Ireland's Economic Program

Information visit by German Journalists

September 10, 2012

Peter Breuer

Overview

- How did the Crisis come about?
- What is the Program Strategy?
- What are the Remaining Challenges?
- How can Europe Help?

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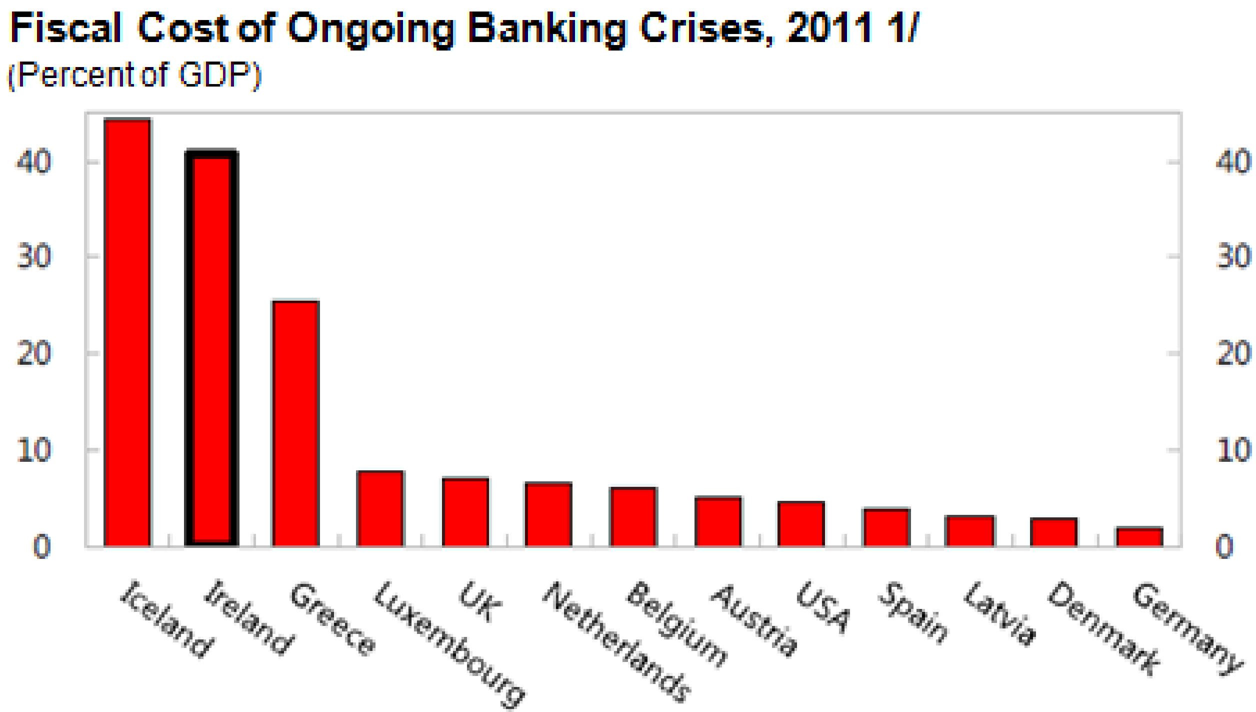
Large scale crisis

