.0	35.4	33.3	34.5	36.8	39.2	41.6	44.0	47.0
Social security receipts	8.2	9.1	9.3	8.9	9.1	8.7	6.9	7.1	7.3	7.4	7.7
Miscellaneous	6.2	6.8	7.6	8.5	9.8	9.1	9.1	9.2	9.4	9.6	9.9
Current expenditure	50.9	56.7	62.0	64.9	65.3	65.0	64.6	64.5	65.6	65.1	68.0
Interest payments	1.6	1.6	1.9	3.3	4.7	5.0	6.1	7.5	9.9	10.8	11.4
Goods and services	9.4	10.6	10.6	9.3	9.3	9.2	8.8	8.8	8.6	8.6	8.8
Compensation of employees	16.4	17.9	20.1	19.5	18.3	18.1	18.1	17.0	16.8	16.4	16.8
Current transfers	21.9	24.8	27.5	30.2	30.4	30.2	29.1	28.6	27.5	26.5	28.1
Depreciation	1.6	1.8	1.9	2.5	2.5	2.5	2.6	2.7	2.7	2.8	2.9
Capital balance	-6.3	-8.8	-11.1	-10.8	-37.2	-37.1	-4.6	-5.2	-4.8	-4.5	-4.7
Capital receipts (excl. taxes on capital)	2.0	2.2	1.9	1.1	1.9	0.9	1.6	0.9	0.9	1.0	1.0
Capital expenditure	8.3	11.1	13.0	11.9	39.1	38.0	6.2	6.1	5.8	5.5	5.7
Gross capital formation	6.7	9.0	9.8	6.6	7.4	5.9	4.5	4.3	4.4	4.1	4.3
Capital transfers (incl. bank support costs)	1.6	2.0	3.2	5.3	31.7	32.1	1.7	1.8	1.4	1.3	1.4
General government balance	5.2	0.1	-13.2	-22.8	-50.2	-49.9	-16.5	-14.2	-12.3	-8.6	-8.1
Primary balance	6.8	1.7	-11.3	-19.5	-45.5	-44.9	-10.4	-6.8	-2.4	2.2	3.3
Memorandum items (in percent of GDP, unless otherwise mentioned)											
Total receipts	36.3	35.8	34.3	33.8	34.6	34.5	34.9	35.2	35.5	35.6	35.9
Current revenue (incl. capital taxes)	35.2	34.6	33.3	33.1	33.4	33.9	33.9	34.6	34.9	35.1	35.4
Capital receipts	1.1	1.2	1.0	0.7	1.2	0.6	1.0	0.6	0.6	0.6	0.6
Total expenditure	33.4	35.8	41.7	48.1	66.7	66.9	45.4	44.1	42.9	40.5	40.4
Current spending	28.7	29.9	34.4	40.6	41.7	42.3	41.5	40.3	39.4	37.4	37.2
Of which: interest payments	0.9	0.8	1.0	2.1	3.0	3.3	3.9	4.7	6.0	6.2	6.3
Capital spending (incl. capital transfers)	4.7	5.8	7.2	7.5	25.0	24.7	4.0	3.8	3.5	3.1	3.1
Overall balance	2.9	0.1	-7.3	-14.3	-32.0	-32.4	-10.6	-8.9	-7.4	-4.9	-4.4
Primary balance	3.8	0.9	-6.3	-12.2	-29.0	-29.2	-6.7	-4.2	-1.4	1.3	1.8
Overall balance (excl. bank support)	2.9	0.1	-7.3	-14.3	-12.6	-12.0	-10.6	-8.9	-7.4	-4.9	-4.4
Primary balance (excl. bank support)	3.8	0.9	-6.3	-12.2	-9.6	-8.8	-6.7	-4.2	-1.4	1.3	1.8
Structural primary balance (percent of potential GDP)	-3.4	-6.7	-10.4	-7.8	-6.0	-5.8	-3.1	-1.2	0.9	3.1	3.1
Gross general government debt	24.8	25.0	44.4	65.6	98.9	96.2	111.1	116.7	120.1	119.8	118.7
Output Gap (percent of potential GDP)	2.8	6.5	2.2	-6.0	-6.3	-6.6	-6.4	-5.1	-3.7	-2.4	-1.1
Nominal GDP (in billions of Euros)	177.3	189.4	180.0	159.6	156.6	153.9	155.8	160.2	166.5	174.1	182.5

Sources: Department of Finance; and staff estimates.

1/ In line with the initial program, the baseline projections incorporate the fiscal consolidation measures for 2011-14 that were approved by government in late 2010. Staff and the authorities project that additional measures will be required to meet the Stability and Growth Pact deficit target of 3 percent in 2015. For comparability of treatment with other European countries, this target is not reflected in the Fund's medium-term projections as the underlying measures are not yet articulated.

Table 4. Ireland: Indicators of External and Financial Vulnerability, 2004–10

	2004	2005	2006	2007	2008	2009	2010
<b>External indicators</b>							
Exports (annual percent change, value in euros)	6.9	5.9	6.2	8.3	-1.4	-3.6	9.4
Imports (annual percent change, value in euros)	8.6	10.3	8.9	9.5	-1.1	-10.1	7.4
Terms of trade (goods, annual percent change)	-1.4	1.2	-4.6	-3.3	-4.7	3.3	-0.8
Current account balance (in percent of GDP)	-0.6	-3.5	-3.6	-5.3	-5.6	-3.0	-0.7
Capital and financial account balance (in percent of GDP)	2.7	-0.1	2.8	6.4	9.0	-2.9	8.5
<i>Of which:</i>							
Inward portfolio investment	100.0	106.9	124.9	86.4	-10.2	5.7	44.6
Inward foreign direct investment	-5.7	-15.7	-2.5	9.5	-6.2	11.1	13.3
Other investment liabilities	39.7	57.7	74.5	92.1	85.4	-55.2	-45.3
U.S. dollar per euro (period average)	1.24	1.25	1.26	1.37	1.47	1.39	1.33
U.K. pound per euro (period average)	0.68	0.68	0.68	0.68	0.79	0.89	0.86
<b>Financial markets indicators</b>							
General government debt (in percent of GDP)	29.4	27.2	24.8	25.0	44.4	65.5	96.2
Government bond yield (in percent, 10-year, end-period)	3.5	3.3	4.0	4.5	4.4	4.9	9.2
Spread of government bond yield with Germany (in percent, end of period)	0.4	0.1	-0.3	0.0	1.3	1.3	6.1
Real government bond yield (in percent, 10-year, period average, based on HICP)	1.9	1.2	1.0	1.6	1.5	6.6	10.8
Annual change in ISEQ index (in percent, end of period)	26.8	16.8	27.8	-26.3	-66.2	27.0	-3.0
Personal lending interest rate (in percent)	9.9	10.1	11.2	11.7	11.9	11.1	11.3
Standard variable mortgage interest rate (in percent)	3.5	3.6	4.8	5.4	4.8	3.3	4.0
<b>Financial sector risk indicators</b>							
Annual credit growth rates (to Irish resident private sector, in percent)	26.6	28.8	25.9	17.0	7.3	-7.6	-5.3
Personal lending as a share of total Irish resident credit (in percent)	45.7	44.7	42.3	39.6	35.2	35.6	35.8
<i>Of which:</i>							
House mortgage finance	36.7	36.5	34.9	32.8	29.0	30.1	30.3
Other housing finance	0.3	0.2	0.4	0.3	0.3	0.2	0.3
Other personal lending	8.7	7.9	7.0	6.5	5.9	5.3	5.2
Irish resident household mortgage debt annual growth rates (in percent) 1/	33.9	28.9	17.3	11.2	-7.1	-3.9	-10.1
Commercial property lending as a percent of total loans (excluding financial intermediation) 2/	21.2	25.3	31.2	...	...	...	...
Foreign-currency denominated assets (in percent of total assets)	29.4	33.9	33.7	36.5	31.7	34.3	30.3
Foreign-currency denominated liabilities (in percent of total liabilities)	32.2	35.9	36.9	41.1	35.5	31.1	25.8
Contingent and off-balance sheet accounts (in percent of total assets) 3/	662	879	1133	...	...	...	...
Non-performing loans (in percent of total loans) 4/	0.8	0.7	0.7	0.8	2.6	9.0	8.6
Total provisions for loan losses (in percent of total loans)	0.7	0.5	0.4	0.4	1.3	4.0	5.3
Regulatory capital to risk-weighted assets of domestic banks (in percent)	12.6	12.0	10.9	10.7	10.6	10.9	10.4
Bank return on assets (before tax, in percent)	1.1	0.8	0.8	0.7	...	...	...
Bank return on equity (before tax, in percent)	20.7	19.6	19.1	16.4	...	...	...
Liquid assets of all banks to total assets (liquid asset ratio, in percent)	33.0	34.2	32.7	28.4	...	...	...
Liquid assets of all banks to short-term liabilities (in percent)	40.0	40.2	38.4	34.4	...	...	...
Deposits to M3 ratio 5/	1.4	1.4	1.3	1.4	1.3	1.4	1.5
Loan-to-deposit ratio vis-à-vis Irish residents 6/	1.6	1.8	1.9	2.1	2.2	2.1	2.1
vis-à-vis total 6/	1.7	1.8	1.9	2.1	2.2	2.2	2.1
<b>Concentration ratios in the banking sector</b>							
No. of banks accounting for 25 percent of total assets	2.0	2.0	3.0	3.0	2.0	2.0	2.0
No. of banks accounting for 75 percent of total assets	17.0	16.0	17.0	15.0	14.0	13.0	13.0
Share of state-owned banks in total assets (in percent)	0.0	0.0	0.0	0.0	0.0	6.0	8.0
Share of foreign-owned banks in total assets (in percent)	34.0	32.3	36.3	32.2	62.0	65.0	66.0

Sources: Data provided by the authorities; Central Bank of Ireland; International Financial Statistics; Bloomberg; and Fund staff estimates.

1/ Including securitisations.

2/ Includes lending for construction and real estate activities.

3/ Credit equivalent values.

4/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.

5/ Non-government deposits vis-à-vis Irish and nonresidents. The M3 compilation methodology has been amended in line with Eurosystem requirements.

6/ Nongovernment credit/nongovernment deposits ratio.

Table 5. Ireland: Summary of Balance of Payments, 2008-13

	2008	2009	Prel. 2010	2011	Proj. 2012	2013
(In billions of euros)						
Current account balance	-10.2	-4.9	-1.1	0.8	1.9	1.1
Balance of goods and services	16.1	24.0	28.6	32.8	36.4	39.9
Trade balance	23.8	32.4	37.1	39.7	43.0	46.4
Exports of goods	81.0	77.0	83.9	88.2	92.9	97.5
Imports of goods	-57.2	-44.7	-46.7	-48.6	-49.9	-51.1
Services balance	-7.7	-8.4	-8.5	-6.9	-6.6	-6.5
Credit	67.9	66.6	73.3	79.1	85.3	91.2
Debit	-75.6	-75.0	-81.8	-86.0	-92.0	-97.7
Income balance	-25.2	-27.9	-28.6	-32.1	-34.4	-38.6
Credit	84.0	54.5	56.8	59.2	60.3	60.9
Debit	-109.2	-82.4	-85.3	-91.3	-94.8	-99.4
Current transfers (net)	-1.2	-0.9	-1.2	0.0	-0.1	-0.2
Capital and financial account balance	16.2	-4.6	13.1	-39.3	-20.9	-11.1
Capital account balance	0.0	-1.3	-0.7	-0.1	-0.4	-0.4
Financial account	16.1	-3.3	13.9	-39.2	-20.5	-10.7
Direct investment	-24.2	0.5	8.2	1.0	1.1	0.6
Portfolio investment	-45.7	18.8	94.7	-15.0	-11.2	-8.2
Other investment	86.1	-22.6	-89.0	-13.4	-3.7	0.0
Change in reserve assets 1/	-0.1	0.1	0.0	-11.9	-6.7	-3.1
Net errors and omissions	-6.0	9.4	-12.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	38.5	19.0	10.0
Program financing	0.0	0.0	0.0	38.5	19.0	10.0
IMF	0.0	0.0	0.0	12.8	6.3	3.4
EU	0.0	0.0	0.0	25.7	12.7	6.6
(In percent of GDP)						
Current account balance	-5.6	-3.0	-0.7	0.5	1.2	0.7
Balance on goods and services	9.0	15.0	18.6	21.0	22.7	24.0
Trade balance	13.2	20.3	24.1	25.5	26.9	27.9
Services balance	-4.3	-5.3	-5.5	-4.4	-4.1	-3.9
Income balance	-14.0	-17.5	-18.6	-20.6	-21.5	-23.2
Current transfers	-0.6	-0.6	-0.8	0.0	-0.1	-0.1
Capital and financial account balance	9.0	-2.9	8.5	-25.2	-13.0	-6.7
Of which:						
Direct investment	-13.4	0.3	5.3	0.7	0.7	0.4
Portfolio investment	-25.4	11.8	61.5	-9.6	-7.0	-4.9
Other investment	47.9	-14.2	-57.8	-8.6	-2.3	0.0
Change in reserve assets	0.0	0.0	0.0	-7.6	-4.2	-1.9
Net errors and omissions	-3.3	5.9	-7.8	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	24.7	11.9	6.0
Program financing	0.0	0.0	0.0	24.7	11.9	6.0
IMF	0.0	0.0	0.0	8.2	3.9	2.0
EU	0.0	0.0	0.0	16.5	7.9	3.9

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

Sources: The Central Statistics Office; and Fund staff estimates.

