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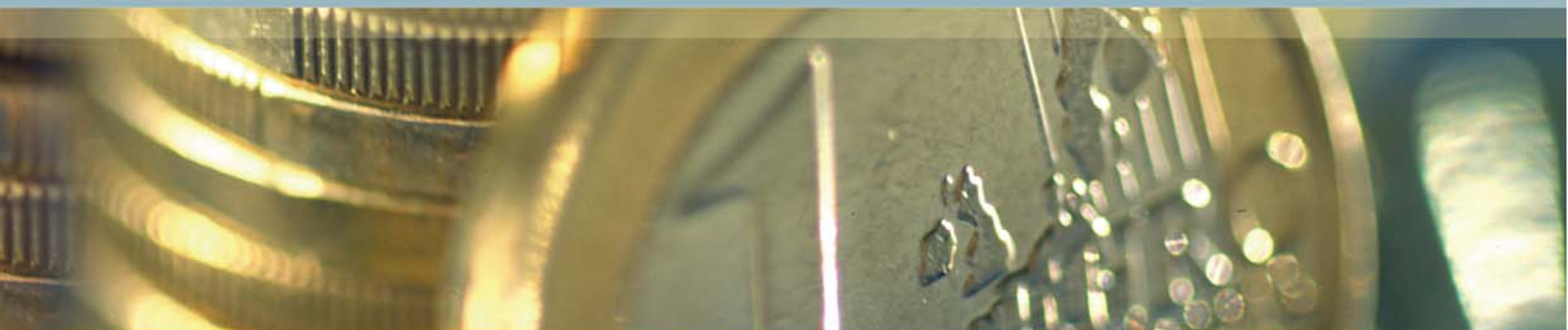

Economic Adjustment Programme for Ireland
Autumn 2011 Review

Directorate-General for Economic and Financial Affairs

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European Commission
Directorate-General for Economic and Financial Affairs

Economic Adjustment Programme for Ireland

Autumn 2011 Review

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Executive summary

Despite a very challenging domestic and external backdrop, Ireland continues to perform well under the programme:

- *Growth has exceeded programme expectations in the first half of 2011, on the back of strong exports driven by ongoing competitiveness gains. Fiscal consolidation is continuing according to plan, with the 2011 deficit expected to stay well within the programme ceiling (10.1% of GDP versus 10.6%).*
- *The reform of the domestic financial sector, though not yet complete, is proceeding well. The landmark recapitalization of the domestic banks was substantively completed at end-July. Progress has been made in dealing with remaining weaknesses in the credit union sector, while the assessment of options to strengthen the recently submitted restructuring plan for Irish Life & Permanent has begun in earnest. Banks' sales of non-core assets are broadly in line with programme assumptions, despite the weakened market sentiment. In addition, significant progress has been made in implementing the Central Bank of Ireland's action plan to strengthen supervision of credit institutions.*
- *Structural reforms to enhance competitiveness and allow stronger job creation were also significantly advanced. Sheltered sectors of the economy are being opened up with the publication of several reform bills (in particular for the legal and medical professions), while steps are being taken to raise caps on the size of retail premises and to strengthen the enforcement of competition law. Moreover an action plan is in place to modernise the framework for sectoral wage-setting arrangements and work continues towards the end-2011 commitment to identify state assets suitable to be privatized.*

Strong programme implementation, together with the significant improvement in the terms of the EU loans, has led to a sharp improvement in market perception of Ireland's riskiness since the last review. Nevertheless, Ireland continues to face important challenges:

- *The near-term macro and fiscal outlook has worsened on foot of weakening global activity and higher-than-anticipated unemployment.*
- *Market sentiment remains fragile, amidst intensification of the euro area debt crisis, uncertainty surrounding its resolution and discussions about greater private sector involvement in addressing Greece's debt problems.*

These challenges call for continued firm steering of policies to underpin market confidence in the continued support by Ireland's partners in the EU (and, especially, euro area).

Of particular importance, in light of the increased risks to the fiscal outlook, will be the implementation of the 2012 budget. The authorities remain strongly committed to observing the programme ceiling of 8.6% of GDP for 2012 and to bring the deficit ratio below 3% of GDP by 2015, as required under the Excessive Deficit Procedure (EDP). They plan to implement consolidation measures in the 2012 budget for EUR 3.8 billion. On the expenditure side, the new measures in the 2012 budget are savings in the wage bill (through public service numbers' reductions), social welfare and across a range of other current expenditure areas, and reprioritising and reducing capital spending. On the revenue side, the main VAT rate is being raised by 2 percentage points to 23%, capital gains taxes are increased, and a yearly EUR 100 household charge on primary residences is being

introduced as a step toward a value-based property tax. The measures are of structural nature and yields are prudently estimated.

The authorities have also set out the consolidation plans for 2013-15, including ceilings by expenditure group up to 2014. The implementation of the announced measures is projected to keep the deficit within the EDP ceilings throughout the period to 2015. Authorities remain ready to do more, if needed, to remain within the agreed deficit path. Good progress has been made toward the development of a medium-term budgetary framework and multiannual expenditure ceilings to strengthen the capacity to put debt on a sustained downward path after 2013. The establishment of the independent Irish Fiscal Advisory Council is welcome.

Turning to the domestic banking sector, the remaining challenges, namely the copper-fastening of the banks' restructuring plans and the restructuring of the small but important credit union sector, need to be managed very carefully, with a view to both maintaining the high standards set with the 2011 Financial Measures Programme and minimizing the call on public funds.

Conclusion of the review allows disbursements of EUR 4.2 billion from EFSF/EFSM, EUR 3.8 billion from the IMF, and EUR 0.5 billion from the UK. The EU disbursement is expected in January 2012.

Introduction

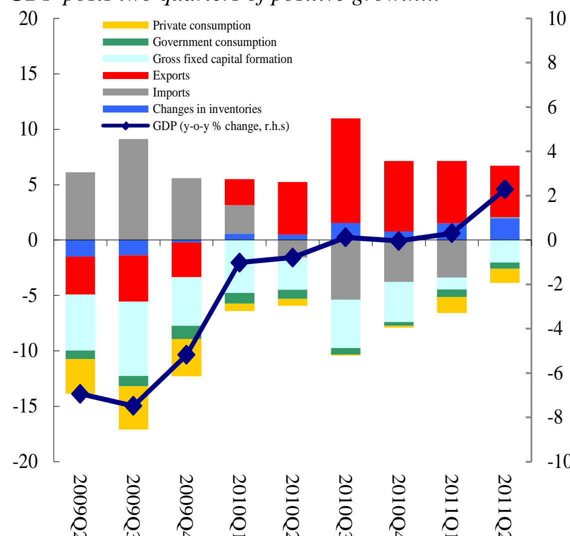
A joint mission of staff from the European Commission, the European Central Bank and the International Monetary Fund visited Dublin during 10-20 October to conduct the fourth review of the EU/IMF-supported economic adjustment programme for Ireland. This report covers recent macroeconomic developments, programme implementation, the main challenges ahead and the policy discussions with the Irish authorities.

1. Macroeconomic Developments

Buoyed by robust exports, real GDP grew faster than expected in the first half of 2011, the first period of sustained growth (two consecutive quarters) since 2007**.** The second quarter was particularly strong, with real GDP growing by 1.6% quarter-on-quarter and 2.3% year-on-year (Graph 1). Export growth was strong in the first half of 2011 (up 5.4% y-o-y in volume terms), particularly in the chemicals and agricultural sectors. Competitiveness gains are continuing, supported by wage moderation (hourly labour costs have fallen 3.5% in the year to the second quarter of 2011 in contrast to an increase of 3.6% in the euro area). Despite the overall weakness in domestic demand, imports have risen (albeit at a lesser pace then exports, i.e. 2.1% y-o-y), reflecting the large import content of Ireland's exports. Machinery and equipment investment picked up in the first half of the year from the lows of 2010, a positive development given tight financing constraints, particularly for SMEs (lending to SMEs contracted by 3.3% quarter-on-quarter and 9.9% year-on-year in 2011Q2). However, the continuing (but expected) contraction in construction saw overall investment fall by 11.8% in the first half of 2011 compared to the same period in 2010.

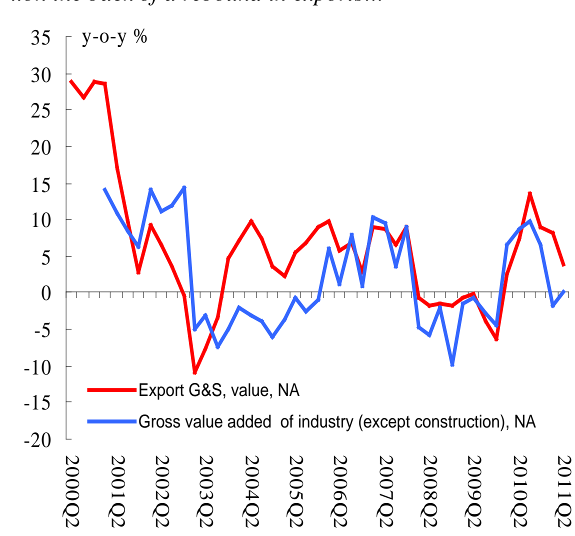
Graph 1: Real GDP performance and key drivers

GDP posts two quarters of positive growth…



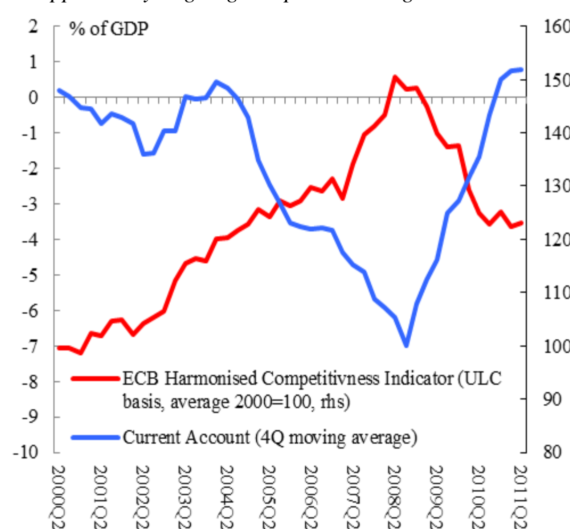
Yearly growth rates, Source: CSO

..on the back of a rebound in exports…



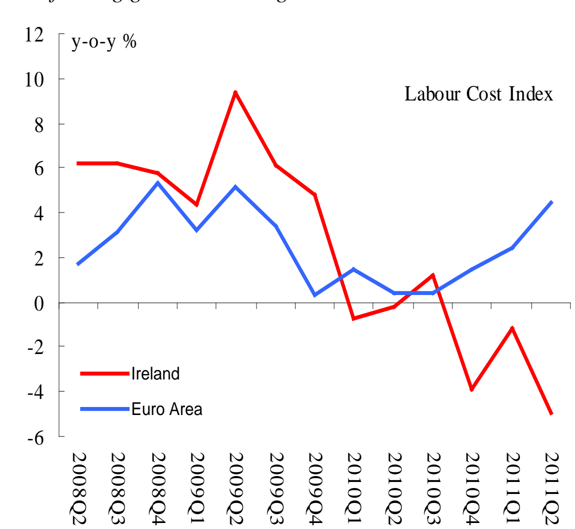
Source: CSO, Eurostat

…supported by ongoing competitiveness gains…



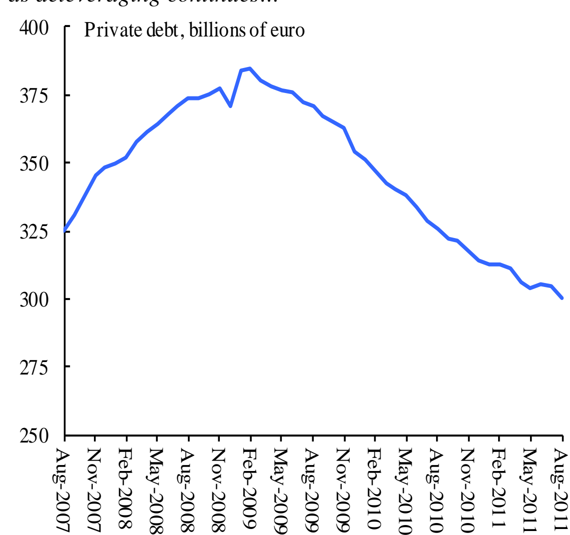
Source: CSO, CBI. Note: an increase in the ECB HCI indicates a loss of competitiveness

…reflecting generalized wage moderation.



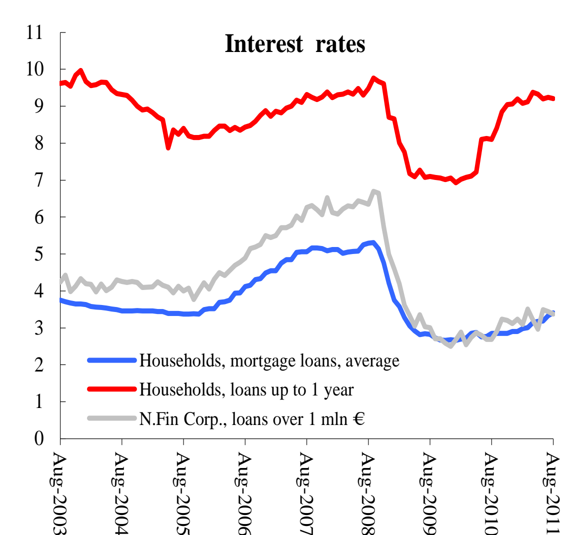
Source: Eurostat

Domestic demand, on the other hand, remains subdued, as deleveraging continues…



Source: CBI

…amid raising debt servicing costs.



Source: IFS

In nominal terms, however, GDP has contracted sharply, reflecting adverse terms of trade effects (see Box 1). In particular, Ireland's high import dependence in energy has led to a 10%-deterioration in the goods terms of trade in the first half of 2011. Although headline inflation has picked up in November (with annual rate of HICP inflation at 1.7%), it remains significantly lower than the euro area average (presently 3.0%).[1] While this implies continued competitiveness gain, the overall weak growth in the deflator makes observing deficit-to-GDP ratio ceilings more difficult, due to slower growth of the size of the tax base and a smaller nominal GDP.

Box 1: Downward revision to nominal GDP in 2011

While the forecast for real GDP growth in 2011 has been revised up since the last review (from 0.6% to 1.1%--see also Section 2 below), the GDP deflator is now set to contract by 1% in 2011, rather than expanding by 0.5% as previously expected, for two main reasons:

- There was a q-o-q terms of trade deterioration of about 1% in Q2, and despite similar assumptions on domestic demand deflators (as in previous reviews), the high weight of trade in Ireland's GDP has a large impact.
- Import price growth is likely to be higher-than-expected for 2011 as energy products comprise an increasingly large share of imports. For 2012, a terms-of-trade improvement is likely due to weakening energy prices, while the expected depreciation in the euro would boost export prices. The overall GDP deflator is expected to grow by 0.9% on average in 2012, and there might be some small upside risk.

Together with downward revisions in the assumptions for real growth in 2012–2013, the lower forecast for nominal GDP in 2011 has important implications for the path of nominal GDP going forward. GDP in 2015 is now forecast at EUR 180 billion, almost 3% lower than the EUR 185 billion when the programme was agreed in November 2010. Despite the lowered growth outlook, the debt path is relatively unchanged over the programme period due to reduction in lending margin and lower-than-expected bank recapitalisation costs (see Table 7 in Annex 2).

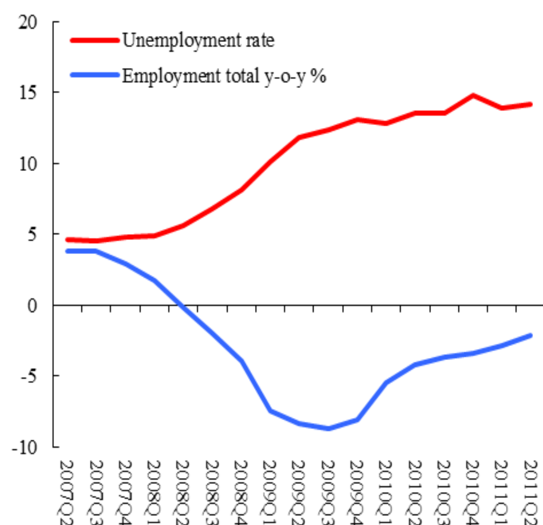
The labour market also has failed to benefit much from the stronger than anticipated real growth so far in 2011 (Graph 2), although recoveries in the labour market typically lag those in activity. The claimant-based measure of unemployment reached 14.5% in November, and the construction sector continues to shed jobs. Growth from the export sector (in particular chemicals, pharmaceuticals and food) is not sufficiently labour-intensive to offset this in the short term. This is compounded by challenging skills mismatches, as

[1] Consumer price levels fell from 29% above the euro area in 2008 to 18% in 2010 with the inflation differential continuing in 2011.

reflected in the increasing number of long-term unemployed (now 54% of total) who originate disproportionately from the construction and manufacturing sectors.

