Ireland’s Economic Program

Visit by European Union Journalists for the Irish Presidency of the Council of the European Union

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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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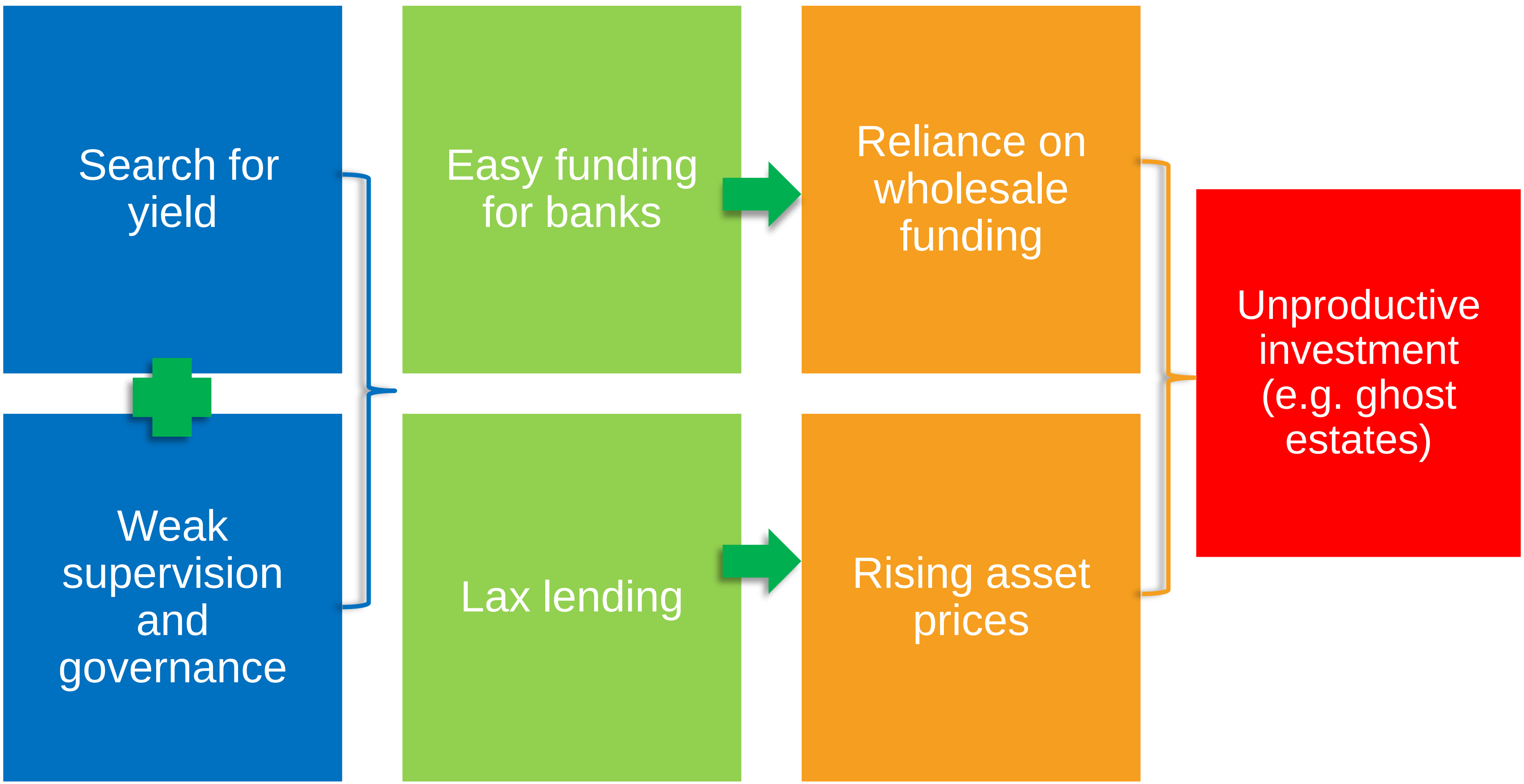
Financial sector bubble…



…affects real economy…

Rising property prices

Positive wealth effects

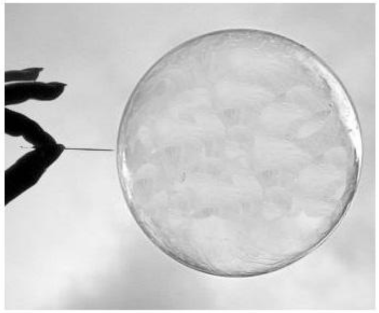
Private consumption ↑

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 funding ↑
- 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