Table 6. Ireland: External Financing Requirements and Sources, 2008-13  
(In billions of euros)

	2008	2009	Prel. 2010	2011	Proj. 2012	2013
Gross financing requirement	723.7	845.8	783.0	653.8	592.8	549.8
Current account deficit	10.2	4.9	1.1	-0.8	-1.9	-1.1
Medium- and long-term debt amortization	98.3	110.0	114.8	97.5	106.5	106.7
Public sector (incl. Central Bank of Ireland) 1/	13.3	28.1	20.2	24.1	22.9	21.4
Banks	41.6	30.1	42.0	16.1	20.7	15.9
Other	43.3	51.7	52.7	57.3	63.0	69.3
Short-term debt amortization	615.2	730.9	667.1	557.0	488.1	444.3
Public sector (incl. Central Bank of Ireland)	1.4	63.4	69.0	150.9	143.9	131.5
Banks	500.0	566.7	493.2	292.8	219.6	175.7
Other	113.7	100.8	104.9	113.3	124.6	137.1
Sources of financing	723.7	845.8	783.0	615.3	573.8	539.8
Capital account	0.0	-1.3	-0.7	-0.1	-0.4	-0.4
Foreign direct investment	-24.2	0.5	8.2	1.0	1.1	0.6
Equities	15.1	8.7	11.7	5.0	-6.6	3.3
Medium- and long-term borrowing	96.0	84.4	135.6	75.1	85.8	101.4
Public sector (incl. Central Bank of Ireland)	9.5	26.0	16.3	0.0	0.0	12.4
Banks	-34.6	-2.6	20.5	12.1	16.5	12.7
Other	121.1	60.9	98.8	63.0	69.3	76.2
Short-term borrowing	730.9	667.1	557.0	488.1	444.3	415.2
Public sector (incl. Central Bank of Ireland)	63.4	69.0	150.9	143.9	131.5	126.6
Banks	566.7	493.2	292.8	219.6	175.7	140.5
Other	100.8	104.9	113.3	124.6	137.1	148.1
Other sources, including errors and omissions	-94.3	86.4	71.2	46.1	49.5	19.8
Financing gap	0.0	0.0	0.0	38.5	19.0	10.0
Program financing	0.0	0.0	0.0	38.5	19.0	10.0
IMF	0.0	0.0	0.0	12.8	6.3	3.4
EU	0.0	0.0	0.0	25.7	12.7	6.6

1/ Includes budget deficit financing.

Sources: The Central Statistics Office; and Fund staff estimates.

Table 7. Ireland: Monetary Statistics  
(In billions of euros)

	Government guaranteed banks				IFSC			
	Dec-08	Dec-09	Dec-10	Feb-11	Dec-08	Dec-09	Dec-10	Feb-11
Assets	623.2	646.0	623.2	626.5	654.1	523.4	436.0	392.4
Loans Residents	349.5	348.1	332.2	336.0	63.9	53.5	58.9	45.2
Bank-nonaffiliated	10.3	8.5	2.7	3.2	27.1	22.5	14.7	10.2
Bank-affiliated	88.6	109.8	111.5	115.1	25.1	21.2	34.5	26.4
Private sector	250.4	229.6	186.9	186.6	8.3	7.1	7.9	7.6
Households	106.9	102.8	101.7	100.8	1.0	1.1	1.1	1.1
NFC	110.8	97.8	62.3	62.8	2.6	1.8	2.2	2.2
Other private sector	32.6	29.0	22.9	22.9	4.7	4.1	4.6	4.3
Other loans	0.3	0.3	31.1	31.1	3.4	2.6	1.8	1.0
Other assets	154.3	152.3	152.2	169.3	372.2	291.6	176.5	161.7
Loans nonresident	119.4	145.5	138.7	121.3	218.0	178.3	200.5	185.5
Private sector loans	30.3	32.1	36.0	33.9	80.7	61.6	54.5	51.5
Other loans	89.0	113.4	102.8	87.4	137.3	116.7	146.1	134.0
Liabilities	623.2	646.0	623.2	626.5	654.1	523.4	436.0	392.4
Deposits	229.6	252.0	234.3	230.2	61.1	46.5	53.4	41.0
Bank-nonaffiliated	8.4	10.8	5.6	5.7	6.4	2.9	2.3	1.7
Bank-affiliated	88.2	105.7	111.9	113.0	44.7	35.9	38.9	27.3
Private sector	130.2	132.4	113.7	108.6	9.9	7.6	12.2	11.9
Households	71.0	72.3	66.7	64.7	0.0	0.1	0.5	0.6
NFC	31.3	28.7	23.9	23.0	2.3	1.9	3.3	3.0
Other private sector	27.9	31.3	23.0	20.9	7.6	5.6	8.5	8.3
Other deposits	2.9	3.1	3.1	2.8	0.0	0.0	0.0	0.0
Other liabilities	197.6	222.7	285.3	312.2	257.0	181.0	164.8	144.4
Deposits nonresident	196.1	171.2	103.6	84.2	336.0	295.9	217.8	207.1
Private sector deposits	37.5	27.1	12.5	12.0	69.8	64.6	62.7	59.6
Affiliates' deposits	114.1	106.3	68.1	52.0	200.0	181.6	102.6	102.0
Other deposits	44.4	37.8	23.0	20.3	66.2	49.7	52.5	45.5

Source: Central Bank of Ireland.



Table 8. Ireland: Schedule of Reviews and Purchases

Review	Availability Date	Action	Purchase		
			SDRs	Percent of old quota 1/	Percent of new quota 1/
	December 16, 2010	Board approval of arrangement	5,012,425,200	598	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	168	112
Third Review	August 15, 2011	Observance of end-June 2011 performance criteria, completion of Third Review	1,319,000,000	157	105
Fourth Review	December 14, 2011	Observance of end-September 2011 performance criteria, completion of Fourth Review	3,309,000,000	395	263
Fifth Review	March 15, 2012	Observance of end-December 2011 performance criteria, completion of Fifth Review	1,920,000,000	229	153
Sixth Review	June 15, 2012	Observance of end-March 2012 performance criteria, completion of Sixth Review	1,191,000,000	142	95
Seventh Review	September 15, 2012	Observance of end-June 2012 performance criteria, completion of Seventh Review	1,191,000,000	142	95
Eight Review	December 15, 2012	Observance of end-September 2012 performance criteria, completion of Eight Review	1,191,000,000	142	95
Ninth Review	March 15, 2013	Observance of end-December 2012 performance criteria, completion of Ninth Review	831,000,000	99	66
Tenth Review	June 15, 2013	Observance of end-March 2013 performance criteria, completion of Tenth Review	831,000,000	99	66
Eleventh Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of Eleventh Review	681,000,000	81	54
Twelfth Review	November 15, 2013	Observance of end-September 2013 performance criteria, completion of Twelfth Review	579,374,800	69	46
Total			19,465,800,000	2,322	1,548

1/ Old quota refers to Ireland's quota (SDR 838.4 million) when the program was approved in December 2010. As a result of the implementation of the Quota and Voice reform, Ireland's new quota is SDR 1,257.6 million effective from March 4, 2011.

Source: IMF staff projections.

Table 9. Ireland. Indicators of Fund Credit, 2010–24 1/  
(In millions of SDR)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
<b>Fund credit</b>															
Disbursement	-	11,050	5,493	2,922	-	-	-	-	-	-	-	-	-	-	-
Stock 2/	-	11,050	16,543	19,466	19,466	18,931	16,830	13,934	10,690	7,445	4,201	1,492	349	-	-
Obligations	-	184	565	819	1,167	1,762	3,243	3,863	3,986	3,742	3,499	2,769	1,162	353	1
Repurchase	-	-	-	-	-	535	2,101	2,896	3,244	3,244	3,244	2,709	1,143	349	-
Charges	-	184	565	819	1,167	1,227	1,142	967	741	498	254	60	18	4	1
<b>Stock of Fund credit</b>															
In percent of old quota 3/	-	1,318	1,973	2,322	2,322	2,258	2,007	1,662	1,275	888	501	178	42	-	-
In percent of new quota 3/	-	879	1,315	1,548	1,548	1,505	1,338	1,108	850	592	334	119	28	-	-
In percent of GDP	-	7.0	11.9	14.6	14.5	13.8	11.8	9.3	6.8	4.5	2.4	0.8	0.2	-	-
In percent of exports of goods and services	-	8.4	13.1	14.2	13.4	12.3	10.5	8.2	6.0	4.0	2.1	0.7	0.2	-	-
<b>Obligations to the Fund</b>															
In percent of old quota 3/	-	22	67	98	139	210	387	461	475	446	417	330	139	42	0
In percent of new quota 3/	-	15	45	65	93	140	258	307	317	298	278	220	92	28	0
In percent of GDP	-	0.1	0.4	0.6	0.9	1.3	2.3	2.6	2.5	2.3	2.0	1.5	0.6	0.2	0
In percent of exports of goods and services	-	0.1	0.4	0.6	0.8	1.1	2.0	2.3	2.2	2.0	1.8	1.3	0.5	0.2	0

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.

3/ Old quota refers to Ireland's quota (SDR 838.4 million) when the program was approved in December 2010. As a result of the implementation of the Quota and Voice reform, Ireland's new quota is SDR 1,257.6 million effective from March 4, 2011.

Table 10. Quantitative Performance Criteria and Indicative Targets Under the Economic Program for 2010–11

	December 31, 2010		March 31, 2011		June 30, 2011	September 30 2011	December 31, 2011	March 31, 2012
	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
(In billions of Euros)								
	Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-15.8	-14.7	-7.9	-6.3	-10.9	-14.2	-15.0	-6.0
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
	Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	83.6	81.7	92.1	88.5	94.6	98.2	101.1	107.9

1/ Adjusted.

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

3/ Applies on a continuous basis.

Table 11. Program Monitoring

Measure	Date	Status
<b>Quantitative Performance Criteria</b>		
Cumulative exchequer primary balance	End-December 2010 End-March 2011	Observed Observed
<b>Indicative Targets</b>		
Ceiling on the stock of central government net debt	End-December 2010 End-March 2011	Observed Observed
<b>Continuous Performance Criterion</b>		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
<b>Structural Benchmarks</b>		
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 recognised consulting firms.	End-December 2010	Observed
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.	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	Ongoing
The Central Bank will direct the recapitalization of ILP to achieve a capital ratio of 12 percent core tier 1.	End-May 2011	Replaced 3/
Establish a Budget Advisory Council.	End-June 2011	Ongoing
Introduce a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area.	End-July 2011	Deferred until end-Dec. 2011

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 March 31, 2011.

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.

3/ See Table 12, which has a new structural benchmark for the recapitalization of banks by end-July.

Table 12. Prior Action and Structural Benchmarks Under the Program for 2011

Measure	Date	Status
<b>Financial sector policies</b>		
Finalize plans for the recapitalization of Irish Life and Permanent (MEFP, ¶8).	End-May 2011	Structural benchmark
Complete the recapitalization of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society (MEFP, ¶17).	End-July 2011	Structural benchmark
Submit to Oireachtas the Supervision and Enforcement Bill (MEFP, ¶19)	End-July 2011	Structural benchmark
Complete the legal merger procedures of EBS Building Society and Allied Irish Banks (MEFP, ¶8).	End-September 2011	Structural benchmark
The merger of Irish Nationwide Building Society and Anglo-Irish bank (MEFP, ¶9).	End-December 2011	Structural benchmark
<b>Fiscal policies</b>		
Ensure strict budget neutrality of the Jobs Initiative in 2011 and over the period to 2014 by specifying fully costed offsetting measures (MEFP ¶23).		Prior action
Establish a Fiscal Advisory Council (MEFP, ¶25).	End-June 2011	Structural benchmark
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets (MEFP, ¶25).	End-December 2011	Structural benchmark

## Annex: Debt Sustainability Analysis

### Public sector debt

**The baseline scenario for the debt-to-GDP ratio is somewhat better than at program approval.** Debt is expected to peak at 120 percent of GDP in 2013—against 125 percent in the original program—and then to decline modestly to 117 percent of GDP by 2016. The assumed recapitalization cost of about €19 billion net of liability management exercises, is less than the program’s baseline contingency funding for banks of €35 billion. The impact on the debt ratio of lower outlays on bank support is partly offset by a lower nominal GDP (about 2 percent by 2015), and an upward revision to international and Irish interest rates.

**However, recent growth and interest rate developments points to risks to the debt outlook.** The alternative scenarios and bound tests illustrate important sensitivities to growth and interest rate assumptions:<sup>1</sup>

- A negative shock to the baseline growth rate could put debt on an upward path. With a permanent shock of one-third standard deviation, debt would increase to 136 percent of GDP by 2016. A one-third standard deviation shock reduces the average growth rate from 2¾ to 1½ percent over 2011–16. The size of the shock, which depends on deviations from the average, is affected by the sharp boom and bust of the Irish economy over the past years.
- The debt outlook is sensitive to interest rate developments. Since program approval, market interest rates have persisted at high levels. However, Irish government debt has predominantly fixed interest rates, hence higher market interest rates would only affect interest payments on new borrowings. Therefore, assuming that interest rates on new borrowing remain at current levels is equivalent to assuming a ½ percentage point higher average interest rate on the full debt stock. In this scenario, debt would peak at 121 percent of GDP in 2013, then decline slowly to 120 percent by 2016.
- The planned fiscal consolidation, which is projected to deliver a primary surplus of 2 percent by 2016, is essential to put debt on a declining path. In the absence of fiscal consolidation, debt would reach 151 percent of GDP by 2016 and be on an upward path.

### External debt

**Ireland’s gross external liabilities are very large in relation to GDP, but are mostly offset by external assets.** Ireland’s gross non-resident liabilities are large at 1,040 percent of GDP (end-2010). But this is due mainly to the presence of the large International Financial

---

<sup>1</sup> The alternative scenarios have been modified from their standardized versions.

Services Center (IFSC), which also possesses sizeable external assets. Excluding the IFSC, external liabilities are significantly smaller, in the order of 340 percent of GDP (at end-2010). Indeed, a more comprehensive measure of Irish external liabilities is the International Investment Position (IIP). According to this measure, when holdings of foreign assets are taken into consideration, the Irish external position is a net liability of some 97 percent of GDP (at end-2010).