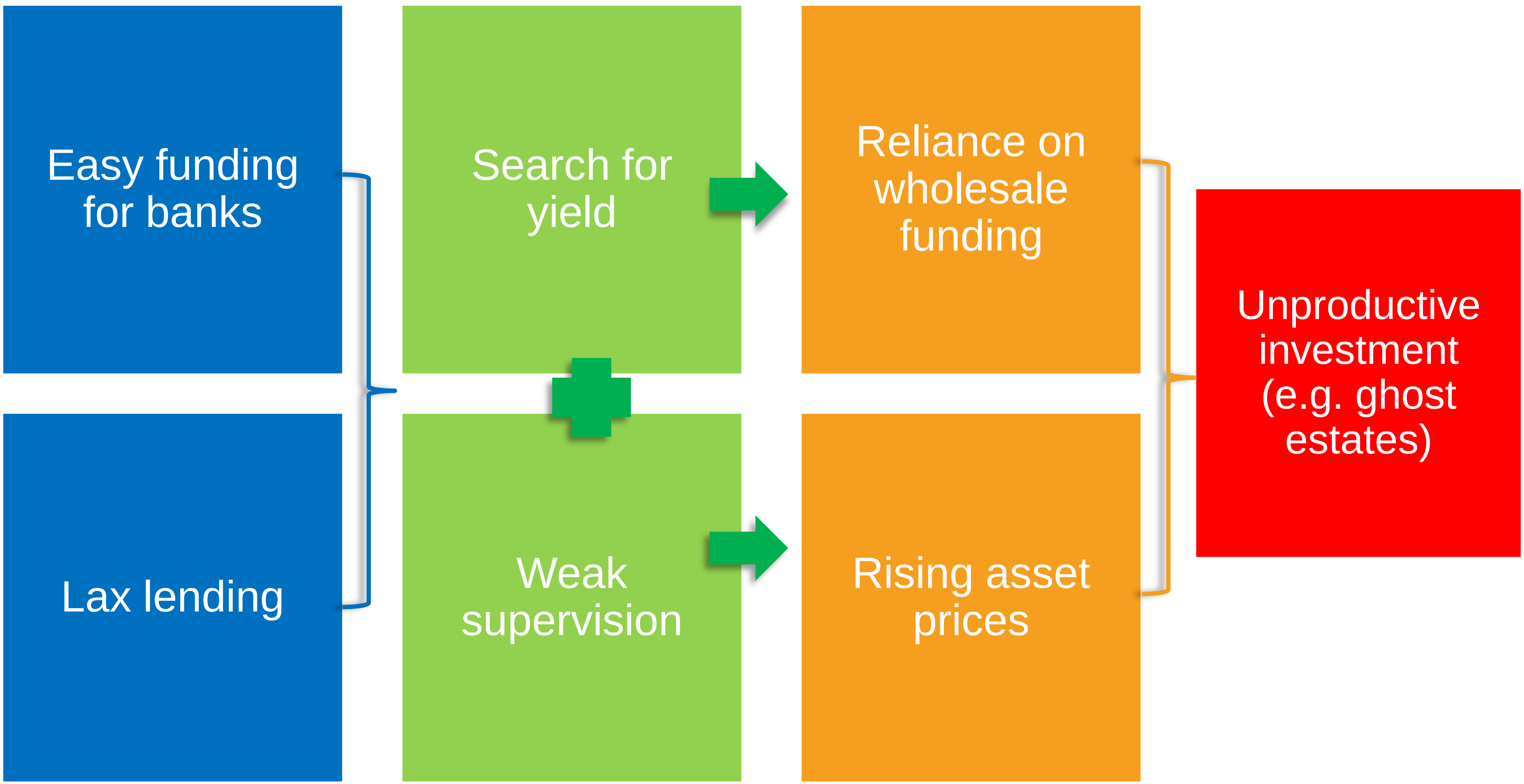
Ireland’s crisis is one of the most expensive in recent history



1/ Sample of ongoing systemic banking crises. Recapitalization and other restructuring costs, excluding liquidity support and asset guarantees. Greece includes bank recapitalization funds under the 2012 program (23 percent of GDP) although these funds had not been fully used as of May 2012.

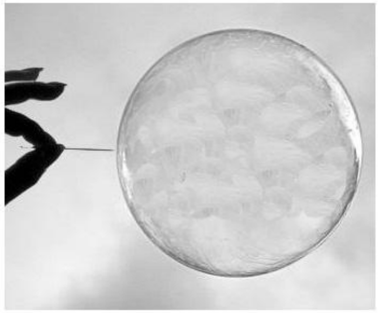
Source: Laeven and Valencia (2012)

