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Economic Adjustment Programme for Ireland Spring 2012 Review

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Directorate-General for Economic and Financial Affairs

Economic Adjustment Programme for Ireland

Spring 2012 Review

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Executive Summary

A joint EC/ECB/IMF review mission visited Dublin between 17-26 April to conduct the sixth quarterly review of Ireland's economic adjustment programme supported by EU and IMF financial assistance. Successful completion of this review would trigger the release of EUR 2.3 billion from the EFSM, EUR 1.4 billion from the IMF, and around EUR 0.5 billion from a bilateral loan from the UK.

The mission found that economic activity is evolving broadly as had been anticipated in the fifth review. Real GDP returned to full-year growth in 2011 for the first time in four years, and is expected to continue to grow in 2012, albeit modestly (0.5%), reflecting subdued prospects in key trading partners and continued balance-sheet repair by domestic agents. Lending to the domestic private sector is contracting, though signs of stabilisation in the credit extended to SMEs are emerging. Unemployment remains high, and increasingly long-term, though some signs of stabilisation and possible turn-around have begun to emerge, with positive quarterly employment growth recorded in the last quarter of 2011. Headline inflation has increased, mostly as a result of high energy prices and some increases in taxes and administered prices, but remains lower than in trading partners, enabling continued recovery of the competitiveness lost in the pre-crisis boom years.

Programme implementation remains strong. In particular, the central government cash deficit in the first quarter of 2012 was below profile, and the projection for the 2012 general government deficit is well within the programme ceiling (the outturn for the general government deficit-to-GDP ratio in 2011 excluding bank support measures was revised down to 9.4% from 9.9% estimated as of the fifth review). The strong year-to-date performance is supported by solid tax and nontax revenue, more than offsetting some spending overruns in the social protection and health budgets, which the authorities anticipate will be compensated in the rest of the year, including through savings on primary expenditure elsewhere if necessary. The fiscal framework is being strengthened further. The draft bill included in the documentation for the end-May referendum, in addition to enabling the ratification of the Treaty on Stability, Coordination and Governance (the so-called "Fiscal Compact"), would also grant by law financial and functional independence to the Irish Fiscal Advisory Council and task it with monitoring the government's observance of the fiscal rules enshrined in the Fiscal Compact.

Ireland has achieved further progress towards reorganising, right-sizing and strengthening its banking sector. Increasing confidence is reflected in stabilising deposits (with Irish private sector deposits in covered banks up for four consecutive months for a cumulative 2.8% increase since the November 2011 trough), albeit at significantly higher rates. An agreement was reached on the strategic direction of Permanent TSB (PTSB, ILP's banking subsidiary), based on the segregation of a core retail bank, composed of carefully selected assets, the UK buy-to-let business (CHL), and a dedicated strategic business unit to deal with problematic legacy loans over time. Deleveraging is on track, with more than half of three-year targets achieved already, but is becoming more challenging. Reliance on euro-system and/or central bank funding is slated to temporarily increase in the near term, despite the above-mentioned increase in deposits, as sizeable wholesale funding matures in the next two years. Banks are well capitalised but earnings remain weak, with growing non-performing loans, high cost of funding, low margins, and one-off costs for personnel restructuring. The authorities are stepping up efforts to improve banks' approaches to dealing with mortgage arrears as the quality of bank loan portfolios continues to

deteriorate. Still, capital developments at covered banks in 2011 have been broadly in line with the levels assumed under the 2011 PCAR. Core Tier 1 ratios remain among the highest in Europe. Looking ahead, key challenges will be for banks to effectively implement mortgage arrears resolution strategies and to continue identifying steps to underpin a prompt return to profitability. The focus will be on the revised restructuring plans of AIB and PTSB. The next PCAR stress test will be aligned with the next EBA stress tests in 2013, and would retain the rigour and high degree of transparency of the well-received 2011 PCAR exercise.

The importance of securing growth to bolster debt sustainability was a common theme of the discussions. In light of the weaker-than-anticipated support from external demand, the authorities intend to give renewed impetus to measures and reforms that can underpin a timely return of domestic demand to growth. Various avenues are being explored, including scope to increase lending for productive infrastructure and commercial projects by the European Investment Bank and the reinvestment of a greater share of proceeds from the sale of some state-owned assets, for which preparations are underway. Structural reforms were also advanced further. The authorities announced the transfer of water provision services from local authorities to a soon-to-be-established regulated water utility, further strengthened the legal framework underpinning competition law, and decided to increase the staffing of the competition authority. The very high unemployment, and in particular an increasing number of long-term unemployed, turns early activation and re-skilling of job-seekers and welfare reform into a key priority. Work towards legislative reforms of both sectoral wage setting frameworks and the personal insolvency regime continues, though the complexities of the issues at stake have resulted in a somewhat longer timeline than previously envisaged.

Despite the substantial progress made so far, the programme's ultimate success remains subject to important risks. These have to do with still fragile market sentiment towards Ireland, continued uncertainties in the outlook for growth and debt sustainability in the euro area, and the complexity of the envisaged financial sector reforms. A specific source of risk is the reform of the personal insolvency regime, given difficulties in drafting legislation that strikes the right balance between promoting the restructuring of unsustainable debt burdens and protecting creditor rights. Careful design and prompt finalization of the framework will be necessary to avoid a deterioration of payment discipline and thus the quality of banks' loan portfolios.

1 Introduction

This report covers recent macroeconomic developments, programme implementation, and the main challenges ahead, as assessed by the 17-26 April joint EC/ECB/IMF staff mission that visited Dublin in the context of the sixth review of the economic adjustment programme, as well as the associated policy discussions with the Irish authorities.[1]

2 Macro-fiscal and financial developments

Recent national accounts data suggest that economic activity in Ireland has stabilised (Figure 1). In 2011, despite a slowdown in the second half of the year in line with a deceleration in the euro area, full-year real GDP growth was positive (0.7%)—for the first time since 2007. In terms of demand breakdown, late in 2011 there was a somewhat more pronounced deceleration of exports (and public consumption) than previously projected, while domestic consumption surprised somewhat on t he upside (0.5% q-o-q growth in the fourth quarter). Seasonally-adjusted employment increased 0.6% q-o-q in the same quarter, with employment gains also seen in export-intensive sectors such as manufacturing and technology. Yet unemployment remains high (14.3% in May) and is becoming increasingly structural in nature. Inflation, which measured 1.9% in April, is running in line with expectations.

Irish sovereign bond yields were on a steadily declining path until late February, reflecting Ireland's strong programme implementation as well as the positive impact on general investor confidence of the ECB's long-term refinancing operations (LTROs). Since then, the yield on the benchmark 9-year bonds[2] fluctuated around 7% reflecting the uncertainty associated to the results of the referendum, until in early May heightened political risks in the euro area caused a sudden widening in spreads (Figure 2). The moves in the spreads were accentuated by limited liquidity in Irish government bonds. The yield curve has flattened considerably since then, with the front end increasing by over 100 bps in the first two weeks of May (Figure 3), reflecting elevated market uncertainty.

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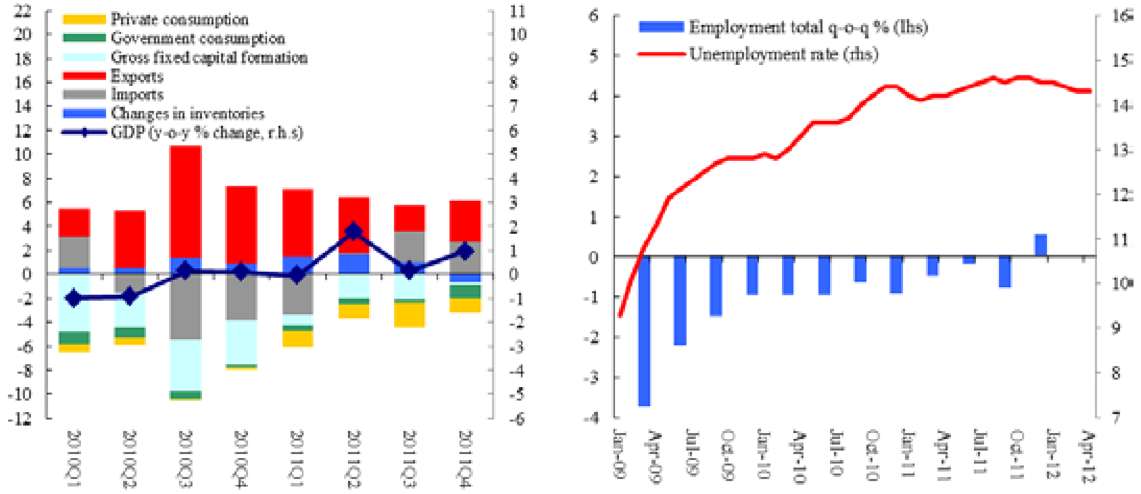
[1] This report reflects information as of 30 May 2012.

[2] As Ireland has no outstanding 10-year bond, the market uses the 9-year bond maturing in October 2020 as the benchmark in this maturity segment.

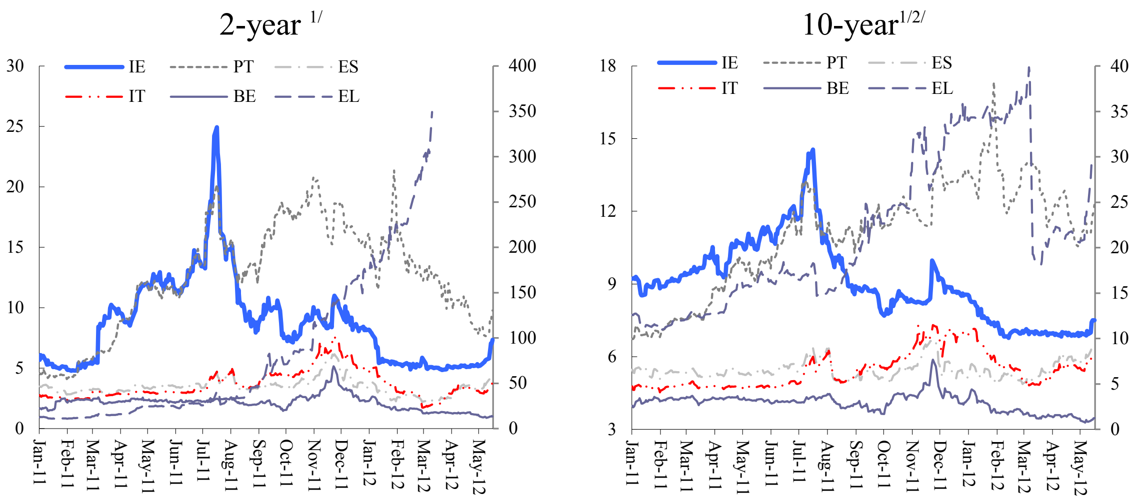
Figure 1: Macroeconomic indicators

GDP grows on the back of external demand *Unemployment stabilises, at a high level, as employment returns to growth.*



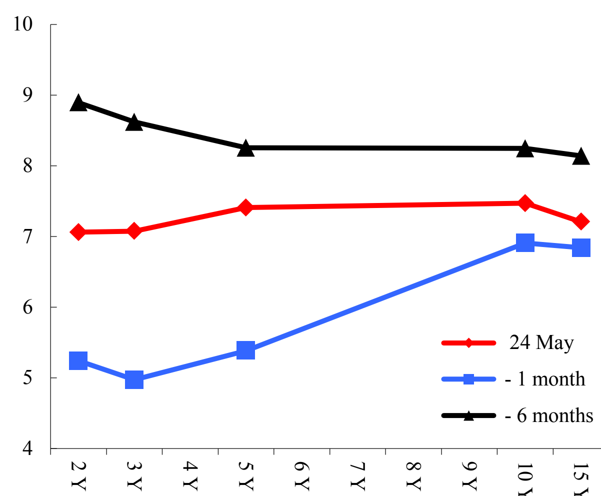
Source: CSO *Source: CSO, Eurostat*

Figure 2: Sovereign bond yields, selected euro area member states



Source: Bloomberg. *Notes*: 1/ Greece yields on the right axis; 2/ 9-year for Ireland

Figure 3: Yield curve on Irish sovereign bonds (%)



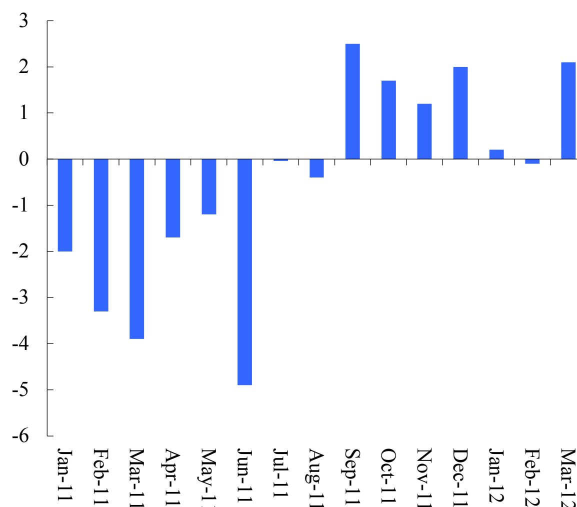
Source: Reuters

Deposits in the domestic banking sector have continued to increase for a third consecutive quarter, but the banking system remains fragile. More than EUR 9.5 billion in net inflows were recorded by domestic banks since September 2011 (Figure 4), with both retail and corporate deposits rebounding considerably in the last two quarters (EUR 4.1 billion and EUR 3.1 billion increases respectively). Importantly, the retail deposit stock is now 0.8% higher than in December 2010, reflecting the abatement of individual bank concerns and a general improvement in confidence in the system, and possibly also recent lump sum payments to the many retirees in the public sector (see below, Section 5.1). Another recent positive development has been the uptick in customer deposits originating in the Republic of Ireland. Whilst the increases in deposits recorded during the last two quarters of 2011 reflected mainly inflows originating in Irish banks' subsidiaries abroad (mostly in the UK), in the first quarter of 2012 Irish deposits made up more than half of total inflows (up from below 10% on average in the last two quarters of 2011).

Central bank funding of domestic banks is declining but remains sizeable, in line with previous programme projections. Central bank funding decreased considerably during 2011, as some banks managed to dispose of more non-core assets than envisaged despite rather challenging market conditions, while also obtaining some market funding using previously ECB-eligible securities. A further modest decline was also recorded in the first quarter of 2012. Domestic banks' use of ECB facilities has reduced to about

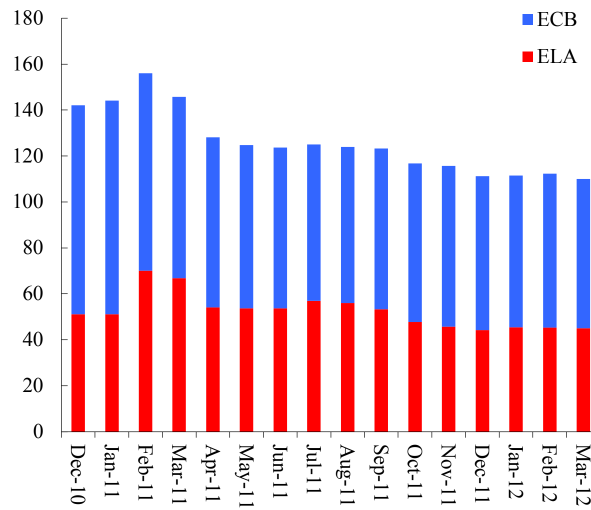
EUR 65 billion in March 2012 from a peak of EUR 93 billion in January 2011 (Figure 5), while their relative *share* of *total* ECB liquidity provision has also declined to pre-programme levels (as the bulk of recent ECB liquidity provision was taken up by banks in other euro area countries). However, risks to this favourable tendency remain, mainly due to still limited prospects for market refinancing of upcoming sizeable wholesale maturities (Figure 6), including due to persistently high market yields (Figure 7). A positive recent development in this context has been AIB's successful issuance of residential mortgage-backed securities (RMBS), utilising prime UK mortgage loans as collateral, for an amount close to EUR 400 million. This transaction brings the total unguaranteed term funding raised by covered banks from market counterparties (including through repos) since the beginning of the programme to some EUR 7.3 billion.

Figure 4: Net deposit inflows/outflows at covered banks (EUR billion)



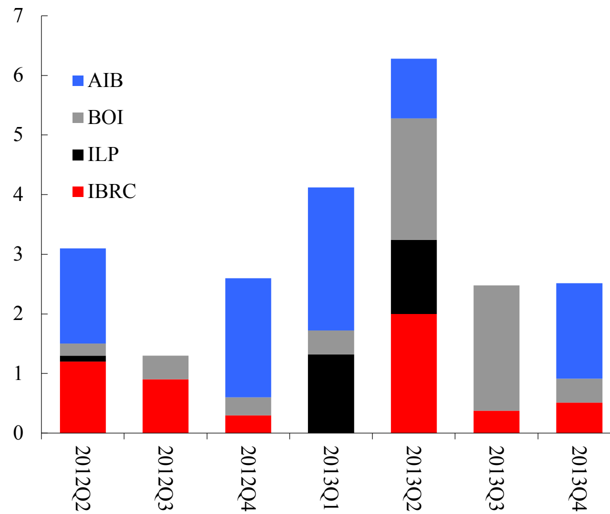
Source: Department of Finance
Note: Figures are consolidated and include deposit inflows/outflows for foreign subsidiaries (e.g. in the UK) of covered banks.

Figure 5: Domestic banks central bank funding (EUR billion)



Source: Central Bank of Ireland
Notes: (i) Data for ELA is an approximate measure (i.e., the CBI's "other assets" series); (ii) domestic banks include BOI, AIB/EBS, ILP and IBRC.

Figure 6: Domestic banks' bond maturities, 2012-2013 (EUR billion)



Source: Bloomberg
Note: Scheduled principal repayments of covered banks' secured, unsecured and government-guaranteed bonds in EUR equivalent.

Figure 7: Irish banks' and government bond yields (%)

Source: Bloomberg
Note: Bank bonds benefit from a government guarantee.

Bank deleveraging remains on-track, but is now entering a more challenging phase. By end-2011, more than half of the EUR 70.2 billion three-year deleveraging target was achieved, though this partly reflects net reductions in banks' core balance sheets, unanticipated in the end-2013 PLAR target (Table 1). Asset disposals accounted for some 40% of total balance sheet deleveraging, with the remainder stemming from sizeable net amortisation of both core and non-core portfolios and provisions in excess of some banks' deleveraging plans. By end-March 2012, EUR 17.6 billion in asset disposals was completed or sale-agreed, of which more than 90% had settled by that date. The impact on bank capital associated with disposals was broadly neutral for the system as a whole, as the discounts attained were within the PCAR/PLAR baseline assumptions. Beyond the covered banks, IBRC has also made notable progress, having achieved some EUR 9.9 billion of deleveraging (more than double its 2011 target), mainly resulting from a well-timed portfolio sale of its US commercial loan book. Nevertheless, the pace of deleveraging is set to decelerate in 2012 as market appetite and pricing for the remaining non-core assets earmarked for disposal become less conducive.