**External public sector liabilities have increased.** Since end-September 2008, gross external liabilities of credit institutions (both IFSC and non-IFSC) and money market funds—primarily with a short-term maturity—have been declining. In contrast, the public sector (including general government and monetary authority) has been accumulating external liabilities. In particular, the gross external debt of the Central Bank of Ireland—related to liabilities to the European System of Central Banks (ESCB)—was €145 billion as of end-December 2010. While public gross external debt at about 111 percent of GDP amounts to around 10 percent of all external debt, IIP data indicate that the public sector is now responsible for around 130 percent of total net external liabilities.

**Under the baseline scenario, gross external debt is expected to have peaked at end-2010 at some 1,040 percent of GDP, and to decline to 807 percent of GDP by end-2016.** The baseline scenario incorporates the assumption that the full amount of the EU-IMF financing will be drawn, partly contributing to a buildup in Irish foreign assets (about €19 billion). Under the baseline projections, public sector external liabilities will continue to increase, while deleveraging will lower private sector liabilities. Public sector external debt is expected to peak at 120 percent of GDP in 2013, three years later than total external debt.

**As illustrated by alternative scenarios and bound tests, risks to the baseline scenario are non-negligible:**

- With a permanent shock to growth, the external debt ratio would reach 915 percent of GDP by 2016. The external debt-to-GDP ratio will still stabilize, in spite of the severity of the shock ( $-2\frac{1}{2}$  percentage points lower growth than in the baseline scenario).
- The sensitivity to exchange rate development is mitigated by a high estimated degree of euro denominated external debt. Should the real exchange rate depreciate by 30 percent in 2010, debt would reach 1,050 percent of GDP by 2012, to decline to 895 percent by 2016.

Annex Table 1. Ireland: Public Sector Debt Sustainability Framework, 2006-2016  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 10/ 0.7
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Baseline: Public sector debt 1/	24.8	25.0	44.4	65.6	96.2	111.1	116.7	120.1	119.8	118.7	117.4	
Change in public sector debt	-2.4	0.2	19.3	21.3	30.6	14.9	5.7	3.4	-0.3	-1.1	-1.3	
Identified debt-creating flows (4+7+12)	-5.2	-1.6	8.6	19.9	35.3	15.2	5.9	3.0	-0.3	-1.1	-1.3	
Primary deficit	-3.8	-0.9	6.3	12.2	29.2	6.7	4.2	1.4	-1.3	-1.8	-2.1	
Revenue and grants	36.3	35.8	34.3	33.8	34.5	34.9	35.2	35.5	35.6	35.9	35.6	
Primary (noninterest) expenditure	32.5	34.9	40.6	46.0	63.7	41.6	39.4	36.9	34.3	34.1	33.6	
Automatic debt dynamics 2/	-1.4	-0.7	2.3	7.7	5.7	2.7	1.6	1.6	1.0	0.8	0.7	
Contribution from interest rate/growth differential 3/	-1.4	-0.7	2.3	7.7	5.7	2.7	1.6	1.6	1.0	0.8	0.7	
Of which contribution from real interest rate	-0.1	0.6	1.4	3.9	5.0	3.3	3.7	4.3	4.3	4.5	4.5	
Of which contribution from real GDP growth	-1.3	-1.3	0.9	3.8	0.7	-0.5	-2.1	-2.7	-3.4	-3.7	-3.8	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.4	5.8	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.4	5.8	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.8	1.8	10.7	1.3	-4.7	-0.3	-0.2	0.4	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	68.5	69.9	129.2	194.1	278.8	318.6	331.6	338.3	336.3	330.5	329.4	
Gross financing need 6/ in billions of U.S. dollars	-2.9 -6.4	3.1 8.1	7.4 19.6	21.9 47.8	46.1 97.9	31.7 68.4	14.3 31.9	14.1 32.8	17.0 41.6	9.4 24.2	19.1 51.4	
Scenario with key variables at their historical averages 7/						111.1	111.9	113.3	114.2	115.2	116.2	0.0
Scenario with no policy change (constant primary balance) in 2011-2016						111.1	119.2	127.9	135.6	143.2	150.7	0.9
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.3	5.6	-3.5	-7.6	-1.0	0.6	1.9	2.4	2.9	3.3	3.3	
Average nominal interest rate on public debt (in percent) 8/	3.6	3.6	4.0	4.1	4.8	4.1	4.3	5.3	5.4	5.5	5.5	
Average real interest rate (nominal rate minus change in GDP deflator, in perce	-0.2	2.5	5.4	8.2	7.4	3.4	3.4	3.9	3.8	4.0	4.0	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.8	9.2	7.3	-6.8	0.7	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	3.7	1.1	-1.5	-4.0	-2.6	0.6	0.9	1.4	1.6	1.5	1.5	
Growth of real primary spending (deflated by GDP deflator, in percent) 9/	7.2	13.7	12.1	-1.0	-1.6	-3.4	-3.3	-4.1	-4.3	2.6	1.7	
Primary deficit 9/	-3.8	-0.9	6.3	9.7	8.8	6.7	4.2	1.4	-1.3	-1.8	-2.1	

1/ General government gross debt. The projections include Fund and EU disbursements. Government-guaranteed NAMA bonds are excluded, based on Eurostat guidance.

For 2015, no policy change is assumed.

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\varepsilon(1+\tau)] / (1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\varepsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\varepsilon(1+\tau)$ .

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt and short-term debt at end of previous period, and bank recapitalization costs.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Excluding bank support costs.

10/ 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 Table 2. Ireland: External Debt Sustainability Framework, 2006-2016  
(In percent of GDP, unless otherwise indicated)

	2006	2007	Actual			Projections							Debt-stabilizing non-interest current account 6/ -26.1			
			2008	2009	2010	2011	2012	2013	2014	2015	2016					
<b>Baseline: External debt</b>	<b>754.9</b>	<b>813.3</b>	<b>942.1</b>	<b>1036.9</b>	<b>1040.9</b>											
<b>External debt excl. IFSC</b>	<b>207.6</b>	<b>258.0</b>	<b>341.8</b>	<b>341.1</b>	<b>337.1</b>											
Change in external debt	57.1	58.4	128.8	94.8	4.0	-46.5	-55.6	-50.1	-30.0	-28.7	-22.9					
Identified external debt-creating flows (4+8+9)	-84.9	-85.9	53.1	117.3	26.2	-10.3	-16.4	-25.1	-25.2	-26.8	-26.3					
Current account deficit, excluding interest payments	-6.8	-7.3	-9.0	-9.0	-11.3	-15.9	-15.7	-14.2	-13.3	-12.3	-11.8					
Deficit in balance of goods and services	-147.9	-150.7	-156.6	-165.0	-185.6	-193.8	-199.8	-202.7	-204.7	-207.4	-210.0					
Exports	79.1	80.3	82.8	90.0	102.1	107.4	111.3	113.3	115.0	116.4	117.8					
Imports	-68.8	-70.4	-73.8	-75.0	-83.5	-86.4	-88.5	-89.4	-89.7	-91.0	-92.1					
Net non-debt creating capital inflows (negative)	-29.3	-43.3	5.0	-5.7	-12.9	-3.9	3.4	-2.3	0.1	0.0	0.0					
Automatic debt dynamics 1/	-48.8	-35.4	57.1	132.1	50.5	9.5	-4.1	-8.5	-12.1	-14.6	-14.6					
Contribution from nominal interest rate	10.3	12.6	14.6	12.1	12.0	15.4	14.5	13.6	12.7	12.3	11.9					
Contribution from real GDP growth	-34.0	-39.8	30.4	80.5	11.2	-5.9	-18.6	-22.1	-24.8	-26.9	-26.4					
Contribution from price and exchange rate changes 2/	-25.1	-8.2	12.1	39.5	27.3	...	...	...	...	...	...					
Residual, incl. change in gross foreign assets (2-3) 3/	141.9	144.3	75.7	-22.6	-22.2	-36.2	-39.1	-25.0	-4.7	-1.9	3.4					
External debt-to-exports ratio (in percent)	954.2	1013.1	1138.2	1152.3	1019.4	925.8	843.7	784.2	747.0	713.1	684.9					
<b>Gross external financing need (in billions of US dollars) 4/</b>	<b>514.2</b>	<b>567.5</b>	<b>723.7</b>	<b>845.8</b>	<b>783.0</b>	<b>653.8</b>	<b>592.8</b>	<b>549.8</b>	<b>519.0</b>	<b>535.5</b>	<b>561.7</b>					
in percent of GDP	290.0	299.7	402.1	529.8	508.6	10-Year	10-Year	419.5	370.0	330.3	298.1	293.4	293.4			
<b>Scenario with key variables at their historical averages 5/</b>						<b>994.4</b>	<b>909.1</b>	<b>844.8</b>	<b>803.0</b>	<b>763.6</b>	<b>730.4</b>			<b>-42.0</b>		
<b>Key Macroeconomic Assumptions Underlying Baseline</b>						Historical Average	Standard Deviation									
Real GDP growth (in percent)	5.3	5.6	-3.5	-7.6	-1.0	2.6	4.9	0.6	1.9	2.4	2.9	3.3	3.3			
GDP deflator in US dollars (change in percent)	3.7	1.1	-1.5	-4.0	-2.6	1.4	3.1	0.6	0.9	1.4	1.6	1.5	1.5			
Nominal external interest rate (in percent)	1.6	1.8	1.7	1.1	1.1	1.4	0.3	1.5	1.5	1.5	1.5	1.5	1.5			
Growth of exports (US dollar terms, in percent)	7.2	8.4	-2.0	-3.6	9.4	4.6	6.0	6.5	6.5	5.8	6.1	6.1	6.2			
Growth of imports (US dollar terms, in percent)	9.0	9.2	-0.4	-9.9	7.4	4.1	7.3	4.7	5.4	4.9	5.0	6.2	6.2			
Current account balance, excluding interest payments	6.8	7.3	9.0	9.0	11.3	6.2	2.9	15.9	15.7	14.2	13.3	12.3	11.8			
Net non-debt creating capital inflows	29.3	43.3	-5.0	5.7	12.9	23.2	23.7	3.9	-3.4	2.3	-0.1	0.0	0.0			

1/ Derived as  $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $\rho$  = change in domestic GDP deflator in US dollar terms,  $g$  = real GDP growth rate,  $\varepsilon$  = nominal appreciation (increase in dollar value of domestic currency), and  $\alpha$  = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $[-\rho(1+g) + \varepsilon\alpha(1+r)] / (1+g+\rho+g\rho)$  times previous period debt stock.  $\rho$  increases with an appreciating domestic currency ( $\varepsilon > 0$ ) and rising inflation (based on GDP deflator).

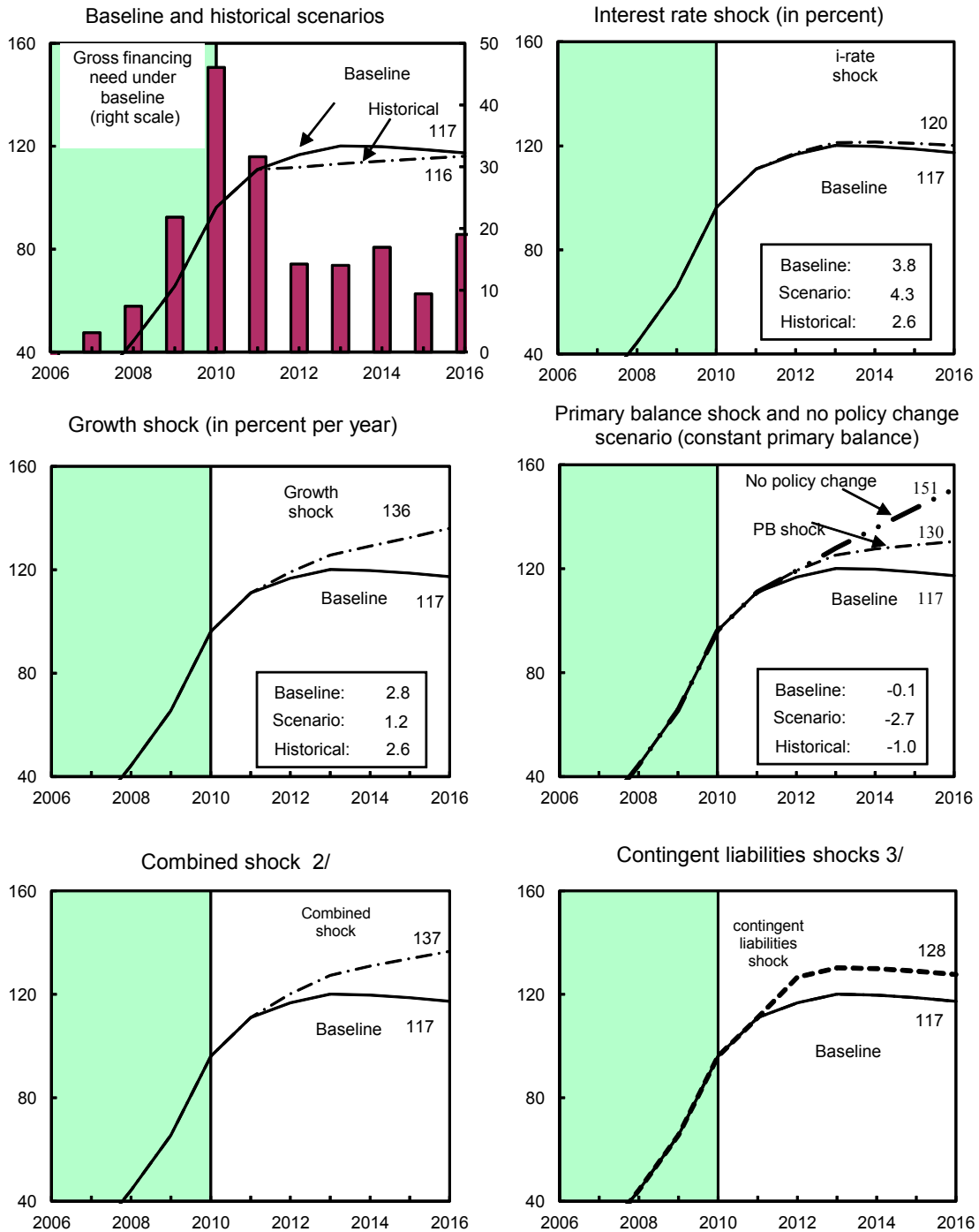
3/ For projection, line includes the impact of price and exchange rate changes.