Financial sector bubble…



…affects real economy…

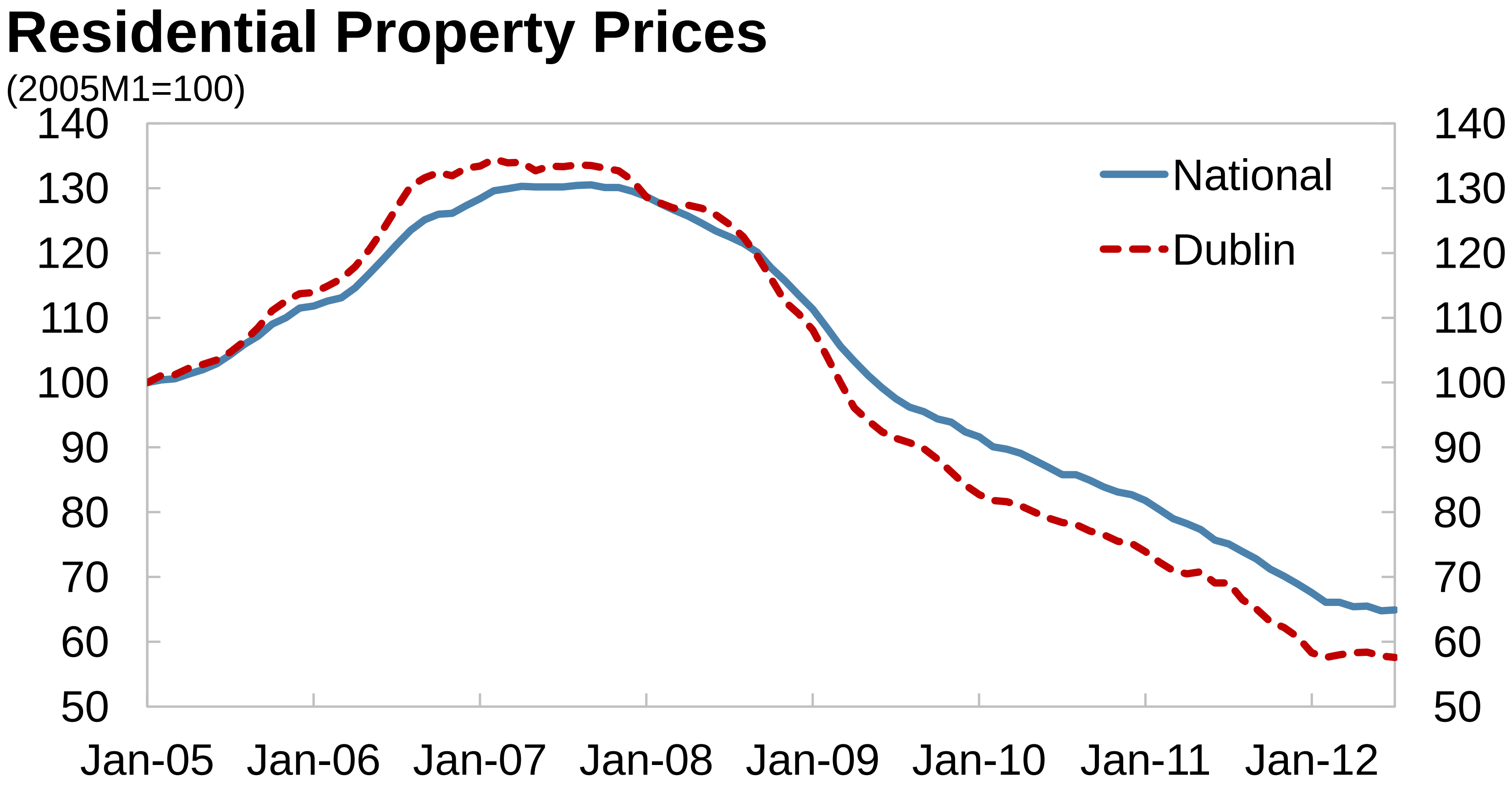
- Rising property prices
- Positive wealth effects
- Private consumption ↑
- Income and employment ↑
- Eroding competitiveness
- Compressed real interest rate, more investment



…and bursts suddenly.