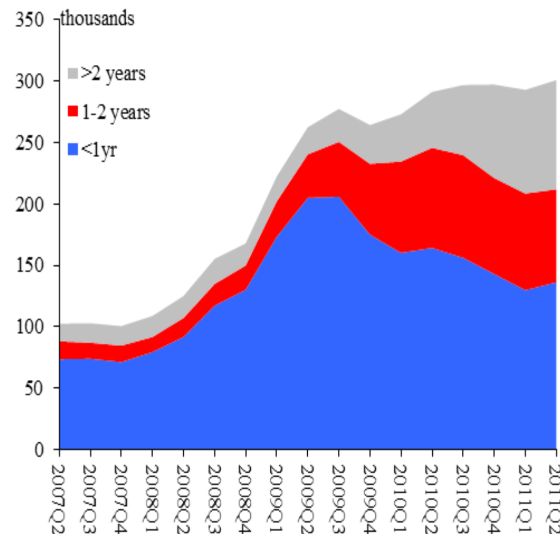
Graph 2: Labour market developments

Employment continued to contract, albeit at a slower pace…



Source: CSO

…with the share of long-term unemployment steadily increasing



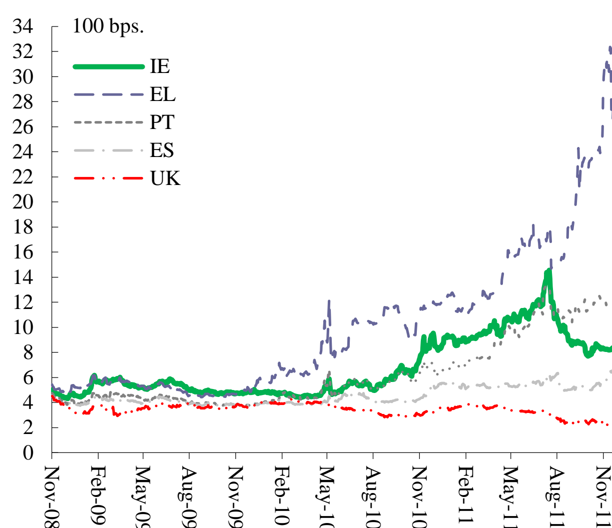
Source: CSO

Financial markets have welcomed enhanced EU support for Ireland that substantially reduces the interest expenditure. The lending rate margins on the EFSM have been eliminated and maturities extended, which is estimated to result in potential savings of up to EUR 6.7 billion (or 4.3% of 2011 GDP) over the lifetime of the EFSM loans. As to the EFSF loans, on 21 July, the Heads of State or Government of the euro area and the European Institutions decided to lower the margin on EFSF loans and pledged to continue supporting Ireland until it regains market access, provided Ireland implements the agreed adjustment programme (the UK has also announced that it will change the margin on its bilateral loan to Ireland in line with the EFSF loans, while negotiations with Denmark and Sweden are ongoing). The margin on EFSF loans to Ireland has since been eliminated meaning that advances will carry an interest rate close to the EFSF cost of funds, taking account of costs and fees. The potential net interest savings on margin reduction and extension of the average maturity of the EFSF funds from 7.5 to 12.5 years are estimated at up to EUR 5.5 billion over the lifetime of the loan.[2]

[2] This is an estimate of the direct effects of the changes to the terms of the EFSF loans to Ireland. It needs to be kept in mind that, with its increasing financing needs, the EFSF's own cost of funding has increased and thus the reduction in the interest rate charged to Ireland will likely be less than the reduction in the margin. No final decision on the maturity of EFSF loans has been taken.

Indeed, Ireland has decoupled from other vulnerable euro area states in recent months. Yields on two- and ten-year Irish sovereign bonds have fallen sharply, to a low below 8% from peaks of above 24% and 14% respectively in mid-July (Graph 3). This, and other positive developments (e.g., Bank of Ireland (BOI)'s receipt of private risk capital and of term funding, albeit on a secured basis) has led many commentators to expect an earlier-than-previously anticipated return to market funding on the part of Ireland. As market turbulence in the euro-area heightened, yields increased again.

Graph 3: 10-year yields on select Sovereign bonds.



2. Outlook

Risks to 2011 real growth have tilted to the upside, and the forecast has been upped to 1.1% (see Table 1), from 0.6% in the previous review. The surprisingly strong first half led the staff of the European Commission and IMF to revise up the programme's forecast for real growth in 2011 as a whole from 0.6% to 1.1%. Risks around this forecast are possibly somewhat skewed to the upside, given the strong carry-over (2.0% as of 2011Q2) and the surprisingly strong showing of industrial production in the summer months.

On the other hand, the slowdown in main trading partners calls for revising down the growth forecast for 2012. GDP is now expected to grow by 1.0% in 2012, down from 1.9% in the previous review, on the back of a contribution from net exports of around 1.8 pp, which is lower than previously assumed and also lower than the 3.2pp expected in 2011. The contribution from net exports will be offset to some extent by a further decline in domestic demand, though the resulting drag on growth would be significantly smaller than in recent years (final demand, in particular, would "only" subtract 0.8pp from GDP growth,

significantly less than the 3.0 pp drag in 2011, and the 6% average drag over 2009-11, mainly because fixed investment is envisaged to remain broadly flat in 2012, following three years of sharp declines). All else equal the fall in external demand vis-à-vis the last forecast and the indirect tax increases announced in Budget 2012 should see a pass-through to lower private consumption too. However the downward revision to the path for the short-term interest rate in 2012 is likely to cushion the impact on the Irish household sector. Although the outlook for private consumption remains worse than in the previous review, staff have revised the private consumption forecast down only slightly from -1.0% to -1.3% in 2012. This is due to the now lower-than-expected path of mortgage service costs in 2012 (floating rate mortgages accounted for some 84% and 92% respectively of all mortgages for main dwellings and buy-to-lets as of end-March 2011).

Continued slack in the economy suggests underlying inflation will remain low and the weak employment picture will continue. Employment looks now set to contract for the fifth successive year in 2012 as the public sector shrinks, the financial sector downsizes, and domestic demand remains weak. As a result, the unemployment rate forecast for 2012 has been revised from 13.8% to about 14.2%. HICP inflation is projected at about 1.3% in 2012. Underlying price pressures are set to remain low next year with upward pressure on the headline inflation coming mostly from carryover of regulated energy prices increases in late 2011 and the effect of some of the measures in the 2012 budget (e.g., increases in VAT, excises on cigarettes, fuel and motor taxes).[3]

There is substantial uncertainty around the real GDP forecast of 1.0% for 2012, chiefly reflecting concerns of greater disruption from ongoing euro area debt problems and global demand weakness. At the same time, the a-cyclical nature of some of Ireland's exports (particularly pharmaceuticals) as well as recent competitiveness gains should limit the near term impact of weaker-than-expected global demand.[4]

Over the medium-term, growth is envisaged to accelerate gradually towards 3% in 2015. This assumption would enable the gradual closing of the output gap and is predicated on a gradual release of the presently high rates of private savings, as balance sheets are repaired, the uncertainty associated with length, scope and modalities of the required consolidation subsides over time, and risk premia decline accordingly. Ireland's medium-

[3] The motor tax is an annual tax paid according to the car's C02 emissions or the engine's size.

[4] The Central Bank of Ireland "Q4 Quarterly Bulletin" (October 2011) has an analysis of the sensitivity of Irish GDP growth to growth in Ireland's main trading partners. While concluding that this sensitivity is generally elevated, the analysis also underscores the resilience of Irish exports, attributed to favorable product effects (as in the wake of the 2009 global recession).

term prospects remain solid, based on strong underlying demographics, continued human capital deepening, and structural reforms of product and labour market under the programme shifting out the supply curve.

Table 1: Ireland—Updated macro-economic framework

	2010	2011	2012	2013	2014	2015
	% change on previous year					
Real GDP growth	-0.4	1.1	1.0	2.3	2.7	3.0
Private consumption	-0.9	-2.4	-1.3	0.5	1.8	1.9
Public consumption	-3.1	-2.9	-1.8	-2.4	-3.5	-3.7
Fixed investment	-25.1	-10.5	0.6	4.2	4.7	5.3
Domestic demand (contribution)	-5.0	-3.0	-0.9	0.2	0.7	0.9
Inventories (contribution)	0.9	0.9	0.0	0.0	0.0	0.0
Exports	6.3	4.5	3.8	4.3	4.8	4.9
Imports	2.7	1.6	2.4	3.0	3.8	3.9
Net trade (contribution)	3.7	3.2	1.9	2.1	2.0	2.1
Employment	-4.1	-1.9	-0.6	0.6	1.4	2.0
Unemployment rate (level)	13.7	14.4	14.2	13.5	12.8	11.9
GDP deflator	-2.4	-0.9	1.2	1.3	1.6	1.7
HICP inflation	-1.6	1.1	1.3	1.2	1.4	1.8
Current account (% of GDP)	0.5	0.7	1.5	1.9	2.5	3.2
Nominal GDP (EUR billion)	156.0	156.3	159.7	165.4	172.6	180.6
	level as % of GDP					
General government						
Government balance	-31.3	-10.1	-8.5	-7.5	-4.7	-2.9
Government balance (EUR billion)	-48.8	-15.9	-13.5	-12.4	-8.2	-5.3
Primary balance	-28.2	-6.8	-4.3	-1.9	1.0	2.7
Interest expenditure	-3.1	-3.4	-4.2	-5.6	-5.7	-5.6
Gross debt	92.5	104.6	114.4	118.8	118.6	116.3
Gross debt (EUR billion)	144.3	163.5	182.7	196.5	204.7	210.1

3. Programme Implementation

Programme implementation has remained strong. Programme conditionality for 2011Q3 has been met. In particular:

- **Fiscal consolidation is on track**. The 2011 fiscal deficit ceiling is expected to be observed with a margin, despite a less supportive macroeconomic environment than anticipated under the programme (most importantly lower nominal GDP and weaker

domestic demand depressing tax revenues, and higher unemployment weighing on social expenditure), supported also by a reduction of interest rate margin on EU loans. Tight budget executions and prudent fiscal planning, distinct characteristics of the programme, were key to the success on this front. The authorities have reviewed the **savings from the ongoing efficiency-enhancing measures** ("Croke Park deal") in the public service's pay bill and found them in line with programme assumptions.

- **Progress is also continuing towards a stronger, more focused, and better supervised financial sector** (Boxes 2-5). Domestically owned banks have been recapitalized at a significantly lower-than-earlier anticipated cost to the state (see Boxes 2-3). Non-core asset disposals have continued apace in line with agreed targets. Despite the adverse market conditions, domestically owned banks continue to make progress towards reaching their interim loan-to-deposit ratio targets, though there is uncertainty as to whether the end-2011 targets will be met, due to lower deposits than previously envisaged (see Box 4). Significant wholesale funding transactions with market counterparties have been executed by domestically owned banks, whilst reliance on Central Bank funding has stabilised (see Box 2). The authorities have presented a report on the implementation of the action plan to strengthen supervision of credit institutions (see Box 5), and introduced legislation to strengthen the Central Bank's supervisory and enforcement powers (the "Central Bank (Supervision and Enforcement) Bill 2011"), while a proposal to enhance the amount and quality of the credit information made available to credit providers was submitted to the Minister for Finance.
- As regards the **labour market**, the efforts to rationalize the labour market activation system and unemployment support schemes, so as to improve incentives to participation and job search, have continued. The Department of Social Protection will strengthen the framework and commence quarterly reporting on intervention numbers. The government has discussed the findings of the independent review of the Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs) with social partners and has presented an action plan to the programme partners, which aims at increasing flexibility and thus the scope for the significant sectoral labour market reallocation that is required to underpin the economic recovery. Legislation is expected imminently.
- Two pieces of legislation have been published to **enhance competition in the legal and medical professions**. Restrictions on medical advertising have also been separately eased. The government also published a draft bill to both strengthen

enforcement of competition law (through expanded tools and increased sanctions) and merge the Competition Authority with the National Consumer Agency (a move dictated chiefly by the need to generate synergies and reduce costs). Additional measures, if appropriate, will be taken to ensure adequate resourcing of the Competition Authority and effective sanctions and enforcement capacity against anti-competitive behaviour.

- An action plan was also agreed to **relax some ceilings on retail spaces** in a bid to enable economies of scale and, thus, lower prices.
- Finally, **an independent assessment of the electricity and gas sectors** was launched as envisaged. The assessment is being carried out by the International Energy Agency (IEA).

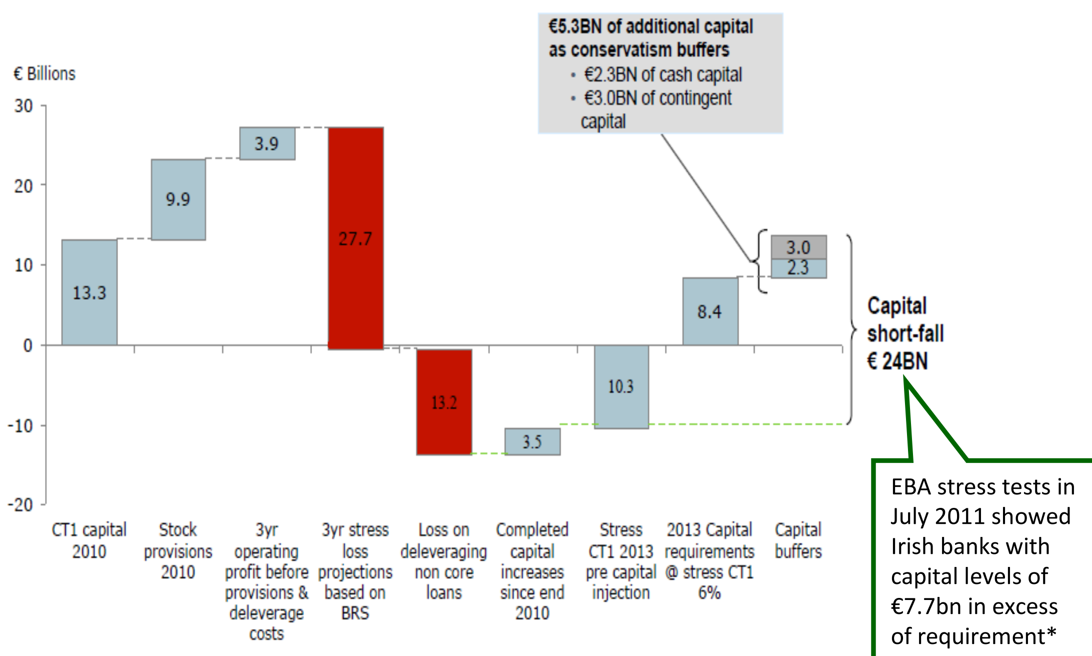
Available information suggests that policy conditionality associated with future reviews is also broadly on track to be observed. Given the very heavy legislative agenda, including in the run-up to the 2012 budget, and to enable full consultation with relevant stakeholders, the authorities have requested an extension of the end-2011 deadlines associated with the publication of two bills: fiscal responsibility legislation (to the first quarter of 2012) and a new regulatory framework for the credit union sector (to the second quarter of 2012). The authorities consider that the additional time would enable them to further improve the existing drafts, including by further examination of best international practices. Troika staff support the authorities' request.

Box 2: Update on the implementation of the Financial Measures Program

Recapitalization

Irish domestically owned banks were subject to a thorough and rigorous stress test in March 2011 (PCAR 2011). Following this, a recapitalisation need of EUR 24 billion was identified, including EUR 5.3 billion in additional capital buffers designed to shore up market confidence in the ailing domestic banking sector (see Graph 4). This capital requirement was some EUR 7.7 billion higher than the one identified by the subsequent EU-wide stress test conducted by the European Banking Authority (EBA).