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 Figure 1. Ireland: Public Debt Sustainability: Bound Tests 1/  
(Public debt in percent of GDP)



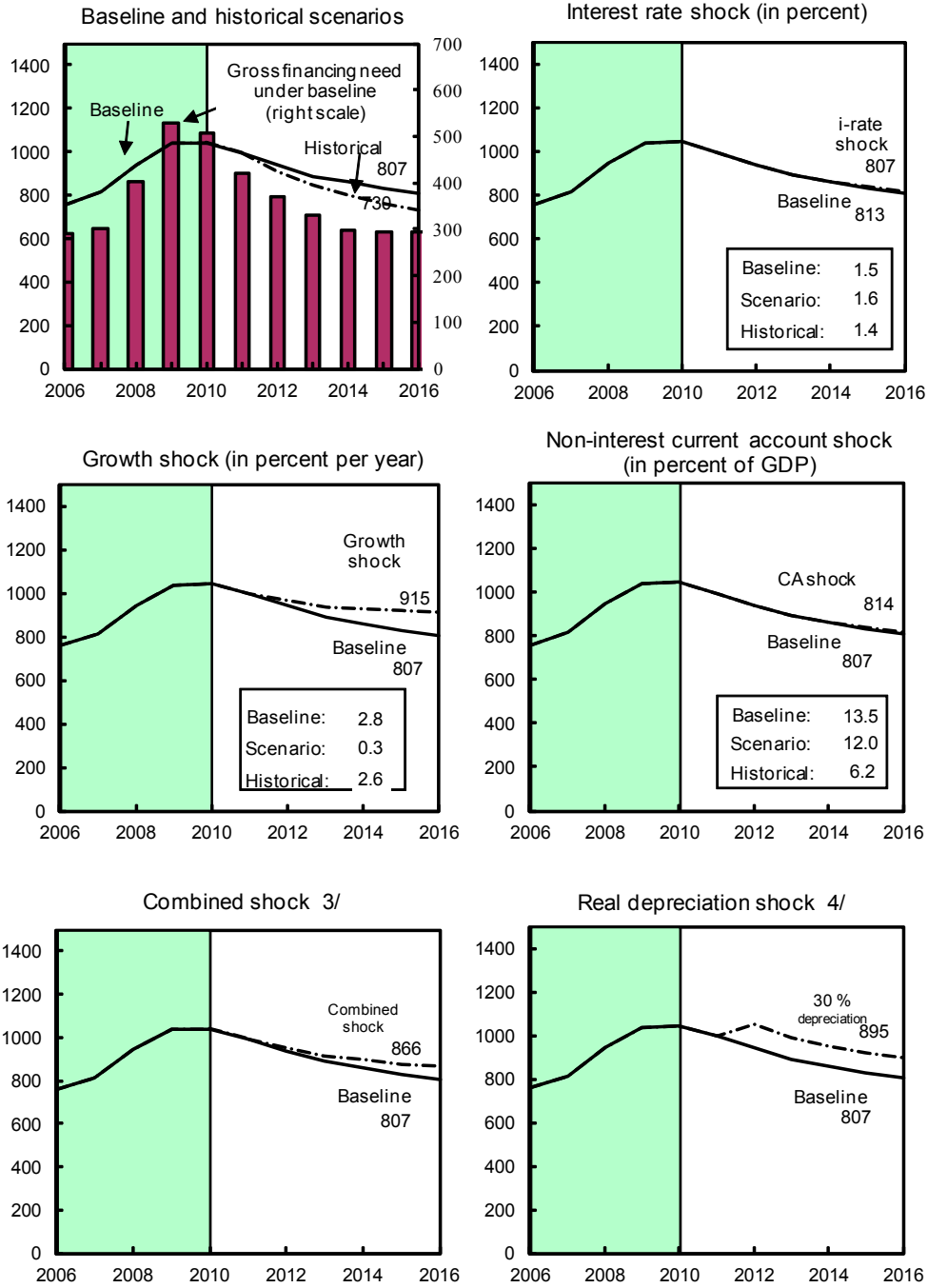
Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks, except for the growth and interest rate shocks, which are one-third and one-sixth standard deviation, respectively. 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time 10 percent of GDP shock to contingent liabilities occur in 2011.

Annex Figure 2. 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 2011.

**ATTACHMENT I. IRELAND: LETTER OF INTENT**

Dublin, 28 April 2011

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

1. In the February 25 election, the Government has been given a strong mandate to govern. Its policies, as set out in our Programme for Government are designed to facilitate economic growth, restore confidence, fix the banking system, bring order to our public finances, and support the creation of jobs. By the end of this current Dáil's term it is the Government's desire that Ireland will be recognised as a fairer, more socially inclusive and equal society supported by a productive and prosperous economy.
2. Policy implementation since the announcement of the EU/IMF-supported programme in November 2010 has been determined (MEFP Table 1):
  - The fiscal programme is on track. All performance criteria relevant for the completion of the first and second programme reviews have been met. The quantitative performance criteria for the exchequer primary balance were met for end-December 2010 and end-March 2011, as was the continuous performance criterion on external payments arrears. The end-December 2010 and end-March 2011 indicative targets on net central government debt have also been met.
  - We have made important progress in addressing banking sector challenges. Almost all the structural benchmarks have been implemented, with one measure not implemented due to early parliamentary elections:
    - The two end-December 2010 structural benchmarks—preparation of terms of reference for the diagnostic study and definition of scenarios for the stress tests—were implemented. The Central Bank and Credit Institutions

(Resolution) Bill 2011 was laid before the Seanad (the upper House of the Oireachtas) on 28 February 2011.

- Recapitalisation to a 12 percent core tier- 1 capital ratio by end-February, which was to have been an early confidence building measure in advance of the stress tests, was not implemented as the outgoing Finance Minister considered it inappropriate to inject public resources with the Dáil dissolved for elections. The new government formed on March 9 considered it was appropriate to await the publication of the *Financial Measures Programme* at end March to determine the recapitalisation needed.
  - All the critical benchmarks for end-March were observed, including the assessment of banks deleveraging plans and the completion of diagnostic evaluation of banks' assets and the stress tests. Indeed, the CBI released the detailed results in the *Financial Measures Programme*, which was endorsed by the financing partners and has been well received by financial markets.
3. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our plans to further advance towards meeting the objectives laid out in our programme under the Extended Arrangement. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request moving the timing of the second review to May 15, 2011 and the completion of the combined first and second programme reviews under the Extended Arrangement.
  4. In view of the smaller immediate external financing need than was envisaged in the original phasing, we have revised our assessment in terms of the timing of the purchases to reduce the immediate financing being made available, while raising the financing available later in the programme to cover debt amortisation requirements and potential risks to the availability of market funding. Hence, we request that the second and third purchases become available at the time of the completion of the combined first and second reviews, in a total amount equivalent to SDR 1.41 billion, and that the remaining purchases be rephased.
  5. We propose that quantitative performance criteria under the arrangement be established for June 30, 2011 and for September 30, 2011, with quarterly reviews, as set out in the attached MEFP. As detailed below, we propose new structural benchmarks against which to measure progress under the programme (MEFP Table 3). The Technical Memorandum of Understanding (TMU) explains how programme targets are measured.
  6. We are confident that the policies set forth in the Letter of Intent of December 3<sup>rd</sup>, 2010 and in this letter are adequate to achieve the objectives of our 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, the European Commission and the ECB on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum.

7. This letter is being copied to Messrs. Juncker, Matolcsy, Rehn, and Trichet.

Sincerely,

/s/

---

Michael Noonan T.D.,  
Minister for Finance

/s/

---

Patrick Honohan  
Governor of the Central Bank of Ireland

## ATTACHMENT II. IRELAND: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. Ireland is making progress in overcoming the worst economic crisis in recent history. The new government's *Programme for Government*, which incorporates its strategy for restoring Ireland to the path of sustained growth, sound finances, and job creation has been put forward in the context of the EU/IMF-supported programme. Developments since the programme was announced in November strengthen our confidence for the future but remind us that many challenges remain. Programme implementation in all areas has been strong, despite the uncertainties created by an election. A government with a clear mandate is now in place. On the positive side, recent stress tests have been recognised as providing a credible basis for rebuilding the domestic banking sector within a cost envisaged under the program. On the other hand, while the external sector is performing well, domestic demand has recovered less quickly than expected with the attendant costs for jobs; and further headway is needed to regain access quickly to sovereign and bank debt markets.

The MEFP outlines how, with the support of the EU and IMF, we propose to build a secure future for the Irish people on the foundation now in place.

### **Recent Economic Developments and Outlook**

2. We expect output growth to resume in 2011. The currently estimated decline in real GDP in 2010 was larger than anticipated, at 1 percent, largely reflecting unexpectedly weak net exports in the last quarter of the year, although quarterly data are subject to significant volatility and revisions. Moreover, unemployment data were higher than forecast, which together with a delayed investment recovery, warrants some downward revision to the projected 2011 growth rate. Nonetheless, export growth was strong in 2010, and strong demand for Irish exports will continue, driving a modest overall expansion in 2011, strengthening next year and beyond.

3. Inflation is expected to be driven by international energy and food prices even as domestic price pressures remain weak. After two years of falling prices, annual Harmonized Consumer Prices rose in the first quarter of 2011, but this was mostly accounted for by higher energy and food prices. Higher medical insurance fees and indirect taxation measures are also expected to contribute to positive inflation. Nonetheless, core inflation (excluding energy prices) is expected to remain subdued in 2011, owing to the continued slack in the economy.

4. The current account is expected to turn into surplus in 2011. The export-led recovery, coupled with low private investment and continued high saving as households deleverage, boosted the trade balance surplus in 2010. Reflecting both the composition of Irish exports and the slightly stronger international economy, rising net exports is expected to continue in 2011, although the size of the current account turnaround may be dampened somewhat by factor income outflows.

## Financial Sector Policies

5. We are moving forward with purpose to put the banking system on a firm footing for the future so that it can become an enabler of the economic recovery. The election results gave the government a clear mandate to create a new banking system that meets the needs of our economy. To do so, we must restore the market's confidence in the Irish banks, which means our banks will need to be smaller, more focused on core operations, well capitalised and have stable market-based funding.

6. We have therefore completed a comprehensive assessment of the capital and liquidity conditions and needs of domestic banks.<sup>1</sup> The Financial Measures Programme comprised:

- The Prudential Capital Assessment Review (“PCAR”) 2011 assessed the capital resources of four domestic banks under a baseline scenario and a stringent 3-year stress scenario. These tests identified the additional capital required to meet minimum Core Tier 1 capital ratios of 10½ percent in the baseline and 6 percent in the stress scenario.
- An independent loan loss forecasting exercise performed by BlackRock Solutions. These loss forecasts, which were notably more conservative than those of the banks, were the foundation for the assessment of the capital requirements in the PCAR.
- The Prudential Liquidity Assessment Review (“PLAR”) 2011, established targets for banks participating in the PCAR to reduce their leverage and reliance on short-term central bank funding, and to ultimately drive convergence to liquidity standards to be established under the Basel III framework.

Completing these exercises simultaneously has allowed the CBI to model balance sheet and profit and loss dynamics in a transparent, coherent, and conservative manner. The credibility of the exercise has been reflected in the positive market reaction, with bond yields and spreads declining notably, and positive reports by financial analysts and credit ratings agencies. We also welcome the subsequent statements by the ECB which supported market confidence that the Eurosystem will continue to provide liquidity to banks in Ireland given the commitment of the Irish authorities to substantially strengthen the capital base of the banks.

7. On the basis of this rigorous analysis, we have adopted a comprehensive strategy to reorganise and reform the domestic Irish banks. The main aim is to place these banks in a position where they can fund themselves and generate capital, thereby progressively reducing reliance on central bank funding and the Irish State. The process to return to a more normal,

---

<sup>1</sup> The participating banks were Bank of Ireland (BoI), Allied Irish Banks (AIB), EBS Building Society (EBS) and Irish Life and Permanent (ILP).



fully functioning banking sector was laid out in our comprehensive announcement on March 31, 2011. Importantly, these banks will be reorganised and deleveraged to ensure the full benefits from their recapitalisation for the health of the banks and their prospects to regain market confidence. Although the implementation of these reforms will require sustained and intensive efforts, we are determined that they will culminate in healthy and fully privately owned banking system.

### ***Restructuring***

8. The domestic banks will be substantially reorganised to ensure that they will provide the economy with the services and credit it needs. The new system will be organised around two “pillar banks,” Bank of Ireland (BoI) and Allied Irish Banks (AIB):

- AIB and the EBS Building Society (EBS) will be merged. A detailed execution plan will be overseen by a steering committee, with project managers in each institution. EBS will initially operate as a subsidiary of AIB; the merger plan will be available in mid-May. The legal merger procedures will be completed during the summer and not later than end-September 2011 subject to regulatory and competition clearances being received (proposed structural benchmark).
- A capital plan for Irish Life and Permanent (ILP) group has been produced. Plans for the execution of ILP’s recapitalisation will be agreed between the authorities and ILP by end-May 2011 (proposed structural benchmark). A process to effect the sale of ILP’s life insurance subsidiary, Irish Life Assurance, will start immediately and it will be offered for sale by end-October 2011.