- Global financial turmoil 2007/08
- Property prices ↓
- Wholesale funding run → Euro-system liquidity ↑
- Vicious downward cycle begins
  - Negative wealth effect on spending
  - Falling incomes
  - Unemployment jumps
- 2007-10: real GDP falls 8 percent,
  nominal GNP falls 20 percent

Real estate prices collapse…

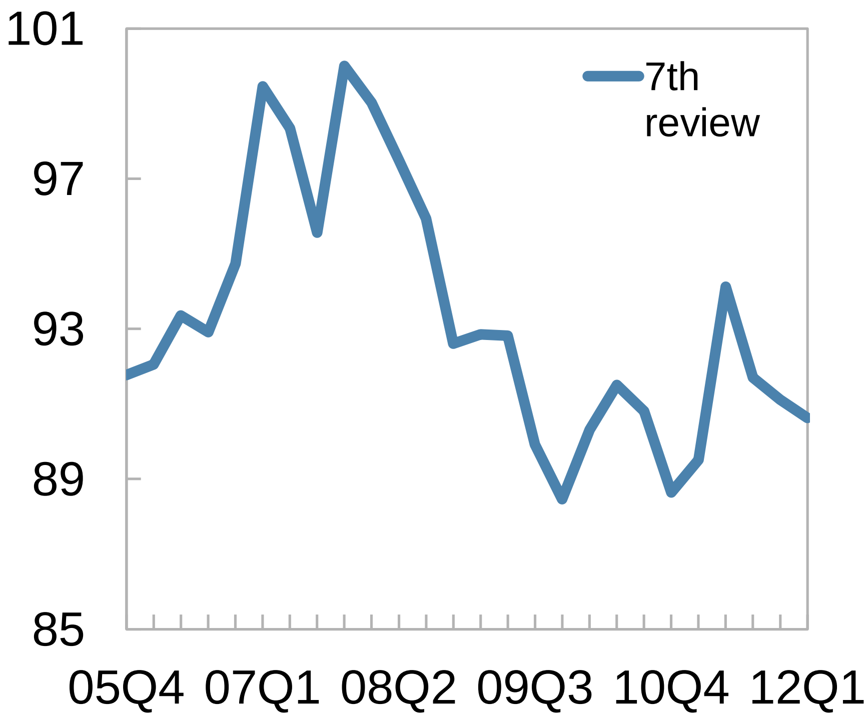


Source: CSO

…as does the real economy.

Real GDP

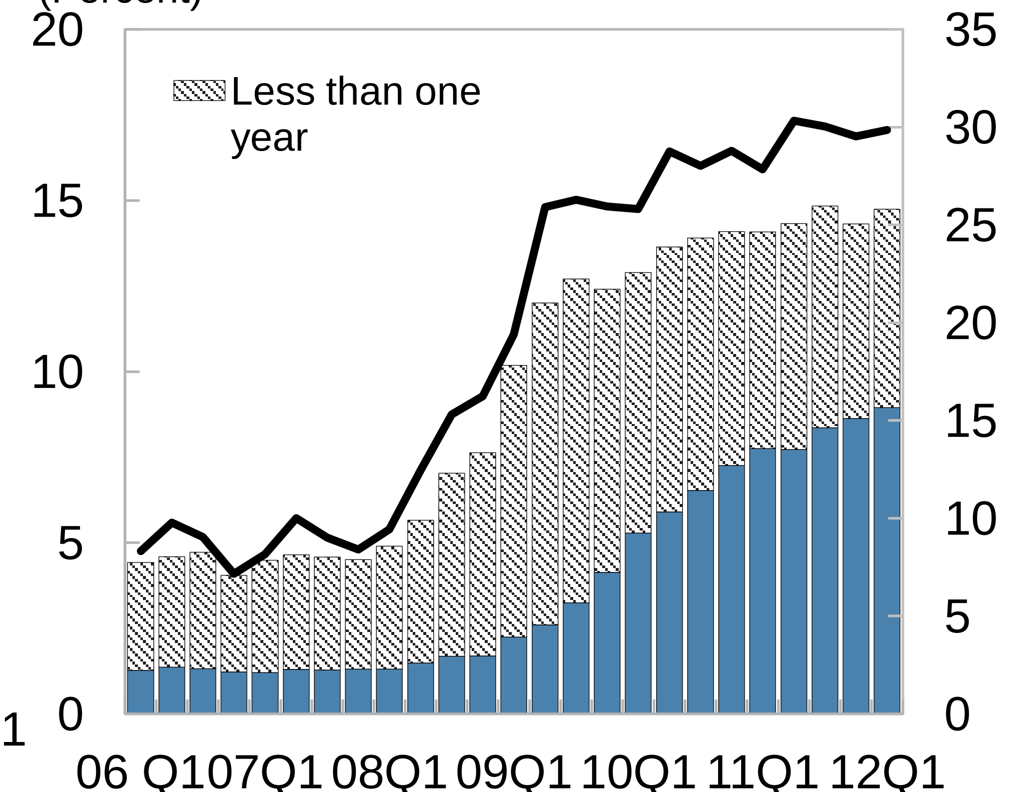
(Pre-crisis peak, Q4 2007=100)