Graph 4: PCAR Stress Test underlies strong capitalisation for Ireland's banks



Source: Department of Finance Banking Division.
This chart shows graphically the conclusions of the 2011 PCAR exercise. As of end 2010, core tier-1 capital plus stock provisions plus the expected operating profits over the PCAR horizon totalled EUR 27.1 billion. Against projected losses of EUR 40.9 billion (of which EUR 13.2 billion on the sale of non-core assets), capital would have been negative in the amount of EUR 13.8 billion, against a target of EUR 8.4 billion required to ensure a core tier-1 ratio of at least 6%. On top of this, some EUR 5.3 billion in additional capital buffers were deemed desirable. Considering that EUR 3.5 billion in new capital had already been injected after end-2010 and before the completion of the 2011 PCAR, the capital shortfall was identified at EUR 24 (=8.4+13.8+5.3-3.5) billion.

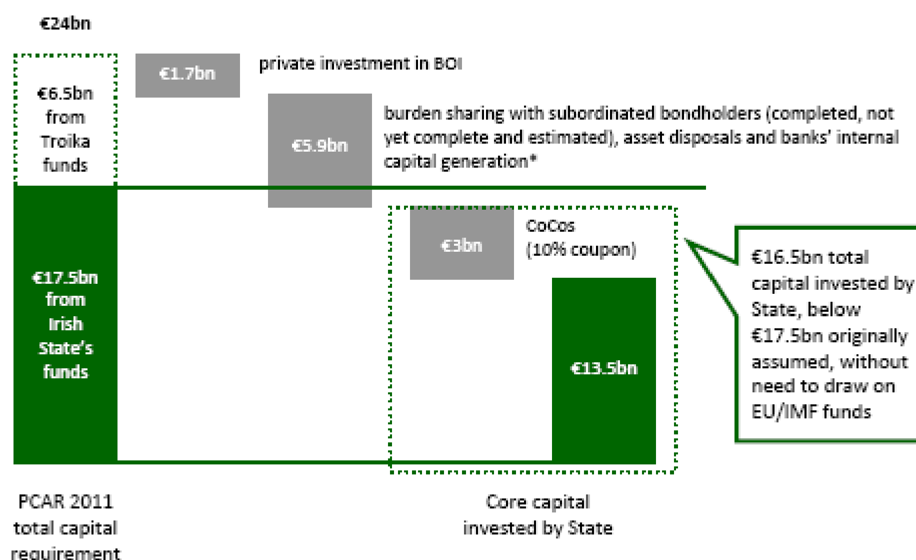
Irish domestically owned banks have been recapitalised according to schedule, by 31 July 2011, subject to adjustments for outstanding burden sharing with subordinated bondholders in BOI and for the completion of the then planned sale of ILP's insurance business. BOI has subsequently fulfilled the outstanding capital requirement of EUR 350 million through a series of debt buy-back transactions completed on 2 December. The authorities have committed to completing the recapitalisation of ILP, having sourced a considerable amount of the outstanding capital requirement via a series of LMEs with subordinated bondholders.[5,6]

[5] All figures in this box exclude any additional possible public capital injection for ILP that may be required following the announcement on 25 November that the sale of Irish Life would not materialise as originally envisaged by the end of 2011. Core Tier 1 gains from LMEs do not benefit ILP's overall group capital requirement until after the insurance and banking businesses of the group are legally separated.

Overall, Ireland's banks' core Tier 1 levels are now amongst the highest in the EU. This high level of capitalisation reflects in part the fact that, in compliance with IFRS, PCAR loan loss estimates are not accounted for, though it is important to note that significant progress in the recognition of loan provisioning has already been made by domestically owned banks (and especially majority state-owned banks).

The recapitalisation of Ireland's domestically owned banking system has been completed at lower-than-originally-envisaged costs to the budget (see Graph 5). The Irish authorities sought private investors, as well as burden sharing with subordinated debt holders, with the objective of ultimately reducing cost for the taxpayer. Following a series of successfully executed LMEs, the authorities have succeeded in substantively completing the recapitalisation of the domestically owned banking sector for a total cost for the public purse of EUR 16.5 billion entirely sourced from State funds, without the need to draw on the EU/IMF programme envelope.

Graph 5: Recapitalisation costs well below target



Source: Department of Finance Banking Division, September 2011.

Domestically owned banks' capital positions have now been shored up with a strong capital buffer, which should provide the necessary resources to enable them to absorb future loan losses and deleveraging haircuts going forward. The unweighted average core Tier 1 capital ratio of BOI, AIB/EBS and ILP is now at 21.3%, as compared to 8.1% in December 2010.

Deleveraging

The domestically owned banks continue making progress towards implementing their deleveraging strategy, with asset disposals taking place at discounts within the PLAR assumptions (see Graph 6). Even though the progress for the system as a whole has been strong, notable differences remain between domestically-owned banks' individual performances. BOI, in particular, has made significant progress, having announced divestments totalling circa EUR 5 billion of non-core loans in October and an additional disposal of almost EUR 0.6 billion of project finance loans in November. The combined impact of these divestments continues to remain within the base case discounts assumed as part of the 2011 PCAR and PLAR processes and will be neutral to BOI's core Tier 1 ratio. AIB has completed EUR 10.7 billion of non-core deleveraging by end October 2011 through asset disposals including US and European property, project and leveraged finance loans, as well as through repayments and redemptions, and increased provisioning. Asset disposals have been completed at better discounts than those assumed in the Financial Measures Programme, with a broadly neutral capital impact.

Outside the scope of the PLAR, Anglo (now IBRC) has also progressed with its planned deleveraging, having contracted the sale of USD 6.5 billion of its US commercial property portfolio which is expected to complete by end December 2011. Negotiations with identified bidders for the balance of the US portfolio are

[6] This transaction is expected to affect the fiscal accounts early in 2012.

also progressing.

Funding

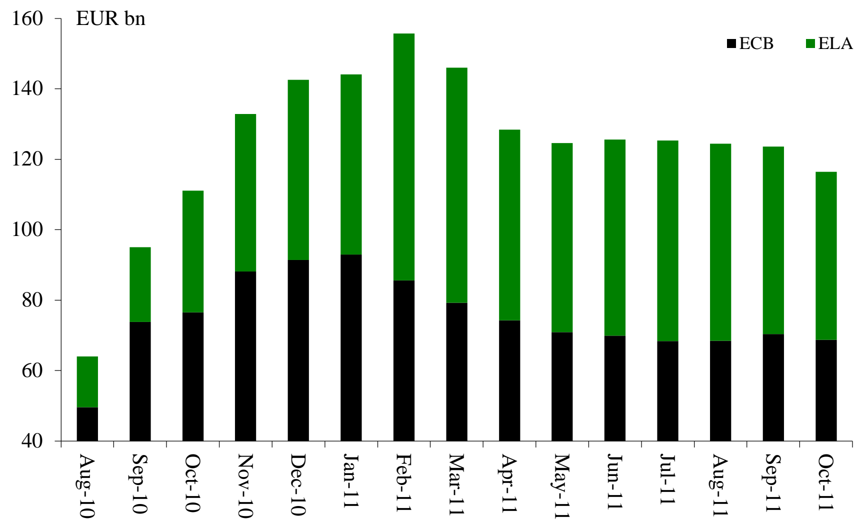
Domestically owned banks have continued to make good progress towards diversifying their sources of funding, while reducing reliance on central bank financing. Despite the very challenging market conditions, deposit inflows were recorded in the third quarter of this year, interrupting sustained quarterly deposit outflows that had continued from the first quarter of 2010 until the end of the second quarter in 2011. Important unguaranteed term funding transactions have been successfully executed by both BOI and ILP with international banks for a total amount in excess of EUR 6.7 billion. The banks utilised securitised pools of UK asset portfolios, as well as Irish automotive finance loans in the case of ILP, as collateral for wholesale repos. This, together with state capital injections and continued deleveraging has helped stabilise domestic banks' reliance on central bank funding (see Graph 7).

Graph 6: Asset and business disposals of Irish banks

	Businesses	Assets
AIB/EBS	1. Sold Polish unit (BZWBK) shareholding in April 2010 with profit of EUR 1.5 billion 2. Sold Goodbody Stockbrokers for EUR 24 million 3. Sold M&T (US) stake	1. Disposals comprising principally US and European property, project and leveraged finance assets completed at better discounts than PCAR base case
Anglo Irish	1. Closed branches in Chicago, Jersey, Vienna and Dusseldorf 2. All INBS offices closed and activities centralised in Dublin	1. Sale of USD 6.5 billion US commercial property loan portfolio completed 2. Negotiations advanced with identified bidders for the balance of US commercial property portfolio
Bank of Ireland	1. Sold Foreign Currency Exchange for USD 42 million 2. Sold 50% stake in Paul Capital for EUR 13 million 3. Disposal of Bank of Ireland Security Services announced 4. Sold Bank of Ireland Asset management for EUR 57 million	1. Sale of USD 1.13 billion US commercial property loan portfolio completed 2. Sales of GBP 1.33 billion UK commercial property and GBP 1.23 billion UK mortgage loan portfolios agreed 3. Sales of project finance loan portfolios agreed for total of EUR 1.55 billion in commitments 4. Negotiations on a number of other portfolios taking place
IL&P	1. Irish Life sale advisors appointed, transaction progressing	1. Market sounding process completed for CHL portfolio

Source: Department of Finance Banking Division, September 2011, bank websites.

Graph 7: Reliance on Central Bank funding has stabilised



Source: CBI. Data for ELA is an approximate measure (i.e., the CBI's "other assets" series).

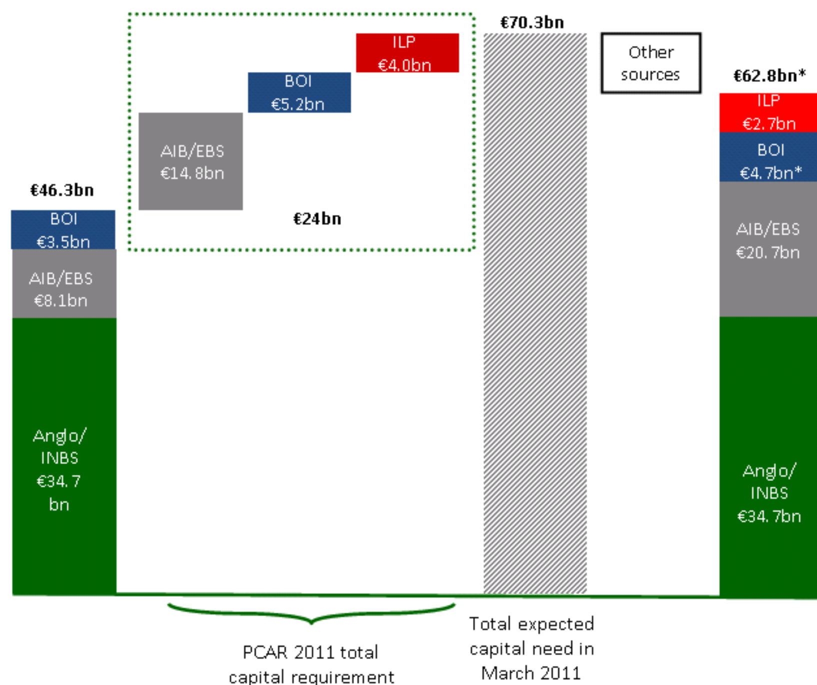
Box 3: The Cost of the Irish Banking Crisis for the Public and Private Sectors[7]

A full picture of the incidence of the banking crisis should reflect both the costs to the public and the *private* sector. Despite the widely recognised need to recapitalise Ireland's financial sector in order to sever the negative feedback loop between the country's ailing banks and government finances, successive recapitalisations have not had broad-based public support. Limited reporting on losses borne by private investors in the banks may have contributed to a perception that virtually the whole cost of the banking crisis has been covered by the state.

Indeed, the amount of private sector losses associated with the collapse of Ireland's banks is *higher* than the cost to the public purse:

- **Direct state support** provided to date for Ireland's domestically owned banks amounts to some EUR 62.8 billion, equivalent to more than 40% of 2010 GDP, almost 74% of which was injected before end December 2010 (see Graph 8).

Graph 8: Expected/actual direct State support



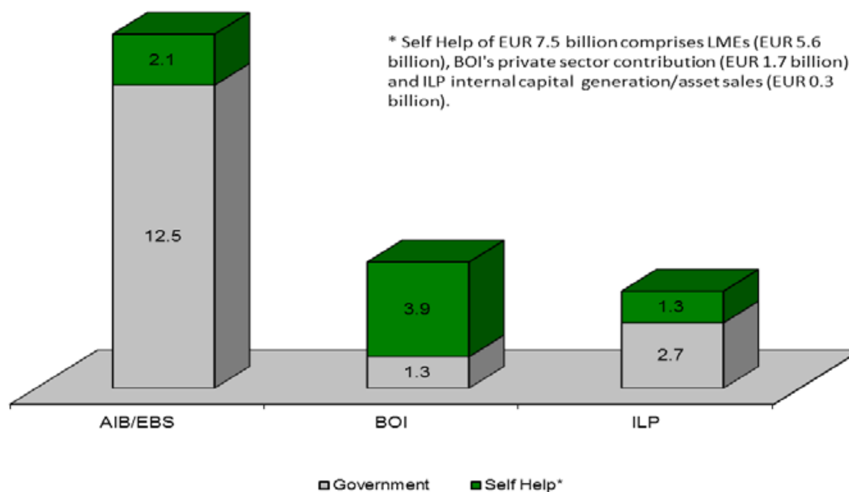
Source: Department of Finance Banking Division

- By comparison**, the total cost for the private sector** associated with the collapse of Ireland's banks, including voluntary contributions to the recapitalisation effort via burden sharing, has so far totalled about EUR 65 billion:
  - In terms of capital support, some EUR 15 billion has been contributed since 2009, including EUR 5.2 billion secured via a series of LMEs, executed since March 2011. Additionally, EUR 1.7 billion in private capital has been raised by BOI in 2011 (see Graph 9).
  - Since January 2007, some EUR 50 billion in shareholder value has been lost, as Irish banks' share prices collapsed in the wake of mounting losses resulting from the

[7] All figures in this box exclude any additional possible public capital injection for ILP that may be required following the announcement on 25 November that the sale of Irish Life would not materialise as originally envisaged by the end of 2011.

escalating property crisis, and domestic banks were nationalised in response to this (see Graph 10).[8]

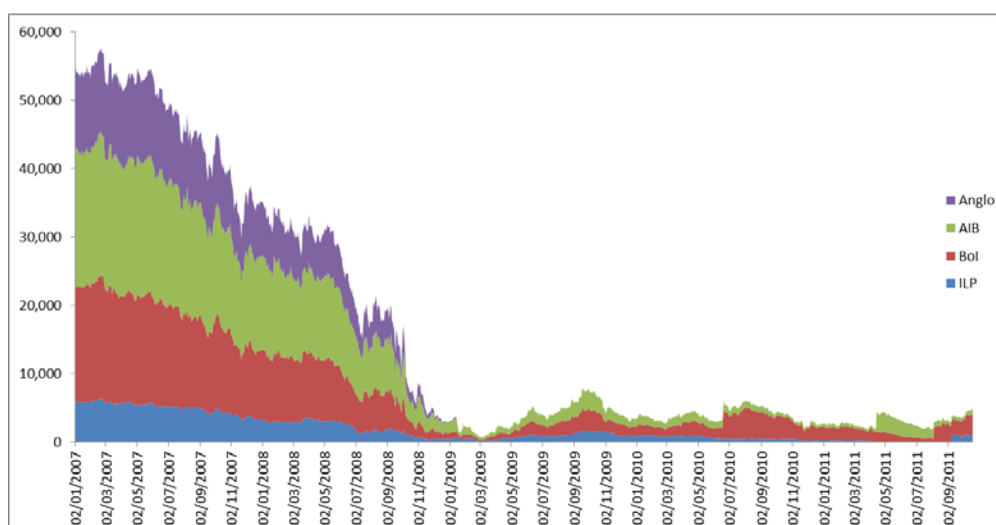
Graph 9: Sources of 2011 EUR 24 billion PCAR Recapitalisation (EUR billion)



Source: Department of Finance Banking Division

Significantly, the state has also received income from support provided to Irish banks, with total cash return to date since the beginning of the programme amounting to some EUR 3.0 billion (including EUR 2.3 billion of fee income from government guarantee schemes and 0.7 billion from the sale of warrants as well as cash dividend generated from preference shares in BOI). Further revenues are expected in the future from some of these sources. In addition, the eventual sale of the state-owned banks can be expected to generate some further recovery of the government support, and reduce gross debt.