9. We have started the process of resolving the unviable banks. As a first step, the deposits of Anglo Irish Bank (“Anglo”) and Irish Nationwide Building Society (“INBS”) were transferred in early 2011 to AIB and ILP, respectively. An independent advisor is in the process of validating the methodologies used during 2010 in the estimation of the future credit losses of Anglo and of performing a three year and lifetime loan loss forecast for INBS. The Central Bank will release the conclusions of this exercise in May. The Irish authorities will implement in due course the recommendations that will arise from this exercise. To minimise costs, the two banks will be merged by transferring INBS into Anglo (proposed structural benchmark for end-2011). Joint restructuring plans were submitted for EC approval at end January, and we intend to implement this plan to the extent possible on an accelerated basis while minimising further capital losses. Managers of these institutions will be subject to strict performance targets to ensure that these banks are worked out in a timely fashion.

10. An extensive diagnostic and stress test of the small, but locally important, credit union sector is underway. In light of this diagnostic, a plan to underpin the solvency and viability of undercapitalised institutions will be prepared by end-May 2011. A key element of

this plan will be to obtain the necessary powers to promote a higher degree of consolidation of the sector through mergers where appropriate, with government financial support if warranted. In addition, the Government will by end-May 2011 establish a Commission on Credit Unions to design a strategy for the future evolution of the sector having regard to its particular nature. By end-2011 we will submit legislation to the Oireachtas to assist the credit unions with a strengthened regulatory framework including more effective governance and regulatory requirements.

### ***Deleveraging***

11. We are targeting a significantly smaller and more robust banking system while avoiding fire sales. The target is that by the end of 2013 the domestic banks will achieve a loan to deposit ratio of 122.5 percent, which will facilitate them regaining access to market sources of funding. Non-core assets totaling €73 billion have been identified for deleveraging by end-2013, through a combination of run-offs and a carefully phased programme of disposals. To facilitate the deleveraging, the recapitalisation allows for a total potential loss on disposals of up to €13bn, which is estimated under stress conditions by the Central Bank.

12. To achieve this goal we are establishing a strong framework for the management, governance, and monitoring of deleveraging. Banks are reorganising their balance sheets and operations into core and non-core assets. The latter will also be managed by an individual and/or team possessing the necessary skills and experience and incentivised appropriately under a time-limited contract to execute the deleveraging plans, and which reports to the Deleveraging Committee. This execution will be under the close oversight of a Deleveraging Committee of each bank's board to be chaired by a non-executive Director and which includes observers representing the Minister for Finance and the Central Bank. To monitor progress, semi-annual interim targets have been adopted for key liquidity indicators and progress against these will be reported every six months. Banks will submit detailed plans on actions to achieve deleveraging in the coming six months to the authorities, and update the authorities on progress towards the interim targets on a quarterly basis. If actual or forecast performance is not consistent with the interim targets, the authorities will require that remedial plans be submitted and, as necessary, will use their powers to ensure achievement of the goal.

13. Progress with deleveraging will be demonstrated in future reviews of the program, taking into account relevant market conditions. We will have prepared by end-June 2011 specification of the management and internal incentive structures designed to ensure (i) prompt deleveraging and (ii) best prices taking into account market conditions, and consistent set of objectives for the Deleveraging Committee. Moreover, to support market confidence in improving the funding structure of the banks, every six months information on aggregate progress with deleveraging, together with liquidity indicators for the banks undergoing deleveraging, shall be published.

14. The implementation of deleveraging will be subject to ongoing review. In particular, a portion of the assets now within the scope of the deleveraging exercise (specifically, land and development loans in amounts below €20 million) were previously intended for resolution by NAMA. Currently, the government no longer intends to transfer these assets to NAMA. We will require AIB and BoI by end-May 2011 to provide contingency plans to meet the deleverage targets. If these plans are not feasible, we will find and implement alternative ways to meet the deleveraging goals and may reconsider the possibility of transferring the remaining loans to NAMA.

### ***Recapitalisation***

15. The PCAR found that a further €24 billion is required to ensure a sound capital basis of the banks. This capital will cover losses up to and beyond the end 2013, over and above current and projected loan loss provisioning, including allowance for significant losses on residential mortgages and commercial real estate. Within this amount, we have included a buffer of €5.3 billion to cover additional but unlikely losses post 2013 to provide an extra layer of resilience, including contingent capital of €3 billion. We will make arrangements for a claw back of any injection of capital by the State. Subject to approval by the CBI, this mechanism will require the banks to repay any such capital in excess of their regulatory obligations, when these financial institutions again have stable access to the wholesale funding market or have otherwise stabilised their funding including a normal reliance on central bank funding. From 2012 onward, the timetable for conducting the annual PCAR exercise will be aligned with the European Banking Authority's EU-wide bank stress tests.

16. Recapitalisation will be completed in a timely manner. Although the recapitalisation is well within the funding envelope available for this purpose, it is important to mitigate the cost to the Irish taxpayer in a manner that preserves financial stability. We will therefore seek direct contributions to significantly reduce the cost to the taxpayer, for example by requiring significant contributions from subordinated debt holders, by the sale of assets to generate capital, and where possible, by seeking private sector investors.

17. We are therefore promptly undertaking the steps needed to execute bank recapitalisation. We are initiating liability management exercises (LME) on subordinated debt, aiming to reduce the principal by the maximum extent possible. Allowing adequate time for the LMEs to be completed, we will complete the recapitalisation of AIB, BoI, ILP and EBS by end-July, 2011, including the placement of contingent capital in these banks, subject to appropriate adjustment for expected asset sales in the case of ILP (proposed structural benchmark).

18. Consistent with the substantial State resources invested in the banking system, we will take the following steps:

- The responsibility for the banking sector within the government will be reorganised. We intend to create a more integrated decision making and supervision structure

among all relevant Departments and Agencies with banking responsibilities, which will include strengthening the capacity of the Department of Finance in the area of banking policy, and ensuring that the Department has the appropriate policy responsibilities and financial market and banking expertise to advise Government on potential systemic threats and on measures to address and mitigate these.

- Strict governance standards for state-owned banks will be adopted. For majority state owned banks we are taking steps to ensure that they are run professionally and on the basis of best international banking practices. We commit to appoint a professional and qualified team to manage these financial institutions and let them operate at arm's length from the state. Our goal is to maximise value for the Irish taxpayer and to prepare the banks for return to private ownership as soon as conditions permit.

### ***Strengthening the Banking Framework***

19. We are addressing underlying weaknesses that led to the banking crisis. This will involve:

- Continuing to enhance banking supervision. We have fundamentally restructured the supervisory function in the CBI, by more than doubling staffing and training, substantially increasing budget resources having made a high proportion of external hires, and we are commencing the design and implementation of a regulatory risk model. However, we will continue to work to strengthen practices including data collection financial reporting, and credit risk assessments. By end-June, 2011, the Central Bank will prepare an action plan to address these gaps and provide an update on measures initiated in 2010. This will include recommendations, following a benchmarking exercise against international public sector peers and relevant private sector institutions, on how to secure the retention of regulatory staff with skills and experience likely to be in demand in private markets. It will also include a review of the comprehensiveness and structure of training for regulatory staff. Moreover, we will submit a "Supervision and enforcement bill" to the Oireachtas to expand and clarify supervisory powers and sanctions, by end-July 2011 (proposed structural benchmark).
- Ensuring that banks adopt prudent policies to address the deterioration in asset quality. To this end, the CBI will issue guidelines by end-June 2011 to encourage the timely and adequate allocation of provisions. The CBI will commence ongoing monitoring of the implementation of these guidelines in July 2011, which will also address any delays in the recognition of loan arrears which may be affecting the timely recognition of loan losses. Furthermore, by end-September 2011, the CBI will publish 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.

- Ensuring sound bank lending and risk management. We have instructed banks to enhance their capacity to measure financial risks by hiring highly-skilled senior personnel and retraining existing staff. In addition, we have drafted new corporate governance standards, and our new “fit-and-proper” standards for bank managers will be effective in September 2011. Finally, CBI will take steps to ensure that the frequency and quality of banks’ information disclosure and transparency will be enhanced by end-September, 2011.
- Enhancing the quality and availability of credit information available to credit providers. We will develop a legal framework that would facilitate the collection and centralisation of financial information on borrowers. The establishment of such a framework will improve the information available to banks to make sound credit assessments, and will be a vital tool for banking supervision. Proposals will be submitted for the Minister’s consideration by the Department of Finance by end-September, 2011.

20. We will improve asset recovery procedures by:

- Addressing weaknesses in the personal insolvency regime. We are preparing draft legislation to reform our personal insolvency law and procedures seeking to balance efficient and effective insolvency proceedings with the risk of moral hazard. While the proposals are likely to focus on significant amendment of the Bankruptcy Act, we also intend to provide for the introduction of a new structured non-judicial debt settlement and enforcement system to provide for an alternative to court supervised proceedings. Further analysis is needed of the economic and financial effects of the new arrangements and the ongoing intensive discussions with relevant stakeholders will be completed shortly.
- Strengthening NAMA. NAMA will be required to maintain the highest standards of governance with appropriate accountability and transparency arrangements. We will ensure that the costs of NAMA operations are reduced and that NAMA constructively contributes to the restoration of the Irish property market in the course of meeting the asset disposal targets established and monitored by the NAMA Board, including disposal of 25 percent of assets by end 2013.

21. Finally, we are improving our crisis preparedness. The work on establishing a special resolution regime for banks is well advanced. As the Dáil had been dissolved due to the calling of the general election on the 25th of February 2011 and as the Central Bank and Credit Institutions (Resolution) Bill could be initiated in either House of the Oireachtas, it was submitted to Seanad Éireann at the end of February. Notwithstanding the submission of this Bill, in order to progress the legislation as quickly as possible, we will reintroduce the

Bill in Dáil Éireann. Elections to the Seanad Éireann are currently underway and the new Seanad is not expected to convene before early to mid-May 2011. Moreover we are preparing amendments to the Bill designed to enhance the resolution toolset in line with the evolving EU principles on crisis resolution and in the light of discussions with the external partners.

### **Fiscal Policies**

22. Ireland faces significant adjustments to ensure that debt remains on a sustainable path and to win back access to market funding. Accordingly, in our Programme for Government we have fully committed to fiscal consolidation in line with the terms of the EU/IMF-supported programme and we reaffirm the goal to deliver a 3 percent of GDP fiscal deficit in 2015. To ensure that the overall consolidation is underpinned by the most effective use of our scarce resources, we have recently launched an ambitious and comprehensive review of expenditure. As part of this process the scale of the necessary consolidation in Budgets 2013-2015 will have to be reviewed in the context of the likely growth prospects nearer the time.

23. Our immediate priority is to support job creation through a fiscally neutral Jobs Initiative. To this end, we will adopt a package of measures, including job training programmes for the unemployed, temporary tax incentives for labour-intensive sectors till end-2013, and a reorientation of public investment towards local and regional infrastructure. We will submit the Jobs Initiative to Dáil Éireann in May 2011. Consistent with our commitment to the programme's fiscal consolidation targets, we will ensure strict budget neutrality in 2011 and over the period to 2014 of adopted fiscal measures and will specify fully costed measures to deliver the requisite offsetting savings in the Jobs Initiative (prior action).

24. We will seek to ensure that future fiscal consolidation is fair and does not over burden those most in need. As a first step, we will reverse the recent reduction in the national minimum wage, mitigating any effects on employment through the targeted reduction in PRSI in the Jobs Initiative. Despite the surge in social protection spending there remains many vulnerable groups in the country. There is also evidence that some welfare schemes are susceptible to abuse, while others may be contributing to poverty and inactivity traps. The Department of Social Protection will build on their recent studies on working age payments, child income support and disability allowance and submit to Government, by end-March 2012, a comprehensive programme of reforms that can help us better target social support to those on lower incomes, and ensure that work pays for welfare recipients. To this end, the Department will submit a progress report by end-December 2011.

25. We are undertaking institutional fiscal reforms to firmly anchor the sustainability of public finances:

- In the context of the proposals set out in the Programme for Government and pre-existing commitments under the EU/IMF-supported programme, we will establish a Fiscal

Advisory Council to provide an independent assessment of public finances by end-June (structural benchmark). The Council will report publicly to Government and the Oireachtas on a regular basis. By end-June 2011, we will specify the role of the Council, appoint its members, and allocate resources. Its mandate and independence will be given statutory basis as part of the Fiscal Responsibility Bill later in the year.

- The Fiscal Responsibility Bill, to be submitted to Dáil Éireann in the fourth quarter of 2011, will reform the budgetary framework. To safeguard fiscal discipline over the cycle, the Bill will also give legal backing to a set of fiscal rules. The rules will provide a basis for assessing the appropriateness of official targets and performance.
- In the meanwhile, to reinforce fiscal discipline and facilitate a more strategic allocation of spending, following the comprehensive review of expenditure, we will introduce by end-December 2011 binding multi-annual expenditure ceilings with broad coverage and consistent with the government's fiscal consolidation targets under the EU/IMF-supported programme and the Stability and Growth Pact provisions (proposed to be re-set as structural benchmark for end-December 2011).

The *Programme for Government* contains proposals for reforms to Ireland's budgetary framework and the Department will organise a seminar in May 2011 to allow for discussion of policy options. The discussion will have regard to the *Programme for Government* and the proposals in the Report of the Joint Oireachtas Committee on Finance and the Public Service entitled *Macroeconomic Policy and Fiscal and Economic Governance*, the Department's discussion document and other relevant inputs.

26. We are taking proactive measures to reduce our long-term pension liabilities. The next few months will see significant changes to pensions terms put into law. The most important of these changes is a three-step increase in the retirement age for social welfare pensions from 65 to 68, over 2014-28. In addition, we are introducing a new single pension scheme for all new entrants to the public service – it will link the pension age to that for the social welfare pension and entitlements will be based on average career earnings and annual increases in consumer prices. These measures will considerably and credibly strengthen our public finances over the long term.

### **Product and Labour Market Reforms**

27. We are adopting policies to lower costs in sheltered sectors, thus boosting purchasing power and underpinning further competitiveness gains. These will include reforms to the regulation of the legal profession and reducing barriers to entry to the medical profession with the aim of bringing down costs. We will also ensure that the competition enforcement regime is reinforced by strengthening the powers of the Competition Authority. No further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF-supported programme and the needs of the economy.