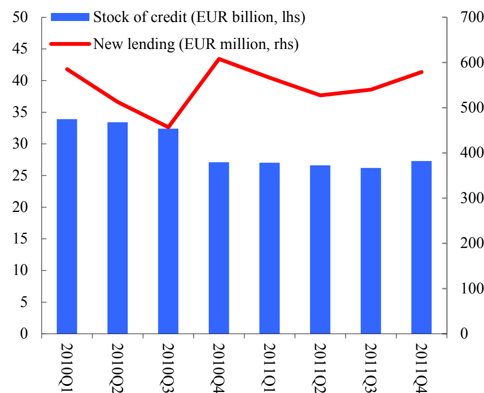
Box 1: Key developments in SME lending

The SME sector is a key driver of economic growth and job creation in Ireland. In 2010 SMEs made up 99.5% of all Irish enterprises and accounted for some 67% of private sector employment and 48% of gross value added. As a result of the crisis, however, the sector's gross value added contribution and employment have contracted sharply, respectively by 5% and 15% between 2007 and 2010.[3]

Although at a significantly lower level than its 2008 peak, SME lending has stabilized in 2011, partially thanks to agreed lending targets with banks (Figure 8). In 2011 the stock of credit to indigenous SMEs was largely flat at around EUR 27 billion, with gross new lending to the sector amounting to over EUR 2 billion.

This stabilization could in part reflect lending targets for the sector agreed between the government and pillar banks (EUR 21 billion for the 2011-2013 period). The EUR 6 billion target for 2011 was achieved, though a significant proportion of this lending was allocated to refinancing or restructuring of existing loan facilities, while figures quoted as part of the target also include amounts sanctioned but not drawn-down.

Figure 8: Stock of credit and new lending to indigenous SMEs



Source: CBI
Notes: Data excludes SMEs from financial intermediation and property-related sectors; new lending is net of restructurings and reclassifications and reflects drawn down amounts; data on new lending available only from Q1 2010

Two more schemes are being implemented to facilitate lending to SMEs: a partial credit guarantee scheme and a microfinance fund. The former is a temporary measure, envisaged to last for three years, to enable commercially viable firms to access credit through a partial state guarantee on new loan facilities for up to 75% of the value. The scheme seeks to address the problem of inadequate collateral in some SMEs and is expected to facilitate new lending of up to EUR 150 million per annum. The microfinance fund is targeted at small start-ups, providing loans of up to EUR 25,000, with the government supplying seed capital of EUR 10 million. Going forward this amount is intended to be further supplemented by private sources, including banks.

[3] SBA Factsheet 2010/2011, European Commission: http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2010-2011/ireland_en.pdf

Table 1: Deleveraging at covered banks by end-2011 (EUR billion)

	Asset disposals	Net amortisation	Impairments	FX & other adjustment	Total
BOI	7.9	6.4	1.5	-1.6	14.2
AIB	6.8	6.1	7.6	-1.1	19.4
ILP	0.0	1.6	1.4	-0.2	2.8
Total	14.7	14.1	10.5	-2.9	36.4

Source: Central Bank of Ireland; covered banks' deleveraging plans.
Notes: Total deleveraging reflects net loan balance reduction, including in banks' core portfolios.

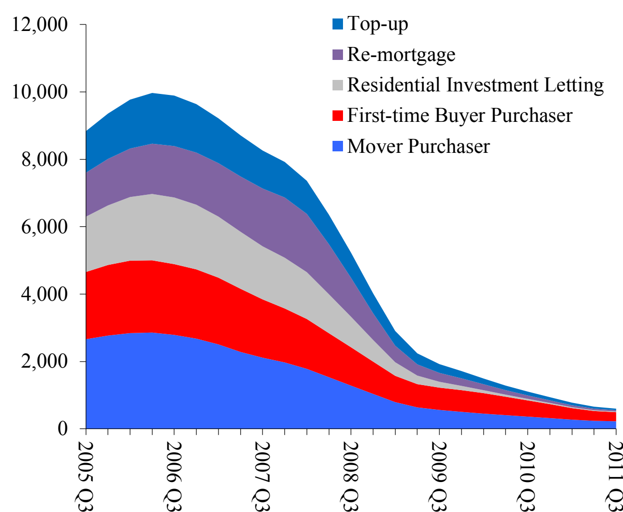
Lending to the domestic private sector by resident credit institutions is contracting, though signs of stabilisation in the credit extended to SMEs are emerging. At about EUR 27 billion by end 2011, the stock of lending to indigenous SMEs[4] was down by about 19.5% relative to the first quarter of 2010. This is likely to reflect both tightened lending conditions and weak loan demand. Nevertheless, the stock of credit to indigenous SMEs was largely flat in 2011, with gross new lending amounting to over EUR 2 billion, including as a result of specific government initiatives (Box 1). Credit extension to households for house purchase continues to decrease, with gross new mortgage lending down by about 94% from its peak in 2006 (Figure 9). In terms of mortgage rates, some banks have passed the reduction in ECB policy rates on to mortgage debtors, with the weighted average interest rate on outstanding mortgages with original maturity over five years (accounting for 99% of outstanding mortgage loans) down to 2.98% by end March 2012, from a high of 3.42% in September 2011. However, interest rates on new mortgage loans have increased slightly in the first quarter of 2012 (from 3.12% in December to 3.25% in March).

The quality of bank loan portfolios continues to deteriorate. Owner occupier mortgage arrears of over 90 days past-due reached almost EUR 15.4 billion (Figure 10), or about 13.7% of Irish banks' principal dwelling mortgage loan book at end-March 2012, of which more than two/thirds were in arrears of 180 days. However, the pace of increase of mortgage arrears (in terms of balances) appears to have modestly slowed down in recent months, with a q-o-q increase of 1.3% recorded in the first quarter of 2012, down from 1.5% in the fourth quarter and 1.4% in the third quarter of 2011. Banks' commercial real estate portfolios, as well as business and SME loans, have also continued to

[4] Unless otherwise specified, references to indigenous SMEs reflect data for Irish-resident firms from all sectors, excluding financial intermediation and construction/property.

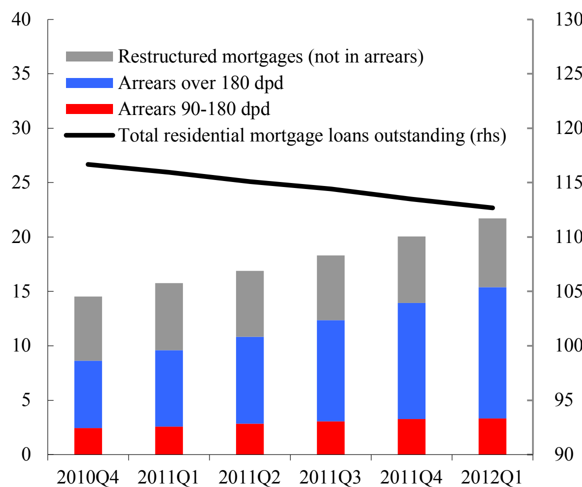
deteriorate (Figure 11) in a context where some macroeconomic variables are projected to be closer to the PCAR adverse rather than base-case scenario (bolded in Table 3 below). Banks have also expressed concerns linked to the potential for uncertainty with regard to the planned changes to the personal insolvency regime (see section 4.3) affecting borrower behaviour.

Figure 9: Gross new mortgage lending by type (4QMA, EUR billion)



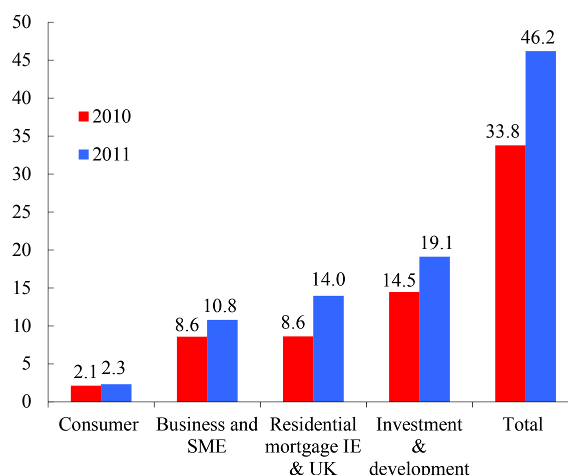
Source: Irish Banking Federation

Figure 10: Mortgage loan balances, arrears and restructurings (EUR billion)



Source: Central Bank of Ireland

Figure 11: NPL evolution by business segment (EUR billion)



Source: Central Bank of Ireland

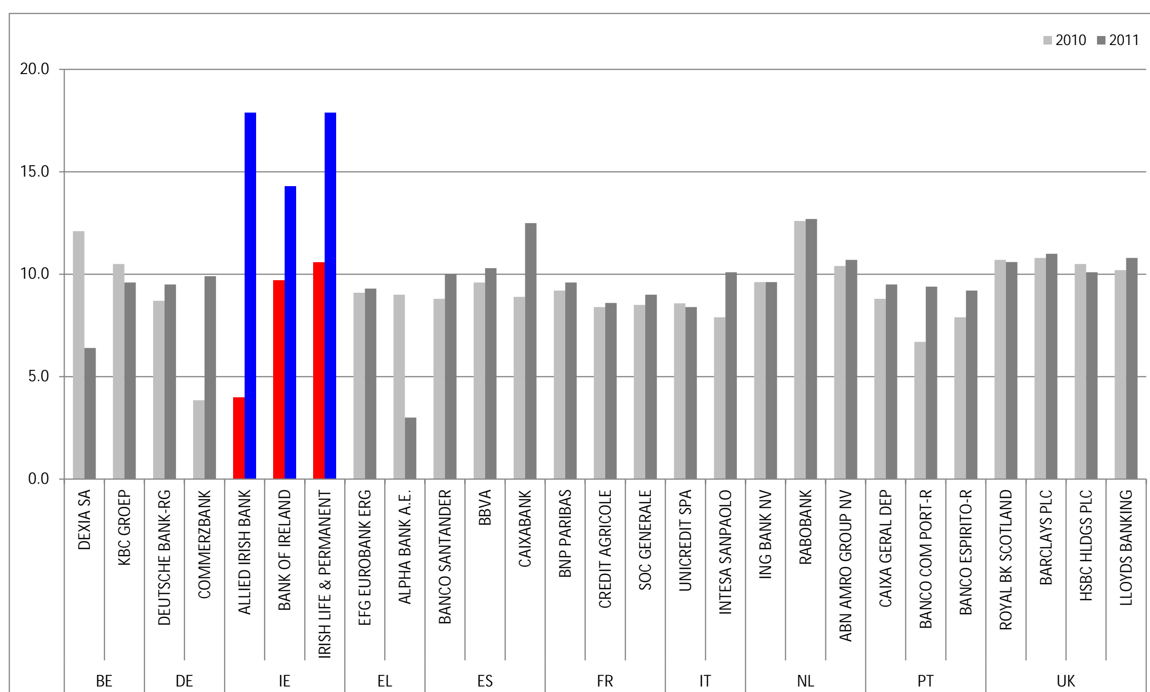
Capital developments at covered banks in 2011 have been broadly in line with the levels assumed under PCAR. Asset disposals were completed at discounts mostly within base-case forecasts, resulting in a broadly neutral aggregate capital impact. At the same time, changes to recognition requirements for impairment losses and provisions, introduced by the Central Bank in late 2011, ha ve contributed to some capital consumption at covered banks, as they front-loaded provisions in their core portfolios (core provisions exceeded PCAR/PLAR forecasts by some EUR 3.6 billion in 2011). Other factors, such as the prevailing low interest-rate environment (compressing banks' interest income) and the persistently high cost of funding (deposits and wholesale), have also had an adverse effect on banks' Core Tier 1 ratios. While the continued deterioration in asset quality has also contributed to some capital consumption, overall domestic banks' Core Tier 1 r atios are still among the highest in Europe (Figure 12) and banks are significantly better capitalised than in December 2010 a s a result of successive bank recapitalisations (from both public and private sources) and successful liability management exercises (Table 2**).**

Table 2: Core Tier 1 ratios at covered banks

	Actual Core Tier 1 Ratio - Dec 2010	Actual Core Tier 1 Ratio - Dec 2011
AIB	4.44%	16.98%
BOI	8.50%	14.30%
ILP	7.73%	18.69%

Source: Central Bank of Ireland

Figure 12: Core Tier 1 ratios in select European and Irish banks (%)



Source: Bloomberg, Banks' 2011 Annual Reports.
Note: Sample includes largest banks in the euro area and the UK.

Box 2: Economic developments vis-à-vis 2011 PCAR assumptions

Performance to date of the key macroeconomic variables underpinning the PCAR 2011 stress-testing exercise has been mixed (Table 3). The outturn for real GDP in 2011 was close to the baseline scenario, although the real GDP growth outlook for 2012-2013 is now less benign. Unemployment is higher than expected under the baseline, which may have implications for NPLs. House prices fell in line with the baseline scenario in 2011. Some recent data seem more benign, and anecdotal evidence suggests stabilisation in some segments.

Table 3: Comparison of key forecasts with PCAR 2011 scenarios

Scenario	PCAR 2011 Baseline			PCAR 2011 Adverse			Sixth Review Forecast		
Year	2011	2012	2013	2011	2012	2013	2011	2012	2013
GDP	0.9	1.9	2.5	-1.6	0.3	1.4	0.7	**0.5**	**1.9**
Unemployment rate	13.4	12.7	11.5	14.9	15.8	15.6	**14.4**	**14.3**	**13.6**
House prices	-13.4	-14.4	0.5	-17.4	-18.8	0.5	-13.2	n/a	n/a
HICP	0.4	0.6	1.6	0.1	0.6	1.0	1.2	1.7	**1.2**

3 Programme implementation

Programme implementation remains strong overall:

- The quantitative fiscal targets for end-2011 and end-March 2012 were met and the fiscal projections remain within the EDP path. In particular:
  - For 2011 as a whole, the latest EDP notification shows a headline general government deficit of 13.1% of GDP, while the underlying deficit excluding deficit-increasing bank support measures (Box 3) is 9.4% of GDP,[5] significantly smaller than estimated by Commission Services as of the fifth review (9.9% of GDP). This difference reflects both a cautious assessment, as of the 5th review, of the general government balance based on end-2011 central government cash returns (with an improvement of the cash-accrual adjustment accounting for 0.4 pps of GDP) and a positive revision to the local government balance (0.1 pp). Unanticipated under-spending at the line ministerial level and lower interest bill account for the rest of the positive surprise. Overall, the 2011 performance demonstrates a continued robust expenditure control and prudent design of the budget. These, together with savings on the interest bill (following reductions in margins on EU loans), outweighed the effect of the weaker macroeconomic backdrop.
  - Fiscal performance was in line or slightly better than programmed also thus far in 2012. Central government cash data for the first four months of 2012 suggests that the central government overall balance has been broadly as forecast, as solid revenue performance is offset by some expenditure overruns, some of which reflect timing issues, and with the remainder potentially requiring offsetting savings across other areas if the aggregate expenditure target is to be met.
- Several programme milestones for the first quarter of 2012 have been achieved. In particular:

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[5] Recall that one-off bank support is excluded from the assessment of compliance with the programme's deficit targets.

- *Financial sector*: A preliminary proposal to restructure PTSB, the banking arm of ILP, was prepared by the authorities, and submitted to the troika (see below). The focus will now shift towards the bank's revised restructuring plan, which is to be submitted to the Commission (DG Competition) by end-June.
- *Structural reforms*:
  - The strengthened Competition (Amendment) Bill allowing commitments by an undertaking to the Competition Authority (CA) to be made a rule of court has been introduced as a legislative amendment to parliament. Moreover, following a review of the resourcing of the CA to improve its enforcement capacity, the authorities have decided to increase the CA's staffing levels by 25%.
  - The Department of Social Protection has submitted a report to Government outlining a comprehensive programme of reforms that can help better target social support payments to those with lower incomes, and reduce any disincentive to take up work/training, including the proposed introduction of the single working age assistance payment. In this respect, an external evaluation of the data required for the evaluation of the activation and training policies was commissioned and published[6] and an action plan was compiled to address the recommendations of the evaluation.
  - A government plan was submitted to the programme partners detailing the envisaged steps towards the establishment of a new public water utility and the introduction of metering/domestic water charges.

- In a few cases, the authorities have requested additional time to complete envisaged milestones. Commission Services consider that these delays are both justified by intervening developments and/or the complexity of the issues at stake and do not compromise the ultimate achievement of the programme's objectives in the relevant areas. This applies for example to:

- The envisaged amendments to the Industrial Relations (Amendment) Bill 2011, expected to be presented by end-April, which have been postponed due to the need for wider consultation. This deadline has now been reset to end-June.[7]
- Legislation to reform the personal insolvency regime, which was meant to be presented by end-April. Draft heads of the bill were published early this year. However, due to the legal and constitutional complexities and to fully take into account the extensive public consultation in relation to the draft heads of the Bill, more time was required (see below). The drafting is at an advanced stage and the government now anticipates that the legislation will be published before the summer recess of the Oireachtas.

- The authorities have proposed to align the timing of the next PCAR exercise with the EBA calendar, which means that it will take place in 2013. Aligning the stress test would avoid any confusion between the two exercises that would result if they were carried out with possibly significantly different assumptions and scenarios. The troika support this re-phasing, stressing that the PCAR's strengths and rigour should be preserved, including through robust loan-loss forecasts and a high level of transparency. As discussed below, the authorities plan to carry out valuable work-streams during 2012 that will provide quantitative and methodological inputs into the next PCAR exercise. It needs to be kept in mind that the 2011 PCAR had provided banks with sizeable capital buffers (to the tune of about EUR 5 billion). Compliance with the minimum regulatory capital ratio of 10.5% for all PCAR-covered banks (AIB, BOI and PTSB) will continue to be monitored by the Central Bank. Developments relative to PCAR 2011 will be reviewed and the overall results published by the end of 2012.

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[6] http://www.welfare.ie/EN/Policy/ResearchSurveysAndStatistics/Pages/gearyreport.aspx

[7] In the interim, the legal vacuum created by last year's High Court ruling means that new hiring in sectors covered by Employment Regulation Orders (EROs) takes place with the sole floor represented by the national minimum wage.

Box 3: One-off bank support measures in 2011

In accordance with PCAR 2011 requirements, the government injected EUR 16.5 billion into domestically-owned banks, of which EUR 5.8 billion (3.7% of GDP) is now reclassified as a general government deficit-increasing non-financial capital transfer (Table 4). This estimate remains preliminary and can still change when the restructuring plans of AIB and ILP are approved by the European Commission (DG Competition). Eurostat has expressed a specific reservation on this issue: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-23042012-AP/EN/2-23042012-AP-EN.PDF.

Table 4: Government capital injections into banks in 2011 (gross), EUR billion

		AIB		ILP		BOI	Total	
Exchequer	Financial	2.5	3.9	2.1	2.7	1.0	5.6	7.6
	Non-financial	1.4		0.6			2.0	
NPRF	Financial	5.0	8.8			1.2	6.2	10.0
	Non-financial	3.8					3.8	
General government / total	Financial	7.5	12.7	2.1	2.7	2.2	11.8	17.6
	Non-financial	5.2		0.6			5.8	

Note: Net capital injections into the banking sector amount to EUR 16.5 billion, as the government has already sold shares in BOI worth slightly more than EUR 1 billion

4 Macroeconomic outlook

Despite the somewhat weaker real growth outturn in 2011, the macroeconomic outlook was kept broadly unchanged relative to the fifth review. Risks mostly stem from continued uncertainty in the euro area and the on-going balance sheet repair at home. On the upside, very low interest rates may ease the burden of household balance adjustment, while strong FDI inflows may boost the export capacity of the economy.