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

Unemployment Rates

(Percent)



Sources: CSO; and Haver Analytics**.**

Government finances deteriorate…

- Deficit: 0% in 2007 → 10% of GDP in 2010
  - Tax revenue down 30 percent 2007-09
    - Heavy reliance on property-related revenues
  - Rising social outlays

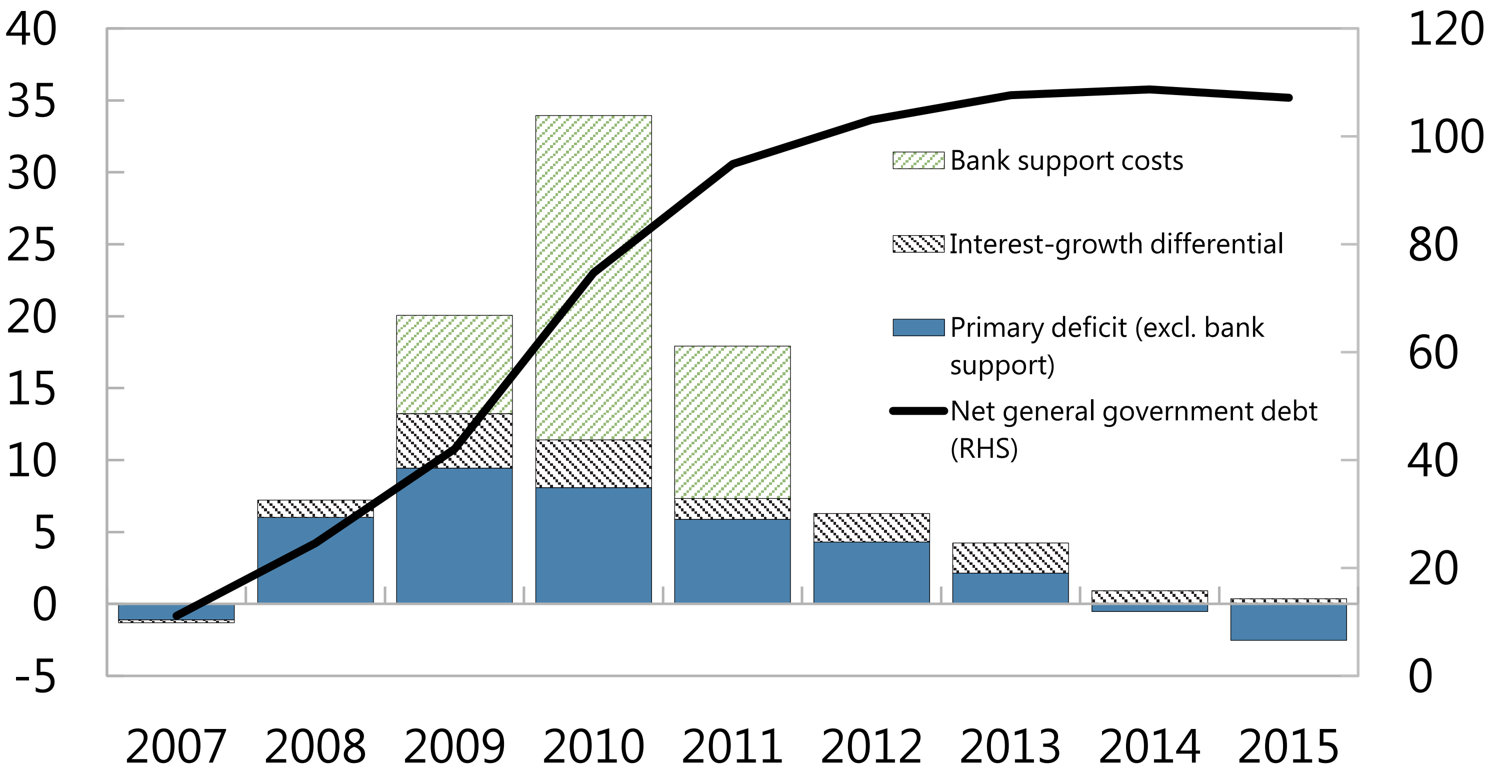
- Debt rises rapidly
  - Bank support 30% of GDP by end 2010
  - No cushion from burden-sharing on banks' senior debt

→ Doubts about debt sustainability

…driving up net debt.