28. It is important that we make effective use of our state assets and, where appropriate, dispose of them to help reduce our government debt. We are committed to studying the recommendations of the just-concluded Review of State Assets and Liabilities, with a view to raising the efficiency of commercial semi-state bodies via governance reforms and cost-control, and a phased privatisation of selected enterprises supported by associated development of the regulatory system as appropriate.

29. We are committed to create conditions conducive to job creation. We are awaiting the results of currently ongoing independent review of sectoral wage agreements (Employment Regulation Orders – EROs - and Registered Employment Agreements - REAs) and will present a time bound action plan to follow-up on its recommendations by end September 2011.

### **Programme Financing**

30. Given the desirability of combining the first and second reviews (see LOI), we request that the timing of drawings from the EU and IMF be adjusted so as to bring forward to May 15, 2011 the disbursement originally scheduled to be available on June 15, 2011. In addition, we request that the total of the second and third purchases from the IMF be reduced by 2.3 billion SDRs due to a lower immediate balance of payments need than envisaged in the original programme, and that the remaining purchases be rephased accordingly, while keeping the total amount available under the EU-IMF financing package unchanged. Based on the commitments made by our EU bilateral partners, we are in the process of completing arrangements for the funding of the programme, where we have recently signed a bilateral agreement with the United Kingdom, and we are finalising similar arrangements with Sweden and Denmark, expected to total about €5 billion, ensuring that the programme is fully financed.

### **Programme Monitoring**

31. Progress in the implementation of the policies under the programme will continue to be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews, with the third and fourth reviews expected to be completed on or after August 15 and December 14, 2011, respectively. The programme also continues to be in compliance with requirements under the Memorandum of Understanding on Specific Policy Conditionality. 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 primary balance are monitored through quarterly performance criteria and net central government debt is an indicative target (Table 2). As is standard in EU/IMF arrangements, there is a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms is monitored through structural benchmarks (Table 3).



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

Table 1. Programme Monitoring

Measure	Date	Status
<b>Quantitative Performance Criteria</b>		
Cumulative exchequer primary balance	End-March 2011	Observed
<b>Indicative Target</b>		
Ceiling on the stock of central government net debt	End-March 2011	Observed
<b>Continuous Performance Criteria</b>		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
<b>Structural Benchmarks</b>		
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 recognised consulting firms.	End-December 2010	Observed
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.	End-February 2011	Not observed <sup>2</sup>
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed <sup>3</sup>
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	Ongoing
The Central Bank will direct the recapitalisation of ILP to achieve a capital ratio of 12 percent core tier 1.	End-May 2011	Modified or replaced <sup>4</sup>
Establish a Budget Advisory Council.	End-June 2011	Ongoing
Introduce a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area.	End-July 2011	Modified or replaced

<sup>2</sup> 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.

<sup>3</sup> 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.

<sup>4</sup> See Table 3.

Table 2. 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	March 31, 2012
	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
(In billions of Euros)								
	Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-15.8	-14.7	-7.9	-6.3	-10.9	-14.2	-15.0	-6.0
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
	Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	83.6	81.7	92.1	88.5	94.6	98.2	101.1	107.9

1/ Adjusted.

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

3/ Applies on a continuous basis.

Table 3. Prior Action and Structural Benchmarks under the Programme for 2011

Measure	Date	Status
<b>Financial sector policies</b>		
Finalise plans for the recapitalisation of Irish Life and Permanent (MEFP, ¶8).	End-May 2011	Structural benchmark
Complete the recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society (MEFP, ¶17).	End-July 2011	Structural benchmark
Submit the Supervision and Enforcement Bill to Oireachtas (MEFP, ¶19)	End-July 2011	Structural benchmark
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society (MEFP, ¶8).	End-September 2011	Structural benchmark
The merger of Irish Nationwide Building Society and Anglo-Irish bank (MEFP, ¶9).	End-December 2011	Structural benchmark
<b>Fiscal policies</b>		
Ensure strict budget neutrality of the Jobs Initiative in 2011 and over the period to 2014 by specifying fully costed off-setting measures (MEFP, ¶23).		Prior action
Establish a Fiscal Advisory Council (MEFP, ¶25).	End-June 2011	Structural benchmark
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets (MEFP, ¶25).	End-December 2011	Structural benchmark

### ATTACHMENT III. IRELAND: TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

April 28, 2011

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, 2010 as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 SDR.

#### QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

##### 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.<sup>5</sup> 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

---

<sup>5</sup> 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

(continued)

from 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).<sup>6</sup>

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 EU, IMF, and ECB staffs.

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, 2011:	
End-June 2011 (performance criterion)	-10.9
End-September 2011 (performance criterion)	-14.2
End-December 2011 (indicative target)	-15.0
From January 1, 2012:	
End-March 2012 (indicative target)	-6.0

7. The performance criterion on the exchequer primary balance (floor) 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) and national training fund contributions against the current projection which is listed below:<sup>7</sup>

---

National Pensions Reserve Fund), the Social Insurance Fund, semi-state bodies and local governments are not part of the Exchequer system.

<sup>6</sup> Net debt interest payments are as per the end-month Exchequer Statements.

<sup>7</sup> Exchequer tax receipts are comprised of income tax (including the universal social charge), value added tax (VAT), corporation tax, excise duties, stamp duties, capital gains tax, capital acquisitions tax and customs duties.

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2011:	
End-June 2011 (projection)	18.5
End-September 2011 (projection)	28.6
End-December 2011 (projection)	41.3
From January 1, 2012:	
End-March 2012 (projection)	9.9

8. Any policy changes, including in administration and enforcement of taxes, which impact the revenue projection set out in paragraph 7 will lead to a reassessment of the adjustor in the context of program reviews.

### **Ceiling on the Stock of Central Government Net Debt**

9. The stock of net central government 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 as of the test 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, and 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-March 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-March 2011 (provisional)	88.5
End-June 2011 (indicative target)	94.6
End-September 2011 (indicative target)	98.2
End-December 2011 (indicative target)	101.1
End-March 2012 (indicative target)	107.9

### **Non-accumulation of External Payments Arrears by Central Government**

12. The central government will accumulate no external payments 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, excluding any contractual grace period. 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.

### **REPORTING REQUIREMENTS**

14. Performance criteria under the programme will be monitored using data supplied to the EU, IMF, and ECB staffs. 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 EU, IMF and ECB 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.



**ATTACHMENT IV. IRELAND: LETTER OF INTENT**

Dublin, 28 April 2011

Mr. Jean-Claude Juncker  
Eurogroup President  
Ministère des Finances  
3, rue de la Congrégation  
L-1352  
Luxembourg

Mr. György Matolcsy  
Minister for National Economy  
Honvéd u. 13 - 15  
H - 1055 Budapest  
Hungary

Mr. Olli Rehn  
Commissioner for Economic and Financial Affairs  
European Commission  
BERL 10/299  
B-1049 Brussels  
Belgium

Mr. Jean-Claude Trichet  
President  
European Central Bank  
Kaiserstrasse 29  
60311 Frankfurt am Main  
Germany

Dear Messrs. Juncker, Matolcsy, Rehn and Trichet,

1. In the February 25 election, the Government has been given a strong mandate to govern. Its policies, as set out in our Programme for Government are designed to facilitate economic growth, restore confidence, fix the banking system, bring order to our public

finances, and support the creation of jobs. By the end of this current Dáil's term, it is the Government's desire that Ireland will be recognised as a fairer, more socially inclusive and equal society supported by a productive and prosperous economy.

2. Policy implementation since the announcement of the EU-IMF programme in November 2010 has been determined:

- The fiscal programme is on track. The deficit is projected to stay within the path set by the EU Council in its Decision on granting financial assistance to Ireland. The quantitative performance criteria for the exchequer primary balance were met for end-December 2010 and end-March 2011. The end-December 2010 and end-March 2011 indicative targets on net central government debt have also been met.
- We have made important progress on addressing the banking sector challenges:
  - The two end-December 2010 structural benchmarks—preparation of terms of reference for the diagnostic study and definition of scenarios for the stress tests—were implemented. The Central Bank and Credit Institutions (Resolution) Bill 2011 was laid before the Seanad (the upper House of the Oireachtas) on 28 February 2011.
  - Recapitalisation to a 12-percent core tier-1 capital ratio by end-February, which was to have been an early confidence building measure in advance of the stress tests, was not implemented as the outgoing Finance Minister considered it inappropriate to inject public resources with the Dáil dissolved for elections. The new government formed on March 9 considered it was appropriate to await the completion of the *Financial Measures Programme* at end March to determine the recapitalisation needed.
  - All the critical end-March benchmarks were observed, including the assessment of banks restructuring plans, and the completion of diagnostic evaluation of banks' assets and the stress tests. Indeed, the CBI released the detailed results of the *Financial Measures Programme*, which was endorsed by the financing partners and has been well received by financial markets.
- Important steps have been taken towards the achievement of the structural reform objectives of the programme. These include the launching of a thorough independent review of the sectoral wage setting arrangements and a reform of unemployment benefit system to reduce replacement rates and increase the effectiveness of activation measures.

3. In the attached Memorandum of Economic and Financial Policies (MEFP), we set out our plans to further advance towards meeting the objectives laid out in our EU/IMF financial assistance programme. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request completion of

the first review under the Council Implementing Decision 2011/77/EU of 7 December 2010 on granting Union financial assistance to Ireland.

4. In view of the smaller financing need for recapitalisation than was allowed for in the original phasing, we request a rephasing of the loan disbursements. Under the proposed phasing of disbursements, we request the second EU disbursement under this financial assistance programme in an amount of EUR 2.9 billion.

5. The implementation of our programme will continue to be monitored through quarterly reviews in coordination with the IMF based on performance relative to the policy conditionality as described in the attached MEFP and first update of the Memorandum of Understanding (MoU). In the course of these reviews, understandings will be reached on any additional measures that may be needed to achieve our programme objectives.

6. We are confident that the policies set forth in the Letter of Intent of December 3, 2010 and in this letter are adequate to achieve the objectives of our programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. We will consult with the European Commission, the European Central Bank and the IMF on the adoption of such actions in advance of necessary revision of policies contained in this letter and the updated MoU.

7. This letter is being copied to Mr. Strauss-Kahn.

Sincerely,

/s/

---

Michael Noonan T.D.,  
Minister for Finance

/s/

---

Patrick Honohan  
Governor of the Central Bank of Ireland

## ATTACHMENT V

**Ireland****Memorandum of Understanding  
on  
Specific Economic Policy Conditionality**  
*(First update)*

28 April, 2011

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 Implementing Decision 2011/77/EU of 7 December 2010 on granting Union financial assistance to Ireland.

The quarterly disbursement of financial assistance from the European Financial Stabilisation Mechanism (EFSM)<sup>8</sup> 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 this Updated Memorandum of Understanding on specific economic policy conditionality (MoU), which details and further specifies the 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.

For the duration of the EU/IMF financial assistance programme the authorities will take all the necessary measures to ensure a successful implementation of the programme and minimise the costs to the taxpayers. In particular, they commit to:

- Rigorously implement fiscal policy consistent with the requirements of the excessive deficit procedure. In particular, the Department of Finance and the Department of Public Expenditure and Reform will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to ensure that the primary deficit target in cash (see Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the

---

<sup>8</sup> 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 there under are subject to the compliance with the conditions of this Memorandum.

general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved. Any additional unplanned revenues must be allocated to debt reduction. Moreover, the nominal value of Social Welfare pensions will not be increased.

- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.
- Ensure that no further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF Programme and the needs of the economy.
- Consult with the European Commission, the ECB and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

To facilitate programme monitoring, the authorities will provide the European Commission, the ECB and the IMF with:

- All information required to monitor progress during programme implementation and to track the economic and financial situation.
- A compliance report on the fulfilment of the conditionality prior to the release of the instalments
- Reliable and regular availability of budgetary and other data as detailed in annex 1.

## **1. Actions for the third review (actions to be completed by end Q2-2011)**

### **i. Fiscal consolidation**

Government will introduce the necessary measures to offset in full the estimated fiscal costs of new measures in the '2011 Jobs Initiative' in 2011 and over the period to 2014 while avoiding measures that would endanger the successful implementation of the programme. To ensure the latter, Government commits to consult with the European Commission, the ECB and the IMF on these measures.

### **ii. Financial sector reforms**

#### *Recapitalisation*

The authorities will ensure that a process of banking system recapitalisation is immediately set in motion. This recapitalisation process will respond to the outcome of the PCAR 2011, which identified a total capital need of EUR 24 billion for BOI, AIB, EBS and IL&P, of which EUR 21 billion should be met in the form of Core Tier 1 (CT1) capital and EUR 3 billion in the form of contingent capital.

As part of the recapitalisation process, liability management exercises (LMEs) in respect of the banks' subordinated debt holders will be initiated aiming to reduce the principal by the maximum extent possible. The possibilities for private placements will be explored.

The Irish authorities will submit a comprehensive term sheet for a contingent capital instrument in the amount of EUR 3 billion. This term sheet will be agreed with the European Commission, IMF, and ECB by 15 May 2011 at the latest.

The Irish authorities will make arrangements for a claw back of any injection of capital by the State. Subject to approval by the CBI, this mechanism will require the banks to repay any such capital in excess of their regulatory obligations, when these financial institutions again have stable access to the wholesale funding market or have otherwise stabilised that funding including through a normal reliance on central bank funding.

An independent advisor is in the process of validating the methodology used in the estimation of future credit losses of Anglo and of performing a three year lifetime loan loss forecast for INBS. The Central Bank will release the conclusions of this exercise in May. If necessary the Central Bank will undertake remedial action. To minimise costs, the two banks will be merged by transferring INBS into Anglo by end-2011. The joint restructuring plan of Anglo and INBS was submitted for EC approval at end January, and the Irish authorities intend to implement this plan to the extent possible on an accelerated basis while minimising further capital losses. Managers of these institutions will be subject to strict performance targets to ensure that these banks are worked out in a timely fashion.