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

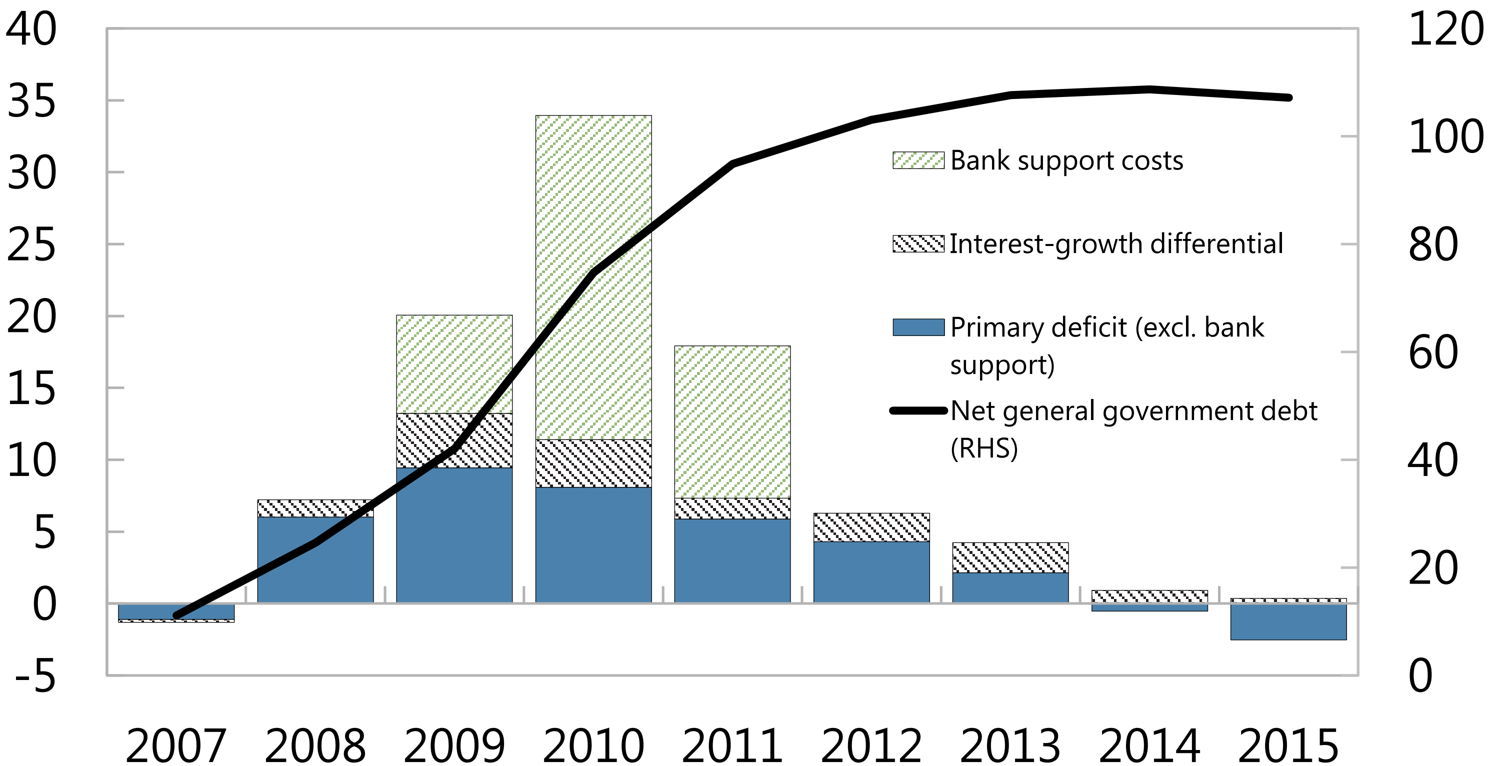
- Debt rises rapidly
  - Bank support 30% of GDP by end 2010
  - No cushion from burden-sharing on banks' senior debt

⇒ 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 **Cut Unemployment** **Limit 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