Graph 10: Market capitalisation of Irish domestically owned banks (EUR million)



Source: Bloomberg, Irish Stock Exchange

[8] It is important to note that the estimate of private shareholder losses associated with the collapse of Ireland's banks depends on the selected reference period, as well as on the choice of listing for each entity. Considering only the listings of domestically owned banks on the Irish Stock Exchange, as graphically presented in Graph 10, it should be noted that peak-to-trough private shareholder losses amounted to EUR 57 billion.

Box 4: Developments on Irish banks' balance sheets since the start of the programme[9]

While the programme has an exclusive focus on restructuring the domestically owned banks in Ireland, developments in foreign owned banks matter equally from a macroeconomic perspective. Data[10] from the Central Bank of Ireland on covered institutions (i.e. domestically owned banks covered by the government guarantees) versus foreign-owned retail institutions provide empirical material for a comparative analysis of trends since the beginning of 2011. Care has to be used when interpreting these data as these balance sheets are unconsolidated and can be heavily influenced by intra-bank trends.

Covered institutions' total balance sheets shrank by EUR 91 billion (-14.6%). More than 60% of this reduction in amounts outstanding, EUR 57 billion, relates to loans to Irish residents. It should be noted that this decrease encompasses underlying transactions as well as reclassifications and valuation effects including securitisations. These non-transaction effects account for approximately 36 per cent of the decline in loans to Irish residents. Excluding non-transaction effects, the largest decline relates to loans to other Irish resident MFIs, which fell by EUR 25 billion (21.8%). The underlying flow of loans to the other domestic sectors, which include General Government and the private sector declined by EUR 879 million (-2.8%) and EUR 10.5 billion (-5.6%) respectively. Loans to non-residents have contracted by EUR 37 billion (-26.8%) largely reflecting underlying transactions. This contraction mainly reflects a decline in loans to counterparties outside the euro area. While holdings of domestic securities increased by almost EUR 18 billion (+26.5%), this is almost exclusively due to valuation effects with underlying transactions accounting for less than EUR 1 billion. Conversely holdings of foreign securities went down by more than EUR 15 billion (-28.3%).

With respect to resources, covered institutions faced a decline in resident deposits by more than EUR 38 billion (-16.4%), with deposits from the private sector (which includes pension funds and other financial intermediaries) down by EUR 12 billion (-10.4%). Non-resident deposits went down by more than EUR 33 billion (-32.1%). Long-term funding through securities issued on the capital market declined by almost EUR 9 billion (-14.1%). Total capital of covered institutions has increased by almost EUR 13 billion (+23.7%), largely reflecting capital injections from government. Borrowings from the Eurosystem related to the regular monetary operations contracted by EUR 23 billion (-24.9%).

Developments on non-covered retail institutions' balance sheets have been less pronounced. Their total assets declined by approximately EUR 3 billion (-2.2%), with the amount of loans outstanding to the private sector expanding by 2.0%. However, when non-transaction effects are excluded, there was a small underlying decline in lending to the private sector. Based on underlying flows, assets have remained broadly stable, although there were falls of over EUR 2 billion (-22.9%) in loans to residents outside the euro area, and in holdings of securities issued by the Irish private sector, which contracted by EUR 2.5 billion (-8.6%). With respect to their resources, foreign-owned retail institutions have seen a small decline in locally attracted funds. Deposits from Irish residents went down by almost EUR 4 billion (-6.4%), while deposits from non-residents declined by EUR 4.7 billion (-14.0%). Increases in capital and reserves of foreign-owned retail banks largely reflected intra-group movements. Regular Eurosystem borrowings declined by significantly less than EUR 310 million (-10.0%).

These data suggest some differences between developments in covered and non-covered retail institutions. First, consistent with the programme's gradual deleveraging objectives, some balance-sheet contraction is taking place in the covered institutions. Second, when non-transaction effects are excluded, the decline in private sector lending by the non-covered retail banks is marginal, in contrast to much larger falls in the covered banks. There was also a greater decline in total deposits held in the covered banks (-21.2%), compared to those in the foreign retail banks (-9.2%).[11] This underscores the possible role the foreign banks might play if long-term funding and short-term liquidity strains on the covered institutions were to hold back the availability of credit. Third, the contraction of funds attracted from abroad by non-covered institutions suggests that they may be suffering from a contagious reputational effect.

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[9] This box covers data up to October 2011.

[10] Data refer to un-consolidated resident offices' credit institutions' balance sheets.

[11] This is without prejudice to balance sheet contraction within non-covered institutions that has already occurred prior to December 2010, e.g. RBS (Ulster Bank) and Lloyds (BOSI).

Box 5: Implementation of the authorities' action plan to strengthen supervision

Significant progress has already been achieved with respect to the Central Bank of Ireland's continuous efforts to strengthen supervision of credit institutions. All actions identified as priorities in the Bank's 2010 strategy for banking supervision have been taken and additional initiatives for 2011 and 2012 continue to be developed and implemented, including amongst others, new provisioning requirements, new public disclosure requirements, a new risk assessment framework, rollout of a new performance management system and an enhanced training programme for all credit institutions' supervision staff. Preparatory work on the PCAR 2012 programme has already started with a view to ensure high quality standards for the 2012 stress test exercise (see also section 4.2 below).

The CBI published its regulations and standards on fitness and probity on 1 September. The new regime, which introduces requirements in terms of competence, capability, honesty, integrity and financial soundness for holders of control and pre-approved control functions, is to be introduced gradually by December 2012. It is meant to guarantee that holders of key management and operational functions will comply with stringent professional and ethical criteria. The gradual introduction of the standards will be consistent with the ongoing renewal (now almost complete) of executive and non-executive directors at all credit institutions.

The credit team within banking supervision is consolidating its work. The new credit risk assessment framework is based on a detailed credit risk ratings grid, which identifies eight components of credit risk. These will be informed by analysis, which is both quantitative and qualitative in nature. The work will involve onsite and offsite engagement, as well as monitoring of the external market. A quarterly Credit Panel is in place to inform on key issues.

Separately, PRISM, the Central Bank's new risk assessment system will be used to rate all regulated financial service firms including banks (both domestic and foreign-owned institutions). The introduction of PRISM has been motivated by supervisors' awareness of the need to consolidate analytical progress in order to safeguard financial stability. This new risk assessment framework will be based on management information and is expected to provide a judgmental tool for better understanding banks' risk profile.

The credit team is working on a stock-taking document, which seeks to draw lessons from the current crisis, and which will cover credit, legal and valuation issues. It will reference Basel Credit Principles and also include some good practice observations. It is intended to be used as a training guide for management. This report is expected to be complete by the end of December.

A second report covering the use of certain types of credit limits, from a prudential point of view, is at an early stage of development. This would take under consideration policy tools including Mortgage Insurance Guarantees and Loan-to-Value (LTV) limits, as well as potentially fixing all interest rates for certain products such as mortgages. It would also consider the use of some portfolio/concentration restrictions on high-risk property lending. Due to low levels of lending at present, the urgency for completion of this report is reduced. The credit team intends to present a discussion document before the end of the year, outlining a wide range of policy options and assessing the associated benefits and disadvantages. The Financial Stability committee would then be able to decide on the key priorities for further research, with conclusions and recommendations for implementation to be agreed by the end of Q1 2012.

With respect to disclosure of provisions, the supervisor is confident of a positive outcome from its consultation with credit institutions and representatives of the accounting industry (see also Section 4.2). Banks have agreed to about 70% of the new narrative and numerical disclosures requested by the CBI. The new disclosures will be included in the 2011 reports as non-audited addenda, but will be challenged by audits in the subsequent years. Relative to current international practice, the new public disclosure standards in Ireland are among the most transparent and detailed.

With respect to actual provisions, the CBI is working on issuing new guidelines by end-December. The Irish authorities have committed to ensuring that banks recognize provisions and losses on disposals as early as possible within the scope of IFRS, which mandates the incurred loss model to provision recognition. They are working with the banks to ensure that their impairment triggers, management judgments, assumptions and estimated are changed to a conservative basis which reflects the economic circumstances.

4. Policy Discussions

4.1. Fiscal Policy

Discussions took place against the background of a less supportive macroeconomic environment. As mentioned above, although real GDP growth was seen to exceed earlier projections for 2011, nominal GDP—a better measure of the revenue tax base—is now projected to be lower both this year and over the medium term. Moreover, higher unemployment weighs on social expenditure. As foreseen under the programme, the authorities have announced through a Medium-term Fiscal Statement and the 2012 budget their consolidation plans over 2012-15 (Table 2). This ambitious consolidation strategy builds on the significant consolidation efforts already undertaken since 2008 (Table 3).

As far as 2011 is concerned, despite weak domestic demand, the authorities have kept the fiscal accounts on track to observe the 2011 deficit ceiling, supported by savings from the interest margin reduction on EU loans (0.2% of GDP)**.** Staff's current forecast for 2011 deficit is at 10.1% of GDP,[12] against a 10.6% of GDP programme deficit ceiling (in nominal terms the projection for the government deficit in 2011 has not changed as compared to the summer 2011 review of the programme):

- Tax revenue performance on a cash basis was below the authorities' target in the second half of the year (see Graph 11) and slightly worse than under the original programme profile (see Box 6 comparing the current fiscal projections against the November 2010 programme projections). Earlier-than-planned tax receipts and positive effect from the measures introduced in the May's Jobs Initiative (0.2% of GDP net effect on tax revenue) masked the underlying revenue weakness (about 0.3% of GDP relative to the forecast in the third review).[13]

- Non-tax revenue (on an accrual basis) is now expected to be on balance higher-than-programmed in 2011, as larger fees on the bank guarantees (increased by around 0.4% of GDP, reflecting the banks' ratings downgrade) and interests on the bonds

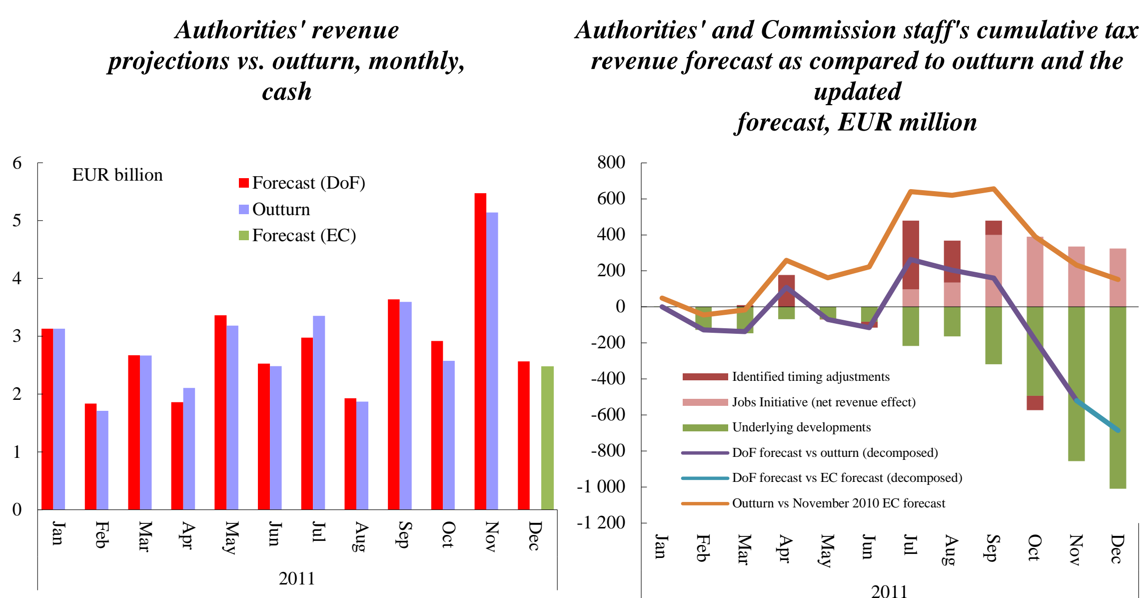
[12] Pending receipt of the final version of the business plans for the banks involved, the Irish statistical authorities (Central Statistics Office, CSO) provisionally treat these capital injections as financial transactions. By March 2012 at the latest, CSO, in consultation with Eurostat, will decide whether such statistical treatment complies with the rules of the European System of Accounts (ESA95).

[13] Monthly public finance cash reports monitor a large part of direct and indirect tax revenue performance against monthly targets set by the authorities. This revenue was projected at EUR 34.1 billion for 2011 in the original programme and at EUR 34.9 billion in the 2011 budget, based on information available to the authorities in early-December 2010. Currently, staff forecasts this revenue at EUR 34.2 billion in 2011 including the effect of the Jobs Initiative. Excluding the latter, the current estimate is some EUR 185 million lower than that at the beginning of the programme.

injected as convertible contingent capital into the domestic banks (0.1% of GDP) more than offset the shortfall from the delay in the sale of the mobile telephony license (0.3% of GDP, now expected to be realized in 2012).

- Aggregate cash expenditure to end-November was below the forecast. While delayed payments are generally expected to be settled towards the end of the year, savings of some 0.2% of GDP in current expenditure and 0.1% of GDP in capital expenditure are now expected (the unused capital appropriations are carried over to 2012).[14] Other small changes in the assumptions underlying the revenue and expenditure forecasts reflecting latest available information broadly balance each other out.

Graph 11: Fiscal performance so far in 2011



Source: Department of Finance, Commission services

Source: Department of Finance, Commission services.

Notes: The authorities' tax revenue forecast in the graphs refers to tax revenue profile published in February 2011. A more recent tax revenue estimate for 2011 is published in the 2012 budget, which is broadly similar to the current Commission services estimate. The outturn against November 2010 forecast is also affected by temporary timing adjustments and effect of the Jobs Initiative quantified in bars in the graph on the right.

[14] Capital carryover from 2010 to 2011 was EUR 13.5 million, while carryover from 2011 to 2012 is estimated at EUR 115 million. The positive effect in 2011 is not expected in the following years as carryovers between the years of a similar size are assumed.

Table 2: Fiscal adjustment path, 2011-15, EUR billion

	2011	2012	2013	2014	2015
Permanent consolidation measures	5.2	3.8	3.5	3.1	2.0
of which new measures	5.2	3.2	3.2	2.9	1.7
Revenue	1.3	1.7	1.25	1.1	0.7
First year effect	*1.3*	*1.1*	*0.95*	*0.9*	*0.4*
Carryover from the previous year		*0.6*	*0.3*	*0.2*	*0.3*
Expenditure	3.9	2.15	2.25	2.0	1.3
Current	*2.1*	*1.4*	*1.7*	*1.9*	*1.3*
Capital	*1.8*	*0.75*	*0.55*	*0.1*	*0.0*
One-off measures	0.1	0.4			
Memo item:					
Jobs Initiative*	0.2	-0.1	-0.1	0.3	

Notes: Includes the measures of the budget for 2011 (with associated carry-overs for outer years) and the measures in the budget for 2012 and for 2013-15 as announced in the Medium-Term Fiscal Statement (MTFS). Permanent consolidation for each year is defined as consolidation from *new* permanent measures introduced in that year plus carry-over from permanent consolidation measures introduced in previous years. The total consolidation amount of EUR 3.8 billion for 2012 includes a carryover of EUR 0.6 billion agreed in the programme, but excludes an additional EUR 0.5 billion in carryover, resulting predominantly from the Universal Social Charge implemented in the 2011 Budget. Rounding may affect totals.
*The Jobs Initiative is designed to be budgetary neutral over the period 2011-2014 and as such is not a part of the consolidation measures. It includes temporary measures stimulating economic activity in targeted sectors, in particular tourism sector, and is financed through the imposition of a temporary levy on pension funds.
Source: Commission Services.

