Ireland's Economic Program

Visit by London-based Journalists

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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…

Search for yield

\+

Weak supervision and governance

Easy funding for banks → Reliance on wholesale funding

Lax lending → Rising asset prices

Unproductive investment (e.g. ghost estates)

…affects real economy…

Rising property prices

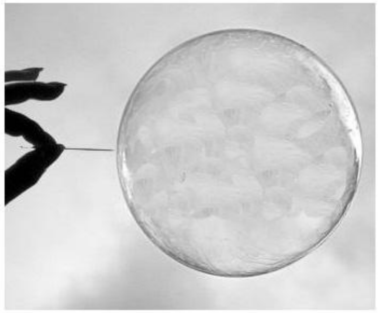
Positive wealth effects

Private consumption ↑

Income and employment ↑

Eroding competitiveness

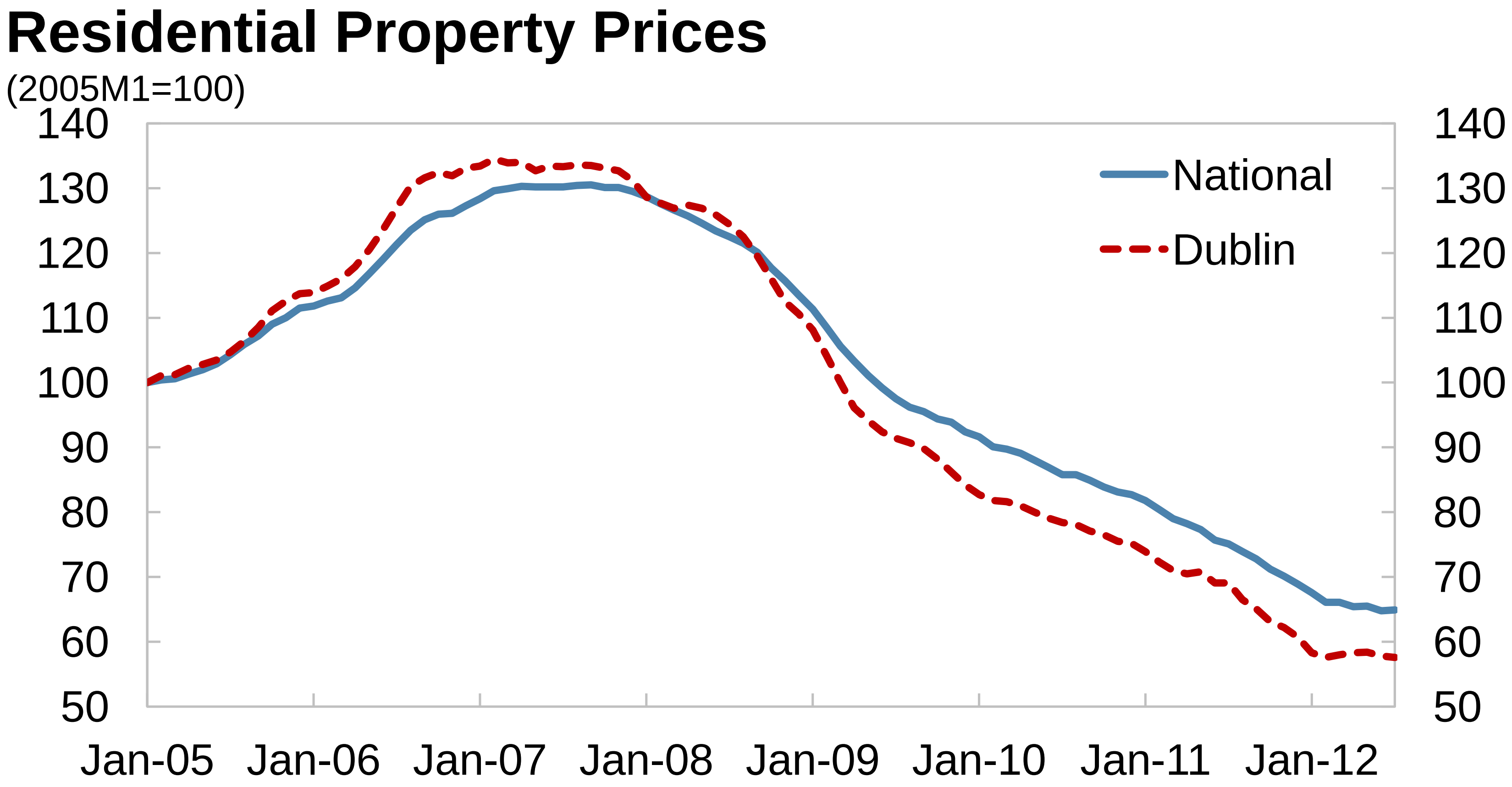
Compressed real interest rate, more investment