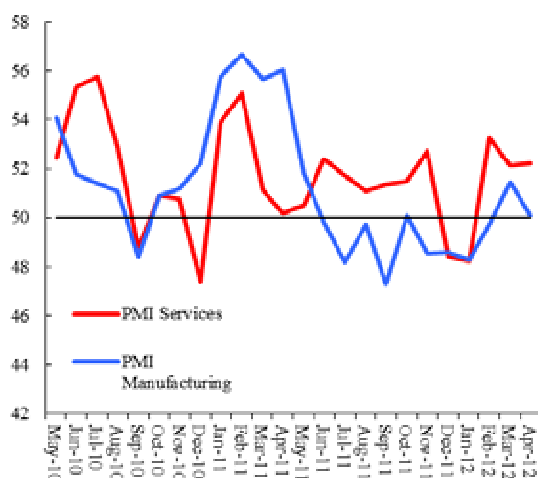
The programme's growth forecast for real GDP in 2012 was kept unchanged at 0.5% (Table 5).[8] Although the real GDP outturn in 2011 was somewhat weaker than anticipated as of the fifth review (+0.7 versus +0.9%), near-term prospects for external demand have improved marginally. The euro area is expected to experience a somewhat shallower contraction (-0.3% versus -0.5% at the time of the previous review), and expectations for US growth have been revised upwards somewhat. High frequency indicators for the first few months of the year support this unchanged outlook (Figure 13). On the positive side, the cash fiscal outturn to end-April was somewhat better than

[8] The authorities' latest projections are broadly in line with those of the Commission Services, especially following their downward revision of the real GDP growth forecast for 2012 (to 0.7% in the April 2012 stability programme update, down from the 1.3% underpinning Budget 2012, which was published in early December 2011).

forecast. The income tax take may be pointing to a stabilisation of employment trends, and Purchasing Managers' Indices (PMIs) in April continue to perform strongly in both manufacturing (50.1) and services (52.2). The latter indicators reflect healthy new export orders, and are noteworthy given the lacklustre performance of PMIs in the rest of the euro area. However, retail sales fell 2.4% quarter-on-quarter in the first quarter of 2012 (though this might in part reflect the spike in consumption seen in December last year in anticipation of January's VAT increase).

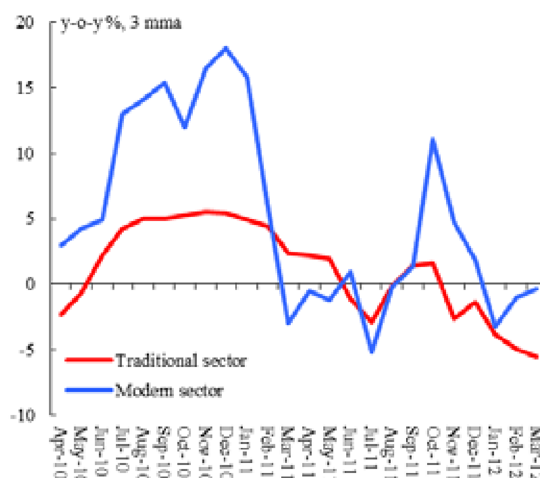
Figure 13: Macroeconomic indicators

PMIs perform strongly in April



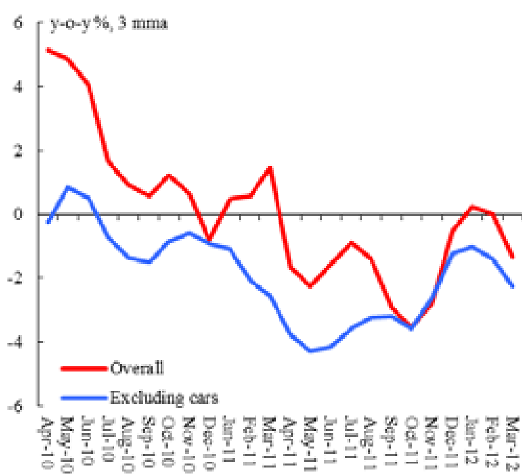
Source: NCB

Industrial production softens in Q1



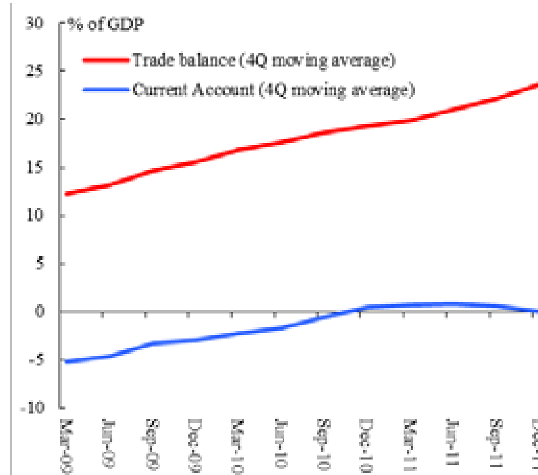
Source: CSO

Retail sales slip in Q1



Source: CSO

Current account stays in balance



Source: CSO

Importantly for its implication on the fiscal outlook, the nominal GDP outlook has been revised upward. This is to take into account the favourable exchange rate developments of late, recently elevated energy prices, and the higher-than-expected growth in nominal GDP in 2011 (by 0.4%).

The outlook for the medium term has also remained broadly unchanged. Between 2013 and 2015 domestic demand is expected to make a small contribution to growth. Private consumption growth will remain low, however, as household deleveraging continues and fiscal consolidation weighs on real incomes. Exports are expected to pick up further in 2013 a nd beyond, on the back of more stable external demand and competitiveness improvements, while the recent uptick in FDI announcements should provide capacity on the supply side. Positive employment growth is expected to resume, resulting in a fall of unemployment to about 12½% by 2015, still considerably above the pre-crisis rate of around 4%. Over the medium term core inflationary pressures and wage growth are expected to remain low, enabling the competitiveness adjustments underway to continue, while the current account is likely to reach a surplus of 4% of GDP on the back of an improving trade balance (Table 5).

Table 5: Updated macroeconomic framework

	Staff Current Forecasts			Winter 2011 (fifth review)			Authorities' forecasts (2012 Stability Programme)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
	% change on previous year (unless otherwise specified)								
Real GDP growth	0.7	0.5	1.9	0.9	0.5	2.0	0.7	0.7	2.2
Private consumption	-2.7	-1.7	0.3	-2.8	-1.6	0.5	-2.7	-1.7	0.0
Public consumption	-3.7	-3.8	-2.7	-3.0	-2.4	-1.8	-3.7	-2.2	-2.2
Fixed investment	-10.6	-4.0	1.0	-14.0	-4.6	3.0	-10.6	-2.5	1.5
Domestic demand (contribution)	-3.3	-1.9	-0.2	-3.6	-1.7	0.2	n.a.	-1.5	-0.2
Inventories (contribution)	0.9	0.0	0.0	0.9	0.0	0.0	n.a.	-0.1	0.0
Exports	4.1	3.2	4.2	4.2	2.8	3.8	4.1	3.3	4.3
Imports	-0.7	1.2	3.0	0.8	1.0	2.7	-0.7	1.4	2.6
Net trade (contribution)	4.7	2.3	2.0	3.6	2.2	1.8	n.a.	2.3	2.4
Employment	-2.1	-0.6	0.7	-2.2	-0.8	0.7	-2.1	-0.4	0.8
Unemployment rate (level)	14.4	14.3	13.6	14.3	14.5	13.7	14.4	14.3	13.6
GDP deflator	-0.4	1.2	1.2	-1.0	1.4	1.2	-0.4	0.9	1.0
HICP inflation	1.2	1.7	1.2	1.2	1.6	1.2	1.1	1.8	1.3
Current account (% of GDP)	0.1	1.6	3.1	0.4	1.6	2.1	0.1	1.1	2.2
Nominal GDP (EUR billion)	156.4	159.2	164.2	155.8	158.8	164.0	156.4	158.9	164.2

5 Policy discussions

5.1 Fiscal policy

The authorities are on track to observe the 2012 general government deficit ceiling, although emerging overruns in some spending areas warrant strict monitoring. Staff encouraged the authorities to fully identify the measures to underpin the still-sizeable consolidation requirements over the medium term. Particular attention should be paid to addressing the implications of the demographic dynamics—in the near as well as the long term—and ensuring better targeting of the various components of the social welfare budget, while making efforts to protect the most vulnerable.

The 2012 fiscal deficit is expected to be within the programme ceiling (8.6% of GDP), though some incipient spending pressures require strict monitoring. Commission Services forecast the general government deficit this year at around 8.3% of GDP, in line with the authorities' forecast in the stability programme. This is notably lower than the programme ceiling and the forecasts underpinning the 2012 budget and the fifth review (all equal to 8.6% of GDP). Against a broadly unchanged nominal macro outlook, the projected improvement compared to the fifth review is mainly due to lower interest costs, higher revenues from both bank guarantees and bank dividends (accruing through the National Pensions Reserve Fund, which holds most of government's shares in the Irish banks) and some changes to the forecast reflecting the updated 2011 outturn. Commission Services underscored the need to closely monitor spending areas which are running somewhat ahead of profile (in health and social expenditure). The authorities were confident that mechanisms are in place to ensure that spending in these areas will remain within the allotted budget appropriations and that, if they don't, appropriate savings will be achieved elsewhere.

The authorities remain satisfied that their strategy of reducing the public sector pay-bill through a nominal wage freeze to 2014 and a voluntary reduction in numbers (the so-called 'Croke Park' agreement[9]) will work. A significant number of public

[9] This is an agreement with unions reached in 2010 trading off a series of productivity improvements (including more flexible working arrangements, use of shared services, and greater staff mobility) in exchange for a commitment by the government not to impose further nominal pay cuts.

employees retired by late February from the third quarter of 2011 (9,000, well in excess of the expected 6,000), ahead of the planned closure of a transitional or "grace" period during which benefits were calculated on the basis of public service pay-scale levels prior to the 2010 salary cuts. Commission Services enquired whether a policy of achieving savings by reducing the number of employees, rather than by lowering average wages (which are at high levels by international comparison), could risk jeopardising the delivery of public services. The authorities are confident that a deterioration in service delivery can be avoided and they plan to hire a significant amount of workers to cover any gap, while staying within the envisaged numbers' reduction path. Commission Services stressed that it would be important to ensure that the new hires be subject to the reformed pension regime,[10] whose parliamentary approval should thus be secured as a matter of priority. On the whole, the authorities consider that the Croke Park agreement is delivering the envisaged savings whilst facilitating wider reform of the public sector. Commission Services stressed once again that this should be kept under review, and that should the desired savings not materialise it would be prudent to consider taking additional measures (e.g. revisions to some pay scales and savings in some non-core pay and allowances).

Medium-term (2013-15) fiscal projections remain in line with the programme consolidation objectives (Table 6). The authorities have outlined last November the split between revenue and expenditure of the measures needed to deliver the envisaged consolidation, leading to a deficit below 3% of GDP by 2015. They have however reiterated that they consider it appropriate to identify the remainder of the specific detailed measures to underpin the consolidation only closer to budget time, to take advantage of all the information that might become available until then and to reflect any

[10] Although the Irish authorities had presented to Parliament legislation to enhance the long-term sustainability of the public finances in at end-September2011, as envisaged under the programme, it became clear during this mission that some elements of the envisaged reform have yet to be adopted by Parliament (in particular, as regards pension entitlements for new entrants to the public service, including a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices, the linking of pension benefits to career average earnings and of retirement age to state pension retirement age). The authorities have committed to secure the approval of these provisions before the Dail's summer recess.

updated prioritization of objectives on the part of the government.[11] The authorities at all levels concurred with the need to continue meeting the targets, and do "whatever it takes" to stay within the set programme deficit ceiling should unforeseen risks to the achievement of budgetary targets materialise. Continuing to adhere to the agreed programme deficit targets remains key to further enhancing credibility. Moreover, there is little or no scope for fiscal slippage in case of some growth slowdown, considering that at 8.3% of GDP the expected fiscal deficit target for 2012 is still the largest in the EU. The openness of the economy also implies that, everything else equal, fiscal policy has a more limited impact on economic activity in both directions than in more closed economies, as the import content of public and private consumption and investment is high.

Yet, despite major progress, fiscal consolidation is far from complete. In particular, the fiscal balance presently benefits from a s ome temporary factors (bank guarantee revenue, interest on convertible bonds, bank stock dividends, high central bank dividends (Box 4) low programme interest rates, and expected proceeds from one-off divestitures such as the spectrum auction). This means that, for Ireland to achieve a budgetary position that ensures the sustainability of public finances while allowing room for budgetary manoeuvre once these factors taper off, a substantial additional adjustment will be required. In addition, Ireland is facing significant demographic challenges in the near-term, as a result of fast growth in both its very young and its old age populations and net outward migration (Box 5). The budgetary impact of these developments is intensified by the existence of a host of universally-provided benefits linked to age. To ensure that people most in need can continue to be sufficiently provided for while coping with the increasing budgetary challenges, these benefits should be reviewed and streamlined to allow better targeting to the most vulnerable.

[11] Staff called for the authorities to bring forward the presentation of draft budget to mid-October, in line with the reforms of the European governance under discussion in the context of the so-called "two-pack". The authorities indicated that they stand ready to do so, if the "two-pack" regulation is passed.

Table 6: Ireland—Updated Fiscal Forecast

	2008	2009	2010	2011	2012	2013	2014	2015
			% of GDP					
Indirect taxes	12.3	11.3	11.4	11.5	11.5	11.6	11.8	11.5
Direct taxes	11.5	10.7	10.6	11.7	12.4	12.6	13.0	13.1
Social contributions	6.8	7.5	7.4	6.6	6.3	6.2	6.1	5.9
Sales	2.3	2.7	3.2	3.2	3.0	2.5	2.5	2.4
Other current revenue	1.3	1.3	1.5	1.4	1.5	1.5	1.4	1.3
Total current revenue	**34.3**	**33.5**	**34.1**	**34.4**	**34.7**	**34.5**	**34.7**	**34.3**
Capital transfers received	1.2	1.3	1.5	1.3	1.0	1.1	1.1	1.0
Total revenue	**35.5**	**34.8**	**35.6**	**35.7**	**35.8**	**35.6**	**35.8**	**35.3**
Compensation of employees	11.2	12.2	11.6	11.4	11.2	10.7	10.1	9.7
Intermediate consumption	5.8	6.4	6.2	5.6	5.4	4.9	4.4	4.0
Social transfers in kind via market producers	2.0	2.1	2.1	2.0	1.9	1.7	1.5	1.3
Social transfers other than in kind	12.2	15.2	15.6	15.8	15.5	14.4	13.4	12.8
Interest paid	1.4	2.0	3.1	3.4	4.1	5.6	5.6	5.5
Subsidies	0.5	0.6	0.6	0.4	0.4	0.4	0.3	0.3
Other current expenditure	2.5	2.8	2.5	2.4	2.3	2.3	2.2	2.1
Total current expenditure	**35.7**	**41.3**	**41.7**	**40.9**	**40.7**	**39.9**	**37.5**	**35.5**
Gross fixed capital formation	5.2	4.0	3.9	3.3	2.7	2.3	2.1	2.0
Other capital expenditure	1.9	3.6	21.2	4.5	0.6	0.9	0.9	0.7
Total expenditure	**42.8**	**48.8**	**66.8**	**48.8**	**44.1**	**43.1**	**40.6**	**38.3**
General Government balance (EDP)	**-7.3**	**-14.0**	**-31.2**	**-13.1**	**-8.3**	**-7.5**	**-4.8**	**-2.9**
			EUR billion					
Indirect taxes	22.2	18.2	17.8	18.0	18.3	19.1	20.2	20.6
Direct taxes	20.7	17.2	16.5	18.3	19.8	20.7	22.2	23.5
Social contributions	12.2	12.0	11.6	10.3	10.1	10.2	10.4	10.6
Sales	4.2	4.4	5.1	4.9	4.7	4.2	4.3	4.3
Other current revenue	2.4	2.1	2.3	2.1	2.4	2.5	2.3	2.3
Total current revenue	**61.7**	**53.9**	**53.2**	**53.8**	**55.3**	**56.6**	**59.4**	**61.3**
Capital transfers received	2.2	2.0	2.3	2.1	1.7	1.8	1.8	1.8
Total revenue	**63.9**	**55.9**	**55.6**	**55.8**	**57.0**	**58.4**	**61.2**	**63.1**
Compensation of employees	20.2	19.6	18.2	17.9	17.8	17.6	17.3	17.3
Intermediate consumption	10.5	10.2	9.6	8.7	8.6	8.1	7.6	7.1
Social transfers in kind via market producers	3.6	3.4	3.3	3.2	3.0	2.7	2.5	2.3
Social transfers other than in kind	22.0	24.4	24.4	24.7	24.6	23.7	22.9	22.8
Interest paid	2.5	3.3	4.9	5.4	6.5	9.1	9.6	9.8
Subsidies	0.9	0.9	0.9	0.6	0.6	0.6	0.6	0.5
Other current expenditure	4.6	4.5	3.9	3.7	3.7	3.7	3.7	3.7
Total current expenditure	**64.2**	**66.3**	**65.0**	**64.0**	**64.8**	**65.6**	**64.2**	**63.5**
Gross fixed capital formation	9.4	6.4	6.1	5.2	4.3	3.7	3.6	3.6
Other capital expenditure	3.4	5.8	33.0	7.0	1.0	1.4	1.5	1.3
Total expenditure	**77.1**	**78.4**	**104.2**	**76.4**	**70.2**	**70.7**	**69.4**	**68.4**
General Government balance (EDP)	**-13.2**	**-22.5**	**-48.6**	**-20.5**	**-13.2**	**-12.4**	**-8.2**	**-5.3**

Box 4: Banking sector-related non-tax revenue

While Ireland's fiscal position has been significantly negatively affected by the banking crisis, it has also indirectly benefited from some of the bank support measures which generate non-tax revenues for the government. These have increased from some 0.1% of GDP in 2008 to 1.7% of GDP in 2012, but are expected to decline over the forecast period and can cease even earlier as the exceptional financial crisis measures are withdrawn. Table 7 below shows government revenue from these measures as incorporated in the fiscal projections.

Table 7: Banking sector-related non-tax revenue

	2008	2009	2010	2011	2012
	EUR billion				
Bank guarantee fees	0.1	0.4	1.1	1.2	0.9
Preference shared dividends		0.4	0.5	0.5	0.5
Dividends from CBI			0.2	0.6	1.0
CoCo dividend				0.1	0.3
Total	0.1	0.8	1.8	2.4	2.6
% of GDP	*0.1*	*0.5*	*1.1*	*1.5*	*1.7*

The main sources of revenue are:

- **Fees on bank guarantees.** These compensate the government for the increased interest rates resulting from its increased contingent liabilities. These revenue increased between 2008 and 2012 as a result of the increased premia (reflecting the downgrades of the beneficiary banks and an increase in fee costs to discourage banks form using this exceptional state support), while the total amount of guaranteed liabilities has been declining. The expected end of the guarantee scheme in 2012 could lead to a rapid decline in fee revenue as guaranteed liabilities mature.

- **Income on preference shares**. The government holds preference shares in BoI (EUR 1.8 billion) and AIB (EUR 3.5 billion). These have a fixed coupon of 10.25% and 8.0%, respectively. The related coupon payments since issue covering the 2009-11 period were paid in shares (four) and in cash (two), as banks had losses. Shares are valued at average price of thinly traded shares of the banks.[12] The preference shares are projected to last over the forecast period, but can be redeemed by banks earlier resulting in higher one-off revenue.

- **Higher dividends from the Central Bank of Ireland (CBI),** including as a result of the increased provision of funding to domestic banks at a margin over the main ECB refinancing rate. These dividends are expected to gradually decline over the forecast period.