Table 3: Fiscal consolidation measures since mid-2008, % of GDP

	2008	2009	2010	2011	2012	2013	2014	2015
Permanent measures	0.3	3.7	4.4	3.6	2.4	2.1	1.8	1.1
One-off measures		0.6	0.7	0.1	0.3			

Notes: Annual consolidation measures are net of fiscal stimulus measures and exclude banking support measures. The estimates do not consider second round effects of consolidation effort through fiscal impact on economic activity. Figures are comparable to those in Table 2, but it should be noted that consolidation effort of 3.6% of GDP in 2011 includes 0.2% of GDP carryover from the measures implemented in the previous years.
Source: Commission Services.

For 2012, the deficit is projected at 8.5% of GDP,[15] in line with the programme and EDP deficit ceiling of 8.6%. The weak domestic demand and higher-than-expected unemployment are expected to continue weighing on the fiscal accounts in 2012, through lower tax revenue (0.6% of GDP) and higher unemployment spending (0.3% of GDP) than projected in the previous review of the programme. These pressures would be offset by higher-than-planned non-tax revenues (for 0.2% of GDP from bank guarantee fees, 0.2% of GDP from higher central bank profits, and 0.2% of GDP from the return on the convertible bonds in the banks) and savings from the interest margin reduction on EU loans (0.6% of GDP). An improvement in the 2012 nominal deficit vis-à-vis the previous review of 0.3% of

[15] Excluding "direct effect" of banking support measures in 2011 and outer years (including for the possible capital injection in the credit union sector mentioned in the third update of the Memorandum of Specific Economic Policy Conditionality)—see also footnote 12.

GDP is partly offset by a GDP denominator effect and consequently the deficit-to-GDP ratio is 0.1 percentage point lower. This forecast is based on new consolidation measures of EUR 3.2 billion as outlined in the 2012 budget (see Table 4). Given the carry-over from the measures already introduced in the 2011 budget of EUR 0.6 billion, a total consolidation effort amount to EUR 3.8 billion for 2012 as compared to the EUR 3.6 billion minimum envisaged under the programme. The authorities have decided to take additional measures of EUR 0.2 billion as compared to earlier plans to safeguard the 2012 deficit target. Assumptions on interest earned on resources held by the National Treasury Management Agency and the National Pensions Reserve Fund have been revised down (some 0.2% of GDP in 2011). This, and other minor adjustments to the forecast with a small negative effect in 2012, would be offset by one-off revenue from the sale of the mobile telephony licence (0.3% of GDP), originally planned to impact the deficit in 2011 but now likely to be postponed to 2012.

The 2012 budget builds on the fiscal adjustment plans outlined in the Medium-term fiscal statement (MTFS) and Medium-term Exchequer framework for infrastructural and capital investment. On the revenue side, the main measures include a 2 percentage points increase in the standard VAT rate to 23%, introduction of a yearly EUR 100 household charge on principal residence, increases in retail deposit withholding tax (DIRT), Capital Gains Tax (CGT) and Capital Acquisitions Tax (CAT); an increase in the Carbon Tax of EUR 5 per tonne (to EUR 20 per tonne), as well as an increase in motor tax. On the expenditure side, the government has decided to slightly increase the amount of permanent consolidation measures to offset some spending pressures, while at the same time modifying the relative share of current and capital expenditure consolidation, relative to the National Recovery Plan, by frontloading the latter.[16] Current expenditure reductions predominantly concentrate on the three highest spending areas, namely social welfare (EUR 0.48 billion),[17] health sector (EUR 0.54 billion),[18] and education (EUR 0.13 billion).[19] Savings in both agriculture and justice departments will amount to about EUR 0.1 billion. The small residual

[16] As such, this frontloading could raise questions on the quality of the adjustment and the government's preference for taking politically easier measures. However, given that structural reforms addressing current expenditure will generate saving over time, front-loaded capital investment cuts are justified to deliver the quantum of the required fiscal consolidation. That said, fiscal adjustment still relies predominantly on cuts in current expenditures.

[17] This includes, among others, reduction of entitlements to higher rates for the third and subsequent children's allowance, reduction in employer's rebate under redundancy and insolvency scheme, reduction of winter fuel allowance from 32 to 26 weeks, as well as enhanced fraud and control measures.

[18] The bulk of the expenditure reducing measures in the health sector is to be achieved via reduction in employment levels and pay costs, increases in charges for private beds in public hospitals, increased service efficiencies, and savings in public procurement.

[19] Savings are secured mainly via reduction in teacher numbers, schools funding and student grant systems. The third level student contribution will also be increased by EUR 250 to EUR 2,250.

amount is covered via other measures. The 2012 budget also sets out expenditure ceilings for each department over the period 2012-2014 and outlines areas of possible savings to achieve these targets.

Table 4: Permanent consolidation measures in the 2012 budget (EUR millions)

Revenue measures	**1072**
Increase in standard VAT rate from 21% to 23%	560
Increase in carbon tax by EUR 5per tonne (to EUR 20 per tonne)	80
Increase in retail deposit withholding tax from 27% to 30%	35
Increase in capital gains tax (CGT) from 25% to 30%	81
Increase in capital acquisition tax (CAT) from 25% to 30%	51
Introduction of household charge of EUR 100 on principal residences	160
Increase in motor tax (between EUR 11 and EUR 117, depending on the category)	47
Change in USC collection basis from weekly to annual	45
Increase in tax on tobacco (+25 cents on a packet of 20 cigarettes)	41
Improved enforcement/compliance	45
Change to treatment of employer PRSI on pension contributions	57
Increase in mortgage interest relief for first-time buyers	-52
Reduction in the commercial property transaction tax from 7% to 2%	-64
Targeted reductions in universal social charge (USC)	-34
Other	20
Expenditure measures [1]	**2150**
Current expenditure	*1395*
Social welfare	475
Health care	543
Education	132
Agriculture	105
Justice	100
Other	191
Offsetting current expenditure pressures	-150
Capital expenditure	*755*
Total	**3222**

Source: Department of Finance and Department of Public Expenditure and Reform.

[1] Certain savings are to be used to offset expenditure pressures (the 2012 Budget presents measures both on a gross and on a net basis).

Box 6: Comparison of fiscal projections

Current fiscal projections differ from those underlying the original programme (November 2010) because of changes in the macroeconomic forecasts (explained in the main text), but also new policies, statistical adjustments, and the availability of additional data (Table 5).

Two main **policy changes** have intervened since the launching of the programme in November 2010:

(1) The 2011 budget, presented in December 2010, introduced a **Universal Social Charge (USC)**, which replaced the income levy and the health levy on a revenue-neutral basis in 2011 (since the health levy was previously recorded as social contribution, its replacement by the USC, which is part of direct taxation, explains a level shift change in both items). Importantly, the USC is estimated to yield a positive carry-over effect into 2012 of EUR 0.4 billion—a net addition to the fiscal effort of the National Recovery Plan which underpinned the programme.

(2) The **Jobs Initiative,** launched in May 2011, was designed to be budgetary neutral over the period 2011-2014, but has a net positive effect of EUR 200 million on the government balance in 2011 and 2014, and a net negative effect of EUR 100 in 2012 and 2013 (see Table 2). It increases indirect tax revenue by EUR 340 million in 2011, while reducing social contributions by EUR 90 million in 2011 and by EUR 200 million in 2012 and 2013.

Table 5: Current fiscal forecasts compared to November 2010 programme forecasts (EUR billion)

	2010		2011		2012		2013	
	Update	Nov. 2010	Update	Nov. 2010	Update	Nov. 2010	Update	Nov. 2010
Indirect taxes	17.8	17.7	17.9	17.6	18.0	18.0	19.0	18.7
Direct taxes	16.4	16.1	18.9	17.6	20.0	19.1	20.9	20.3
Social contributions	11.7	11.5	10.5	11.4	10.6	11.5	10.7	11.8
Sales	4.9	3.7	4.9	3.7	4.4	3.3	4.2	3.1
Other current revenue	2.3	2.8	1.8	2.9	1.9	2.7	1.8	2.7
Total current revenue	**53.1**	**51.8**	**53.9**	**53.2**	**54.9**	**54.6**	**56.6**	**56.6**
Capital transfers received	2.3	3.2	1.5	2.1	1.5	2.3	1.7	2.4
Total revenue	**55.4**	**55.0**	**55.4**	**55.4**	**56.4**	**56.9**	**58.3**	**58.9**
Compensation of employees	18.4	18.3	18.2	17.9	18.0	17.5	17.6	17.2
Intermediate consumption	9.4	9.2	8.8	8.3	8.3	7.7	8.0	7.4
Social transfers in kind	3.3	3.3	3.1	3.1	3.0	2.9	2.7	2.6
Social transfers other than in kind	24.7	25.1	24.8	24.7	24.2	23.9	23.4	23.2
Interest paid	4.9	4.8	5.2	6.0	6.7	7.5	9.3	10.2
Subsidies	0.8	1.2	1.0	1.2	1.0	1.2	0.9	1.2
Other current expenditure	3.8	3.4	3.8	3.3	3.8	3.3	3.8	3.3
Total current expenditure	**65.4**	**65.3**	**65.0**	**64.6**	**65.0**	**64.0**	**65.8**	**65.1**
Gross fixed capital formation	5.9	7.0	4.8	5.5	4.0	5.1	3.5	4.7
Other capital expenditure	32.9	32.8	1.4	2.0	1.0	1.9	1.4	1.9
Total expenditure	**104.2**	**105.1**	**71.2**	**72.1**	**69.9**	**70.9**	**70.7**	**71.7**
General government balance (EDP	**-48.8**	**-50.1**	**-15.8**	**-16.7**	**-13.5**	**-14.1**	**-12.4**	**-12.7**
% of GDP	-31.3	-32.0	-10.1	-10.6	-8.5	-8.6	-7.5	-7.5
GDP at market prices (value)	**156.0**	**156.4**	**156.0**	**158.5**	**158.8**	**162.7**	**165.0**	**169.0**

Revenue and expenditure items have also been affected by numerous **statistical changes** since last November

including: (i) reclassification of entities into the government sector; (ii) updates as detailed accounts become available; and (iii) changed recording of items inside the government accounts.

Among the main statistical changes, detailed accounts of the **local authorities** for 2009 revealed much lower capital transfers received and lower gross fixed capital formation (around EUR 1.1 billion). This has no deficit effect, but scales down projected level for both items. Reclassification of **Housing Rental Accounts** into the government sector increased sales (EUR 830 million) and reduced other current revenue (EUR 500 million) in 2010 and over the forecast period. The **2010 government deficit** was reduced by EUR 1.1 billion in September 2011 as more complete data on 2010 become available, but this improvement does not carry through to the following years. However, the effect of this correction cannot be quantified for each revenue and expenditure category. One-off revenue from the **transfer of the pension fund assets** to the government sector in 2010 (EUR 1 billion) were initially recorded as a negative other capital expenditure, but now as a capital transfer received. Finally, there has been a level increase in **intermediate consumption in 2011**, reflecting small adjustments elsewhere and is similar to an estimate produced by the government's centralised accounting system. Information from the administrative source can be considered as an alternative to more general forecast assumptions at this stage of the year. The general assumption of expenditure freeze and changes generated by fiscal consolidation measures still hold for the outer years.

The 2013 deficit is projected at 7.5% of GDP—within the programme's limits. The opening position for 2013 is weaker than anticipated when the EDP and programme targets were set due to a more adverse macroeconomic background now and lapse of one-off measures described above. The authorities have increased their consolidation effort in 2012 and 2013 by EUR 0.2 billion and EUR 0.4 billion, respectively, as compared to the previous commitments in order to adhere to the programme deficit targets. The updated forecast is based on the newly announced consolidation of EUR 3.5 billion (including carryovers) to be introduced in the 2013 budget (see also Table 2).

The authorities have committed to taking the necessary measures to meet programme and EDP deficit ceilings also in the outer years. They have announced the overall composition of revenue and expenditure adjustments for 2012-15 in the first week of November. In early December, the budget for 2012 introduced measures for the next year and provided further details on the broad measures underpinning the adjustment in the outer years. The planned adjustment in revenue side and capital expenditure is supported by broad measures, but not all adjustment in current expenditure is underpinned by measures. In particular, departmental expenditure ceiling until 2014 includes both specified measures (see Table 6 below)[20] and not yet specified adjustment needs, and the adjustment for 2015 is not

[20] On the revenue side, measures area spread over 2012-2015 so as to minimise increases in tax burden in a given year resulting from similar type of taxes. For example, household charge, water charge and value-based property tax are of comparable nature and will be phased over the period of three years. Similarly, carbon, excises and motor tax will be spread over the coming years as well.

detailed. Timely announcement of adequate measures is necessary to entrench the recent confidence gains against the background of deteriorated global sentiment. This point was also independently made by the recently established Irish Fiscal Advisory Council, which in its first publication of October 2011 argued for frontloading and possibly increasing the planned fiscal adjustment to maintain confidence in the achievement of programme targets even in difficult macroeconomic conditions. The Council suggested more frontloaded consolidation, allowing the completion of the fiscal adjustment by 2015 (in the sense that no further improvements in the primary balance would be required after 2015 to keep debt on a steady downward path).

The Comprehensive Review of Expenditure provides a menu of consolidation measures. Each department has prepared a detailed assessment report looking at every spending item and identifying a menu list of savings at the same time examining options for reform measures. These reports have been presented to the government and informed the discussions on the 2012 budget and the medium-term fiscal consolidation plans. They will also inform the government's further expenditure decisions in the coming few years.[21] The authorities have also prepared a list of possible taxation measures with detailed costing and impact assessments. The mission urged the authorities to underpin their consolidation efforts with high-quality structural measures.

Authorities explained how hitherto unspecified savings on public sector pay bill in 2012 to 2014 will be achieved (EUR 0.5 billion). The authorities intend to secure these savings via higher public service number reductions, in line with the Programme for Government. The numbers reductions are expected to be achieved by maintaining the previously planned retirement rates combined with lower new recruitments. Public service employment is expected to be reduced by 23,500 (full-time equivalents) between end-2010 and 2015, generating gross savings of EUR 1.2 billion on the public service pay bill. On a net basis the reductions will be somewhat less given the additional pension costs and the considerably lower tax paid by public service employees on retirement, although this effect is captured in the macro-fiscal baseline. This approach honours the existing public wage agreement for 2011-14 (known as the "Croke Park Deal"), which envisages no further wage reductions or involuntary layoffs in exchange for flexible cooperation with wide scale reforms of the public service. The early retirement is promoted by a higher superannuation benefits

[21] The Government has announced its intention to carry out a further Comprehensive Review of Expenditure in late 2013/early 2014 so as to inform its multi-annual expenditure approach for the following period.

(pension and lump sum) reduction of 7% on average after February 2012 as compared to the 4% reduction prevailing for those who retire before that date.

Table 6: Permanent consolidation measures over 2013-2015

Revenue measures

- Income tax measures (reduction in special exemption limits and PRSI reliefs on private pension contributions, elimination of legacy tax reliefs and tightening of other general tax expenditures).
- Carbon tax increase.
- Reform of motor tax.
- Value-based property tax.
- Pension system reform,
- Excises on tobacco and alcohol.

Expenditure measures

- Further reductions in Public Service numbers – the number of public sector employees is to be reduced by additional 23 500 to 282 500 by 2015 from end 2010 levels. This would reduce staff numbers by 37 500 and generate savings in the gross pay bill of EUR 2.5 billion since the peak in 2008.
- Rationalisation of State bodies–the plan foresees rationalisation, mostly via mergers, of 48 State agencies by the end of 2012. Additional 46 bodies will be reviewed by the end of June 2012.
- Improved management of property portfolio.
- Establishment of shared services models for human resources, payroll and pensions.
- Launch of the Public Services Card to improve access to government's services and help cutting welfare fraud (according to the Department of Social Protection estimates, the card is to bring about EUR 625 million in control savings in 2012).
- Reform of public procurement processes.
- Establishment of single awarding authority for student grants, including an online application process.

Sources: Department of Finance and Public Service Reform Plan.

4.2. Financial Sector Policies

The restructuring plan of ILP, submitted to the European Commission in July 2011, requires additional work and options to strengthen it are being developed. An assessment of these options will be completed by end-December 2011 and discussed again in the next review mission in January.

With respect to the credit union sector, the authorities indicated that the Interim Report of the Commission on Credit Unions noted that 56 out of 400+ credit unions (CUs) are undercapitalised, with 27 of these seriously undercapitalised.