#### *Deleveraging*

The PLAR 2011 has established a target loan-to-deposit ratio (LDR) of 122.5% which will be achieved by end 2013 for BoI, AIB, EBS and IL&P. Interim targets will be established by the CBI for the intervening period. The Irish authorities will present a plan which will provide for: a) an appropriate governance structure including appropriate incentives for the deleveraging process in each bank based on objective benchmarks; b) an in-depth monitoring system to examine the compliance with these targets; and c) a set of sanctions for non-compliance with these targets by 30 June 2011.

By 31 May 2011, AIB and BoI will provide alternative deleveraging options to account for the fact that the transfer of sub-EUR 20 million land and development loans to NAMA will now no longer take place. If these plans are not feasible, the authorities will ensure that the banks will find and implement alternative ways to meet the deleveraging goals including reconsidering the possibility of transferring the remaining loans to NAMA

In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the Net Stable Funding Ratio (NSFR) and the Liquidity Coverage Ratio (LCR) in order to ensure convergence to Basel 3 standards by the relevant dates.

#### *Financial supervision*

As Dáil Éireann had been dissolved due to the calling of the general election on the 25th of February, the Central Bank and Credit Institutions (Resolution) Bill was submitted to the Seanad at the end of February. Notwithstanding the submission of the Bill, in order to

progress the legislation as quickly as possible, the Irish authorities will reintroduce the Bill in the Dáil Éireann. Moreover the Irish authorities will prepare amendments to the Bill designed to enhance the resolution toolset available in line with the evolving EU principles on crisis resolution and in the light of discussions with the external partners.

The CBI will continue to strengthen its capacity to supervise credit institutions by further reinforcing its staffing levels and expertise. The CBI will enhance its risk assessment and monitoring framework, including the collection of relevant data from the banking system, particularly drawing on the lessons learned in the PCAR process on data validation and integrity and asset quality review. To this end, the CBI will produce a detailed action plan by 30 June 2011, prioritising those actions considered to be most urgent.

#### *Credit institutions*

Progress in implementation of the strategy for the reorganisation of Irish credit institutions as announced in the 31 March 2011 statement will be assessed by the authorities, together with the European Commission, the ECB and the IMF. In particular, the Irish authorities will ensure that the banks covered by the PCAR/PLAR will begin the process of separating the core and non-core assets and implementing an appropriate governance structure to deleverage the non-core assets.

#### *Credit unions*

An extensive diagnostic and stress test of the small, but locally important, credit union sector is underway. In light of the diagnostic, a plan to underpin the solvency and viability of the undercapitalised institutions will be prepared by the Irish authorities by 31 May 2011. A key element of this plan will be to obtain the necessary powers to promote a higher degree of consolidation in the sector through mergers, where appropriate, with government financial support if warranted. In addition, the Government will by 31 May 2011 establish a Commission on Credit Unions to design a strategy for the future evolution of the sector having regard to its particular nature. By end-2011, the Irish authorities will submit legislation to the Dáil Éireann to assist the credit unions with a strengthened regulatory framework including more effective governance and regulatory requirements. To the extent that the Government is required to provide financial support to the sector, this support will be notified to the European Commission in line with EU State aid rules.

### **iii. Structural reforms**

#### *To enhance long-term fiscal sustainability*

Government will introduce legislation to increase the age at which one qualifies for a Social Welfare pension. Under the National Pension Framework the age at which people will qualify for the Social Welfare pension will be increased to 66 years in 2014, 67 in 2021 and 68 in 2028.

*To support businesses*

Government will extend the voluntary 15-day rule relating to prompt payments to the health service executive, local authorities and state agencies.

*To support employment growth*

We will reverse the recent reduction in the national minimum wage, mitigating any effects on employment through the targeted reduction in PRSI in the Jobs Initiative.

**iv. Structural fiscal reforms***To reinforce a credible budgetary strategy*

Government will establish a Fiscal Advisory Council in the context of the proposals set out in the Programme for Government and pre-existing commitments under the Programme of Financial Support.

**2. Actions for the fourth review (actions to be completed by end Q3-2011)****i. Fiscal consolidation**

Government will review the achieved and projected savings arising from administrative measures to increase efficiency and from public service numbers reductions and present appropriate adjustment measures, including to the overall public service wage bill, to ensure consistency with the fiscal adjustment targets over the programme horizon.

**ii. Financial sector reforms**

The Irish authorities will ensure that the capital needs of BoI, AIB, EBS and IL&P, as identified in the PCAR 2011 have been fully met by 31 July 2011, subject to an appropriate adjustment for asset sales in the case of IL&P.

The Irish authorities will ensure that the banks covered by the PLAR will have identified the separation of their core and non-core assets and have implemented the appropriate governance structure for the deleveraging of non-core assets.

In line with the monitoring system set up, actual and forecast target LDRs shall be reported by the banks to the CBI every six months (first report 31 July 2011). Such reports will include (i) progress achieved towards interim target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the next interim target. If actual or forecast LDRs fail to meet the interim targets, the Irish authorities will within 14 days of becoming aware of such failure inform the European Commission, IMF, and ECB. The CBI will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation. In addition, the Irish authorities will update the European



Commission, the IMF and the ECB on progress in the quarters not covered by the six-monthly report.

The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it with the European Commission, the ECB and the IMF.

Building on the restructuring undertaken to date, the Irish authorities will submit by 31 July 2011, restructuring plans to the European Commission in accordance with EU competition rules taking into account the outcomes of the PCAR and PLAR and covering a period of 5 years. These plans will also be made available to the IMF and the ECB. Commitments already undertaken by the Irish authorities in the context of EU competition decisions will be maintained.

The Department of Finance will, by 31 July 2011, introduce legislation (titled “The Central Bank (Supervision and Enforcement) Bill 2011) enhancing the powers of the CBI to intervene in the financial system when fulfilling its role as supervisor. Following the enactment of this legislation, the CBI will have the power to enforce the implementation of a LDR of 122.5%, including the power to direct the banks subject to the PLAR to sell assets.

The Department of Finance will finalise a detailed plan for enhancing the quality and availability of credit information available to credit providers by 30 September 2011.

### **iii. Structural reforms**

#### *Labour market reforms*

Government will report on reforms to strengthen the labour market activation system and its link to unemployment supports in the fight against long-term unemployment.

Government will discuss with European Commission Services the main findings of the independent reviews of Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs) arrangements, and present a time-bound comprehensive action plan to follow up on its recommendations.

#### *To increase competition*

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.

Government shall bring forward legislation to strengthen competition law enforcement in Ireland by ensuring the availability of effective sanctions for infringements of Irish competition law and Articles 101 and 102 of the Treaty on the Functioning of the European Union as well as ensuring the effective functioning of the Competition Authority.

The authorities will agree with European Commission Services a time-bound action plan to implement the recommendations of the 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.

An independent assessment of the electricity and gas sectors will commence taking due account of the EU regulatory context for these sectors.

#### **iv. Structural fiscal reforms**

##### *To underpin medium-term ceilings and identify savings and efficiencies*

The Authorities will complete a comprehensive review of expenditure which will form the basis for the allocation of binding multi-year expenditure ceilings by expenditure vote group consistent with the aggregate expenditure envelope underpinning the government's fiscal targets under the EU/IMF financial assistance programme and the Stability and Growth Pact provisions.

##### *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 Social Welfare pension retirement age.

##### *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 timely basis.

### **3. Actions for the fifth review (actions to be completed by end Q4-2011)**

#### **i. Fiscal consolidation**

Government will present a draft budget for 2012 aiming to further reduce the general government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures amounting to at least €3.6bn.

The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2012.

Revenue measures to yield EUR1,500m<sup>9</sup> 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 EUR 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 Comprehensive Review of Expenditure (CRE) underway will be completed in September 2011. The budgetary measures outlined above will be examined by the Government in the light of the findings of the Review and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, the government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral.

#### **ii. Financial sector reforms**

The authorities will report on the evolution of the capital within the banks covered by the PCAR.

An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European

---

<sup>9</sup> Inclusive of 2011 carryover

Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it with the European Commission, the ECB and the IMF.

### **iii. Structural reforms**

#### *To prepare for the introduction of water charges*

The Government will prepare proposals for implementation of the recommendations of the independent assessment of transfer of responsibility for water service provision from local authorities to a water utility in consultation with European Commission Services with a view to starting charging during the EU/IMF Programme period.

#### *To better target social support expenditure*

The Department of Social Protection will build on their recent studies on working age payments, child income support and disability allowance with a view to producing a comprehensive programme of reforms that can help better targeting social support to those on lower incomes, and ensure that work pays for welfare recipients, after consultation with stakeholders. To this end, the Department will submit a progress report by end-December 2011.

### **iv. Structural fiscal reforms**

#### *To reinforce the credibility of the budgetary process*

The government will introduce a Fiscal Responsibility Bill consistent with the economic governance framework at the EU level, including provisions for a medium-term budgetary framework, fiscal rules and the Fiscal Advisory Council.

#### *To further reform key sectors of the economy*

The Government is due to consider a potential programme of asset disposals based on the Programme for Government and the Review Group on State Assets and Liabilities. The Government will discuss its plans with the European Commission, the IMF and the ECB when it has finalised its response to the Review.

#### **4. Actions for the sixth review (actions to be completed by end Q1-2012)**

##### **i. Fiscal consolidation**

Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

##### **ii. Financial sector reforms**

The authorities will agree the terms of reference for the PCAR 2012.

In line with the monitoring system set up, actual and forecast target LDRs shall be reported by the banks to the CBI every six months. Such reports will include (i) progress achieved towards interim target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the next interim target. If actual or forecast LDRs fail to meet the interim targets, the Irish authorities will within 14 days of becoming aware of such failure inform the European Commission, IMF, and ECB. The CBI will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation. .

The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

##### **iii. Structural reforms**

Government will introduce legislation to reform the personal debt regime to the Houses of the Oireachtas with the objective of lowering the cost and increase the speed and efficiency of proceedings while at the same time mitigating moral hazard and maintaining credit discipline.

##### *To better target social support expenditure*

The Department of Social Protection will submit to Government the comprehensive programme of reforms that can help better targeting social support to those on lower incomes, and ensure that work pays for welfare recipients.

## **5. Actions for the seventh review (actions to be completed by end Q2-2012)**

### **i. Financial sector reforms**

The PCAR for 2012 will be completed. Before publication, the results of the PCAR for 2012 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2012. Based on these results, the authorities will ensure that banks are adequately capitalised.

An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

### **ii. Structural reforms**

*To assist in covering financing needs and to increase competition*

Based on the results of the assessment of the efficiency of the electricity and gas sectors, the authorities will further strengthen the regulatory and market reform programme in consultation with European Commission Services, with a view to increase efficiency, improve governance, strengthen competition and improve these sectors' ability to contribute towards covering Ireland's financing needs and improving its growth potential and economic recovery.

## **6. Actions for the eighth review (actions to be completed by end Q3-2012)**

### **i. Financial sector reforms**

In line with the monitoring system set up, actual and forecast target LDRs shall be reported by the banks to the CBI every six months. Such reports will include (i) progress achieved towards interim target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the next interim target. If actual or forecast LDRs fail to meet the interim targets, the Irish authorities will within 14 days of becoming aware of such failure inform the

European Commission, IMF, and ECB. The CBI will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation.

The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

## **7. Actions for the ninth 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 fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures amounting to at least EUR 3,100m.

The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2013.

Revenue measures to raise at least EUR 1,100m<sup>10</sup> 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 EUR 2,000m, including:

- Social expenditure reductions.
- Reduction of public service numbers and public service pension adjustments.
- Other programme expenditure, and reductions in capital expenditure.

---

<sup>10</sup> Inclusive of carryover from 2012

The budgetary measures outlined above will be examined by the Government in the light of the findings of the Comprehensive Review of Expenditure (CRE) and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, the government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral.

## **ii. Financial sector reforms**

The authorities will report on the evolution of the capital within the banks covered by the PCAR.

An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

## **8. Actions for the tenth review (actions to be completed by end Q1-2013)**

### **i. Financial sector reforms**

The authorities will agree the terms of reference for the PCAR 2013.

In line with the monitoring system set up, actual and forecast target LDRs shall be reported by the banks to the CBI every six months. Such reports will include (i) progress achieved towards the final target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the final target. If actual or forecast LDRs fail to meet the interim targets, or it does not appear to be feasible that the bank will meet the end of year target, the Irish authorities will within 14 days of becoming aware of such failure inform the European Commission, IMF, and ECB. The CBI will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation.

The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.



The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

## **9. Actions for the eleventh review (actions to be completed by end Q2-2013)**

### **ii. Financial sector reforms**

The PCAR for 2013 will be completed. Before publication, the results of the PCAR for 2013 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2013. Based on these results, the authorities will ensure that banks are adequately capitalised.

An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

## **10. Actions for the twelfth review (actions to be completed by end Q3-2013)**

### **i. Financial sector reforms**

In line with the monitoring system set up, actual and forecast target LDRs shall be reported by the banks. Such reports will include (i) progress achieved towards the final target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the final target. If actual or forecast LDRs fail to meet the interim targets, or it does not appear to be feasible that the bank will meet the end of year target, the Irish authorities will within 14 days of becoming aware of such failure inform the European Commission, IMF, and ECB. The CBI will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation.

The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.

## **11. Actions for the thirteenth review (actions to be completed by end Q4-2013)**

### **ii. Financial sector reforms**

The authorities will report on the evolution of the capital within the banks covered by the PCAR.

A final report of the banks' implementation of their deleveraging plans under the PLAR 2011 and their compliance with the LDR target will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.

The Irish authorities will present a comprehensive report on progress in implementing the CBI action plan for strengthening supervision of credit institutions and discuss it 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. The External Programme Compliance Unit (EPCU) of the Department of Finance will coordinate and collect data and information and forward to all external programme partners.

