Current Issues in Macroeconomic Policy

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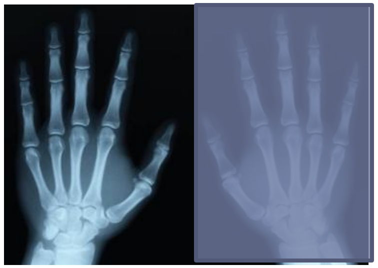
Macroeconomic Situation & Policy Priorities

I. Strong policies but lingering vulnerabilities → Macroeconomy

II. **Keep on pursuing program goal:** Debt sustainability for durable return to market financing → Fiscal

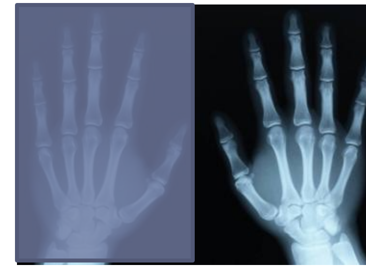
III. **Growth is key:** Enable financial sector to contribute to growth → Financial

I. Macro situation: The "good hand"



- Strong **policy efforts**…
  - Budget on track
  - Efforts to durably address NPLs under way
- …rewarded with **positive outcomes**:
  - Decline in **DD** slows
  - **Labor market** beginning to stabilize
  - **Market access** under good conditions
  - Reduced **financing needs** from lengthening of maturities and promissory note transaction
  - **Gradual recovery**:
    - 1.1% growth in 2013, 2.2% in 2014, 2.7% in 2015

I. Macro situation: The "bad hand"



- But clear and present **dangers** remain:
  - **Trading partner** growth recovery at risk
    (0.5% in 2013 → 1.7% in 2014)
  - "Tapering" may halt "**search for yield**", increasing market funding costs, and possibly weakening market access
  - **Lending revival** may take longer
  - Drag effect of **fiscal consolidation** measures depends on composition of measures (1.75 of GDP to be identified)

I. Macro situation: What if…

- …**growth** remains stuck at 1% during 2014-18?
  - Deficit in 2015: 3.5% instead of 2.5%
  - Debt in 2018: 130% instead of 106.4%
- …NAMA needs to be compensated for **IBRC asset purchases**?
- …depressed property prices crystallize a **shortfall in NAMA**?

II. Ensure Debt Sustainability: D↓

- Debt sustainability needed for **durable market access**
- State spends **€1bn every month** more than it takes in
- **Steady budgetary adjustment** least harmful for growth and market access:
  - Reach MT fiscal targets safely
  - Don't risk goal by scaling back consolidation path on the basis of PN interest savings
  - Use savings to build buffers to reach target safely
- Flexibility to allow **automatic stabilizers** to work:
  - Accommodate revenue shortfalls if growth significantly weaker

II. Ensure Debt Sustainability: GDP↑

- Go for **least growth-unfriendly** measures
  - Spending, but protect core public services
  - Less distortive taxes, e.g., property tax
- Proceed with **state asset sales** and invest half of proceeds as agreed
- Engage with **unemployed** to provide right training, motivate job search
- Ensure **financial sector** can contribute

III. Financial Sector: The problem

- Banks made **€500m losses every month** in 2012 using up capital provided by state
  - Not building capital to support new lending
  - Avoid need for further support
- **NPL**s at 25%
  - Deprive banks of income and capital for new lending
  - A source of operational costs
  - Undermine reliability of asset values
  - Drain market confidence

III. Financial Sector: Solutions

- **NPL resolution**
  - Hold banks to mortgage resolution targets
  - Timely removal of unintended barriers to repossessions
  - Ensure rapid implementation of Insolvency Service
  - CCMA to facilitate constructive engagement between banks and borrowers
  - Adopt resolution targets for SME loans

- **Workstream on bank profitability**
  - Operating profit analysis: expenses, funding cost, NPLs
  - Options to reduce funding costs of tracker mortgages

Conclusion

- Policy efforts being rewarded with outcomes
- Macroeconomic vulnerabilities remain
- Debt sustainability key to durable market exit
- Financial sector key to growth revival