Staff urged the authorities to thoroughly restructure the sector, even at the cost of some additional public funds. The authorities were in agreement, and indicated that they intend

to draw on resources within the sector, as well as to rely on competitive processes to facilitate transfers between weak and stronger credit unions, to minimize the call on public funds. Nonetheless, they have committed to inject by the end of 2011 EUR 250 million into a resolution fund that would provide the necessary capital for the restructuring of the sector. If needed, a second capital injection will be made in 2012. This funding will be recoupable over time via a levy on credit institutions. The authorities have also secured the necessary tools to resolve a credit union, if needed, with the passing of the Central Bank and Credit Institutions (Resolution) Act 2011. They have requested more time, until the end of June 2012, for the publication of a new regulatory framework for CUs, to permit broader consultation with stakeholders. The staff of the Troika found this request acceptable.

The Irish authorities have committed to ensuring that banks recognize provisions and losses on disposals as early as possible within the scope of IFRS, which mandates the incurred loss model to provision recognition. They agreed in principle that conservative provisioning would ensure that appropriate provision coverage levels would be recognised as early as possible for the loan losses which are already incurred in the portfolios. The authorities are working with banks to ensure that their key impairment triggers, management judgements, assumptions and estimates are changed to a conservative basis, which reflects the economic circumstances. Concerns were raised, however, regarding the accounting treatment of upfront provisioning for the expected losses on disposal in particular by both the banks and the banks' auditors, who argue that an expected loss model would not be consistent with IFRS. The authorities are continuing to engage with the banks and their auditors, and remain committed to issue new provisioning guidelines to banks by year-end. Meanwhile, the banks appear to be changing their provision methodologies to a more conservative approach within the scope of IFRS.

The 2012 PCAR exercise was also discussed. The CBI will run a stress test of the sector similar to the 2011 PCAR. The main change that has been proposed so far is to further align the test with the EU-wide EBA stress test. It is important to avoid any significant changes to the methodology that might be perceived as lowering the bar on Irish banks, in light of the still fragile market confidence.

4.3. Structural fiscal reforms

The authorities briefed the Troika on the work being done to introduce the fiscal responsibility legislation. The work appeared well advanced, as it has benefited from an

extensive consultation process, started earlier in the year with a dedicated seminar hosted by the Department of Finance, with significant participation of international experts. The legislation aims at introducing the recent EU-level enhancements of the Stability and Growth Pact, in the form of fiscal rules and medium term expenditure frameworks. It will also establish the independence of the recently appointed Irish Fiscal Advisory Council on a statutory basis. Despite the good progress, as discussed in section 3, it was agreed to postpone the deadline for publication to the end of the first quarter of 2012, to allow for broader consultation with stakeholders and ensure that the eventual bill meets the highest possible standards, and thus found the request acceptable.

The mission discussed the ongoing efforts to enhance activation of the unemployed. The Irish government reported on the new activation model in the context of merging delivery of active and passive labour market policies in the new National Employment and Entitlement Service (NEES). In particular the report described the currently rolled-out new customer profiling and case management model with a new IT system and more group engagements. The mission stressed the importance of effective and efficient activation given high levels of unemployment and noted that, in an international comparison, the use of financial sanctions for uncooperative unemployed is still very rare. The authorities have committed to commission an external review of the revised national employment action plan and to ensure that the necessary data and reporting system to ensure effective intervention are in place by the first quarter of 2012.

The authorities briefed the mission on the status of their discussions with social partners on the planned reform of the sectoral wage-setting arrangements (ERO/REAs). There is general agreement that the reduction of unemployment in Ireland requires increasing labour market flexibility and facilitating labour reallocation across sectors. This motivated the commission of the independent review of the ERO/REAs (see Box 7 for more details). A July 2011 High Court ruling that certain aspects of employment regulation orders (EROs) are unconstitutional and thus null and void created a legal vacuum in this area. The government is planning on re-introducing a legislative framework to allow for voluntary renegotiation of EROs. The new regulation of ERO/REAs will have to ensure that they are more responsive to changing economic circumstances. Important elements will be effective derogation clauses and clear criteria for establishment, modification and cancellation of a number of sectoral arrangements. The renegotiation of EROs is likely to take up to a year and renegotiated EROs are likely to be largely bound by the market conditions that will prevail in the meantime (for example, employers report anecdotally that

new hirings are taking place at or near the national minimum wage, though their number is low. In one other sector employers and unions have reached a voluntary collective agreement). The authorities confirmed their plans to move expeditiously in this crucial area, and they expect to be in a position to present a bill imminently.

Box 7: Background and objectives behind the authorities' efforts to modernising sectoral wage setting

The programme aims at reforming the system of Employment Regulation Orders (EROs) and Registered Employment Agreements (REAs) to facilitate adjustment in the labour market and to prevent distortions associated with sectoral minimum wages.

EROs are sector-specific regulations issued by the tripartite Labour Court and prepared by sector-specific Joint Labour Committees (JLCs). EROs usually provide for minimum wages above the national minimum wage, overtime premiums, Sunday premiums and specific non-wage working conditions. The ERO minimum wages are on average 10% above the national minimum wage (Duffy and Walsh report). The coverage of EROs is about 15% of private sector employment. The main sectors covered are retail, catering, hotels, contract cleaning and security services.

REAs are regular collective agreements between unions and employer associations. Registering them at the Labour Court makes them universally applicable in the respective sector, i.e. extends them to non-signing parties. The coverage of REAs is 8% of private sector employment, mostly in construction, the other main REA covering electrical contracting. Compared to EROs the REAs provide for much higher sectoral minimum wages. In construction the minimum wages for operatives and for craftsmen are 59% and 99% above the national minimum wage respectively. In electrical contracting it is 148% above the national minimum wage. Following the bust of the construction boom total employment in construction fell by 59% since its peak in Q1 2007. As a consequence in February 2011 the Labour Court lowered the construction REA minimum wages by 7.5%.

As a first step the Irish Government commissioned an independent review of EROs and REAs. The review by Mr Kevin Duffy and Dr Frank Walsh was delivered in April 2011. It concluded that the basic framework of EROs and REAs should be retained, but that the system requires radical overhaul so as to make it fairer and more responsive to changing economic circumstances and labour market conditions. Adding urgency to the issue, on July 6 the High Court ruled that sections of the legislation governing EROs are unconstitutional because they in effect delegate legislative powers to the Labour Court and the JLCs without adequate legislative guidelines.

The Irish government on July 28 outlined proposed changes to EROs and REAs aimed at increasing employers' willingness to hire, in particular in sectors hard hit by the crisis, and to facilitate the necessary cross sector adjustment. These announcements took into consideration the implication of the independent review and the High Court ruling.

Regarding EROs, the reforms will allow the targeted abolition of some EROs and greatly streamline the number of minimum wages set by restricting each ERO to a basic adult rate and two supplementary rates reflecting experience. EROs will no longer include conditions of employment covered in existing legislation, such as compensation for working on Sunday. In setting ERO rates the Labour Court will be required to consider economic conditions such as unemployment, wage trends, and international competitiveness. Companies facing financial difficulties will be have greater flexibility to deviate from EROs and REAs.

Regarding REAs, the reforms will establish a time-bound process by which REA terms may be varied without consent of all parties, clarify the representativeness of parties necessary to register an REA, and clarify when REAs may be cancelled. The time-bound action plan delivered by the Irish government in September foresees submission of legislation to the Oireachtas by November 2011, enactment by end-2011 and renegotiation of revised EROs in the first half of 2012.

The authorities are identifying assets to be disposed (an end-2011 commitment). They have set up a dedicated agency, NewERA, which is intended to facilitate the exercise of the state's shareholder rights in a centralised manner, as well as advising the government on the

disposal process. NewERA is also working with the National Pension Reserve Fund (NPRF) which is considering ways to use some of its discretionary portfolio (presently amounting to some EUR 5.3 billion) over the course of the next few years to set up investment funds (with matching or greater private sector involvement) to invest in Ireland in infrastructure, venture capital and long-term capital to the SME sector. The authorities indicated that their focus will be on enhancing long-term growth, and that any short-term demand stimulus effect would be welcome, but not the main intention.

The mission suggested that authorities finalize their public investment plans taking fully into account the substantial infrastructure overhang and the State's tight financial position. It also advised the authorities against initiatives that may maximize the short-term revenue raising potential of the state assets but undermine the economy's medium-term competitiveness and growth potential by, for example, forestalling competition in the post-divestiture industry structure. In this context, it was confirmed that the recently announced sale of a minority share in the Electricity Supply Board (ESB) would not be finalised until the regulatory steps and changes deemed necessary, including those required to be consistent with relevant EU legislation, had been identified and progressed to ensure compliance. A more substantive discussion on the authorities' divestiture plans is envisaged during the forthcoming January review mission.

The authorities are making legislative proposals and implementing reforms to increase competition in hitherto protected legal, medical and retail service sectors (thus meeting end-Q3 2011 commitments). Regarding the legal profession, the government published in early October the Legal Services Bill with a number of significant proposals, above all a new regulatory authority for the sector to replace the sector's current self-regulatory structure, a new complaints procedure, an independent disciplinary tribunal for the legal profession and a new office of legal costs adjudicator. Meanwhile, restrictions on the number of general practitioners (GPs) qualifying have been eliminated. As that was agreed with the Irish College of General Practitioners, the recognised training body for GPs in Ireland, legislation was unnecessary. In practice, the very narrow definition of what constitutes relevant GP experience has been scrapped, permitting fast track GP training for GPs with relevant hospital training and experience. In addition, a Medical Services Bill was published in late September entitling the Health Service Executive to enter into a contract to reimburse any suitably-qualified and vocationally-trained GP providing services to Irish medical card holders for free (a scheme formerly referred to as the General Medical Scheme); currently, such contracts are strictly controlled. The removal of restrictions on advertising continues,

on the basis of guidelines set out in 2009 from the Irish Medical Council. Finally, an action plan has been agreed with the authorities to raise some ceilings on retail spaces in urban areas by between 14% and almost 17% in a bid to enable economies of scale and, thus, lower prices.

Progress is made on the programme objective of strengthening the enforcement of EU and Irish Competition Law. The recently published Competition (Amendment) Bill contains provisions that increase the sanctions available to the relevant authorities (the Competition Authority and the Commission for the Communication Regulation), by raising both pecuniary and jail limits. It also includes provisions aimed at facilitating the pursuit of civil redress by an aggrieved party against a defendant, once a criminal or civil proceeding has found that the latter has engaged in an anticompetitive behaviour. However, some concerns remain as to the actual capacity of the measures to have an impact in practice. This also relates to the effective ability of the Competition Authority to pursue certain types of cases (e.g., abuse of dominant position), which are intrinsically complex and less suitable for a pursuit through jury trial within a criminal procedural framework. The authorities have committed to reviewing the staffing level of the Competition Authority, so as to ensure its effective functioning in view of the expected number and complexity of cases based on the Competition (Amendment) Bill. A broader review of the progress made in competition law enforcement will be completed by end 2012.

5. Financing Issues

The EU and the IMF have so far disbursed EUR 29.59 billion of financial assistance (19% of GDP) under the programme. This corresponds to 44% of total external financial assistance (EUR 67.5 billion) envisaged under the programme. The disbursed EU funds of EUR 20.5 billion were provided by the European Financial Stability Mechanism (EUR 13.8 billion), the European Financial Stability Facility (EUR 6.6 billion) and a bilateral contribution from the UK (EUR 0.461 billion). Bilateral contributions from Sweden and Denmark are expected to follow in the first quarter of 2012.

The planned loan disbursement for the last quarter of 2011 was confirmed during the mission (Table 7)**.** Successful completion of the fourth review would allow the release of EUR 4.2 billion from EFSF/EFSM, EUR 3.8 billion from the IMF and EUR 0.5 billion from the UK. Due to the comfortable exchequer cash position, the EU tranche is likely to be disbursed only in January.

Table 7: Financing needs and sources, 2010-2013 (EUR billion)

	2010	2011					2012					2013	2010-2013
	Dec	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Year	Total
A. Gross financing needs public sector 1/	7.9	12.8	5.2	3.2	12.4	33.7	12.5	3.5	2.3	5.0	23.4	23.7	88.6
B. Bank recapitalisation	0.0	0.0	19.0	-1.7	-0.8	16.5	0.0	0.0	0.0	0.0	0.0	0.0	16.5
C. Market financing	0.5	0.7	0.3	0.2	0.1	1.2	0.3	0.7	1.4	1.4	3.7	14.7	20.1
Net financing needs (A.+B.-C.)	**7.3**	**12.1**	**23.9**	**1.4**	**11.6**	**49.0**	**12.2**	**2.9**	**1.0**	**3.6**	**19.7**	**9.0**	**85.0**
E. Irish financial assets 2/	**7.3**	**-5.7**	**19.5**	**-2.1**	**3.3**	**15.0**	**-1.7**	**-1.2**	**-1.6**	**1.0**	**-3.5**	**-1.4**	**17.5**
F. EU-IMF loan disbursement	**0.0**	**17.8**	**4.4**	**3.5**	**8.2**	**33.9**	**13.9**	**4.1**	**2.6**	**2.6**	**23.2**	**10.3**	**67.5**
EFSM/EFSF	0.0	12.0	3.0	2.0	3.5	20.5	10.0	2.3	1.0	1.3	14.6	5.1	40.2
Bilaterals 3/	0.0	0.0	0.0	0.0	0.9	0.9	0.7	0.5	0.7	0.5	2.3	1.5	4.8
IMF	0.0	5.8	1.4	1.5	3.8	12.5	3.2	1.4	0.9	0.9	6.3	3.7	22.5
Programme financing (E.+F.)	**7.3**	**12.1**	**23.9**	**1.4**	**11.6**	**49.0**	**12.2**	**2.9**	**1.0**	**3.6**	**19.7**	**9.0**	**85.0**

Notes:
The table reflects information as of mid-October 2011.
1/ Includes exchequer cash deficit, maturing long-term and short-term debt as well as contingency element.
2/ Includes Treasury cash reserves and NPRF assets. "-" indicates an increase in cash reserves.
3/ Bilaterals include UK, Sweden and Denmark.

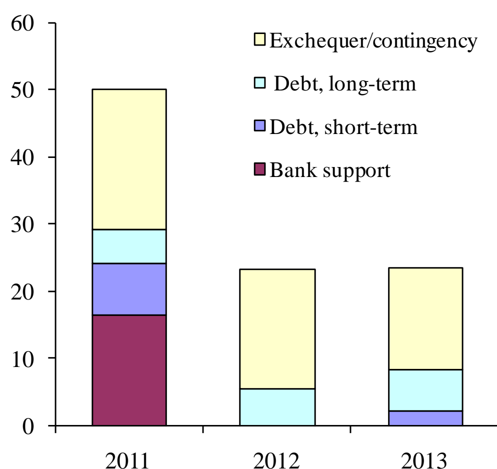
Loan disbursements for 2012 have been rescheduled within the year to allow a more prudent financing position. On the basis of current projection, the government cash position is expected to remain above EUR 6 billion over the full programme period. Some pressure on the cash balance will be exerted in March 2012 when debt amounting to EUR 8.7 billion (including EUR 3.1 billion from promissory notes) will mature. At the same time, access to commercial funding remains impaired and the exchequer faces sizeable collateral requirements for swap lines to hedge the interest rate and currency risk of IMF SDR-denominated loans. To improve the cash position in the run-up to this redemption hump, Troika and Irish authorities agreed to increase the Q1-2012 instalment by EUR 3 billion. This amount is deducted in equal tranches from the third and fourth quarter 2012, keeping total disbursements in 2012 unchanged.

Authorities and the mission agreed on the importance of maintaining sufficient buffers in the projected cash position. As a result of institutional approval procedures for the provision of funds, EU-IMF financing is usually provided only in the second half of each quarter. Nevertheless, the Treasury cash position should remain comfortable even in the event of some delays. Moreover, the liquidity projection is quite conservative. Risks are further mitigated by the authorities' potential ability to draw on other state assets for liquidity purposes. Furthermore, the Irish state has substantial liquid assets on top of the exchequer cash reserves, for example, the discretionary portfolio of the NPRF, which amounts to around EUR 5 billion, although only a small share could be made liquid quickly. Finally, any revenues from additional commercial funding or privatisation would further improve the

cash situation. Nevertheless, the liquidity position has to be monitored particularly carefully in light of the large financing needs in spring 2012.