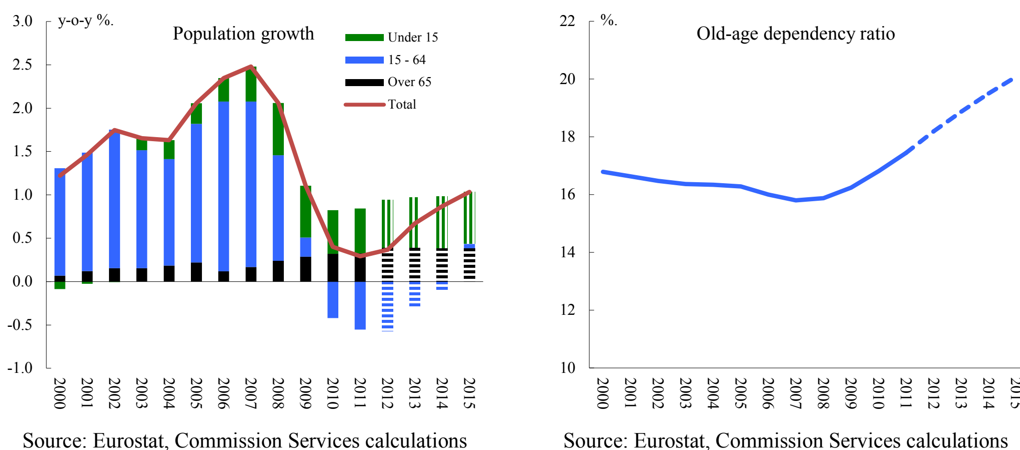
- **Income from contingent capital contributions in the context of the PCAR 2011 recapitalisation (so-called "CoCos").** The CoCos generate a fixed income of 10% per annum (i.e., EUR 300 million on a face value of EUR 3 billion) until the instruments mature in 2016.

[12] The issue of valuation, and a potential capital transfer element, will be further discussed with the Irish statistical authorities.

Box 5: Near-term demographic fiscal challenges

Large fiscal pressures stemming from demographic trends will require difficult policy choices in the short run. Annual growth in the over-65 population is running at about 3% per annum while the working-age (15-64) population is shrinking. The decline in the working age population is driven by net outward migration, estimated at about 1% of the relevant population in 2011. Although net outward migration is a cyclical phenomenon and is forecast to return to zero by 2015, the old age dependency ratio (i.e., the ratio of over 65s in the population to the number aged between 15 and 64) is set to rise sharply from 16% in 2006 to over 20% in 2016. Growth in the elderly population presents particular challenges for expenditure policy given that both social supports and health expenditure tend to be demand-led and non-discretionary in nature. In its last sustainability assessment (2009) the European Commission found that Ireland's public finances were at high long-term risk due primarily to pension costs. Despite significant pension reforms in recent years, the prospective increase in ageing-related costs continues to represent a key challenge for Ireland.

Figure 14: Population growth by age group and old-age dependency ratio[13]



Source: Eurostat, Commission Services calculations

Source: Eurostat, Commission Services calculations

Ireland provides a range of social support schemes which have the potential to heighten the challenges from the ageing population. These schemes include electricity/gas allowances, free TV license, free public transport, and telephone allowance, and cost about 0.3% of GDP annually (Table 8 below). In addition to some disadvantaged groups (e.g., disabled, carers), and subject to certain household conditions, support under these schemes is provided to all over-70s on a universal basis and to some 66-70 year olds on a means-tested basis (see below). Although there has been some downward adjustment in payment rates on these schemes in recent years, better calibration of these social supports toward those most in need may be required to meet the dual goals of protecting the most vulnerable and ensuring fiscal sustainability given these demographic pressures.

The currently high birth rate will create need for additional places at primary education level in the short run and at secondary level by the end of the decade. Ireland's total fertility rate has risen noticeably in recent years and in 2010 was almost at replacement level of 2.1. As a result the under-15 population is set to grow by about 2% per annum in the years to 2016. To cope with demand, authorities have made provision for the construction of new schools in areas of greatest need. Throughout the education sector resources will have to be used efficiently to ensure service delivery in the most effective manner, given that pay accounts for about 80% of

[13] Estimates of the level and composition of Irish population may be revised after the final outturn of the most recent census taken in April 2011.

current education spending. Aside from education, the other main fiscal pressure from the baby boom is the rise in demand for child benefit. The rate of payment stands at €140 per child per month (1.3% of GDP per annum in total). Currently child benefit in Ireland is a universal payment, not means-tested and untaxed. Better targeting could contain fiscal costs while ensuring that adequate child income support is channelled toward the most vulnerable families.

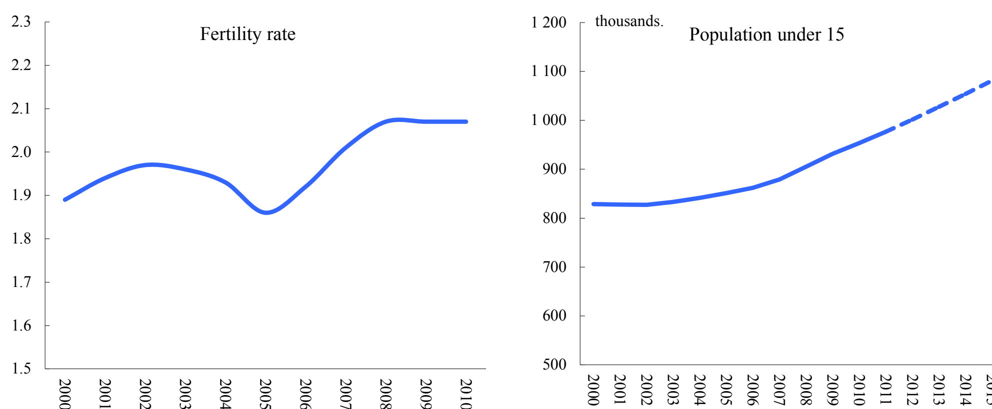
Table 8: Age-related social expenditure

Scheme	Total 2011 cost 1/ (EUR m)	Eligibility	
		66-69	Over 70s
Electricity/Gas allowance	200	Means-tested	Universal
Telephone	112	Means-tested	Universal
TV licence	58	Means-tested	Universal
Free travel	76	Universal	Universal
Total	446		

Source: Staff elaboration based on data from the Comprehensive Review of Expenditure (Department of Social Protection)

Note: 1/Includes cost also for under-66 beneficiaries

Figure 15: Total fertility rate and population under 15



Source: Eurostat,

Source: Eurostat, Commission Services calculations

Efforts to further strengthen the fiscal framework continue. A draft fiscal responsibility bill was published as part of the documentation associated with the end-May referendum which, besides transposing into Irish legislation the so-called Fiscal Compact in case the referendum expresses people's support for it, would also provide a legal basis for the recently-established IFAC, as well as assure its financial and functional independence, including through greater Parliamentary involvement in matters of dismissals, etc. The authorities plan to covering the other reforms envisaged in this area (mainly, the expenditure ceilings) in a separate piece of legislation, which is to be published by end-September.

Commission Services encouraged the authorities to introduce further improvements to current fiscal reporting practices. Specifically, the mission recommended that the authorities break down monthly expenditure reports by economic categories, provide analysis of outturns relative to projections for the entire fiscal balance,[14] and report regularly on a general government basis. The authorities were in agreement in principle, though they also pointed out that a careful data quality assessment is necessary before adopting new reporting standards. As a next step it was agreed that the authorities and staff from the troika would work together to identify suitable templates.

5.2 Financial sector policies

Progress continues to be made, though critical challenges remain, associated with underpinning the return of state-owned banks to profitability, reducing their reliance on central bank funding, and ensuring that they are in a position to support the nascent recovery by extending new credit to the private sector. Discussions focused on the future of PTSB, necessary improvements in banks' strategies to address mortgage arrears, progress on the restructuring of the credit union sector, possible modifications to the monitoring framework for bank deleveraging, the reform of the personal insolvency regime, and the preparations for the next stress test exercise, which will be aligned with the EBA timeline (thus, it will take place in 2013).

A strategic decision on the future of PTSB has been reached, reflecting the assessment that a profitable streamlined retail bank may be obtained by a thorough restructuring of the bank's operations and a separation of legacy loss-making assets. After considering a number of additional alternatives, taking account of the overarching objectives of safeguarding financial stability, containing fiscal costs, strengthening competition, and preserving value for the state and taxpayers, it was determined that maintaining PTSB as a going concern and ring-fencing selected structurally loss-making and low-quality legacy assets for work-out over time was the best solution (Box 6). PTSB's new management presented the broad contours of their restructuring strategy, including significant reduction of operating costs. Based on a granular analysis of the loan

[14] Currently only tax revenue, interest expenditure and ministerial net spending positions on cash basis are covered by this analysis.

book, a "good bank" has been identified, which would focus primarily on mortgages, consumer lending, deposits and current accounts and aim to return to profitability over the next few years. The bank's UK buy-to-let business (CHL) will also remain and continue to manage its assets for value while optimising new lending and seeking an exit as the EU economy recovers. The legacy assets would be ring-fenced into a d edicated strategic business unit, tasked with their work-out over time, which is envisaged to be legally separated in due course. The authorities and the staff of the Troika found merit in the plan and a further in-depth assessment of its operational and financial feasibility will be performed over coming months, also in the context of the revised restructuring plan for ILP, which is due to be submitted to the European Commission (Directorate-General for Competition) by end June.

The process leading to the recapitalization of ILP is continuing. A direction order had been issued by the High Court approving the purchase of Irish Life by the state and allowing for the completion of the recapitalization of ILP**.** A number of legal challenges have since been launched against the State by shareholders in the group, which could lead to a delay to the expected completion of ILP's recapitalisation by end-June. The government will continue to work towards selling Irish Life as soon as market conditions permit.[15]

Under a new management team, AIB's restructuring plan is also being updated to enhance revenue, reduce costs, and restructure operations. Deficiencies in mortgage arrears resolution strategies and operational inefficiencies need to be adequately addressed to underpin AIB's timely return to profitability. The plan will be submitted to the European Commission (Directorate-General for Competition) by end September and assessed in the context of the eight review in October.

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[15] As a result of the government's recapitalization of ILP in July 2011, the government had become the beneficial owner of ILP's shareholdings in NAMAIL, the special purpose vehicle owning NAMA. Thus, NAMA had since been no longer in majority private ownership. For this reason, EUROSTAT's EDP returns published on April 23 included a reservation on Ireland's gross debt figure, to the effect that failure to return NAMA into private ownership momentarily would result in NAMA being reclassified into the general government accounts. The government has since confirmed that a sale of ILP's shareholdings of NAMAIL to a p rivate investor has been agreed. Eurostat expects further information from the Irish statistical authorities when the sale is completed. If this resolves the matter of NAMAIL ownership, Eurostat will publicly announce the lifting of the reservation..

Box 6: A strategic decision for the future of Permanent TSB

The legacy structurally loss-making assets represent a considerable drag on PTSB's profitability in the medium term. Accounting for about half of PTSB's balance sheet, the 'tracker' mortgage portfolio was aggressively ramped-up during the property market boom in 2004-8, and its low average yield (reflecting a small margin over the main ECB refinancing rate) implies insufficient interest income in an environment of rising cost of funding. In addition, if not adequately addressed, growing non-performing loans on PTSB's balance sheet could contribute to the erosion of the considerable capital injected into the bank following PCAR 2011. As a result, a strategic plan underpinning PTSB's long-term viability necessarily includes the segregation of structurally loss-making and low-quality assets, reinforced by more effective strategies for addressing arrears.

A wind-down of the bank was not considered a viable alternative, given the adverse effects this could have had on financial stability, fiscal costs, and competition. The potential capital shortfall associated with disposing of PTSB's portfolio would vary depending on the time horizon over which this is performed, and on prevailing market conditions at the time of sale. The low net present value of long-dated, low-yielding assets, in addition to the liquidity premium appropriate for such assets, would result in significant capital shortfalls upon sale, so any wind-down solution would need to involve gradual run-down over time, rather than outright disposals. However, in the absence of a long-term funding solution for the wind-down period, fiscal costs would be significant. In addition, an announcement of the bank's wind-down could have severely damaged financial stability, leading to adverse customer reactions which in turn could have produced further arrears in PTSB's mortgage portfolio and deposit attrition in favour of non-domestic banks. In such a scenario, funding and capital requirements for the wind-down vehicle and fiscal costs would have been even higher. A potential exit of PTSB from the market would also have reduced competition in a system already dominated by the two pillar banks (which account for about 70% of the market in most business segments). A potential alternative involving the merger of part of PTSB with another domestic bank was also not considered feasible, given considerable execution risks and adverse implications for financial stability (including through significant expected deposit attrition, which could also have created a considerable funding gap for the combined entity), as well as competition.

Maintaining PTSB as a well-governed, mainstream retail bank with a considerably reduced balance sheet over time would mitigate most of the aforementioned risks. The segregation of selected low-yielding and low-quality assets could create a profitable and viable "good bank", allowing it to capitalise on its strong branch network and brand to become a credible player in the Irish retail market. The entity's profitability is envisaged to be supported by improved margins on new business, reduced deposit rates, reinforced mortgage arrears resolution strategies, and the rationalisation of costs. The bank would rely predominantly on deposit funding and is expected to become profitable in the medium-term, potentially becoming an attractive acquisition target in due course. Restoring PTSB to private ownership could thus potentially recover some value for the state and taxpayers, whilst in a potential wind-down scenario such value would certainly have been foregone.

However, this course of action is not without risks. In particular, the timely return to profitability of the bank on consolidated basis (including the legacy low-yielding and low-quality assets) cannot be taken for granted, and is contingent on securing an adequate net interest margin and avoiding substantial further deterioration of asset quality in the "good bank". These risks will be assessed in the context of the revised restructuring plan to be submitted by the bank by end June.

The authorities are stepping up efforts to improve banks' approaches to dealing with mortgage arrears. The CBI has completed a review of banks' mortgage arrears resolution strategies and has identified systemic deficiencies (related to collections, servicing and restructuring policies), in line with similar findings of an independent review performed within the framework of the 2012 Financial Measures Programme. Banks have been requested to address the identified shortcomings. Progress in this area will be monitored by the CBI against identified key performance indicators. Banks are also in the process of launching and completing pilot schemes of various loan restructuring options (e.g. trade-down mortgage, mortgage-to-rent, split mortgage, etc.), as recommended by the Inter-Departmental Mortgage Arrears Working Group, and developing a fully operational menu of available loan work-out options by end 2012. The CBI has also recently issued guidance to banks under the Code of Conduct for Mortgage Arrears (CCMA), clarifying the specific requirements for contacting debtors, with the aim of promoting more effective dialogue between lenders and borrowers in payment difficulties. Progress with removing existing legal impediments to creditors' ability to effectively realise their collateral, including through repossessions, will be closely monitored in the context of future reviews.

Possible modifications to the monitoring framework for bank deleveraging were discussed and a decision on the matter is planned for the next review. This would allow sufficient time for the authorities to adequately calibrate net stable funding ratio (NSFR) goals for banks, also in the context of potential changes to banks' balance sheets in coming months. Given the possibility of potentially replacing loan-to deposit ratios (LDR) as the key liquidity metric assessed under the programme, the set NSFR goals need to ensure consistency with the current LDR-based monitoring framework. Disposals of non-core assets in bank portfolios would continue to be monitored in nominal terms, in accordance with previously set targets.

Turning to Credit Unions, the dedicated Commission has published its report on 18 April, and has advocated a voluntary restructuring and consolidation of the sector. The amount of capital that would be required for restructuring would be determined once the situation of all participating credit unions is assessed over the coming months. Public funds would be used as a last resort only after resources from within the sector (including from the savings protection scheme and available excess capital in participating credit unions) have been drawn on, and would be recoupable through a levy over time. As

regards resolution of the most troubled credit unions, the government has set aside EUR 250 million in a credit union resolution fund and announced that a further EUR 250 million would be available in 2012, though so far no outlays have been incurred as several recapitalisations have been completed using resources from within the sector. The CBI has undertaken resolution action on one large credit union, which was identified as not meeting its minimum regulatory reserve requirements. In January 2012 the CBI appointed a Special Manager who was directed to undertake, inter alia, a review of the credit union's loan portfolio, with particular emphasis on arrears, provisions and security, with a view to ascertaining its financial position.

Commission Services noted that the timeline envisaged in the Commission report (up to 4 years) appeared unnecessarily long, and that genuine restructuring might prove elusive under a fully voluntary scheme. The authorities, however, consider that the report sets out the best strategy to restructure this important sector of Ireland's financial and social landscape. In particular, they are confident that the advocated pace is appropriate, including from the perspective of safeguarding financial stability, and that the voluntary element is essential to secure the buy-in of the sector and thus the success of this critical reform. In any case, the authorities noted that the CBI will in parallel continue to monitor individual weak credit unions, and remains entitled to take any necessary steps to safeguard financial stability, including through intervention and resolution. The authorities committed to appoint without delay the restructuring board envisaged by the report, so that a clear plan identifying credit unions appropriate for restructuring, subject to CBI regulatory approval, can be set out in a timely manner.

In view of the comprehensive legislative recommendations put forward by the Commission on Credit Unions, some modification of the programme deadlines in this area proved necessary. Specifically, while the legislation to establish the levy on the financial sector to recoup over time the public resources contributed to the Credit Union Resolution Fund should still be published by end-September, the deadline to publish legislation to strengthen the Credit Unions' regulatory framework—with particular emphasis on enhancing governance and prudential requirements—was postponed to end-September (from end-June).

The publication of the envisaged reform of the personal insolvency regime has also been delayed, as further legal analysis was necessary to address the complexities

associated with the proposed introduction of out-of-court debt settlement procedures and in order to fully take account of the extensive submissions that arose from the public consultation exercise in relation to the draft heads of the Bill published in January 2012**.** As reported in the context of the previous review,[16] the authorities intend to establish avenues for out-of-court debt settlement and to reform the bankruptcy regime to align more closely the automatic discharge period (presently 12 years in Ireland) with practices elsewhere (in the UK, for example, this is one year). Commission Services underscored the importance of appropriately framing the scope of proposed personal insolvency arrangements (which will address both unsecured and secured debts over a period of up to 6/7 years), taking account of their linkages with bankruptcy legislation and mortgage arrears resolution strategies for banks. Although the underlying principle of the reform is that out-of-court restructuring would be the result of a process voluntarily entered into by both the debtor and the creditor(s), the draft heads of the bill published in January envisaged that a debt settlement arrangement (which will address unsecured debts over a period of up to 5/6 years) and a personal insolvency arrangement can be put in place against a (minority) creditor's will if a qualified majority of other creditors so agrees. However, there are a range of protections for creditors (including specific protections for secured creditors) and the authorities are working to ensure that the draft law strikes the right balance between facilitating restructuring of unsustainable debt burdens and safeguarding creditor rights, including through adequate recourse to the courts where appropriate. The authorities have thus requested to postpone the programme deadline for publication of the bill (end-April) by several weeks, with introduction to the Oireachtas now envisaged before the summer recess. Commission Services consider that the Bill ensures an appropriate balancing of debtor and creditor rights, consistent with Irish legal and constitutional requirements, and as such have acquiesced to the authorities' request for a minor delay. At the same time, they underscored that the uncertainty associated with the precise features of the reformed regime should be resolved as soon as possible, to avoid providing incentives for debtors to opportunistically fall behind schedule on their repayments (although it is noted that the strict access criteria of the out-of-court debt settlement processes will seek to ensure that only honest but unfortunately insolvent debtors will be eligible).

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[16] See Economic Adjustment Programme for Ireland — Winter 2011 Review, page 26.

Careful preparation is required to ensure that the infrastructure that will support the revised personal insolvency regime is put in place in a timely manner. The authorities are prioritising the set-up of the Insolvency Service, including the establishment of appropriate procedures for the licensing and appointing of insolvency practitioners. They anticipate that the legislation would become fully operational early in 2013, if it is enacted by Parliament by the end of this year, and will liaise closely with the European Commission to ensure the consistency of their reform proposals with emerging proposals to reform EU-wide insolvency regulation.