Almost half of increase in net debt (2007-11) due to bank support

Sources of Increase in Net Debt-to-GDP Ratio
(Percent of GDP)



Source: Department of Finance; and IMF staff estimates

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Substantial pre-program government response

Financial

- Government issues blanket guarantee 9/'08
- Banks move commercial property loans to NAMA
- Large scale support for failed banks (Anglo, INBS)
- Equity injections in other banks (AIB, BOI, PTSB)

Fiscal

- 6.2% of GDP in measures 2008-10

Structural

- Croke Park Agreement: wage cut, no further cuts till 2014, voluntary redundancy, but restructure

Externally-supported adjustment program

- By late 2010 government guarantee fails to maintain confidence in banks
- Renewed bank outflows → government loses market access
  - European Union and European bilateral lenders commit € 45 billion
  - IMF commits € 22.5 billion
  - Irish Authorities commit € 17.5 billion
  - ECB continues to provide liquidity to banks

Ultimate Objective	Sovereign Regains Market Access	
Proximate Policy Design Goals	Public debt sustainability	Restore health of financial system
	Revive Growth, Stabilize Asset Prices, Contain Unemployment & Loan Arrears	Resolve private debt issues
	Enhance Competitiveness	Limit structural unemployment

Program Policy—Financial Sector

- Reorganization → universal full-service banks
    - Two pillar banks: BOI and AIB/EBS
    - Failed banks: IBRC
    - PTSB restructuring proceeding
- Recapitalization → 10½% core tier 1 (6% stress)
    - Independent loan loss forecast, PCAR
    - €24 bn recap completed 6/’12, public cost €17.8 bn
- Deleveraging → market funding
    - Core vs. non-core assets
    - Banks delevered more than half of €70 bn in identified assets