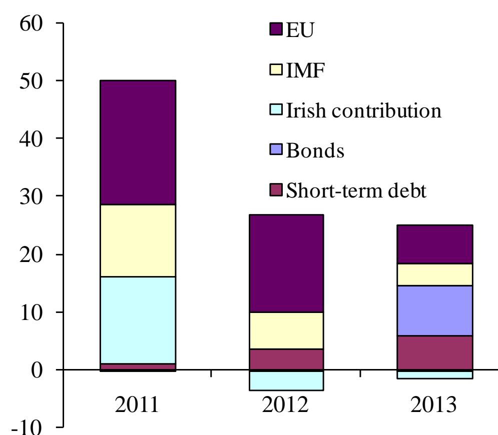
Graph 12: Financing needs

(EUR billion)



Graph 13: Financing sources

(EUR billion)

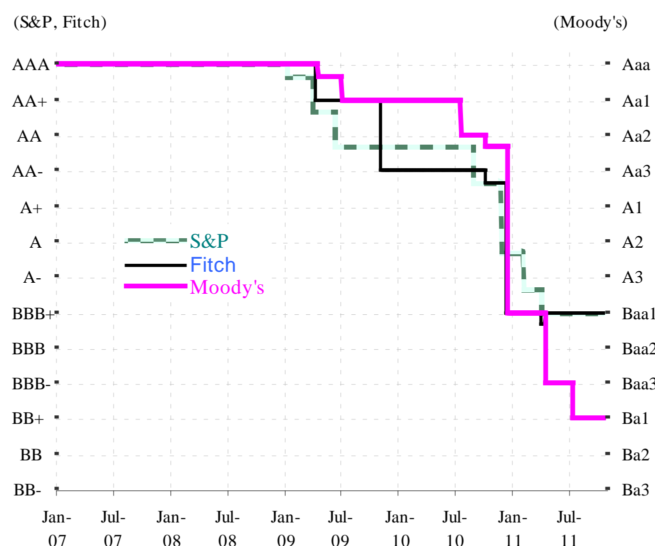


Note: the negative Irish contribution in Graph 13 refers to the planned build-up of cash balances, including in view of large debt redemptions in early 2014.

Overall, the programme remains well financed. Due to the comfortable cash position as well as the decisions taken by the Heads of State or Government of the euro area and EU institutions on 21 July to lower interest rate and extend maturities of financial assistance, there is no need for the Irish sovereign to tap the international bond market until the second half of 2013. Nevertheless, some short-term funding is expected already before and the authorities should re-enter the bond market sooner if market conditions allow, also building a sufficiently large enough cash buffer for the post-programme period. Yields on Irish bonds have fallen by more than 5 percentage points from their peak, and are now around 2 percentage points higher than in September 2010 when the Irish sovereign last went to the bond market. Also credit ratings have stabilized. As a first step to recommencing bond issuance, some short-term paper issuance should be envisaged soon, if market conditions permit. Even though interest rate may initially be higher than those related to official financing, this form of funding would provide a welcome signal that the exchequer does not rely on official funding only and that it is committed to return to the bond market during the programme period. Refinancing needs could also be lowered by resorting to the country's substantial external assets which augment further in the context of the improvement in the current account. To the extent that external assets can be mobilised (e.g. by providing

incentives for private pension funds to invest more into domestic bonds), financing needs are reduced.

Graph 14: Sovereign ratings



6. Risks

Good progress notwithstanding, important risks remain:

- The recent improvements in market sentiment vis-à-vis Ireland remain fragile, and could evaporate in case of adverse developments elsewhere.
- The growth outlook could deteriorate significantly in the months ahead, if Ireland's main trading partners do slide into a recession. Lower growth would complicate the authorities' consolidation effort markedly. On the upside, domestic demand has contracted significantly already and could be expected to rebound once consumer confidence takes a firm footing and the currently high precautionary savings are unwound. Faster export growth can also be expected because of realised improvements in competitiveness, which has also contributed to the current account returning to surplus.
- Political risks associated with consolidation fatigue could intensify, especially if private sector involvement in other counties is seen as a "quicker" and less painful way to address the high debt problem.

- The domestically-owned banks could suffer higher-than-anticipated losses as a result of continued weakness in the property market and higher-than-expected unemployment. Although current macroeconomic developments are broadly in line with the PCAR base case scenario and well within the stress scenario, it cannot be ruled out that they may deteriorate further.[22]

[22] Moreover, calls are increasing in Ireland for some form of debt forgiveness for stretched mortgage borrowers. While the government has consistently indicated that no blanket forgiveness will be granted, and that banks will be urged to analyse the situation of borrowers in distress on a case-by-case basis, risks remain that the repayment culture might be affected, which would have an adverse impact on the quality of banks' loan portfolios (with NPLs already escalating) and ultimately on their capital.

List of Abbreviations

AIB	Allied Irish Bank
BOI	Bank of Ireland
DoF	Department of Finance
CBI	Central Bank of Ireland
CSO	Central Statistics Office Ireland
CCR	Centralized Credit Registry
EC	European Commission
ECB	European Central Bank
EBS	Educational Building Society
EDP	Excessive deficit procedure
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
EROs	Employment Regulation Orders
ESB	Electricity Supply Board
GDP	Gross domestic product
GMS	General Medical Scheme
GP	General Practitioner
HICP	Harmonised Index of Consumer Prices
HoSG	Heads of State or Government
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 Labor Committee
LDR	Loan-to-deposit ratio
LME	Liability Management Exercise
LTV	Loan-to-value ratio
MEFP	Memorandum of Economic and Financial Policies
MoU	Memorandum of Understanding
MTFS	Medium-term Fiscal Statement
NAMA	National Asset Management Agency
PCAR	Prudential Capital Assessment Review
PLAR	Prudential Liquidity Assessment Review
PMI	Purchasing Managers Index
REAs	Registered Employment Agreements
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—Commission Services' 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	-2.4	-1.3	0.5	1.8	1.9
2. Government consumption expenditure	-3.1	-2.9	-1.8	-2.4	-3.5	-3.7
3. Gross fixed capital formation	-25.1	-10.5	0.6	4.2	4.7	5.3
4. Final domestic demand	**-5.8**	**-3.6**	**-1.2**	**0.3**	**1.0**	**1.2**
5. Change in inventories						
6. Domestic demand	**-4.9**	**-2.6**	**-1.2**	**0.3**	**0.9**	**1.2**
7. Exports of goods and services	6.3	4.5	3.8	4.3	4.8	4.9
7a. - of which goods	5.6	4.5	3.3	4.3	4.9	4.9
7b. - of which services	7.1	4.5	4.3	4.3	4.8	4.9
8. Final demand	**0.9**	**1.3**	**1.7**	**2.6**	**3.2**	**3.4**
9. Imports of goods and services	2.7	1.6	2.4	3.0	3.8	3.9
9a. - of which goods	-1.8	1.6	1.7	2.9	3.8	4.0
9b. - of which services	5.4	1.6	2.9	3.1	3.8	3.9
10. Gross domestic product at market prices	**-0.4**	**1.1**	**1.0**	**2.3**	**2.7**	**3.0**
Contribution to change in GDP						
11. Final domestic demand	-5.0	-3.0	-0.9	0.2	0.7	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	3.2	1.9	2.1	2.0	2.1

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

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-3.0	-1.1	0.0	1.9	3.4	3.8
2. Government consumption expenditure	-8.4	-2.0	-0.6	-2.1	-2.7	-2.7
3. Gross fixed capital formation	-28.7	-12.3	0.4	7.2	9.2	10.8
4. Final domestic demand	**-8.9**	**-2.9**	**-0.1**	**1.7**	**2.8**	**3.5**
5. Change in inventories	-64.5	-177.1	0.0	3.0	-11.0	0.0
6. Domestic demand	**-7.8**	**-2.0**	**-0.1**	**1.7**	**2.8**	**3.4**
7. Exports of goods and services	8.1	4.5	4.7	5.3	5.9	5.9
8. Final demand	**0.4**	**1.6**	**2.6**	**3.8**	**4.6**	**4.9**
9. Imports of goods and services	5.7	3.5	3.2	4.0	4.9	5.2
10. Gross national income at market prices	-3.2	-2.1	0.1	2.2	3.7	4.3
11. Gross value added at basic prices	-2.0	0.0	2.3	3.4	4.1	4.9
12. Gross domestic product at market prices	**-2.9**	**0.2**	**2.2**	**3.6**	**4.3**	**4.7**

Table 3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.2	1.3	1.3	1.4	1.6	1.9
2. Government consumption expenditure	-5.5	0.9	1.2	0.3	0.8	1.1
3. Gross fixed capital formation	-4.8	-1.9	-0.2	2.8	4.3	5.2
4. Domestic demand	**-3.3**	**0.8**	**1.1**	**1.4**	**1.8**	**2.2**
5. Exports of goods and services	1.7	0.0	0.9	1.0	1.0	1.0
6. Final demand	**-0.6**	**0.3**	**1.0**	**1.1**	**1.3**	**1.5**
7. Imports of goods and services	2.9	1.8	0.7	1.0	1.0	1.3
8. Gross domestic product at market prices	**-2.4**	**-0.9**	**1.2**	**1.3**	**1.6**	**1.7**
HICP	**-1.6**	**1.1**	**1.3**	**1.2**	**1.4**	**1.8**

Table 4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015
1. Labour productivity	4.0	3.1	1.6	1.7	1.3	0.9
2. Compensation of employees per head	-3.0	0.2	1.3	0.8	1.2	1.6
3. Unit labour costs	-5.7	-2.6	-0.4	-0.6	0.1	0.4
4. Total population	0.3	0.3	0.4	0.6	0.9	1.0
5. Population of working age (15-64 years)	0.3	0.5	0.5	0.7	1.1	1.2
6. Total employment	-4.1	-1.9	-0.6	0.6	1.4	2.0
7. Calculated unemployment rate - Eurostat definition (%)	13.7	14.4	14.2	13.5	12.8	11.9

Table 5: External balance

levels	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	82.9	86.6	90.3	95.1	100.7	106.7
2. Imports of goods (fob)	46.4	49.7	50.6	52.5	55.2	58.1
3. Trade balance (goods, fob/fob) (1-2)	**36.5**	**37.0**	**39.8**	**42.6**	**45.4**	**48.5**
3a. p.m. (3) as % of GDP	*23.4*	*23.7*	*24.9*	*25.7*	*26.3*	*26.9*
4. Exports of services	74.7	78.1	82.2	86.5	91.6	97.1
5. Imports of services	81.5	82.7	86.1	89.6	93.9	98.8
6. Services balance (4-5)	**-6.7**	**-4.6**	**-3.9**	**-3.1**	**-2.2**	**-1.7**
6a. p.m. 6 as % of GDP	*-4.3*	*-3.0*	*-2.4*	*-1.9*	*-1.3*	*-1.0*
7. External balance of goods & services (3+6)	**29.8**	**32.3**	**35.8**	**39.5**	**43.2**	**46.8**
7a. p.m. 7 as % of GDP	*19.1*	*20.7*	*22.4*	*23.9*	*25.0*	*25.9*
8. Balance of primary incomes and current	-29.0	-31.3	-33.5	-36.4	-38.8	-41.1
8a. - of which, balance of primary income	*-26.7*	*-29.7*	*-32.8*	*-35.8*	*-38.2*	*-40.4*
8b. - of which, net current Transfers	*-2.3*	*-1.6*	*-0.6*	*-0.6*	*-0.6*	*-0.7*
8c. p.m. 8 as % of GDP	*-18.6*	*-20.0*	*-20.9*	*-22.0*	*-22.5*	*-22.8*
9. Current external balance (7+8)	**0.8**	**1.1**	**2.4**	**3.1**	**4.4**	**5.7**
9a. p.m. 9 as % of GDP	0.5	0.7	1.5	1.9	2.5	3.2
10. Net capital transactions	-0.7	-0.5	-0.3	-0.7	-0.7	-0.7
11. Net lending (+)/ net borrowing (-) (9+10)	**0.1**	**0.6**	**2.1**	**2.4**	**3.7**	**5.0**
11a. p.m. 11 as % of GDP	*0.1*	*0.4*	*1.3*	*1.5*	*2.1*	*2.8*

Table 6: Fiscal Accounts

	2008	2009	2010	2011	2012	2013	2014	2015
				% of GDP				
Indirect taxes	12.3	11.3	11.4	11.4	11.3	11.5	11.6	11.3
Direct taxes	11.5	10.6	10.5	12.1	12.5	12.7	13.0	13.2
Social contributions	6.8	7.5	7.5	6.7	6.7	6.5	6.4	6.2
Sales	2.3	2.7	3.1	3.1	2.7	2.5	2.4	2.3
Other current revenue	1.3	1.4	1.5	1.1	1.2	1.1	1.0	0.9
Total current revenue	**34.3**	**33.5**	**34.0**	**34.5**	**34.4**	**34.2**	**34.4**	**34.0**
Capital transfers received	1.2	1.2	1.5	0.9	1.0	1.0	1.0	1.0
Total revenue	**35.5**	**34.7**	**35.5**	**35.4**	**35.3**	**35.2**	**35.4**	**35.1**
Compensation of employees	11.2	12.2	11.8	11.7	11.3	10.7	10.1	9.6
Intermediate consumption	5.8	6.3	6.0	5.6	5.2	4.9	4.3	3.8
Social transfers in kind via market producers	2.0	2.1	2.1	2.0	1.9	1.6	1.4	1.3
Social transfers other than in kind	12.2	15.2	15.9	15.9	15.2	14.2	13.1	12.5
Interest paid	1.4	2.0	3.1	3.4	4.2	5.6	5.7	5.6
Subsidies	0.5	0.6	0.5	0.6	0.6	0.5	0.5	0.4
Other current expenditure	2.5	2.8	2.4	2.4	2.3	2.3	2.2	2.1
Total current expenditure	**35.7**	**41.3**	**41.9**	**41.6**	**40.7**	**39.8**	**37.4**	**35.3**
Gross fixed capital formation	5.2	4.0	3.8	3.1	2.5	2.1	2.0	1.9
Other capital expenditure	1.9	3.6	21.1	0.9	0.6	0.8	0.8	0.8
Total expenditure	**42.8**	**48.9**	**66.8**	**45.6**	**43.8**	**42.7**	**40.2**	**38.0**
General Government balance (EDP)	**-7.3**	**-14.2**	**-31.3**	**-10.1**	**-8.5**	**-7.5**	**-4.7**	**-2.9**
				% change				
Indirect taxes	-11.8	-18.2	-2.3	0.6	0.9	5.1	5.7	2.1
Direct taxes	-13.9	-17.3	-3.9	15.1	5.7	5.0	7.2	6.0
Social contributions	2.7	-2.1	-2.3	-10.6	1.4	0.8	2.9	2.1
Sales	6.6	2.5	13.8	0.4	-11.0	-4.0	-1.7	3.4
Other current revenue	38.0	-6.5	4.0	-23.0	6.2	-5.2	-3.2	-1.7
Total current revenue	**-7.6**	**-12.8**	**-1.3**	**1.5**	**1.8**	**3.1**	**4.9**	**3.6**
Capital transfers received	-27.6	-6.2	15.9	-37.0	6.5	8.9	4.8	4.2
Total revenue	**-8.5**	**-12.6**	**-0.6**	**-0.1**	**1.9**	**3.3**	**4.9**	**3.6**
Compensation of employees	6.9	-3.2	-6.1	-0.8	-1.3	-2.0	-1.3	-0.8
Intermediate consumption	3.3	-2.9	-7.1	-6.4	-5.6	-3.6	-7.5	-6.7
Social transfers in kind via market producers	10.8	-3.9	-4.0	-4.9	-3.3	-10.9	-8.1	-8.1
Social transfers other than in kind	13.5	10.8	1.4	0.4	-2.5	-3.2	-3.5	-0.5
Interest paid	24.8	32.2	49.3	7.2	27.3	40.0	6.2	2.6
Subsidies	7.9	-4.9	-6.0	16.6	-2.0	-6.9	-5.3	-6.3
Other current expenditure	3.5	-0.9	-15.3	-0.8	-1.1	0.6	1.0	1.2
Total current expenditure	**9.0**	**3.1**	**-1.3**	**-0.6**	**-0.1**	**1.3**	**-2.0**	**-1.1**
Gross fixed capital formation	7.1	-30.7	-8.7	-19.3	-16.4	-13.0	-2.9	0.0
Other capital expenditure	77.6	70.7	467.8	-95.7	-29.1	40.9	0.0	0.0
Total expenditure	**10.7**	**2.0**	**32.7**	**-31.7**	**-1.8**	**1.1**	**-2.0**	**-1.0**