…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

Real estate prices collapse…

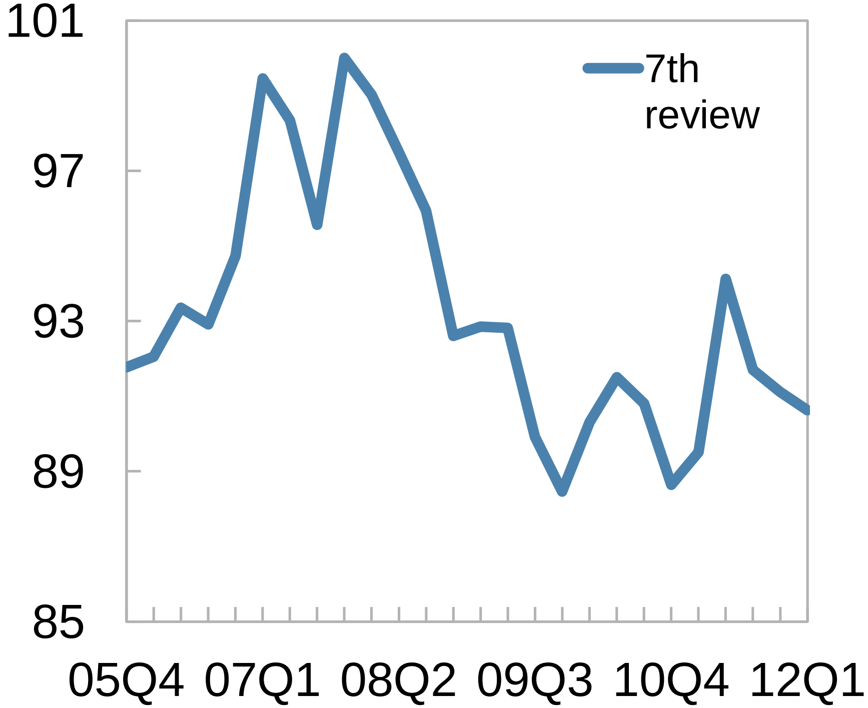


Source: CSO

…as does the real economy.

Real GDP

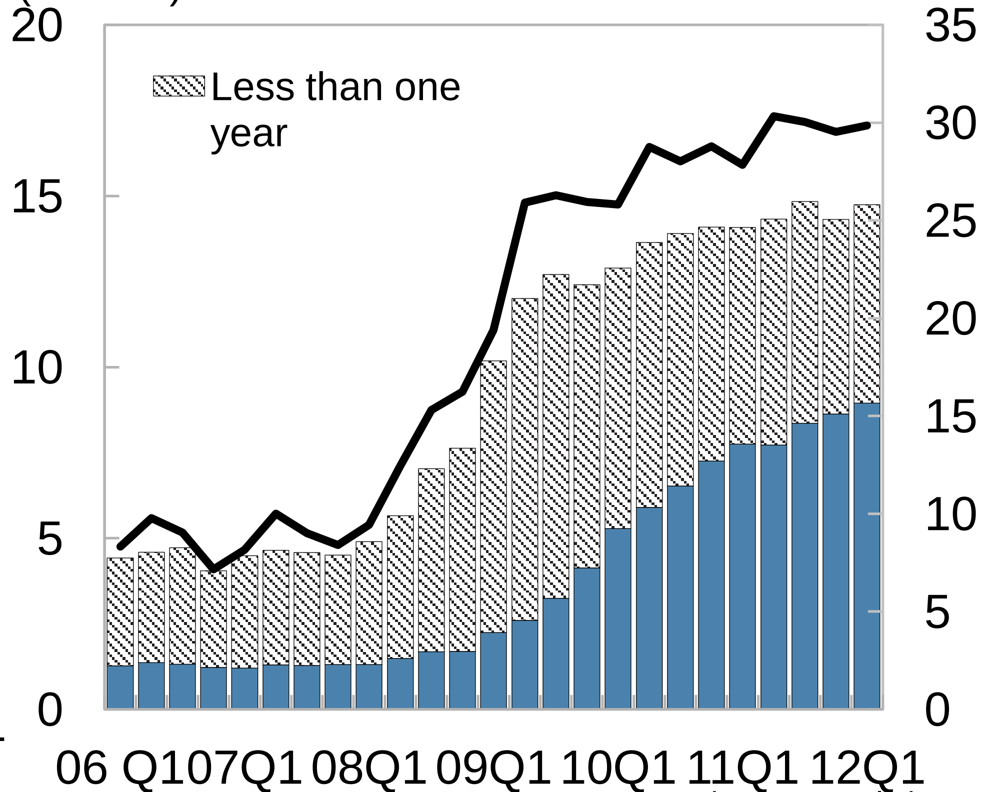
(Pre-crisis peak, Q4 2007=100)



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

Unemployment Rates

(Percent)



Sources: CSO; and Haver Analytics.