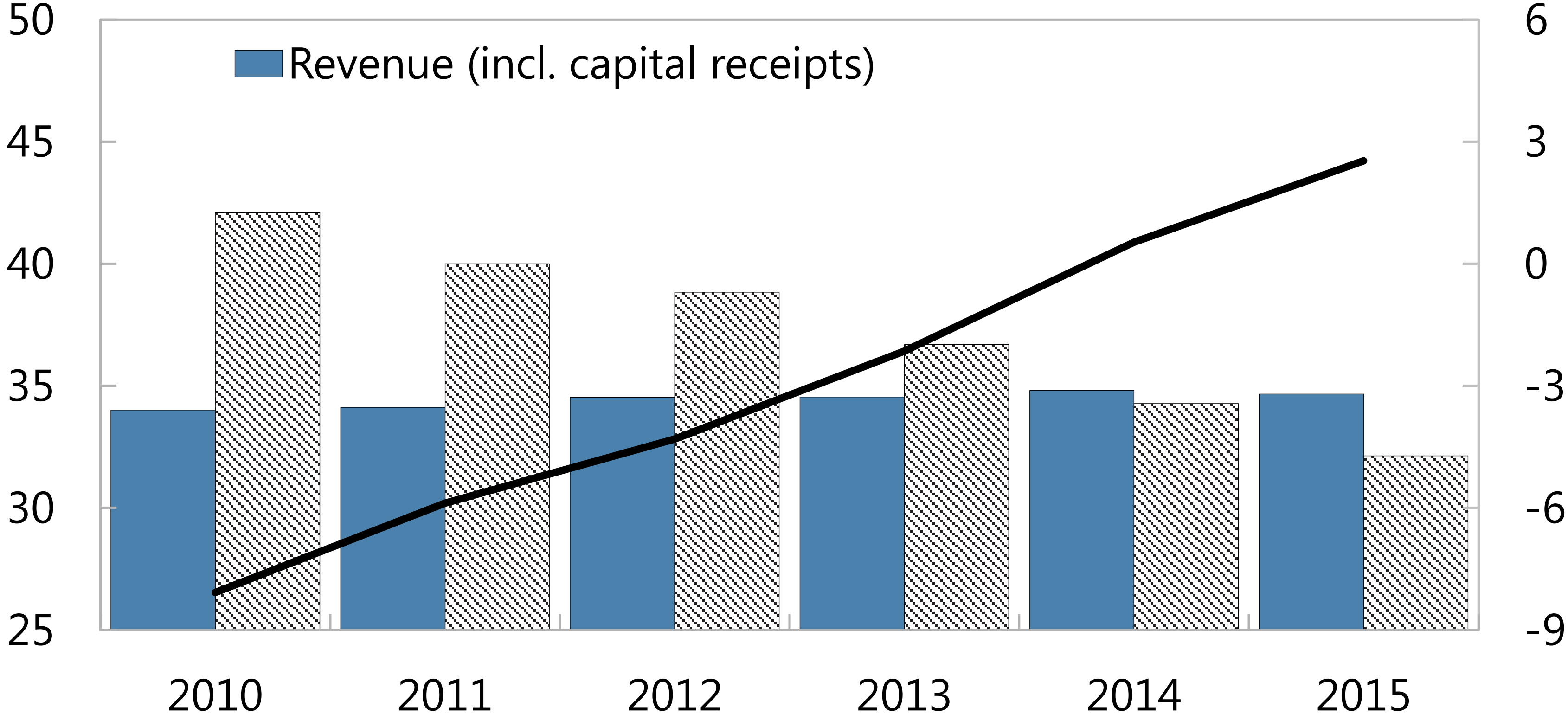
Program Policies—Fiscal

- Credible medium-term consolidation (3% deficit by 2015)
  - Wage bill cut within Croke Park agreement
  - Welfare rates cut
  - Non-pay current and capital budget
  - Personal income tax base broadening
  - Universal charge, elimination of PRSI reliefs
  - VAT increase
- Measures 2011 3.5% of GDP, 2012 2.7%, 2013 2.1%
- Emphasis on ownership, quality, social cohesion
- Reforms: Fiscal Council, Fiscal Responsibility Law

Expenditure is brought in line with revenue gradually

Revenues, Primary Expenditure and Balance

(Percent of GDP)



Source: Department of Finance; and IMF staff estimates

Program Policies—Structural

- Mortgage Arrears Resolution Strategies (MARS)
- Personal Insolvency Reform
- Services and Goods markets
  - Reform of sheltered sectors (legal medical)
  - Improving competition enforcement
- Labour market
  - Strengthening labor activation and training
  - Reforms of sectoral wage agreements
- Sale of state assets (about 2% of GDP from 2013)

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Financial:
Create conditions for robust credit flow

Arresting deterioration in bank asset quality

- Accelerate credit collection and workout capacity
- Implement personal insolvency reform
- Repossession framework

Regain bank profitability to sustain new lending

- End deposit war (need funding alternatives)
- Phase out costly government guarantee
- Reduce operational expenses

Expand bank access to market financing

- Improve liquidity through deleveraging
- Expand collateral -- Loan restructuring
- **But:** Euro area problems, bank-sovereign linkages

Fiscal:
Complete consolidation in durable manner

- Better targeting state’s social supports and subsidies to those who need them
- Reform key government services, especially health and education
- Focus revenue effort on base-broadening rather than rate hikes (eg. property tax, rather than rate hikes)

Structural: Increase potential for employment-rich recovery

- Economic growth most important
- Education and training policies help facilitate mobility of unemployed across sectors
- Enhance resources to help long-term unemployed get back in workforce

Market access on sustained basis

June 29 statement by euro area leaders

- Irish bond spreads declined
- Government issued 5 and 8-year bonds

Substantial risk remains

- Debt rising to almost 120% of GDP in 2013
- Economic recovery needed to put debt on declining path

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Break Sovereign-Bank linkage