The next PCAR stress test will take place together with the next EBA stress tests in 2013 and would retain the rigour, key methodological features and high degree of transparency of the well-received 2011 PCAR exercise. The rationale behind postponing the stress test (initially envisaged to take place during 2012) was to align the publication of its results with the next EBA exercise and to allow sufficient time to factor in important developments into the loan-loss forecast, including the progress achieved by banks in terms of portfolio resolution, ongoing changes to the bankruptcy framework and personal insolvency legislation, and corrective actions in terms of mortgage arrears resolution strategies and provisioning policies. In preparation, work has already commenced for the completion of an independent asset quality review on banks' loan portfolios, a review of banks' distressed credit operations (to assess the effectiveness of their loan workout practices), and data integrity validation and income recognition for troubled loans and re-aging exercises. This work will inform the next PCAR stress test and the authorities will also provide in the fourth quarter of 2012 an update of banks' performance against certain projections of PCAR 2011.

NAMA continues to make progress with divesting its asset portfolio and improving cash flow generation to redeem debt. Gross cash flows since March 2010 amount to more than EUR 7 billion (the vast majority of which have been realised on foreign assets, mostly in the UK). This cash flow has been deployed to redeem senior NAMA bonds (EUR 1.25 billion), repay advances to the Minister for Finance and provide short-term financing to related entities. The NAMA Board has approved additional EUR 2 billion in senior bond redemptions in 2012 and is currently awaiting authorisation to complete these transactions. According to the NAMA report and unaudited accounts for the fourth quarter of 2011, operating profit has increased to about EUR 1 billion in 2011 (from

EUR 0.3 billion in 2010), while net impairment charges have declined to EUR 810 million, leading to an expected net profit of about EUR 200 million in 2011.

While asset quality and property valuations have declined since acquisition, NAMA pursues initiatives to maximise the value of its portfolio. According to the Agency's last quarterly review for 2011, 20% of its assets were performing as at end-December, down from 23% upon acquisition. Nonetheless, it is possible that the performing assets in its portfolio increase in coming months as agreements on revised business plans are reached with a growing number of borrowers, restoring their capacity to meet debt obligations. Despite deteriorated asset quality and the disposal of income-generating assets (about EUR 5.5 billion), NAMA continues to explore alternative schemes to boost disposals of Irish assets (e.g. deferred payment initiative, vendor financing schemes, etc.) and maximise value from its portfolio. An important initiative in this respect is the recently announced scheme of up to EUR 2 billion in investment over the next 4 years in order to complete certain property developments and projects, enhancing their value and enabling their eventual disposal in due course. Additional efforts continue to be made by NAMA to increase property rental yields and improve rental income collection (about EUR 1 billion of total EUR 1.3 billion interest income in 2011 was interest received in cash, of which about half was generated from Irish assets). However, the Special Report on NAMA of the Comptroller and Auditor General (CAG) published in late May found that rental income was about 26% lower than the amount projected when the assets were transferred mainly due to property holding costs that were not included in the valuation methodology (in accordance with accepted market practices). In addition, the CAG report identified considerable challenges to NAMA's ability to meet its debt redemption targets going forward, owing to deteriorated market conditions for property assets (making future disposals more difficult), risks to rental income collection and further deterioration in property prices affecting collateral values. NAMA's senior bond redemption target of EUR 7.5 billion by 2013 was maintained, though subsequent targets could be revised down reflecting these challenges.

5.3 Structural reforms

Structural reforms continue to progress, though in some cases extensions of the programme timelines has proved necessary.

The timeline for parliamentary examination and approval of the legislation reforming sectoral wage arrangements has been extended slightly. Due to some technical issues, and the additional consultations required to introduce in the draft legislation further welcome changes (e.g., to increase the range of parties that can petition for a ch ange to the REAs), publication of the Government's proposed amendments by end-March proved unfeasible. This is now envisaged to occur by end-June, with the law expected to be enacted by end July. Authorities may also have to take account of a Supreme Court ruling on the constitutionality of registered employment agreements (REAs), which is expected to follow upon a hearing in mid-June.

Welfare reform is acquiring increasing priority given the very high unemployment rate and the increasing share of long-term unemployed. Although, as mentioned above, the pace of employment contraction appears to have slowed significantly in recent months, the share of long-term unemployed is growing and their skills appear to be poorly matched with the present focus by policymakers to attract capital intensive FDI in high-productivity sectors. It is also important to ensure that the welfare system encourages a prompt return to active job search. As mentioned above the authorities have undertaken some steps, most recently by commissioning an independent survey to determine the data requirements necessary to strengthen their activation and training schemes, but further reform measures to increase efficiency and improve targeting are required (Box 7).

Good progress is being made on the reform of the legal services sector. According to the authorities, the issue of independence of the new regulatory authority has been addressed by way of engagement with the legal advocacy agencies (the Law Society and the Bar Council), and amendments have been proposed to eliminate requirements of ministerial consents from the draft. The authorities are working to have the Legal Services (Amendment) Bill finalise parliament committee stage before the summer recess, a further step closer to its eventual passing. Commission Services noted that the bill has a strong civil and commercial orientation. They also urged the authorities to check whether criminal proceedings issues are sufficiently covered, in particular

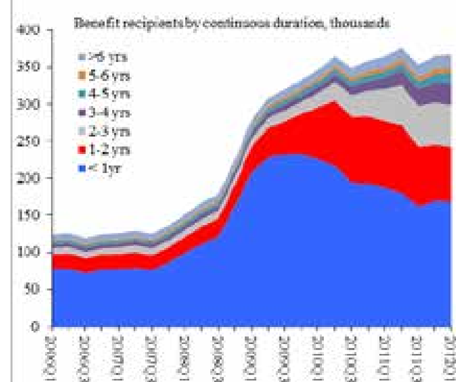
knowledge of members of the Authority and the role of solicitors. To gain the full benefits of the bill and increase the efficiency of justice, the authorities are encouraged to pursue also reforms of the court systems, given that Ireland ranks below average as regards length and costs of contract enforcement in various international surveys.

Box 7: Addressing the challenge of long-term unemployment

Rising long-term unemployment (now at 60%) presents serious policy challenges. While the number of short-term unemployed is slowly reverting to the pre-crisis norms, the stock of long-term unemployed is steadily increasing. A full 18% of recipients have been in receipt of unemployment assistance for 3 *continuous* years or more, with 6% (a full 18,000 persons) in receipt of unemployment assistance for 6 or more years of continuous duration. While demand-side factors are obviously at play, the numbers have increased sharply also due to Ireland's traditionally weak job-search conditionality regime and essentially unlimited duration of unemployment assistance. Growing long-term unemployment has a considerable fiscal cost due to the fact that benefits in Ireland (amounting to about EUR 815 per month, and means-tested after a year) do not decline over time. While recent reforms have resulted in reductions of some benefit rates (around 8%) and the reduction of the duration of payment and tightening of eligibility criteria for jobseeker's benefits, some further calibration of benefits by either age or duration of unemployment might have to be considered. The authorities will also explore the scope for attenuating adverse employment incentives arising from the structure of the social payments through a cross-departmental report (due by end-June 2012).

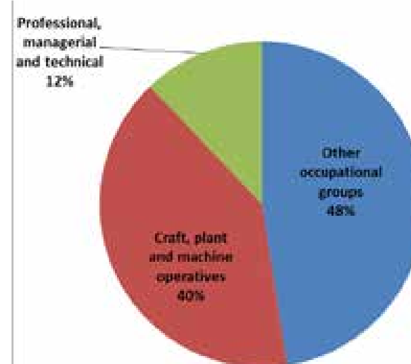
Figure 16: Labour market

Long-term benefit dependence continues to rise



Source: Department of Social Protection

Former construction workers are over-represented on claimant rolls



Source: CSO

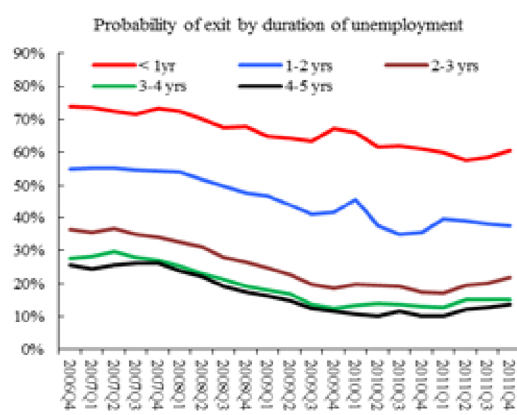
Re-skilling those who formerly worked in the construction sector is also a major task. At end-2011, former craft, plant and machine operatives constituted a full 40% of those seeking employment, having previously worked predominantly in the construction and manufacturing sectors. These two sectors saw a very large contraction in employment between 2008 and 2010 and evidence suggests that the bulk of these workers have not been absorbed elsewhere in the labour market. In contrast, only 12% of those unemployed at end-2011 were previously engaged in managerial, professional, or technical employment. Thus, while the series of strong FDI announcements are welcome, official policy—targeting the creation of high-productivity employment in export-facing sectors—may need to focus more on attracting employment more

suited to the skills profile of the stock of unemployed. Furthermore, vacancy levels are rising in Ireland,[17] pointing to a skills mismatch between the skills demanded by growing sectors and the general skills and education level of the unemployed. This requires effective and efficient systems to ensure that unemployed workers can receive appropriate and timely education and training opportunities. Priority in this area would usefully be given to: (i) integrating the training arm of FAS with the vocational education committee system; (ii) speeding up the announced creation of SOLAS to coordinate the provision of education and training opportunities in cooperation with the new National Employment and Entitlements Service (NEES); (iii) ensuring a heightened link between the workplace and training courses (for example through integrated internships as part of training courses) to maximise their relevance to employers; and (iv) reviewing the operation of the apprenticeship system.

Early activation of the unemployed is essential to ensure that flows from short-term to long term unemployment are reduced. Estimated exit rates in Ireland speak to this fact: benefit recipients for less than a year have currently a 60% higher chance of leaving unemployment than benefit recipients between one and two years. This pre-crisis difference was only 30% in 2007, showing the increased difficulty of finding a job for the long-term unemployed. The exit rates also show that after the second year of receiving unemployment assistance job finding chances decline steeply. Well-designed activation measures should reach the newly unemployed as soon as possible, and their intensity should rise over the duration of the unemployment spell. Only under these conditions can a reduction in long term unemployment be expected when labour demand conditions improve. The government's recently-announced activation and training agenda *Pathways to Work* addresses the right priorities in this regard and swift implementation is now crucial.

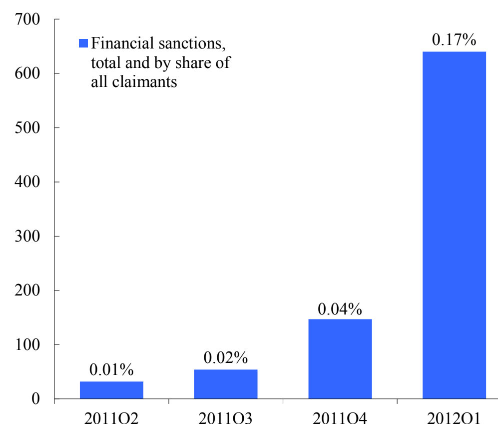
Figure 17: Exit and penalty sanction rates for the unemployed

Exit rates show long-term unemployment is becoming embedded



Source: Commission Services calculations

Penalty sanctions for non-compliance with activation and training have increased



Source: Department for Social Protection

During 2011 the authorities introduced financial sanctions for non-compliance by the unemployed with activation and training measures. The initial financial penalty is a cut of about 25% in payments and about 640 recipients were in receipt of sanctions at the end of March 2012, up from 30 in the first half of 2011. While this increase is no doubt indicative of the increasing robustness of the regime, the absolute number still represents just about 1.5% of all recipients.

[17] See http://www.forfas.ie/publications/featuredpublications/title,8936,en.php for 2012 report by the Expert Group on Future Skills Needs on newly advertised vacancies, found to be most frequent in the engineering, accountancy/financial, ICT and production/manufacturing sectors. The report also surveyed recruitment agencies which noted difficulty in professional vacancies in the ICT, engineering, science, financial and health sectors

To provide a boost to growth in light of the weakened external environment, it was agreed to reinvest a greater share of the proceeds from the envisaged sale of state assets into commercially sound, employment-enhancing projects. It is now important that such projects be promptly identified. The mission also encouraged the authorities to continue apace with the necessary preparatory work (including due diligence and regulatory and corporate governance reforms) necessary to bring state assets identified for disposal (aviation, power generation and forestry) closer to market. Substantive work is expected to be completed in the second quarter of 2012 with the aim of bringing assets to market beginning in 2013.

6 Financing issues

The completion of this review will authorise an additional EU disbursement of EUR 2.3 billion to Ireland. A further EUR 1.4 billion is foreseen from the IMF and around EUR 0.5 billion from the UK (bilateral loan). This would bring the total EU (including bilateral loans[18]) and IMF disbursements under the programme to EUR 52 billion, or about 77% of the programme's total financial envelope (EUR 67.5 billion).

The government's cash balances remain high and provide an effective safety margin. The central government cash deficit in the first quarter of this year was consistent with previous estimates, but allocated contingencies did not materialise, thus lowering the actual funding requirements. Additionally, the amount of short-term borrowing was higher than expected, and the payment of the end-March EUR 3.06 billion promissory note redemption through the proceeds from the tapping of an existing 2025 government bond[19] also contributed correspondingly to stronger-than-planned cash position. As a result of this tapping (which occurred in early April) and the ongoing short-term borrowing and retail funding, Ireland received EUR 4.5 billion of market financing in that quarter (Table 9). Financing needs projections for 2013 assume the promissory notes will be settled in accordance with their current redemption schedule.

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[18] Next to the UK, Sweden and Denmark provide bilateral loans within the programme. Loan agreements between Ireland and the later two have been completed during the first quarter 2012.

Overall, the programme remains adequate to cover the upcoming financing needs if a plausible amount of market funding is factored in. The cash balance is currently projected to exceed EUR 5 billion throughout the life of the programme, i.e. through end 2013, when it is projected at EUR 12 billion. Extraordinary banking sector support will require spending of EUR 1.6 billion this year, in line with previous plans, with no further such expenditures foreseen thereafter.

Table 9: Financing requirements, in billion EUR

	2010	2011	2012					2013					2010-2013
	Dec	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Total
A. Gross financing needs public sector 1/	7.9	28.8	10.7	10.4	2.2	5.2	28.5	8.4	10.8	0.9	3.6	23.7	88.9
B. Bank recapitalisation	0.0	16.5	0.0	1.3	0.0	0.3	1.6	0.0	0.0	0.0	0.0	0.0	18.1
C. Market financing	0.5	1.4	0.4	4.5	1.1	0.9	6.9	4.1	4.9	3.6	0.7	13.1	22.0
Net new debt issuance 2/	0.0	0.0	0.0	4.5	1.0	0.3	5.8	3.4	2.8	3.4	0.2	9.8	15.6
Net financing needs (A.+B.-C.)	**7.3**	**43.9**	**10.3**	**7.2**	**1.1**	**4.6**	**23.2**	**4.3**	**6.0**	**-2.7**	**2.9**	**10.6**	**85.0**
E. Use of Irish financial assets 3/	7.3	9.3	-0.3	0.2	-1.4	2.0	0.4	1.4	3.2	-4.9	0.8	0.5	17.5
F. EU-IMF loan disbursement	0.0	34.6	10.5	7.0	2.6	2.6	22.7	2.9	2.8	2.3	2.1	10.1	67.5
EFSM/EFSF	0.0	21.5	6.2	5.1	1.0	1.3	13.6	1.2	1.4	1.3	1.2	5.1	40.2
Bilaterals 4/	0.0	0.5	1.1	0.6	0.7	0.5	2.8	0.7	0.5	0.3	0.0	1.5	4.8
IMF	0.0	12.6	3.2	1.4	0.9	0.9	6.3	1.0	1.0	0.8	0.9	3.6	22.5
Programme financing (E.+F.)	**7.3**	**43.9**	**10.3**	**7.2**	**1.1**	**4.6**	**23.2**	**4.3**	**6.0**	**-2.7**	**2.9**	**10.6**	**85.0**
Memorandum item:													
Treasury cash buffer 5/	12.3	13.0	13.2	13.0	14.5	12.5	12.5	11.1	7.9	12.8	12.0	12.0	

Notes:
1/ Includes exchequer cash deficit, maturing long-term and short-term debt as well as contingency element.
2/ excludes roll-over financing
3/ Includes Treasury cash reserves and NPRF assets. "-" indicates an increase in cash reserves.
4/ Bilaterals include UK, Sweden and Denmark.
5/ Includes a buffer from financing contingency.

Though risks remain, Ireland is on track to gradually regain market access at acceptable yields. In total, Ireland plans to issue over EUR 15 billion in new debt net of roll-overs until the end of the programme. Starting from the second half of this year, the authorities plan—market conditions permitting—to re-enter the T-bills market, by issuing some EUR 1 billion over multiple tranches. Retail funding is also expected to continue, though prudently at somewhat lower levels than in the first quarter, during which it surprised on the upside. Long term bonds are envisaged to be issued over the course of next year. The authorities aim to ensure that their end-2013 cash buffers (EUR 12 billion)

[19] EUR 3.461 billion of the 2025 bond were issued at a price of 88.11 resulting in proceeds for the exchequer of EUR 3.06 billion: http://ntma.ie/Publications/2012/SaleOf2025BondToIBRC.pdf

cover a substantial part of the total financing needs of the first quarter of 2014, which includes a bond redemption of EUR 8,2 billion. This forecast prudently includes room for adverse contingencies.

7 Risks

Good progress notwithstanding, important risks to the programme's ultimate success remain:

- The fragility of market sentiment towards Ireland was recently exposed when adverse developments in another member state caused significant widening in risk premia on Irish assets. The risk of contagion has increased and spillover effects from other vulnerable member states could exacerbate recent negative market developments further. Additional uncertainty related to domestic factors could also contribute to weakening investor confidence in Ireland.
- Although risks to the macroeconomic outlook remain broadly balanced, important demand-side downside risks stem from: (i) the continuing squeeze on disposable incomes, as households seek to deleverage in light of the substantial fall in their net wealth since mid-2007 (the bulk of it due to declining property values); (ii) continued contraction in lending to the SME and household sector; (iii) any renewed bout of euro area turbulence, which could result in a fall-off in demand for Irish exports. On the production side, there is potential for a number of drugs falling off-patent this year and next to depress industrial output and nominal GDP. The recent weaker-than-expected first quarter data for the UK—a key trading partner—also are a source of concern, though this is partly counterbalanced by the recent appreciation of sterling to levels of late 2008, which may provide a boost to Irish exporters in equivalent sectors.
- In terms of upside risks, the competitiveness improvements achieved since 2008 may help Ireland to secure an increase in its market share of global trade. FDI inflows have performed strongly through the crisis and a rebound from the low levels of economy-wide investment (about 10% of GDP in 2012) is possible if credit constraints are not binding. For households the very low interest rate environment may allow a smaller contraction in private consumption while still allowing for the necessary household balance sheet repair.