<b>To be provided by the Department of Finance in consultation with the Department of Public Expenditure and Reform as appropriate</b>		
Ref.	Report	Frequency
F.1	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
F.2	Updated monthly report on the central government's budget execution and prospects for the remainder of the year.	Monthly, 20 days after the end of each month
F.3	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, 20 days after the end of each month
F.4	Quarterly data on main revenue and expenditure items of local government.	Quarterly, 90 days after the end of each quarter
F.5	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).	Quarterly, 30 days after the end of each quarter
F.6	Quarterly data on general government accounts, and general government debt as per the relevant EU regulations on statistics.	Quarterly accrual data, 90 days after the end of each quarter
F.7	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.	30 days after EDP notifications
F.8	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for Non-Commercial State Agencies	Quarterly , 30 working days after the end of each month
F.9	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for local authorities	Quarterly , 30 working days after the end of each month
F.10	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months for State- owned commercial enterprises (interest and amortisation)	Quarterly, 30 working days after the end of each quarter
F.11	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.	Quarterly, 30 working days after the end of each quarter.
<b>To be provided by the NTMA</b>		
N.1	Monthly information on the Government's cash position with indication of sources as well of number of days covered	Monthly, next working day
N.2	Data on below-the-line financing for central government.	Monthly, no later than 15 days after the end of each month

N.3	Data on public debt and new guarantees issued by central government to public enterprises and the private sector.	Monthly, 30 working days after the end of each month
N.4	Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for central government.	Monthly, 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and government sectors in the next 12 months	Monthly, 30 working days after the end of each month
<b>To be provided by the Central Bank</b>		
C.1	The Central Bank's balance sheet.	Weekly, next working day
C.2	The Central Bank will provide details on the aggregate monetary balance sheet of all Irish authorised credit institutions, EEA and non-EEA branches on a monthly basis.	Monthly, on the last working day of the following month
C.3	Individual maturity profiles (amortisation only) for each of the domestic banks will be provided for the last Friday of each month.	Monthly, 30 working days after each month end.
C.4	The Central Bank will provide monthly consolidated balance sheet information for the domestic banks (collected through the FINREP reporting system)	Monthly, 30 working days after each month end.
C.5	On a quarterly basis the Central Bank will provide balance sheet information, based on products rather than categories (as in FINREP).	Quarterly, 30 working days after the end of each quarter
C.6	The Central Bank will provide detailed information on deposits for the last Friday of each month.	Monthly, 30 working days after each month end.
C.7	For each of the Covered Institutions the Central Bank will provide monthly data on liabilities covered under the ELG Scheme.	Monthly, 30 working days after each month end.
C.8	The Central Bank will provide certain financial stability indicators on a monthly basis, including capital adequacy ratios, liquidity ratios, loan to deposit ratios and sectoral distribution of loans	Monthly, 30 working days after each month end.
C.9	On a quarterly basis the Central Bank will provide additional financial stability indicators including details on non performing loans, provisions, return on assets, return on equity, interest margin and income.	Quarterly, 30 working days after the end of each quarter.

INTERNATIONAL MONETARY FUND

IRELAND

**First and Second Reviews Under the Extended Arrangement and Request for  
Rephasing of the Arrangement**

**Supplementary Information**

Prepared by European Department in Consultation with Other Departments

Approved by Ajai Chopra and Martin Mühleisen

May 11, 2011

1. As planned, the Irish government announced a Jobs Initiative on May 10, 2011 (see ¶23 of the Memorandum of Economic and Financial Policies in EBS/11/65, Attachment II).<sup>1</sup> This supplement discusses the budgetary impact of the initiative, and provides an update on other recent developments since the Staff Report (EBS/11/65) was circulated to the Executive Board on May 2, 2011. The budget neutrality of the Jobs Initiative in 2011, and cumulatively in the period until 2014, is a prior action for the completion of the first and second reviews. The information does not alter the thrust of the staff appraisal.

**I. JOBS INITIATIVE**

2. **The tax measures in the Jobs Initiative seek to refocus demand toward labor-intensive sectors such as tourism.** They include: (i) a 4½ percentage point VAT rate reduction on a subset of items subject to the lower VAT rate of 13½ percent<sup>2</sup>; and (ii) a halving of the lower-tier employer pay-related social insurance (PRSI) rate of 8½ percent on jobs paying up to €356 per week (the minimum-wage level). These measures are to expire by end-2013, and their effectiveness will be reviewed before end-2012. In addition, the €3 air travel tax will be suspended, contingent on an increase in the number of inland passengers on the two major airlines, also subject to review over time.

3. **On the expenditure side, the Jobs Initiative reallocates the capital budget and expands labor activation programs.** Most of the €135 million (about 0.1 percent of GDP) increase in capital spending is for “shovel ready” projects for road reconstruction, one-off

---

<sup>1</sup> See: <http://www.finance.gov.ie/documents/publications/reports/2011/Jobinitiative.pdf>

<sup>2</sup> The items are mostly services, and include catering, restaurants, hotels, cinemas, theatres, museums, art galleries, fairgrounds, amusement parks, sporting activities, printed matter and hairdressing.

maintenance works on schools, and retrofitting to boost home energy efficiency. The net cost to the exchequer is limited in 2011 as four-fifths of the gross outlay is funded through reallocation within the capital budget. The initiative also offers 20,900 new places for training, education and enhancing skills with an annual cost of €30 million from 2012.<sup>3</sup>

4. **The cost of the initiative will be offset by a temporary levy on private pension funds.** The total cost of the package is estimated at €270 million (or 0.2 percent of GDP) in 2011, and €1,861 million (or 1.1 percent of GDP) on a cumulative basis from 2011 to 2014 (Table 1). To offset these expenses, the government plans a levy on the assets of private pension funds—estimated at some €78 billion—which is to expire at end-2014. At a rate of 0.6 percent the levy is expected to yield €468 million in revenue annually or €1,872 million during 2011 to 2014. Staff had reservations about the quality of this measure, including potential behavioral responses, but the authorities consider that the temporary nature of the levy mitigates these concerns.

**Table 1 - The Jobs Initiative - Budgetary Cost and Offsets**  
(In millions of Euro)

	2011	2012	2013	2014	Total
<b>Tax measures</b>	230	648	656	198	1,731
4.5 percentage point cut in 13.5 percent VAT rate on selected items	120	350	350	60	880
Halving of employer PRSI of 8.5 percent on minimum wage earners	85	190	183	15	473
Suspension of air travel tax	15	90	105	105	315
Abolition of employer PRSI on unapproved share options	10	18	18	18	63
<b>Expenditure measures</b>	40	30	30	30	130
Capital projects (cost net of reallocation of €106 million)	29				29
Labor market activation programs	11	30	30	30	101
<b>Total budgetary cost</b>	<b>270</b>	<b>678</b>	<b>686</b>	<b>228</b>	<b>1,861</b>
In percent of GDP	0.2	0.4	0.4	0.1	1.1
<b>Levy on capital value of pension funds (0.6 percent on €78 billion)</b>	<b>468</b>	<b>468</b>	<b>468</b>	<b>468</b>	<b>1,872</b>
In percent of GDP	0.3	0.3	0.3	0.3	1.1

5. **Staff considers that the Jobs Initiative, as announced, meets the prior action on budget neutrality for the completion of the review.** The pension levy is expected to be sufficient to cover the cost of the initiative, both in 2011 and cumulatively through 2014. Looking ahead, staff encourages the authorities to actively review the efficacy of all the measures in the initiative, including their budgetary impact in practice and any potential distortions arising, and to adapt policies appropriately.

<sup>3</sup> The development of a temporary, partial credit guarantee scheme was also announced; it is to be targeted to new or expanding commercially viable SMEs so that they can grow their company, develop new products or expand in to new markets. It is anticipated that the scheme would have little or no costs in 2011, and funding for 2012 and beyond will be found through savings in future budgets.

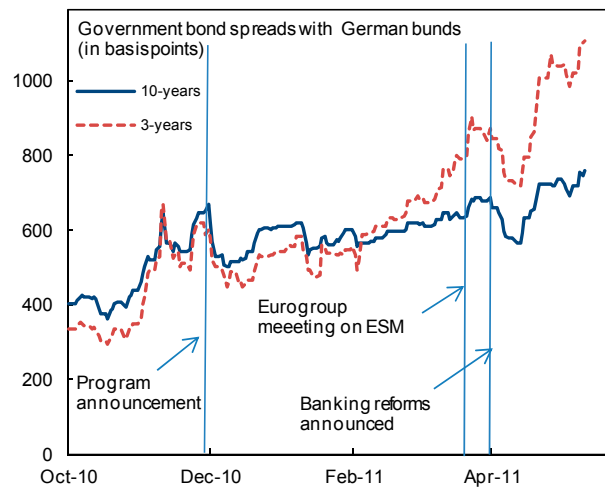
## II. OTHER RECENT DEVELOPMENTS

6. **Recent high-frequency indicators point to a modest recovery.** The Live Register showed a decline in the number of workers signing up for jobseekers' benefit or allowance, with the unemployment rate falling slightly from 14.7 percent in March to 14.6 percent in April. (The latest unemployment rate from the Quarterly National Household Survey was 14.7 percent in the fourth quarter of 2010.) The Purchasing Manger Index (PMI) for manufacturing in April was up slightly from March, continuing to suggest rising activity. The PMI for services showed that business activity rose in April, albeit only marginally. However, industrial production was down by 1¼ percent on a monthly basis in March.

7. **The April 2011 budgetary out-turn (Exchequer basis) was somewhat better than expected.** Both income tax and PRSI exceeded their respective monthly profiles and, adjusted for one-off timing issues, were only marginally behind the corresponding cumulative targets through April. Excises and corporate taxes continued to exceed their expected profile, while VAT underperformed by 3 percent. Expenditure remained within budget, especially on the capital side, with social spending slightly below profile despite the higher level of unemployment than projected at the time of the 2011 Budget. Data on public service numbers for the first quarter of 2011 suggest a decline consistent with the annual numbers reductions budgeted for 2011. Hence, on current trends, the exchequer primary balance remains on track for the 2011 program targets.

8. **Spreads on government bonds remain elevated.** The recent deterioration in market confidence in Greek debt has spilled over to higher spreads for Ireland. For 2- and 3-year maturities, spreads are have risen above 1,000 basis points. It is notable, nonetheless, that pressure from corporate deposit outflows has abated after the March 31 banking announcement, and retail deposits remain relatively stable.

Government bond spreads have edged higher in past days



Source: Bloomberg.



Press Release No. 11/181  
FOR IMMEDIATE RELEASE  
May 16, 2011

International Monetary Fund  
Washington, D.C. 20431 USA

### **IMF Completes First and Second Reviews Under Extended Arrangement with Ireland and Approves €1.58 Billion Disbursement**

The Executive Board of the International Monetary Fund (IMF) today completed the first and second reviews of Ireland's performance under an economic program supported by a three-year, SDR 19.5 billion (about €21.8 billion; or US\$30.9 billion) arrangement under the Extended Fund Facility (EFF), or the equivalent of about 1,548 percent of Ireland's IMF quota. The completion of the reviews enables the immediate disbursement of an amount equivalent to SDR 1.41 billion (about €1.58 billion; or US\$2.24 billion), bringing total disbursements under the EFF to SDR 6.42 billion (about €7.20 billion; or US\$10.19 billion).

The arrangement for Ireland was approved on December 16, 2010 (see Press Release No. 10/496). The arrangement is a part of a financing package amounting to €85 billion (about US\$120 billion) from Ireland's European partners through the European Financial Stabilization Mechanism (EFSM) and European Financial Stability Facility (EFSF), and bilateral loans from the United Kingdom, Sweden and Denmark, and Ireland's own contributions.

The EFSM, EFSF and bilateral European lenders provide €45 billion on similar maturities as the IMF's EFF. The Irish authorities round out the total financing package through a contribution amounting to €17.5 billion (about US\$24.8 billion) from the nation's cash reserves and liquid assets. European Central Bank liquidity support is also an essential component of the overall economic and financial program.

Ireland is making progress in overcoming the worst economic crisis in recent history. The new government's strategy for restoring sustained growth, sound public finances, and job creation has been put forward in the context of the European Union/IMF-supported program. At the end of March the authorities announced the results of an in-depth analysis of the domestic banks, including stringent stress tests. On this basis, the government adopted a comprehensive strategy to reorganize and deleverage the domestic banks, and to strengthen their capital base. The new government has reaffirmed its commitment to the fiscal



consolidation goals in the program. It recently announced a Jobs Initiative including tax and expenditure measures to stimulate employment that is consistent with these goals.

Following the Executive Board's discussion, Naoyuki Shinohara, Deputy Managing Director and Acting Chair said:

“Ireland’s economic program is off to a strong start. Resolute policy implementation by the authorities has kept the program on track during a period of political change and an unsettled external environment. The new government has taken full ownership of the goals and key elements of the European Union/IMF supported program; after only a few weeks in office, it announced comprehensive reforms and recapitalization of the domestic banks.

“These announcements are a major step towards restoring the Irish banking system to health which is crucial for economic recovery. Building upon the credibility of the well received capital needs assessment at the end of March, the government plans to implement bank recapitalization in a timely manner while containing fiscal costs.

“Rigorous management by the authorities will be required to successfully implement the comprehensive banking reform agenda. Deleveraging of domestic banks is needed to help them regain market-based funding, and medium-term availability of Eurosystem financing would support this process. To strengthen their balance sheets, banks should also work out problem loans on the basis of best international practices.

“The budget is on track for the ambitious 2011 fiscal adjustment targets, and the new government has committed to medium-term fiscal consolidation in line with the program. Consistent with this commitment, the recently announced Jobs Initiative is fiscally neutral while supporting the priority of job creation.

“Although the external environment continues to be challenging, the authorities are committed to sustained strong program implementation. Supporting these efforts with a more comprehensive European plan would help overcome market doubts, regain market access, reduce the threat of spillovers, and bring about a recovery of the Irish economy.”