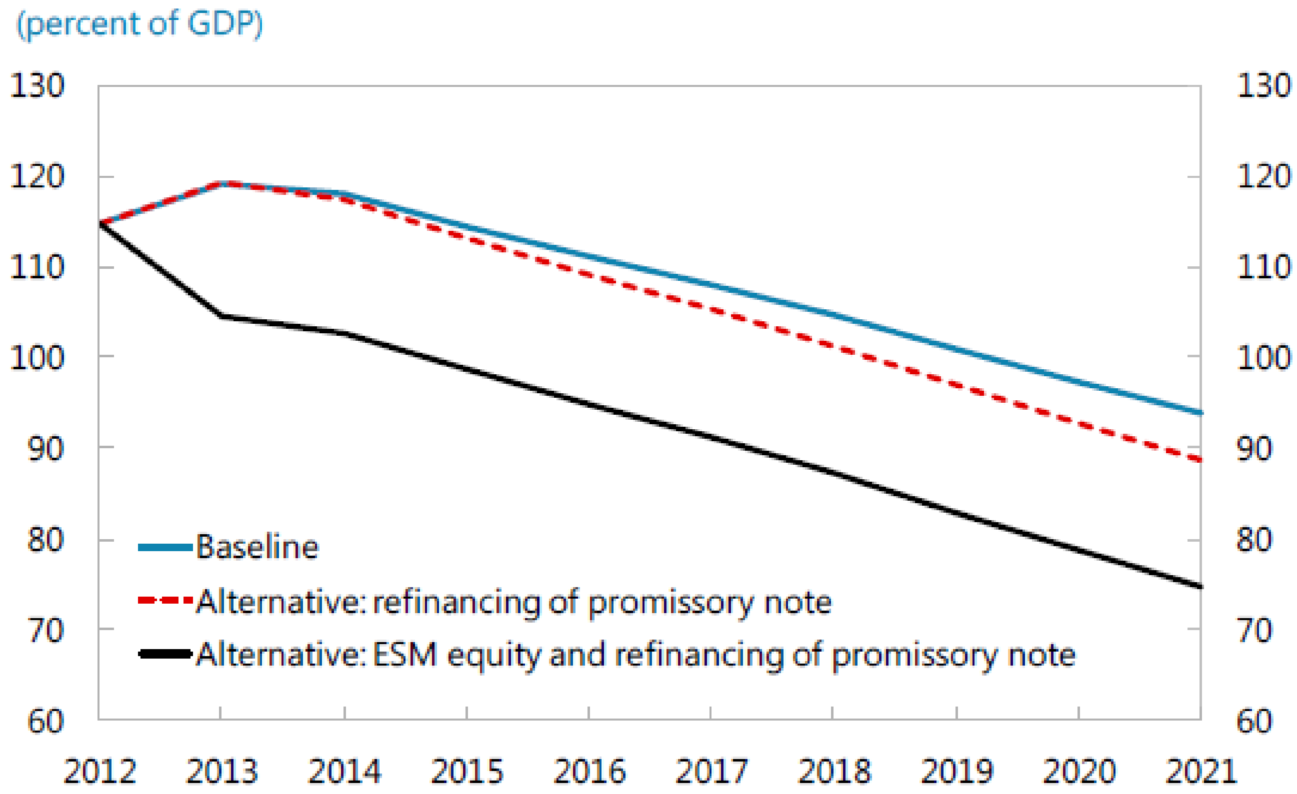
- Government has high debt—not a strong owner of the banks
  - Bank access to market funding is limited and costly
- Temporary bank ownership by ESM
  - eliminate need for guarantees
  - increase other funding options (reduce deposit rates)
- Improved bank profitability
  - Restore capacity for sound lending
  - Support recovery

Improve sustainability and prospect for market financing

- ESM equity helps reduce government debt
  - Example: €24 bn investment (= capital increase) would cut government debt by 14½ pp to 105% of GDP in 2013.
- Refinancing of €28 bn promissory note would much reduce financing needs in coming years
- Together:
  - Would improve prospects for market access
  - avoid prolonged dependence on official financing

Debt outlook

General Government Gross Debt



Source: IMF staff projections

Conclusion

- Ireland exposed to global financial turmoil via financial and fiscal vulnerabilities
- Irish government responded, but overwhelmed by global recession and scale of banking problems
- Exemplary program implementation record while maintaining social cohesion
- But, high debt and bank-sovereign linkages threaten ability to gain lasting market financing
- Both Ireland and Europe benefit from ESM equity investment to address these problems

The End