- The difficulties experienced in the implementation of the new household charge, a EUR 100 charge per household meant to lay down the conditions for a permanent- and quantitatively much more significant-value-based property tax, provide a reminder of the risks that the popular support for continued consolidation and reform might wane, especially if growth remains weak and unemployment high. In order to minimize this risk, it is essential that the burden of the necessary consolidation be fairly and equitably shared.
- The restructuring of the domestic banks remains complex. While banks were provided with sufficient capital buffers following the 2011 PCAR, new recapitalisation needs cannot be ruled out altogether, especially if the economy fails to pick up pace as currently envisaged. Continued weakness in the domestic housing market, growing non-performing loans, uncertainty regarding medium-term funding and a less supportive environment for banks' deleveraging efforts, including possibly with respect to UK assets, pose risks in this regard. Any new capital gap could seriously undermine public support for the programme and market confidence in the banking sector strategy.
- A specific source of concern is the reform of the personal insolvency regime, given difficulties in drafting legislation that strikes the right balance between promoting the restructuring of unsustainable debt burdens and protecting creditor rights. Despite the government consistently ruling out blanket debt forgiveness and reiterating its preference for case-by-case individual arrangements between banks and mortgage borrowers, there is a risk that, unless the legislation is carefully and promptly finalised, the ensuing uncertainty might lead to a deterioration of payment discipline and thus the quality of banks' loan portfolios.

List of abbreviations

AIB	Allied Irish Bank
BoI	Bank of Ireland
bps	Basis points
BRS	BlackRock Solutions
CA	Competition Authority
CBI	Central Bank of Ireland
CHL	Capital Home Loans
CSO	Central Statistics Office Ireland
CCR	Centralized Credit Registry
DoF	Department of Finance
DRC	Debt Relief Certificate
DSA	Debt Settlement Arrangement
EC	European Commission
ECB	European Central Bank
EBA	European Banking Authority
EBS	Educational Building Society
EDP	Excessive deficit procedure
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ELG	Eligible Liabilities Guarantee
EROs	Employment Regulation Orders
ESB	Electricity Supply Board
GP	General Practitioner
HICP	Harmonised Index of Consumer Prices
HoSG	Heads of State or Government
IBRC	Irish Bank Resolution Corporation
IFRS	International Financial Reporting Standards
IFS	International Financial Statistics (IMF)
ILP	Irish Life & Permanent
IMF	International Monetary Fund
INBS	Irish Nationwide Building Society
IT	Information Technology
JLC	Joint Labour Committee
LDR	Loan-to-deposit ratio
LTRO	Long-term refinancing operations
LME	Liability Management Exercise
LTV	Loan-to-value ratio
MEFP	Memorandum of Economic and Financial Policies
MoU	Memorandum of Understanding on Specific Economic Conditionality
MTFS	Medium-term Fiscal Statement
NSFR	Net Stable Funding Ratio
NAMA	National Asset Management Agency
PCAR	Prudential Capital Assessment Review
PIA	Personal Insolvency Arrangement
PLAR	Prudential Liquidity Assessment Review
PMI	Purchasing Managers Index

REAs	Registered Employment Agreements
ROI	Republic of Ireland
SDR	Special Drawing Rights
SLO	Subordinated Liability Order
SME	Small and Medium Enterprises
UK	The United Kingdom of Great Britain and Northern Ireland
USC	Universal Social Charge
VAT	Value Added Tax

Annex 1—Macroeconomic projections

Table 1: Use and supply of goods and services (volume)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-0.9	-2.7	-1.7	0.3	1.5	1.9
2. Government consumption expenditure	-3.1	-3.7	-3.8	-2.7	-4.0	-3.5
3. Gross fixed capital formation	-25.1	-10.6	-4.0	1.0	4.0	4.9
4. Final domestic demand	**-5.8**	**-4.1**	**-2.5**	**-0.3**	**0.6**	**1.2**
5. Change in inventories						
6. Domestic demand	**-4.9**	**-3.0**	**-2.5**	**-0.3**	**0.6**	**1.2**
7. Exports of goods and services	6.3	4.1	3.2	4.2	4.8	4.8
7a. - of which goods	5.6	3.4	5.8	6.8	7.4	7.4
7b. - of which services	7.1	4.9	0.4	1.4	2.0	2.0
8. Final demand	**0.9**	**0.9**	**0.8**	**2.3**	**3.1**	**3.4**
9. Imports of goods and services	2.7	-0.7	1.2	3.0	3.6	3.8
9a. - of which goods	-1.8	-2.8	1.2	2.9	3.6	3.7
9b. - of which services	5.4	0.5	1.3	3.0	3.7	3.8
10. Gross domestic product at market prices	**-0.4**	**0.7**	**0.5**	**1.9**	**2.6**	**2.9**
Contribution to change in GDP						
11. Final domestic demand	-5.0	-3.3	-1.9	-0.2	0.5	0.9
12. Change in inventories + net acq. of valuables	0.9	0.9	0.0	0.0	0.0	0.0
13. External balance of goods and services	3.7	4.7	2.3	2.0	2.1	2.0

Table 2: Use and supply of goods and services (value)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-3.0	-1.8	0.0	1.5	3.2	3.6
2. Government consumption expenditure	-7.6	-3.0	-2.0	-1.1	-3.2	-2.0
3. Gross fixed capital formation	-28.7	-12.0	-4.2	3.1	7.7	9.8
4. Final domestic demand	**-8.7**	**-3.5**	**-1.0**	**1.1**	**2.3**	**3.3**
5. Change in inventories	-64.5	-166.9	0.0	3.0	-11.0	0.0
6. Domestic demand	**-7.8**	**-2.7**	**-1.0**	**1.1**	**2.3**	**3.3**
7. Exports of goods and services	8.1	5.0	4.5	5.8	5.6	5.6
8. Final demand	**0.4**	**1.6**	**2.1**	**3.8**	**4.3**	**4.7**
9. Imports of goods and services	5.7	3.1	2.6	4.7	4.5	5.0
10. Gross national income at market prices	-3.2	-3.1	0.0	2.6	4.1	3.4
11. Gross value added at basic prices	-2.0	-0.3	1.9	3.0	3.9	4.7
12. Gross domestic product at market prices	**-2.9**	**0.3**	**1.8**	**3.1**	**4.1**	**4.5**

Table 3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.2	0.9	1.7	1.2	1.7	1.7
2. Government consumption expenditure	-4.6	0.8	1.9	1.7	1.7	2.5
3. Gross fixed capital formation	-4.8	-1.6	-0.3	2.0	3.6	4.7
4. Domestic demand	**-3.3**	**0.5**	**1.5**	**1.4**	**2.0**	**2.3**
5. Exports of goods and services	1.7	0.9	1.4	1.7	1.0	1.0
6. Final demand	**-0.6**	**0.7**	**1.5**	**1.6**	**1.4**	**1.5**
7. Imports of goods and services	2.9	3.7	1.5	1.7	0.9	1.3
8. Gross domestic product at market prices	**-2.4**	**-0.4**	**1.2**	**1.2**	**1.5**	**1.6**
HICP	**-1.6**	**1.2**	**1.7**	**1.2**	**1.4**	**1.7**

Table 4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015
1. Labour productivity	4.0	2.8	1.2	1.2	1.3	0.9
2. Compensation of employees per head	-3.0	-1.1	-0.8	0.1	0.5	0.8
3. Unit labour costs	-5.7	-3.2	-2.0	-1.0	-0.5	-0.4
4. Total population	0.3	0.2	0.4	0.7	0.9	1.0
5. Population of working age (15-64 years)	-0.8	-1.0	-0.9	-0.5	-0.2	0.1
6. Total employment	-4.1	-2.1	-0.6	0.7	1.3	2.0
7. Calculated unemployment rate - Eurostat definition (%)	13.7	14.4	14.3	13.6	13.0	12.4

Table 5: External balance

levels	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	82.9	87.6	91.4	96.4	101.9	107.6
2. Imports of goods (fob)	46.4	48.9	50.1	52.2	54.6	57.3
3. Trade balance (goods, fob/fob) (1-2)	**36.5**	**38.7**	**41.3**	**44.2**	**47.3**	**50.3**
3a. p.m. (3) as % of GDP	*23.4*	*24.7*	*26.0*	*26.9*	*27.6*	*28.2*
4. Exports of services	74.7	78.0	81.6	86.5	91.4	96.6
5. Imports of services	81.5	83.0	85.1	89.3	93.3	98.0
6. Services balance (4-5)	**-6.7**	**-4.9**	**-3.6**	**-2.8**	**-1.9**	**-1.4**
6a. p.m. 6 as % of GDP	*-4.3*	*-3.2*	*-2.2*	*-1.7*	*-1.1*	*-0.8*
7. External balance of goods & services (3+6)	**29.8**	**33.7**	**37.8**	**41.4**	**45.4**	**48.9**
7a. p.m. 7 as % of GDP	*19.1*	*21.6*	*23.7*	*25.2*	*26.5*	*27.4*
8. Balance of primary incomes and current	-29.0	-33.6	-35.2	-36.1	-37.6	-40.7
8a. - of which, balance of primary income	*-26.7*	*-31.1*	*-33.9*	*-35.7*	*-37.1*	*-40.2*
8b. - of which, net current Transfers	*-2.3*	*-2.5*	*-1.2*	*-0.5*	*-0.5*	*-0.5*
8c. p.m. 8 as % of GDP	*-18.6*	*-21.5*	*-22.1*	*-22.0*	*-22.0*	*-22.8*
9. Current external balance (7+8)	**0.8**	**0.1**	**2.5**	**5.1**	**7.8**	**8.2**
9a. p.m. 9 as % of GDP	0.5	0.1	1.6	3.1	4.5	4.6
10. Net capital transactions	-0.7	-0.4	-0.2	-0.6	-0.8	-0.6
11. Net lending (+)/ net borrowing (-) (9+10)	**0.1**	**-0.3**	**2.3**	**4.5**	**7.0**	**7.6**
11a. p.m. 11 as % of GDP	*0.1*	*-0.2*	*1.4*	*2.7*	*4.1*	*4.3*

Table 6: Fiscal accounts

	2008	2009	2010	2011	2012	2013	2014	2015
				% of GDP				
Indirect taxes	12.3	11.3	11.4	11.5	11.5	11.6	11.8	11.5
Direct taxes	11.5	10.7	10.6	11.7	12.4	12.6	13.0	13.1
Social contributions	6.8	7.5	7.4	6.6	6.3	6.2	6.1	5.9
Sales	2.3	2.7	3.2	3.2	3.0	2.5	2.5	2.4
Other current revenue	1.3	1.3	1.5	1.4	1.5	1.5	1.4	1.3
Total current revenue	**34.3**	**33.5**	**34.1**	**34.4**	**34.7**	**34.5**	**34.7**	**34.3**
Capital transfers received	1.2	1.3	1.5	1.3	1.0	1.1	1.1	1.0
Total revenue	**35.5**	**34.8**	**35.6**	**35.7**	**35.8**	**35.6**	**35.8**	**35.3**
Compensation of employees	11.2	12.2	11.6	11.4	11.2	10.7	10.1	9.7
Intermediate consumption	5.8	6.4	6.2	5.6	5.4	4.9	4.4	4.0
Social transfers in kind via market producers	2.0	2.1	2.1	2.0	1.9	1.7	1.5	1.3
Social transfers other than in kind	12.2	15.2	15.6	15.8	15.5	14.4	13.4	12.8
Interest paid	1.4	2.0	3.1	3.4	4.1	5.6	5.6	5.5
Subsidies	0.5	0.6	0.6	0.4	0.4	0.4	0.3	0.3
Other current expenditure	2.5	2.8	2.5	2.4	2.3	2.3	2.2	2.1
Total current expenditure	**35.7**	**41.3**	**41.7**	**40.9**	**40.7**	**39.9**	**37.5**	**35.5**
Gross fixed capital formation	5.2	4.0	3.9	3.3	2.7	2.3	2.1	2.0
Other capital expenditure	1.9	3.6	21.2	4.5	0.6	0.9	0.9	0.7
Total expenditure	**42.8**	**48.8**	**66.8**	**48.8**	**44.1**	**43.1**	**40.6**	**38.3**
General Government balance (EDP)	**-7.3**	**-14.0**	**-31.2**	**-13.1**	**-8.3**	**-7.5**	**-4.8**	**-2.9**
				EUR billion				
Indirect taxes	22.2	18.2	17.8	18.0	18.3	19.1	20.2	20.6
Direct taxes	20.7	17.2	16.5	18.3	19.8	20.7	22.2	23.5
Social contributions	12.2	12.0	11.6	10.3	10.1	10.2	10.4	10.6
Sales	4.2	4.4	5.1	4.9	4.7	4.2	4.3	4.3
Other current revenue	2.4	2.1	2.3	2.1	2.4	2.5	2.3	2.3
Total current revenue	**61.7**	**53.9**	**53.2**	**53.8**	**55.3**	**56.6**	**59.4**	**61.3**
Capital transfers received	2.2	2.0	2.3	2.1	1.7	1.8	1.8	1.8
Total revenue	**63.9**	**55.9**	**55.6**	**55.8**	**57.0**	**58.4**	**61.2**	**63.1**
Compensation of employees	20.2	19.6	18.2	17.9	17.8	17.6	17.3	17.3
Intermediate consumption	10.5	10.2	9.6	8.7	8.6	8.1	7.6	7.1
Social transfers in kind via market producers	3.6	3.4	3.3	3.2	3.0	2.7	2.5	2.3
Social transfers other than in kind	22.0	24.4	24.4	24.7	24.6	23.7	22.9	22.8
Interest paid	2.5	3.3	4.9	5.4	6.5	9.1	9.6	9.8
Subsidies	0.9	0.9	0.9	0.6	0.6	0.6	0.6	0.5
Other current expenditure	4.6	4.5	3.9	3.7	3.7	3.7	3.7	3.7
Total current expenditure	**64.2**	**66.3**	**65.0**	**64.0**	**64.8**	**65.6**	**64.2**	**63.5**
Gross fixed capital formation	9.4	6.4	6.1	5.2	4.3	3.7	3.6	3.6
Other capital expenditure	3.4	5.8	33.0	7.0	1.0	1.4	1.5	1.3
Total expenditure	**77.1**	**78.4**	**104.2**	**76.4**	**70.2**	**70.7**	**69.4**	**68.4**
General Government balance (EDP)	**-13.2**	**-22.5**	**-48.6**	**-20.5**	**-13.2**	**-12.4**	**-8.2**	**-5.3**

Table 7: Debt developments

	2008	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-7.3**	**-14.0**	**-31.2**	**-13.1**	**-8.3**	**-7.5**	**-4.8**	**-2.9**
EDP gross debt (% of GDP)	44.2	65.2	92.5	108.2	116.1	120.2	119.7	117.4
				levels, EUR billion				
EDP deficit	**-13.2**	**-22.5**	**-48.6**	**-20.5**	**-13.2**	**-12.4**	**-8.2**	**-5.3**
Gross debt	79.6	104.6	144.3	169.3	184.8	197.3	204.7	209.7
Change in gross debt	32.4	25.0	39.6	25.0	15.5	12.5	7.4	5.0
Nominal GDP	180.0	160.6	156.0	156.4	159.2	164.2	171.0	178.7
Real GDP	175.7	163.4	162.7	163.8	164.7	167.8	172.1	177.2
Real GDP growth (% change)	**-3.0**	**-7.0**	**-0.4**	**0.7**	**0.5**	**1.9**	**2.6**	**2.9**
Change in gross debt (% of GDP)	18.0	15.6	25.4	16.0	9.8	7.6	4.3	2.8
Stock-flow adjustments (% of GDP)	10.7	1.6	-5.8	2.9	1.5	0.1	-0.5	-0.2
				% of GDP				
Gross debt ratio	**44.2**	**65.2**	**92.5**	**108.2**	**116.1**	**120.2**	**119.7**	**117.4**
Change in gross debt ratio	19.4	20.9	27.3	15.7	7.9	4.1	-0.5	-2.3
				Contribution to change in gross debt				
Primary balance	6.0	12.0	28.0	9.7	4.2	2.0	-0.8	-2.5
"Snow-ball" effect	2.8	7.5	5.1	3.2	2.2	2.0	0.9	0.3
of which								
Interest expenditure	*1.4*	*2.0*	*3.1*	*3.4*	*4.1*	*5.6*	*5.6*	*5.5*
Real growth effect	*0.8*	*3.5*	*0.3*	*-0.6*	*-0.6*	*-2.1*	*-3.0*	*-3.4*
Inflation effect	*0.6*	*2.0*	*1.6*	*0.4*	*-1.3*	*-1.4*	*-1.8*	*-1.8*
Stock-flow adjustments	**10.7**	**1.6**	**-5.8**	**2.9**	**1.5**	**0.1**	**-0.5**	**-0.2**
Implicit interest rate	*5.1*	*4.1*	*4.7*	*3.7*	*3.8*	*4.9*	*4.9*	*4.8*

Notes:
The projections for gross debt incorporate the completion of the outstanding bank recapitalisation in 2012 (in the amount of EUR 1.3 billion) and other smaller financial transactions. The projections assume no use of precautionary contingencies foreseen in the programme's financing plan and cash balances declining to EUR 12 billion in 2013 and to EUR 9 billion by 2015

Annex 2—Programme documents

Letter of Intent to EU Authorities

Dublin, 30 May 2012

President
European Central Bank
Kaiserstrasse 29
60311 Frankfurt am Main
Germany

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

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

Ms. Margrethe Vestager
Minister for Economics and the Interior
Økonomi- og Indenrigsministeriet
Slotsholmsgade 10-12
1216 København K
Denmark

Dear Messrs Draghi, Juncker, Rehn, and Ms. Vestager

The Irish Government remains firmly committed to the programme, as illustrated by our continued strong implementation of programme policies. All programme targets have been met or in some cases exceeded. We continue to move steadily towards our core goal of returning to the international capital markets during 2013. In this regard, we have stepped up our efforts and are examining ways in which the programme can at the same time place a greater focus on encouraging economic growth, as this is an important part of the process of market re-entry. Additional headwinds being faced by Ireland in relation to developments internationally and, in particular, within the euro area, are a s pecific concern and in this light meeting all of our Programme targets, as we have done to date, is a significant continued demonstration of the Authorities' ownership of the programme.

We are committed to ensuring that the strong record of programme implementation that we have established is maintained. We are also fully conscious of the significant commitment that has been made by our international partners in continuing to support Ireland's efforts as long as its adjustment remains on track.

Once again, for the sixth review, we have met our commitments under the EU/IMF supported programme in terms of policy reforms as well as quantitative targets:

As regards our fiscal consolidation objectives, the cumulative exchequer balance through end-March 2012 was ahead of the programme profile and the 2012 general government deficit is projected to be at, or within the 8.6% of GDP programme ceiling. The latest EDP returns also confirmed that the 2011 underlying general government deficit, at 9.4% of GDP, was kept well below the 10.6% of GDP envisaged under the programme and the Council Recommendation in the context of the excessive deficit procedure. We continue to strengthen our fiscal framework, in line with the evolving EU regulations. In particular, we have advanced work to provide the Irish Advisory Fiscal Council—established on an administrative basis last year as part of the programme—with a legal basis for its functional and financial independence. In this regard we draw attention to the general legislative scheme on this matter that we recently published.

We have continued to advance the envisaged structural reforms. In particular, we have introduced modifications to further strengthen the Competition (Amendment) Bill, announced the transfer of the responsibility for water provision from local authorities to a centralized regulated newly established water utility, published revised planning guidelines, and completed analytical work identifying policy, regulatory, legislative, corporate governance and financial issues that may need to be addressed to dispose of a number of state-owned assets.

The overarching strengthening, restructuring, and right-sizing of the domestic banking sector and the credit union sector is also progressing according to plans, e.g. with the publication of the final report of the Commission on the Credit Unions and of the heads of the law on personal insolvency reform.