Government finances deteriorate…

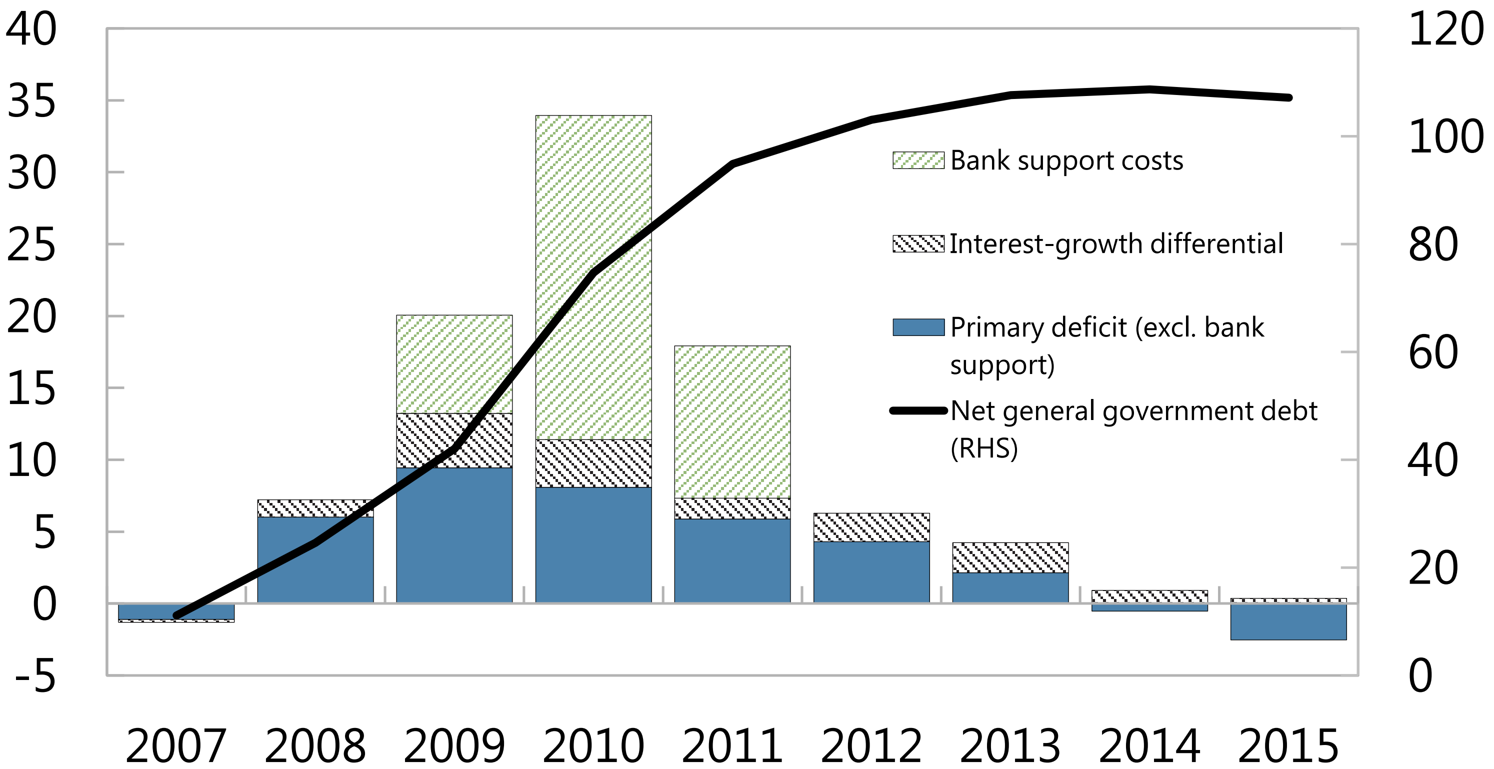
- Deficit: 0% in 2007 → >10% of GDP in 2010
  - Tax revenue down 30 percent 2007-09
    - Heavy reliance on property-related revenues
  - Rising social outlays
- Debt rises rapidly
  - Bank support 30% of GDP by end 2010
  - No cushion from burden-sharing on banks' senior debt

➡ 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

- **Background:** financial sector crisis results in loss of market access for sovereign by late 2010

- **Program:**
  - EU and bilateral lenders: €45 billion
  - IMF: € 22.5 billion
  - Irish Authorities: € 17.5 billion
  - ECB continues to provide liquidity to banks

Ultimate Objective	Sovereign Regains Market Access & Exits Offl. Financing	
Proximate	Public debt sustainability	Restore health of financial system
Policy Design Goals	**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
- 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