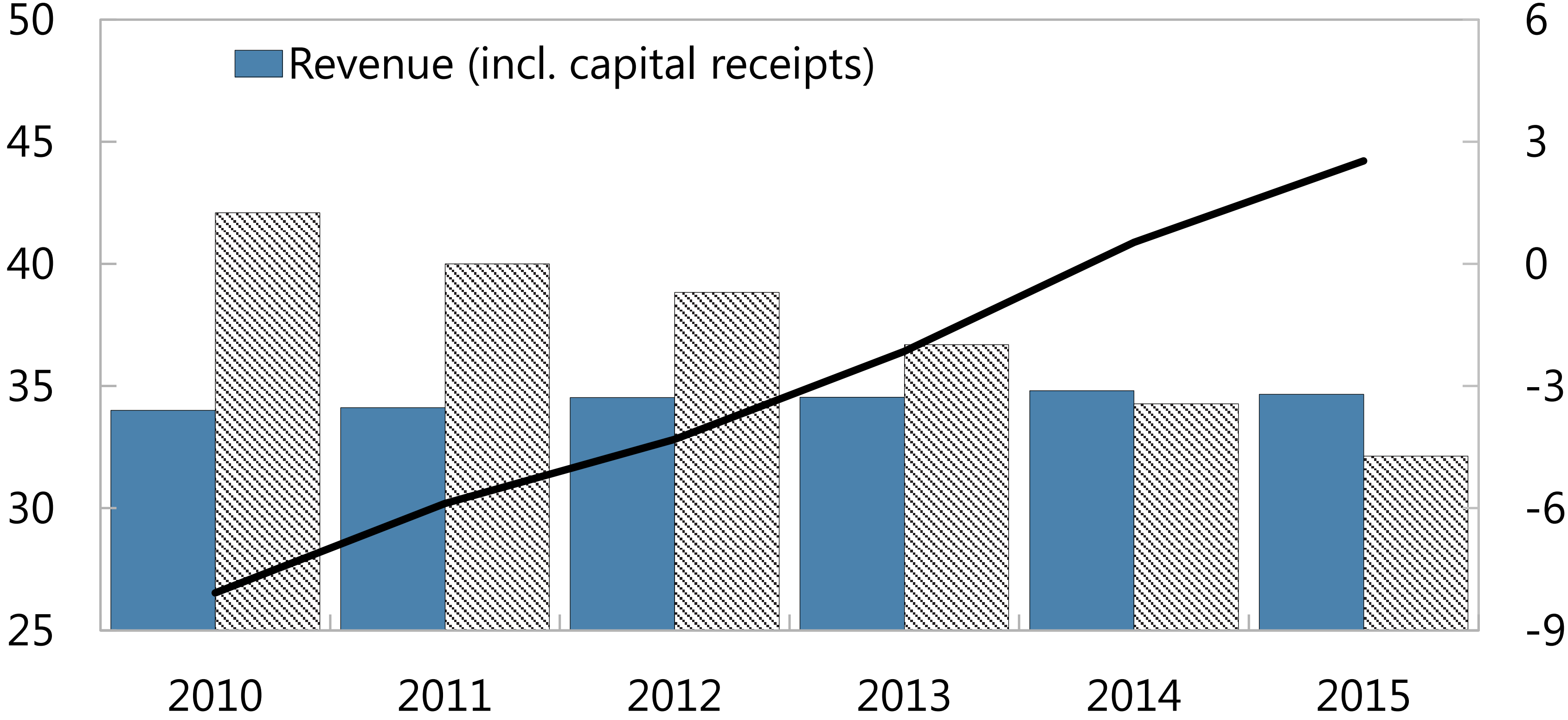
Measures	2011	2012	2013
(% of GDP)	3.5%	2.7%	2.1%

- 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)



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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

Arrest deterioration in bank asset quality	• Accelerate workout capacity • Implement personal insolvency reform • Strengthen repossession framework
Regain bank profitability to sustain new lending	• Reduce deposit rates • 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

- Full implementation of Budget 2013, but no additional measures if growth disappoints
- Full implementation of health sector savings
- Careful preparation for introduction of property tax
- Agreement on public sector pay bill savings

Alternatives to Austerity?

- “Austerity is not working”
- Debt ≈122% of GDP, Deficit ≈8% of GDP

➡ Sustainability needed for market access

- Additional fiscal expansion would imply:
  - slower debt reduction
  - official financing for longer
- Share of senior debt rises → market access? → more official financing
- Best option may be to use EU presidency to advance active growth strategy in Europe

The Effect of Fiscal Consolidation

- Phasing of consolidation over 5 years to protect growth
- No compelling evidence of underestimation of effect (“multiplier”):
  - Modest growth deviations in both directions:
    - positive surprise in 2011
    - negative surprise in 2012 due to external conditions
- Automatic stabilizers should be allowed to operate
- Program under regular review

Structural: Increase potential for employment-rich recovery

- Economic growth is pre-requisite for job creation
- Reform education and training to ensure in line with market needs
- Rollout of integrated employment services to increase engagement with long-term unemployed

Market access on sustained basis

June 29 statement and OMT introduction

- Irish bond spreads declined
- Government issued 5 and 8-year bonds
- Tapped international bond market Jan 8

Substantial risk remains

- Debt rising to 122% of GDP in 2013
- Economic recovery needed to put debt on declining path

→ **Avoid prolonged official financing**

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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 durable market financing

- Debt-equity swap with ESM reduces government debt, breaks bank-sovereign loop, and improves growth prospects
- Refinancing of €28 bn promissory note would much reduce financing needs in coming years
- OMT access reduces tail risks

Would improve prospects for durable market access avoid prolonged dependence on official financing

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
- Delivery on European commitments would help ensure Ireland does not need prolonged official financing.

Thank You