In the attached fifth update of the Memorandum of Understanding of Specific Economic Policy Conditionality (the MOU), as well as in the Memorandum of Economic and Financial Policies (MEFP), we set out our plans to further advance towards meeting the objectives of our economic adjustment programme supported by financial assistance from the EU and the IMF. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request the completion of the sixth review the release of the sixth EFSF/EFSM disbursement of EUR 2.3 billion.

Looking forward, the financing need outlook until 2013 is broadly in line with expectations at the fifth programme review, whereby our larger cash buffer provides additional comfort. That notwithstanding, we intend to regain access to market financing through the issuance of Treasury bills during 2012 as conditions permit, prior to the envisioned return to bond markets in 2013. We expect that the current funding of the

programme and the phasing—as laid out in the fifth review—continues to ensure a prudent liquidity position.

We are confident that the policies set forth in the Letters of Intent of 3 December 2010, and subsequent letters as well as this letter are adequate to achieve the objectives of our Programme. At the same time, while we do not envisage that revisions will be needed, we stand ready to take any corrective actions that may become appropriate if circumstances change. We will continue to consult with staff of the European Commission, the ECB, and the IMF on the adoption of such actions in advance in the event that revision of the policies contained in this Letter and the attached Memoranda becomes necessary.

This letter is being copied to Mme Lagarde.

Sincerely,

__________________ __________________

Michael Noonan, T.D.	Patrick Honohan
Minister for Finance	Governor of the Central Bank of Ireland

IRELAND

MEMORANDUM OF UNDERSTANDING
ON
SPECIFIC ECONOMIC POLICY CONDITIONALITY

(FIFTH UPDATE)

25 JUNE 2012

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, this fifth update of the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) 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 EFSM[20] 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 (EDP), and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and this updated 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 Irish authorities will take all the necessary measures to ensure a successful implementation of the programme and minimise the costs to the taxpayers, while protecting the most vulnerable. 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 effective tax collection and tight supervision of expenditure commitments by the line departments to ensure that the primary deficit target in cash (Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the

[20] 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.

- Use at least half of the proceeds from state asset sales for eventual debt reduction while also reinvesting the remainder of the total realised proceeds in projects which are of a commercial nature, meet ex-ante cost benefit criteria, enhance employment and preserve long term fiscal sustainability, including Programme and EDP fiscal targets.
- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.
- Ensure that activation services are enhanced, to tackle the high and persistent rate of long-term unemployment. In particular, the Department of Social Protection will take steps to improve the ratio of vacancies filled off the live register, focus on re-training the unemployed to reduce the risk of long-term unemployment and ensure appropriate incentives through the implementation of sanctions. Generally, the government will advance its plans to introduce new activation measures building on *Pathways to Work* (the government's strategy for institutional reform of the activation system).
- 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.
- Ensure that NAMA: (i) maintains the highest standards of governance with appropriate accountability and transparency arrangements; (ii) reduces the costs of its operations; and (iii) 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 redemption of €7.5 billion worth of senior bonds by end 2013.
- Ensure that the restructuring of credit unions will underpin the financial stability and long term sustainability of the sector. The restructuring will be completed in as short a timeframe as possible under a clear plan identifying credit unions appropriate for restructuring, subject to Central Bank approval. As regards funding, the first call should be on the credit unions concerned or the sector as a whole; any Exchequer funding should be minimised, should be provided only in the context of a restructuring plan in compliance with EU state aid rules, and should be recouped from the sector over time. In parallel, the Central Bank will continue its inspections to determine the financial condition of the weakest credit unions, and may engage its resolution powers drawing on Resolution Fund resources.
- Ensure continued compliance with the minimum capital ratio of 10.5 percent for all PCAR banks (AIB, BOI, and PTSB).
- Consult ex-ante 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 seventh review (actions to be completed by end Q2-2012)

Financial sector reforms

Capitalisation

- Government will ensure that the recapitalisation of PTSB[21], as identified in the 2011 Prudential Capital Assessment Review (PCAR), is completed.
- In the context of the Financial Measures Programme (FMP), the authorities will carry out the following work streams: (i) an independent asset quality review to assess the quality of aggregate and individual loan portfolios and the processes employed for establishing and monitoring asset quality; (ii) a distressed credit operations review to assess the operational capability and effectiveness of distressed loan portfolio management in the banks including arrears management and workout practices in curing NPLs and reducing loan losses; (iii) a data integrity validation exercise to assess the reliability of banks' data; and (iv) an income recognition and re-ageing project to review existing practices against IFRS and relevant regulatory guidance. The authorities will report on the progress of this work, following completion.

Asset Quality

- The authorities will assess banks' progress with the work-out of their non-performing portfolios in line with milestones established by the Central Bank of Ireland after consultation with staff of the European Commission, the IMF and the ECB. The banks will prepare revised operational plans for distressed mortgage portfolios, will conclude a cohort analysis of their mortgage portfolio and will propose long-term loan modification techniques. Other milestones for mortgages and other portfolios will be developed. As part of the FMP, independent advisors will be engaged as appropriate.

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[21] The legal separation of Irish Life from the Irish Life & Permanent Group is expected to occur soon. Hence from here onwards, the references in this document to IL&P and the equivalent ILP are replaced by a reference to Permanent TSB ("PTSB").

Deleveraging

- The authorities will provide 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 staff of the European Commission, the IMF and the ECB.

- The authorities will continue to monitor the deleveraging of non-core assets, including disposals and run-offs, in accordance with six-monthly targets in terms of nominal volumes. Fire sales of assets will be avoided. On the basis of submissions by the banks in accordance with the recently issued PLAR quarterly forecast balance sheet template, the authorities will, in consultation with the staff of the European Commission, the IMF and the ECB, modify the framework to emphasise the Net Stable Funding Ratio (NSFR) with a view to replacing the loan-to-deposit targets. NSFR goals for end-2013 will be consistent with the deleveraging objectives of previously set LDR targets and in particular with ensuring adequate progress towards Basle 3 requirements.

- The authorities, in consultation with the staff of the European Commission, the IMF and ECB, will monitor closely the evolution of Liquidity Coverage Ratios (LCR) in order to ensure convergence to Basel III standards by the relevant dates.

- The authorities will establish draft rules for the creation and subsequent holding of liquidity buffers by banks in preparation of the new Capital Requirements Regulation which will enter into force in January 2013.

Reorganisation

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

- The authorities will ensure that PTSB will continue to work on its financial and operational restructuring, on the basis of the segregation of a core retail bank from certain legacy and non-performing assets. In this context, PTSB will prepare an updated restructuring plan that will detail the actions needed to ensure the bank's long-term viability, in line with EU state aid rules. The plan should not be premised on there being additional capital injections from the State, and should safeguard financial stability.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it with the staff of the European Commission, the ECB and the IMF.

- The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies. To promote a more effective dialogue between lenders and borrowers, the CBI will provide guidance to banks under the Code of Conduct for Mortgage Arrears. The results of the review of distressed credit operations for non-performing SME loans, including SME's commercial real estate debts, will be available to the staff of the European Commission, ECB and IMF.

Structural reforms

Utility sector

- The authorities will supply programme partners with a detailed, time-bound implementation plan for the transfer of water services provision from local authorities to Irish Water and the plan for the roll-out of a domestic water metering programme with a view to starting charging by the end of the EU-IMF programme period.

Competition

- The authorities will increase the resourcing of the Competition Authority to ensure adequate enforcement capacity of the legislative framework on the basis of the review undertaken in Q1 2012.

Efficient social support expenditure

The Department of Social Protection will:

- Provide an evaluation of the actions taken in respect of jobseekers payments recipients who do not attend employment activation interviews.
- Building on Pathways to Work, introduce one stop shop pilots, NEES employer engagement and job matching.
- Continuously monitor the performance of the activation system and report to programme partners on progress on the following:
    - Reducing the average duration of staying on the live register
    - Increasing the fraction of vacancies filled off the live register
    - Ensuring engagement with employment services as a pre-condition for receipt of jobseeker payments
    - Carrying out profiling, group and individual engagement through interviews
    - Increasing the number of unemployed referred to training courses and employment supports
    - Providing data numbers on live register broken down by continuous duration, and probability of exit by various durations
- Report to programme partners on progress on implementing an improved data collection system to enable ongoing evaluation of activation and training policies, in light of the March 2012 external evaluation.

State assets

- Government will outline in detail the specific regulatory, legislative, corporate governance and financial reforms which need to be taken, ensuring consistency with relevant EU legislation where necessary, to allow for the asset sale programme to proceed, and an ambitious calendar with indicative timelines for sales will be set out.

Labour market reform

- Building on the Industrial Relations (Amendment) Bill 2011, the authorities will present amendments to the Dáil in particular to: (i) provide that the inability to pay clause for EROs and REAs can allow two consecutive exemptions within the overall two year time limit where this is necessary to safeguard employment, and (ii) ensure that the process for the granting of a variation to an REA is conducted in a timely manner.
- The authorities will explore the scope for attenuating any adverse employment incentives arising from the structure of social payments through a cross-departmental report.

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

Financial sector reforms

Deleveraging

- The authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will assess banks' performance vis-à-vis the agreed deleveraging targets including asset disposals and run-off. Actual and forecast net stable funding ratios (NSFRs), loan-to-deposit ratios (LDR) and asset disposals shall be reported by the banks to the Central Bank of Ireland every six months. The Central Bank will oversee the remedial actions to be taken by any bank in case of actual or likely breach of the targets. In addition to providing the six-monthly report, the authorities will update the staff of the European Commission, the IMF and the ECB on progress in the intervening quarters.
- The authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it with the staff of the European Commission, the ECB and the IMF.
- Authorities will publish the legislation to strengthen the credit unions legislative framework taking account of the comprehensive recommendations in the Commission on Credit Unions Report.
- As recommended by the interim and final reports of the Commission on Credit Unions, the legal provision that requires, under the terms of the Deposit Guarantee Scheme, credit unions to maintain an amount in the Deposit Protection account at the Central Bank will be commenced by regulations. The authorities will also adopt regulations underpinning the Resolution Fund Levy to recoup Exchequer resources provided for the resolution of troubled credit unions.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.
- Government will present to Dáil Éireann legislation to establish a statutory credit risk register.
- AIB's new management team will update its restructuring plan to enhance revenue, right-size costs, and restructure operations. This plan will be submitted to the European Commission.

Structural reforms

Personal debt regime

- Government will introduce legislation to reform the personal debt regime to the Oireachtas before the start of the summer recess, with the objective of increasing the speed and efficiency of proceedings while at the same time mitigating moral hazard and maintaining credit discipline.
- A programme to facilitate access to professional financial advisory services, funded by banks, will be activated.

State assets

- Government will report to programme partners on progress, including details of the timetable for publication of necessary legislation to allow the asset disposal programme to proceed and carry out identified reforms of corporate governance in state-owned assets.

Efficient social support expenditure

- In the context of Budget 2013, the Department of Social Protection will present options to Government for consideration, having regard, inter alia, to the results of the actuarial review of the social insurance fund.

Structural fiscal reforms

Fiscal framework

- The Government will publish legislation to anchor its already operational multi-annual expenditure limits.
- Government will publish draft legislation which enshrines the commitment to sound public finances, gives statutory basis to the Irish Fiscal Advisory Council and provides for the Council's independence and adequate resourcing.

3. Actions for the ninth review (actions to be completed by end Q4-2012)

Fiscal consolidation

- Taking account of the European Semester, Government will publish a budget for 2013 aiming for 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.

- On the basis of the aggregate budgetary projections set out in the Medium Term Fiscal Statement (MTFS) of November 2011, consolidation measures for 2013 will amount to at least €3.5 billion. The following measures are proposed for 2013 on the basis of the MTFS:
  - Revenue measures to raise at least €1.25 billion[22], including:
    - A broadening of personal income tax base.
    - A value-based property tax.
    - A restructuring of motor taxation.
    - A reduction in general tax expenditures.
    - An increase in excise duty and other indirect taxes.
  - Expenditure reductions necessary to achieve an upper limit on voted expenditure of €54 billion, which will involve consolidation measures of €2.25 billion on the basis of the MTFS, including:
    - Social expenditure reductions.
    - Reduction in the total pay and pensions bill.
    - Other programme expenditure, and reductions in capital expenditure.

Without prejudice to the minimum consolidation amount referred to in the previous paragraph and to the requirements to achieve the agreed fiscal targets, the Government may, in consultation with the staff of the European Commission, the IMF and the ECB, substitute one or more of the above measures with others of equally good quality based on the options identified in the Comprehensive Review of Expenditure (CRE).

Financial sector reforms

Capital assessment

- The authorities will review developments in the covered banks relative to PCAR 2011, and overall results of this work will be published. The authorities will agree with the staff of the European Commission, the ECB and the IMF on the specific details of the review.

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[22] Inclusive of carryover from 2012.

Deleveraging

- The authorities will present 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 staff of the European Commission, the ECB and the IMF. In addition, the authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the IMF and the ECB.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.
- The authorities will review the implementation of the Provisioning and Disclosure guidelines by the covered banks.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.

Structural reforms

Competition

- On the basis of a report from authorities on developments to be provided by end Q4 2012, the authorities in consultation with staff of the European Commission, IMF and the ECB will review whether sufficient progress has been made toward the goal of strengthening competition law enforcement 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 and the functioning of the Competition Authority, and whether additional measures will be required

Efficient social support expenditure

- The authorities will provide an evaluation of progress in relation to labour market activation measures to enable the unemployed to return to active employment against the targets set out in the 'Pathways to Work' plan.

State assets

- Government will complete the identified regulatory, legislative, corporate governance and financial reforms and will discuss with programme partners the specific assets to be brought to market in 2013.

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

Financial sector reforms

Capitalisation

- The authorities will report on the evolution of regulatory capital within the PCAR banks up to the end of December 2012, and will present and discuss their findings with the staff of the European Commission, the IMF and the ECB.

Deleveraging

- Monitoring – as per requirement under Financial Sector Reforms in 8th Review (Q3 – 2012).
- The authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.
- In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it with the staff of the European Commission, the IMF and the ECB.

Financial supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland’s action plan for strengthening supervision of credit institutions and discuss it with the staff of the European Commission, the IMF and the ECB.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.

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

Financial sector reforms

Capital assessment

- The authorities will complete the PCAR 2013. Building on the outcomes from PCAR 2011 and the FMP 2012, the authorities will conduct another rigorous stress test and this will continue to be based on robust loan-loss forecasts and a high level of transparency. This stress test will draw on our assessment of the banks' calculation of risk weighted assets, loan loss forecasting, and capital modelling. The stress test will focus on the bank balance sheets following the implementation of technical work addressing legacy and nonperforming loans. The authorities will agree with the staff of the European Commission, the ECB and IMF on the specific features of the methodology. Before publication, the results of the PCAR 2013 will be discussed with the staff of European Commission, the IMF and the ECB. Publication of the results of the PCAR exercise will be aligned with the timing of the next EBA exercise. The results and methodology will then be published in full and on a bank-by-bank basis. The authorities will continue to ensure that banks are adequately capitalised.

Deleveraging

- The authorities will present 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 staff of the European Commission, the IMF and the ECB. In addition, the authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.
- The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the IMF and the ECB.

Financial supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the IMF and the ECB.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.

Structural reforms

State assets

- Government will report to programme partners on the quantum of the proceeds of any realised asset sales to date.

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

Financial sector reforms

Capital assessment

- The authorities will report on the evolution of regulatory capital up to the end of June 2013, within the banks covered by the PCAR and will present and discuss their findings with the staff of the European Commission, the IMF and the ECB.

Deleveraging

- Monitoring – as per requirement under Financial Sector Reforms in 8th Review (Q3 – 2012).
- The authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.
- In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the European Commission, the IMF and the ECB.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the IMF and the ECB.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.

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

Financial sector reforms

Deleveraging

- The authorities will produce a final report of the banks' implementation of their deleveraging plans under the PLAR 2011. Their compliance with the asset disposal, NSFR and LDR targets will be discussed with the European Commission, the IMF and the ECB. In addition, the authorities, in consultation with the European Commission, the IMF and the ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel III standards by the relevant dates.
- The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

- The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the European Commission, the IMF and the ECB.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the IMF and the ECB.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.
- The authorities will ensure that the statutory credit risk register is operational.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the staff of the European Commission, the ECB and the IMF by the Irish 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.

To be provided by the Department of Finance in consultation with the Department of Public Expenditure and Reform as appropriate		
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 Exchequer Balance and General Government Balance outlook for the remainder of the year which shows 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.3	Quarterly data on main revenue and expenditure items of local Government.	Quarterly, 90 days after the end of each quarter
F.4	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.5	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.6	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.7	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 quarter
F.8	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 quarter
F.9	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.10	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in	Quarterly, 30 working days after the end of each quarter.

	labour market programmes.	
To be provided by the NTMA		
N.1	Monthly information on the central Government's cash position with indication of sources as well of number of days covered	Monthly, three working days after the end of each month
N.2	Data on below-the-line financing for central Government.	Monthly, no later than 15 working days after the end of each month
N.3	Data on the National Debt	Monthly, 15 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 the National Debt.	Monthly, 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the Exchequer Borrowing Requirement / National Debt in the next 12 months	Monthly, 30 working days after the end of each month
To be provided by the Central Bank of Ireland		
C.1	The Central Bank of Ireland's balance sheet.	Weekly, next working day
C.2	Individual maturity profiles (amortisation only) for each of the domestic banks will be provided as of the last Friday of each month.	Monthly, 30 working days after each month end.
C.3	Detailed financial and regulatory information (consolidated data) on domestic individual Irish banks and the banking sector in total especially regarding profitability (P&L), balance sheet, asset quality, regulatory capital; PLAR funding plan forecasts including LDR and NSFR forecasts.	Quarterly, 35 working days after the end of each quarter
C.4	Detailed information on deposits for the last Friday of each month.	Monthly, 30 working days after each month end.
C.5	Data on liabilities covered under the ELG Scheme for each of the Covered Institutions.	Monthly, 30 working days after each month end.
C.6	Deleveraging committee minutes and deleveraging sales progress sheets, detailing pricing, quantum, and other relevant result metrics.	Monthly, reflecting committee meetings held each month
C.7	Deleveraging reports including (i) progress achieved towards interim target; and (ii) actual and planned asset disposals.	Quarterly, 35 working days after the end of the reference period.

Memorandum of Economic and Financial Policies

A. Recent Economic Developments and Outlook

1. **The economy registered positive growth last year for the first time since 2007, yet growth prospects for 2012 remain modest.** Real GDP grew 0.7 percent in 2011 owing to continuing strong export performance, though domestic demand continued to decline. The current account posted a small surplus as trade balance gains were offset by very strong income outflows. HICP inflation has reached 2.2 percent recently, mainly driven by rising energy prices and also by indirect tax increases, while the unemployment rate remains high at around 14½ percent. Ireland's bond yields have stabilized recently, though the spread versus German bunds—which are trading at historically low yields—is still elevated at around 520 basis points on nine-year bonds. Looking to 2012, further competitiveness gains should help maintain momentum in the export sector, but continuing household deleveraging and the weak labour market will continue to weigh on domestic demand. While banks' deposit funding has stabilized and capital levels are robust, credit growth remains negative and house prices continue to decline.

B. Financial Sector Policies

We will continue to press ahead with a comprehensive set of reforms to restore the health of the Irish financial system in the face of more adverse external market conditions. The reforms aim to underpin banks' long-term viability and restart lending. Restoring wholesale and interbank market access for the banks is becoming increasingly challenging, as the deteriorating external environment is exacerbating vulnerabilities in the financial system. We continue technical work on potential approaches to deepen financial sector reforms to support prospects for growth and market re-entry.