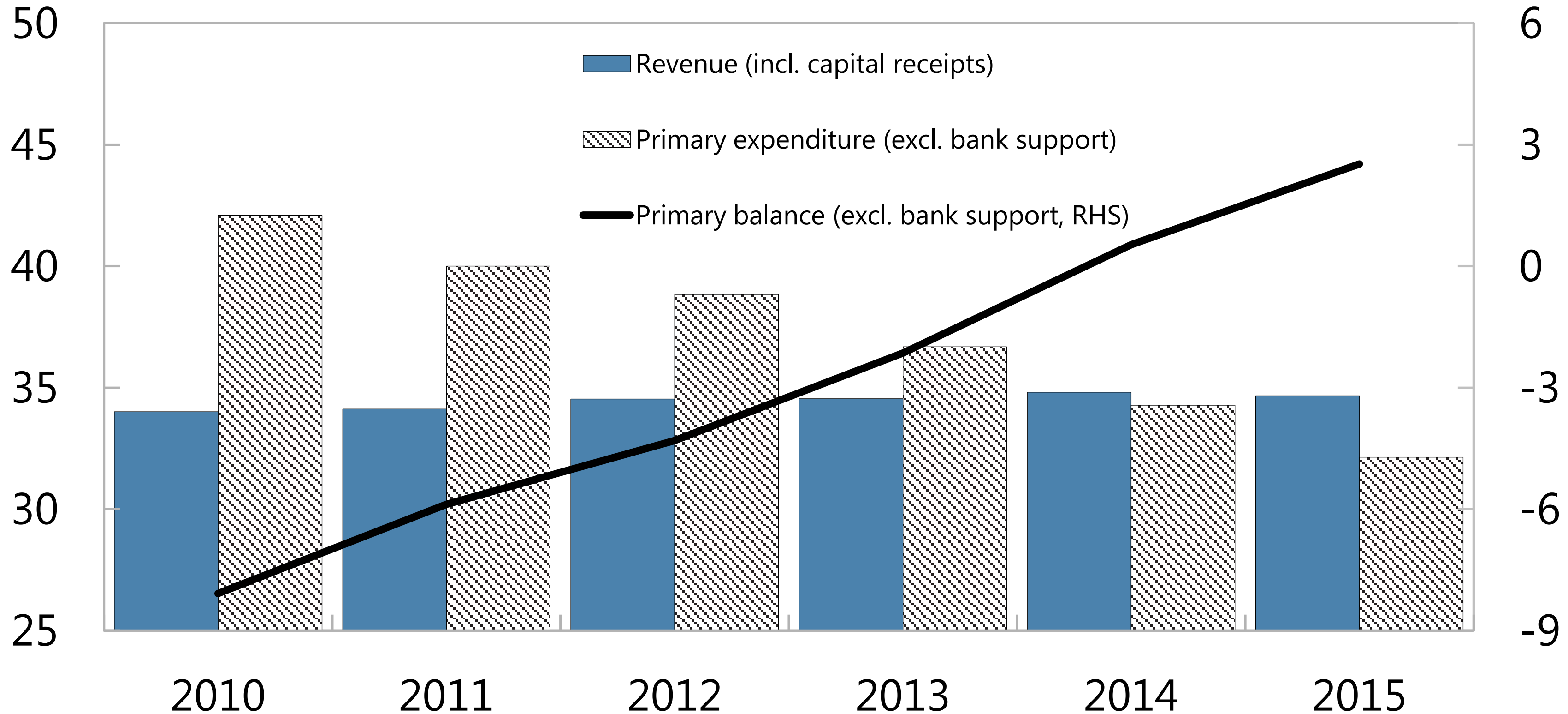
Measures	2011	2012	2013
(% of GDP)	3.5%	2.7%	2.1%

- 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)



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

Arrest deterioration in bank asset quality

- Accelerate workout capacity & engagement
- Implement personal insolvency reform
- Strengthen framework for legal remedies

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 with public sector unions

Alternatives to Consolidation?

- “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?
- 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
- Align education and training with market needs
- Increased engagement with long-term unemployed

Market access on sustained basis

June 29 statement and OMT introduction

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

Substantial risks remain

- 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
- Govt can reduce debt with proceeds from sale

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 promissory note reduces financing needs in near- and medium-term
- OMT access reduces tail risks

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.

Conclusion

- **Key Program Objective**:
  - Exit from Official Financing
- **Need**:
  - Re-gain Market Confidence
- **Means**:
  - Debt sustainability $\longrightarrow$ need consolidation
  - Credit flows $\longrightarrow$ need financial sector
  - Growth $\longrightarrow$ structural reforms
- **And:**
  - Break Bank-Sovereign Link

Thank You