Bank resilience, liquidity, and transparency

2. **We are advancing our Financial Measures Program (FMP) across a range of work streams**. In the first phase, we are carrying out (i) an independent asset quality review to assess the quality of aggregate and individual loan portfolios and the processes employed for establishing and monitoring asset quality; (ii) a distressed credit operations review to assess the operational capability and effectiveness of distressed loan portfolio management in the banks including arrears management and workout practices in curing NPLs and reducing loan losses; (iii) data integrity validation to assess the reliability of banks' data; and (iv) income recognition and re-ageing project to review existing practices against IFRS and relevant regulatory guidance. We will report on the progress on this work during 2012.

3. **Protecting and enhancing the value of bank loan portfolios is a key immediate priority.** The PCAR banks will be required to demonstrate continued progress with the work-out of their non-performing portfolios in line with milestones to be established by the Central Bank. By end June, the banks will prepare revised operational plans for distressed mortgage portfolios, will conclude a cohort analysis of

their mortgage portfolio, and will propose long-term loan modification techniques. Other milestones for mortgages and other portfolios will be developed. A review of distressed credit operations for non-performing SME loans, including SME's commercial real estate debts, is underway and the results will be available by end June. These results will inform the CBI's requirements for the banks to develop their strategies for dealing with SME loan arrears. As part of the FMP, independent advisors will be engaged as appropriate.

4. Publication of the results of the PCAR exercise will be aligned with the timing of the next EBA exercise. Leveraging phase one outputs, we will carry out a rigorous stress test that will continue to be based on robust loan-loss forecasts and feature a high level of transparency. This stress test will draw on our assessment of the banks' calculation of risk weighted assets, loan loss forecasting, and capital modelling. It will focus on the bank balance sheets following the implementation of technical work addressing legacy and nonperforming loans. In the meantime, compliance with the minimum capital ratio of 10.5 percent for all PCAR banks (AIB, BOI and PTSB) will continue to be monitored by the Central Bank. Developments relative to PCAR 2011 will be reviewed by the end of Q4 and overall results of this work will be published. We will agree with the staff of the European Commission, ECB, and IMF on the specific features of the methodology.

5. We are refining our deleveraging framework to minimize risks to lending and discourage excessive competition for deposits. Deleveraging of non-core assets, including disposals and run-offs, will continue to be governed by six-monthly targets for the nominal volume, and safeguards against fire sales will remain in place. The modified framework will emphasize the net stable funding ratio (NSFR) with a view to replacing the loan-to-deposit ratio targets. By end June, the CBI will propose goals for banks' NSFRs for end 2013, based on banks' submissions of current NSFR ratios and forecasts as they move towards adoption of the Basel III requirements. The CBI will supervise progress toward this goal.

6. We have enhanced the quality and level of disclosure and provisioning of the PCAR banks. Reflecting the effectiveness of the revised disclosure and provisioning guidelines, banks' 2011 financial statements have shown a significant improvement in data disclosed to markets and in the level of loan provisioning. We plan to continue deepening efforts by reviewing and enhancing the implementation of the guidelines in the PCAR banks during 2012, taking account of the independent asset quality review under FMP 2012.

7. We are working towards reducing the level of Government support for the funding of the PCAR banks. The Department of Finance is working with the other Irish authorities to ensure that the level of State support under the Eligible Liabilities Guarantee (ELG) scheme and other contingent guarantee mechanisms is declining over time, allowing the banks to rebuild their independent operation on a stabilised basis. This approach will enable the banks to resume normalised operations as envisaged under the Relationship Frameworks.

Advancing financial institution restructuring

8. **The ongoing financial and operational restructuring of the ELG covered banks will be monitored closely.** Under the recently published relationship frameworks with the PCAR banks, we are ensuring that these businesses are run on a commercial arm's length basis. AIB's new management team is updating its restructuring plan to enhance revenue, right-size costs, and restructure operations. The plan will be submitted to the European Commission by end September 2012.

9. **We have determined the way forward for PTSB.** The bank's proposal for financial and operational restructuring sets out a path to address its vulnerabilities. This requires the segregation of certain legacy and non-performing assets and their timely removal from the bank; we will continue to work with the External Partners to achieve a timely solution. We will therefore submit an updated restructuring plan for PTSB detailing the actions needed to ensure viability of the core businesses, in line with EC state aid rules, by end June 2012 (proposed structural benchmark). The restructuring plan will include a set of quarterly performance benchmarks appropriate for each business unit within PTSB, with a view to protecting and enhancing the value of each unit, and will not be premised on there being additional capital injections from the State. In the interim, work on financial and operational restructuring of PTSB will continue apace. Separately, we will continue to work to dispose of Irish Life as soon as market conditions permit.

10. **We continue to implement our strategy to restore the viability and solvency of the credit union sector.** The Commission on Credit Unions has released its final report, which includes wide ranging recommendations on restructuring the sector. Restructuring will be based on the following principles: (i) to ensure the financial stability and long term sustainability of the sector (ii) completion of restructuring in as short a timeframe as possible under a clear plan identifying Credit Unions appropriate for restructuring, subject to Central Bank approval; (iii) the first call for funding should be on the credit unions concerned or the sector as a whole; (iv) any Exchequer funding should be minimised, should be provided only in the context of a restructuring plan in compliance with EU state aid rules, and should be recouped from the sector over time. In parallel, the CBI will continue its inspections to determine the financial condition of the weakest credit unions, and the resolution powers of the CBI may be engaged drawing on Resolution Fund resources. In view of the comprehensive legislative recommendations in the Report, the legislation to strengthen the Credit Unions' regulatory framework with particular emphasis on enhancing governance and prudential requirements will be published during the third quarter (modified structural benchmark). The regulations for the Resolution Fund levy on all credit institutions will be approved by end September (structural benchmark).

Enhancing asset quality

11. **We are deepening efforts to address loan arrears and unsustainable debts.** We will continue to improve the framework within which banks and borrowers together address mortgage arrears and non-performing SME loans. The CBI has reviewed banks'

submissions on t heir strategy for dealing with mortgage arrears, and banks are strengthening their strategies as a result. To assess the implementation of these strategies, the CBI will monitor banks' progress against key performance indicators to be defined by end May. Banks will complete pilots of restructuring options as recommended by the Inter-Departmental Mortgage Arrears Working Group, and provide for a fully operational menu of available workout options by end 2012. The CBI will provide guidance under the Code of Conduct for Mortgage Arrears (CCMA) to promote more effective dialogue between lenders and borrowers in payment difficulties. To better inform households, we are revising and further developing the dedicated website and will be running an information campaign under the umbrella of the Citizens Information Board. A programme to facilitate access to professional financial advisory services, funded by banks, is currently being examined and planned for activation by end September.

12. We are refining proposed reforms of the personal insolvency framework to facilitate the resolution of unsustainable debt while upholding Ireland's strong debt servicing tradition. We published a draft general Scheme of the Personal Insolvency Bill in January. The proposed reforms modernize the Bankruptcy Act, aligning the discharge period more closely with international practice, and establish a non-judicial debt settlement mechanism, including for mortgages. Well targeted eligibility criteria, including adequate engagement through the Mortgage Arrears Resolution Process, and safeguards for creditor rights, will provide the right mix of incentives to maintain debt service discipline. Taking into consideration substantial inputs received during the consultation period from a wide range of stakeholders, we will publish draft legislation providing for an appropriate balance between debtor and creditor rights before the start of the summer recess of the Oireachtas. In parallel, guidance setting out broad principles on applicable income/expenditure will be prepared. Reform of the insolvency law and procedures will require a development of relevant infrastructure, including a new Insolvency Service, and advance planning has commenced in that regard.

C. Fiscal Policies

Our track record of meeting all the fiscal targets in the programme continues. The 2011 deficit (excluding bank support costs) is now estimated at 9.4 percent of GDP, benefitting in part from reduced EU lending rates. This outturn is well within the programme ceiling of 10.6 percent of GDP. Maintaining this track record, the targets for end March 2012 on the exchequer primary balance and net debt were achieved with a margin, reflecting sound revenue collection across the main tax items. This strong fiscal consolidation performance, in the face of challenging macroeconomic and labor market conditions, attests to our prudent budget design and implementation.

13. We are on track to achieve the 8.6 percent of GDP deficit target for 2012. The finance bill and the two social welfare bills to implement Budget 2012 have now been passed by the Dail. While the budget is on track in the first quarter, we are alert to risks, including spending pressures in some areas. Accordingly, as in 2011, we will maintain a careful and proactive approach to budget management to contain spending to budget allocations.

14. Rationalization of the public service is progressing. Public service numbers reductions are on track and the end-2012 ceiling of 294,000 is set to be achieved, with indications that the numbers already fell below this level in the first quarter of 2012. Coupled with targeted savings in overtime, sick pay, and other non-core-pay entitlements, this downsizing is expected to deliver durable reductions in the public service pay bill. We will monitor the impact of recent numbers reductions on service delivery closely in coming months. While ensuring that frontline and key public services are adequately protected, we will continue to exercise rigorous centralized control on recruitment and redeployment, to ensure that any new hiring is supported by a strong business case.

15. To further underpin the achievement of our medium-term fiscal consolidation path, we are advancing the preparation of a fully specified and equitable package of measures. Measures for much of the fiscal consolidation set out in the Medium-Term Fiscal Statement are already specified in Budget 2012 and underpinned by binding multi-annual expenditure limits. To ensure these limits will be met while preserving public services and protecting the most vulnerable of our citizens, we are advancing the development of social welfare reforms. In the context of Budget 2013, the Department of Social Protection will present options to Government for consideration. To replace the household charge, we are undertaking the design of a value-based property tax for implementation in 2013 to provide a stable source of revenue.

16. Institutional fiscal reforms are ready to be implemented. In the context of the forthcoming referendum, we have published draft legislation to implement the European Treaty on Stability, Coordination and Governance. In addition to enshrining our commitment to sound public finances, this draft legislation gives statutory basis to the Irish Fiscal Advisory Council and provides for its independence and adequate resourcing. We will also anchor our already-operational multi-annual expenditure limits in appropriate legislation to be published by end September 2012.

D. Structural Reforms

We will strengthen the growth pillar of the programme. Together with fiscal consolidation, a return to robust growth is essential. We have established a working group to review and adapt our strategy for stronger output and employment growth to the increasingly more challenging external circumstances. As the growth outlook of our trading partners has been revised down, we are examining ways to boost domestic demand and job creation while keeping our strong fiscal consolidation track record. The main objective is to build on what we have achieved to further enhance the economy's competitiveness and flexibility, while safeguarding social cohesion and fiscal sustainability. In this respect, our Pathways to Work project together with our Action Plan for Jobs will help reduce the high level of unemployment. It is recognised that innovative and flexible demand side measures are also required.

17. Additional initiatives to generate growth and jobs are under preparation. Recognising that the European Investment Bank is committed to providing finance for projects in Ireland, we are exploring with them the scope for increased funding for

growth-enhancing investment projects in Ireland to accelerate project delivery. We continue to ensure that all available resources from the EU Budget are focused on maximising job creation. Ireland has a strong record in spending Structural funding and we are in a position to spend unused funds from the EU Budget if available. We will explore the possibility of a "Growth Fund" which could leverage support for job creation activities. We will support any new EU-wide initiatives to support growth and believe that these are urgently required to provide a demand stimulus. We support further measures to deepen the Single Market. We will reinvest a significant portion of the proceeds of asset disposals in job-rich projects which will be consistent with our fiscal targets.

18. We are strengthening our response to the problem of high unemployment. As outlined in our new Pathways to Work labour activation strategy, we will accelerate our profiling efforts to ensure that jobseeker training needs are swiftly identified and effectively met. We will further strengthen our direct engagement with the unemployed through one-to-one interviews, raise the number of vacancies filled off the Live Register, and fortify our system of sanctions. By end June, we will prepare a progress report on the ongoing assessment of the current activation and training policies, including progress on the new data collection system and the possibility to engage with private sector firms specializing in activation of the long-term unemployed. A further report will be completed by end September. We will also explore the scope for attenuating any adverse employment incentives arising from the structure of social payments through a cross-departmental report.

19. We also have a multi-pronged demand-side strategy in place to support jobs. Building on the 2011 Jobs Initiative, and the tax incentives provided in Budget 2012, the recently published Action Plan for Jobs sets out a range of measures to support employment creation. These measures include supporting indigenous start-ups and high-growth mid-sized companies, further enhancing SME credit and R&D incentives, and pursuing targeted growth opportunities in the Green economy and the ICT sector. In the context of this demand-side strategy, there may be scope to consider adapting existing flexible working arrangements in the public service.

20. We are developing the work programmes needed to advance our programme for the disposal of state assets. Following a rigorous process, we have identified the state assets for disposal and will, by end June 2012, develop a detailed outline of the necessary work, including regulatory reforms, to be completed by end 2012 to facilitate the expected commencement of the sales process in 2013. We will use at least half of the proceeds from state asset sales for debt reduction in due course, with the details on timing and implementation to be agreed. The remainder of the total realised proceeds would be reinvested in projects which are of a commercial nature, meet ex ante cost benefit criteria, enhance employment and preserve long term fiscal sustainability, including Programme and EDP fiscal targets.

21. Competitiveness reforms are proceeding as envisaged. We are increasing the resources of the Competition Authority to improve its capacity to tackle anti-competitive

behaviour. We have decided to transfer responsibility for water service provision from local authorities to a regulated water utility and roll out a domestic water metering program. These reforms will raise the efficiency of water usage while protecting poor households, creating employment, and placing the long-term funding of water services on a sustainable footing.

E. Programme Financing and Monitoring

22. The programme remains adequately financed and we are continuing preparations to regain market access as envisaged. Bilateral agreements with Sweden and Denmark have now been concluded. Building on our strong record of program performance, we are maintaining close contact with a wide range of market participants to facilitate our return to market financing as envisaged under the programme. Market conditions permitting, we are seeking to resume Treasury bill issuance in the second half of 2012.

23. 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, as envisaged in our Letters of Intent since the inception of the arrangement on 3 December 2010 along with this letter. 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 (Tables 1 and 3).

24. 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
Quantitative Performance Criteria		
Cumulative exchequer primary balance	End-March 2012	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-March 2012	Observed
Continuous Performance Criteria		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
Structural Benchmarks		
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	Observed
Finalise plans for the recapitalisation of Irish Life and Permanent.	End-May 2011	Observed
Establish a Fiscal Advisory Council.	End-June 2011	Observed
Complete the recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society.	End-July 2011	Observed
Submit the Supervision and Enforcement Bill to Oireachtas.	End-July 2011	Observed
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society.	End-September 2011	Observed
Publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight.	End-October 2011	Observed 3/
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book.	End-December 2011	Observed
Finalise a strategy to guide the development of broader legal reforms around personal insolvency, including significant amendments to the Bankruptcy Act 1998 and the creation of a new structured non-judicial debt settlement and enforcement system.	End-December 2011	Observed
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets.	2012 Budget day in early December 2011	Observed

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 31 March 2011.
2/ In practice this was submitted to the Seanad as discussed in paragraph 21of the MEFP, as the Dáil was dissolved owing to the elections.
3/ Effective end-October 2011 and posted on November 8, 2011.

Table 2. Ireland: Quantitative Performance Criteria and Indicative Targets Under the Economic Programme for 2011–13

	30-Sep-11		31-Dec-11		31-Mar-12		30-Jun-12	30-Sep-12	31-Dec-12	31-Mar-13
	Target 1/	Outcome	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
	(In billions of Euros)									
	Performance Criterion		Performance Criterion		Performance Criterion 4/		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-20.2	-18.3	-22.3	-21.0	-6.9	-5.7	-9.0	-10.6	-10.9	-6.5
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	0	0
	Indicative Target		Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt 1/	115.9	111.7	117.2	115.7	125.0	123.0	128.8	130.9	133.3	141.7

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.

4/ For comparability, the 31-Mar-2012 outcomes for the cumulative Exchequer primary balance and the stock of central government net debt include the payment of the IBRC Promissory Note although settlement of this payment took place in early April through the issuing of a Government bond. The indicative 31-Mar-2013 Exchequer primary balance and Central Government net debt targets assume the IBRC Promissory Note payment is executed in March 2013 as it was in March 2011 – with a cash payment from the Exchequer.

Table 3. Ireland: Upcoming Structural Benchmarks under the Programme for 2012

Measure	Date	Status
Financial sector policies		
Submit an updated restructuring plan for PTSB detailing the actions needed to ensure viability of its core businesses (MEFP, ¶9).	End-June 2012	Proposed structural benchmark
Publish legislation to strengthen the regulatory framework for credit unions, including making legislative provision for effective governance standards and prudential requirements (MEFP Nov. 28, 2011, ¶19).	End-September 2012	Modified structural benchmark
Approve regulations to establish a charge levied across credit institutions to recoup over time the costs of resolving vulnerable institutions (MEFP Feb. 10, 2012, ¶9).	End-September 2012	Structural benchmark
Fiscal policies		
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence (MEFP Feb. 10, 2012, ¶21).	End-September 2012	Modified structural benchmark

Technical Memorandum of Understanding (TMU)

30 May 2012

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 2 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 December 30, 2011 as shown on the IMF's website (http://www.imf.org/external/np/fin/data/rms_five.aspx, accessed 19 January 2012), in particular, €1 = 1.2939 U.S. dollar and €1 = 0.842786 SDR.

I. 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.[23] 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

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

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 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, but including debt issued to IBRC to settle Promissory Note payments).[24]

5. For the purposes of the programme, the floor on t he 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. The floor will be adjusted upward by the amount of proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer receipts. The floor will also be adjusted downward for Exchequer outlays for the resolution of credit unions, and upward for any return of such outlays to the Exchequer and also for the recoupment of such outlays by the Exchequer from the Resolution Fund. Any other financial operation by Government to support banks, including the issuance of guarantees or provision of liquidity, will be reported to EC, 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, 2012:	
End-June 2012 (performance criterion)	-9.0
End-September 2012 (performance criterion)	-10.6
End-December 2012 (indicative target)	-10.9
End-March 2013 (indicative target)	-6.5[25]

[24] Net debt interest payments are as per the end-month Exchequer Statements.

[25] The indicative end-March 2013 Exchequer primary balance and Central Government net debt targets assume the IBRC Promissory Note payment is executed in March 2013 as it was in March 2011 – with a cash payment from the Exchequer.

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:[26]

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2012:	
End-June 2012 (projection)	19.7
End-September 2012 (projection)	30.7
End-December 2012 (projection)	43.8
End-March 2013 (projection)	10.0

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, as well as the NPRF's non-liquid discretionary portfolio are excluded from the definition of liquid assets.

[26] 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.

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 ceiling will also be adjusted (i) downward by the amount of proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer or NPRF receipts; (ii) upward for Exchequer outlays for the resolution of credit unions, and downward for any return of such outlays to the Exchequer and also for the recoupment of such outlays by the Exchequer from the Resolution Fund; (iii) downward by the amount liquidated from the NPRF non-liquid discretionary portfolio; and (iv) downward (upward) by valuation gains (losses) in the NPRF liquid portfolio. 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-December 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-March 2012 (provisional)	123.0
End-June 2012 (indicative target)	128.8
End-September 2012 (indicative target)	130.9
End-December 2012 (indicative target)	133.3
End-March 2013 (indicative target)	141.7

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 t he schedule of external payments obligations reported by the National Treasury Management Agency.

II. Reporting Requirements

14. Performance criteria under the programme will be monitored using data supplied to the EC, 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 primary balance to the EC, IMF and ECB 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 EC, 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.

- The Central Bank of Ireland will provide on a quarterly basis, bank by bank data on the assets of government guaranteed banks, including loans and provisioning by period overdue (90+days and less than 90 days) and category of borrower, 35 working days after the end of each quarter.