Table 7: Debt developments

	2008	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-7.3**	**-14.2**	**-31.3**	**-10.1**	**-8.5**	**-7.5**	**-4.7**	**-2.9**
EDP gross debt (% of GDP)	44.2	65.2	92.5	104.6	114.4	118.8	118.6	116.3
			levels, EUR billion					
EDP deficit	**-13.2**	**-22.8**	**-48.8**	**-15.9**	**-13.5**	**-12.4**	**-8.2**	**-5.3**
Gross debt	79.6	104.6	144.3	163.5	182.7	196.5	204.7	210.1
Change in gross debt	32.4	25.0	39.6	19.2	19.2	13.8	8.3	5.4
Nominal GDP	180.0	160.6	156.0	156.3	159.7	165.4	172.6	180.6
Real GDP	175.7	163.4	162.7	164.5	166.1	169.9	174.5	179.7
Real GDP growth (% change)	**-3.0**	**-7.0**	**-0.4**	**1.1**	**1.0**	**2.3**	**2.7**	**3.0**
Change in gross debt (% of GDP)	18.0	15.6	25.4	12.3	12.0	8.3	4.8	3.0
Stock-flow adjustments (% of GDP)	10.7	1.4	-5.9	2.2	3.5	0.8	0.1	0.1
			% of GDP					
Gross debt ratio	**44.2**	**65.2**	**92.5**	**104.6**	**114.4**	**118.8**	**118.6**	**116.3**
Change in gross debt ratio	19.4	20.9	27.3	12.1	9.8	4.4	-0.1	-2.3
			Contribution to change in gross debt					
Primary balance	6.0	12.1	28.2	6.8	4.3	1.9	-1.0	-2.7
"Snow-ball" effect	2.8	7.5	5.1	3.2	2.0	1.7	0.9	0.4
of which								
Interest expenditure	*1.4*	*2.0*	*3.1*	*3.4*	*4.2*	*5.6*	*5.7*	*5.6*
Real growth effect	*0.8*	*3.5*	*0.3*	*-1.0*	*-1.0*	*-2.5*	*-3.1*	*-3.3*
Inflation effect	*0.6*	*2.0*	*1.6*	*0.8*	*-1.2*	*-1.4*	*-1.8*	*-1.9*
Stock-flow adjustments	**10.7**	**1.4**	**-5.9**	**2.2**	**3.5**	**0.8**	**0.1**	**0.1**
Implicit interest rate	*5.3*	*4.1*	*4.7*	*3.6*	*4.1*	*5.1*	*5.1*	*5.0*

Notes:
Gross debt projections include injections of EUR 16.5 billion into the banking system in 2011 and EUR 1.3 billion in 2012. Cash balances are assumed to increase to round EUR 12 billion in 2013 in line with the programme's financing plan and to remain at this level thereafter.

Annex 2—Programme documents

LETTER OF INTENT

Dublin, 28 November 2011

Mr. Mario Draghi
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
Commissioner for Economic and Financial Affairs
European Commission
BERL 10/299
B-1049 Brussels
Belgium

Mr. Jan Vincent Rostowski
Minister of Finance
Ul Swietokrzyska 12
PL-00-916 WARSZAWA
Poland

Dear Messrs Draghi, Juncker, Rehn and Rostowski:

1. The Government's commitment to the Programme is illustrated by our continued strong performance in its implementation. Once again, for the fourth quarterly review, we have met all the programme targets both in terms of policy reforms as well as quantitative targets:

- On fiscal policy, the outturns up to the end of October are in line with the programme profile, and the general government deficit for 2011 as a whole is expected to be within the 10.6% of GDP programme ceiling. We have also conducted a comprehensive review of expenditure, established an independent fiscal advisory

council, and reformed pension entitlements for new entrants to the public service (including linking them to career average earnings).

- We have substantively completed the recapitalisation of the domestic banks, at a cost to the taxpayer significantly lower than initially anticipated, thanks to private sector participation and burden sharing. Domestic banks have sold a significant amount of non-core assets. The restructuring of the domestic banks is progressing and plans for this have been submitted to the European Commission for clearance in accordance with State Aid rules. We have published a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight.

- We have made significant progress towards opening up sheltered sectors (e.g., pharmacies, general practitioners, and legal services), and laid out an action plan to reform, in consultation with our social partners, the sectoral labour arrangements to facilitate the needed adjustment in the labour market.

2. This performance comes at a time when there have been both positives and negatives for Ireland. On the negative side, the growing uncertainty in relation to Euro Area debt has contributed to increasing financial market pressures. This in turn is being reflected in a deteriorating outlook for the world economy which is contributing to a heightened risk outlook. On the positive side, growth has resumed, albeit mainly export led. Our banking sector is now attracting private investment and is also successfully funding in the private market. In addition, the Euro Area Heads of State or Government meeting on 21 July this year, made the welcome and significant decision to reduce the cost of EFSF loans, and this was followed by similar commitments in respect of the EFSM loan and our UK bilateral loan. Further steps toward establishing a comprehensive framework to address the crisis facing the region were taken on October 26. These positive developments have been reflected in our bond spreads which, though still high, have narrowed considerably from the elevated levels seen earlier this year. Against this background, we are proceeding with the process of preparing Budget 2012, and we have recently published our medium-term fiscal strategy, which sets out our fiscal targets for 2012 and for the years up to 2015. In the case of Budget 2012, we are committed to meeting the deficit target of 8.6% of GDP, and will take the high quality adjustment measures necessary to achieve this target.

3. In particular, in the attached third update of the Memorandum of Understanding on Specific Economic Conditionality (MoU), we set out our plans to further advance towards meeting the programme objectives. The budgetary measures provided in the MoU are based on the current assessment of policy intentions. The final decisions on the measures necessary to achieve the agreed level of fiscal adjustment will be made with the introduction of the Budget – which for 2012 will be announced on 5th and 6th December 2011. 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 fourth review and the release of the fourth EU disbursement of EUR 4.2 billion. The financing needs outlook remains broadly in line with expectations at the third program review, but to allow a more prudent financing position with respect to the timing of the completion of reviews and disbursements, we request a re-phasing of disbursements. Specifically, we request that the disbursement following the fifth review should be €5.8 billion with the additional amount taken equally

from the sixth, seventh and eighth reviews. This represents a redistribution within 2012 of the already agreed disbursements.

4. We are confident that the policies set forth in the Letters of Intent of 3 December 2010, 28 April 2011, 28 July 2011, and in this letter are adequate to achieve the objectives of our programme. The degree of uncertainty and margins of error surrounding macroeconomic and fiscal projections over the period remain high, due mainly, but not exclusively, to international events. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. As indicated in the MoU, we will consult with the European Commission, the ECB and the International Monetary Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum of Understanding.

5. 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

(THIRD UPDATE)

28 November 2011

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 third 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[23] 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, 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 tight supervision of expenditure commitments by the line departments, and effective tax collection, to ensure that the primary deficit target in cash (see Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the 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.
- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.

[23] 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.

- 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.
- 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 fifth review (actions to be completed by end Q4-2011)

Fiscal consolidation

o Following the conclusion of the Comprehensive Review of Expenditure (CRE), Government published the Medium-Term Fiscal Statement on 4 November 2011, setting out a medium-term fiscal consolidation plan for 2012 – 2015 outlining the overall composition of revenue and expenditure adjustments for each year, consistent with the targets set out in the Council Recommendation in the context of the excessive deficit procedure. Moreover, by 2012 Budget day in early December 2011, Government will anchor this consolidation plan in binding medium-term expenditure cash ceilings and will set out revenue and expenditure measures to deliver the needed adjustment.

o Government will propose a budget for 2012 aiming to further reduce the general Government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures amounting to €3.8billion. The Government will introduce:

- o Revenue measures to yield €1.6 billion[24] including:
  - An increase in the standard VAT rate
  - Increases in other indirect taxes
  - A Property tax
  - A reform of capital gains tax and capital acquisitions tax.
- o Expenditure reduction of EUR €2.2 billion including:
  - Social expenditure reductions.

[24] Inclusive of carryover of EUR 0.6 billion from the revenue measures committed in the original programme. For 2012, they exclude one-off measures and EUR 0.4 billion in carryover from the universal social charge which was introduced as part of Budget 2011.

- Reduction of public service numbers and public service pension adjustments.
- Other programme expenditure, and reductions in capital expenditure.

Without prejudice to the minimum consolidation amount referred to in the previous paragraph and in consultation with the staff of the European Commission, the IMF and the ECB, the Government may substitute one or more of the above measures with others of equally good quality following further analysis of the recently completed CRE.

Financial sector reforms

Recapitalization

- Government will ensure that the recapitalization of banks, as identified in the 2011 Prudential Capital Assessment Review, will be completed subject to appropriate adjustments for asset sales of IL&P.

Deleveraging

- 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 Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the Net Stable Funding Ratio (NSFR) and the Liquidity Coverage Ratio (LCR) in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it with staff of the European Commission, the ECB and the IMF. The Irish authorities will continue to work to obtain the approval of the European Commission of the restructuring plans for the banks in the context of the ongoing State Aid cases.
- The Irish authorities, in consultation with the staff of the European Commission, the IMF and the ECB, will complete the assessment of options to strengthen the restructuring plan for IL&P.

Credit unions

- The Irish authorities will act to underpin the solvency and viability of the credit union sector while minimising the fiscal cost. As an immediate step, the authorities will deal with weaknesses in the most troubled institutions in accordance with State aid rules while protecting depositors to ensure financial stability. A commitment to initial resolution funding of €250 million will be made from the Exchequer in Q4 2011 which will be based on a principle of recoupment over the medium term via a levy under the Central Bank and Credit Institutions (Resolution)(No.2) Act 2011.

Financial supervision

- The Irish 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 Central Bank of Ireland will issue guidance to banks for the recognition of accounting losses incurred in their loan book. Specifically, the Central Bank of Ireland will begin requiring the banks: (i) on core assets, to increase the consistency and conservatism in their impairment triggers and provisioning model inputs including inter alia: period of arrears, emergence periods, cure rates and collateral value, and treatment of restructured loans and forbearance; (ii) on non-core assets (assets under deleveraging) to provision to reflect losses arising from their planned disposal, taking account as appropriate of the PLAR/PCAR analysis. We will ensure that the principles governing these disclosure requirements are made transparent so as to ensure that bank reporting is fully understood.
- The Central Bank of Ireland will publish new guidelines for the valuation of collateral for bank loans by end December 2011.

Structural reforms

To prepare for the introduction of water charges

- Government will prepare proposals for implementation of the recommendations of the independent assessment of transfer of responsibility for water service provision from local authorities to a water utility in consultation with European Commission Services with a view to starting charging during the EU/IMF Programme period.

To better target social support expenditure

- The Department of Social Protection will build on their recent studies on working age payments, child income support and disability allowance with a view to producing, after consultation with stakeholders, a comprehensive programme of reforms that can help better target social support to those on lower incomes, and ensure that work pays for welfare recipients. To this end, the Department will submit a progress report by end-December 2011.

To increase competition

- Building on the Competition (Amendment) Bill, the Irish authorities will engage with European Commission services and discuss measures to further enhance the competition enforcement framework and present amendments to the Bill where appropriate.

To reform labour market

- Building on the time-bound action plan presented in September 2011, authorities will present legislation to the Dáil to modernise Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs) with a view to reducing the possible negative impact on job creation and competitiveness of existing arrangements. The Irish authorities will engage with the staff of the European Commission, the IMF and the ECB on the basis of draft legislation in advance of publication.

Structural fiscal reforms

To further reform key sectors of the economy

- Government will consider options for an ambitious programme of asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. Government will prepare a draft programme of asset disposals in this context and discuss it with the staff of the European Commission, the IMF and the ECB by end-December 2011 in advance of taking final decisions on the programme to be pursued. The draft programme will include the identification of the potential assets to be disposed, any necessary regulatory changes and a timetable for implementation, and an assessment of their classification as financial or non-financial transactions. The draft programme will include the identification of the regulatory steps and changes deemed necessary, including those required to be consistent with relevant EU legislation, in relation to the options under consideration before the sale of a minority stake in the Electricity Supply Board (ESB) can be finalised.

2. Actions for the sixth review (actions to be completed by end Q1-2012)

Structural fiscal reforms

To reinforce the credibility of the budgetary process

- Government will introduce a Fiscal Responsibility Bill consistent with the economic governance framework at the EU level, including provisions for a medium-term budgetary framework, fiscal rules and the Fiscal Advisory Council. The Bill will assure the Council's independence through clear arrangements for Council memberships, including consultation with a relevant committee of the Oireachtas for nomination, appointment, extension and termination. The Government will ensure that the Council is adequately funded over time.

Financial sector reforms

PCAR 2012

The Irish authorities will report on the evolution of the capital up to end December 2011, within the banks covered by the PCAR and will present and discuss its findings with the staff of the European Commission, the ECB and the IMF by end February 2012.

- The 2012 PCAR exercise will be carried out in the context of the 2012 European Banking Authority (EBA) stress tests. The Irish authorities will agree with the staff of the European Commission, IMF and ECB on the specific features of the methodology building on the strengths of the PCAR 2011.

Deleveraging

- The Irish authorities, in consultation with the staff of the European Commission, IMF and ECB, will assess banks' performance vis-à-vis the agreed asset disposal targets. In line with the monitoring system set up, actual and forecast LDRs, NSFR's and asset disposals shall be reported by the banks to the Central Bank of Ireland every six months (first report was issued on 31 July 2011). Such reports will include (i) progress achieved towards interim

target; (ii) forecast of LDR and NSFR for the end of the next period; (iii) a detailed plan of action to meet the next interim target; and (iv) actual and planned asset disposals. If actual or forecast asset disposals fail to meet the interim targets for the quantum of asset disposals, the Irish authorities will inform the staff of European Commission, IMF, and ECB within 14 days of becoming aware of such failure. The Central Bank will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation. In addition to providing the six-monthly report, the Irish authorities will update the staff of European Commission, the IMF and the ECB on progress in the intervening quarters.

- The Irish authorities, in consultation with staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Supervision

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

Structural reforms

To reform the personal debt regime

- Government will introduce legislation to reform the personal debt regime to the Houses of the Oireachtas with the objective of lowering the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline.

To further reform key sectors of the economy

- In line with the time-bound action plan submitted in September 2011, authorities will publish a public consultation draft of updated retail planning guidelines which include, *inter alia*, the agreed changes to the retail size caps in Ireland. Building on representations received by end-2011, authorities will issue finalised retail planning guidelines which include the agreed changes to retail size caps.

To improve the activation of the unemployed

- The Irish authorities will take steps to strengthen activation and training policies to help jobseekers get back to work and will commission and publish an external evaluation of the revised national employment action plan to ensure:
    - that the large numbers of unemployed across all regions, including the long-term unemployed, have adequate incentives and skills needed to return to work; and

- the data and reporting systems required to ensure more effective interventions are put in place, including:
    - group intervention statistics (3 to 6 months);
    - ongoing intervention statistics (post 6 months) including numbers and level of penalty sanctions.

- Based on its recommendations the Department of Social Protection will prepare an implementation plan by end-March 2012

To better target social support expenditure

- The Department of Social Protection will submit to Government the comprehensive programme of reforms that can help better targeting of social support to those on lower incomes, and ensure that work pays for welfare recipients.

To increase competition

- Authorities will undertake a review of the resourcing of the Competition Authority and report on whether it is sufficient to allow adequate enforcement capacity of the new legislative framework.

3. Actions for the seventh review (actions to be completed by end Q2-2012)

Financial sector reforms

PCAR 2012

- The PCAR for 2012 will be completed. Before publication, the results of the PCAR for 2012 will be assessed, together with the staff of European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2012. Based on these results, the authorities will ensure that banks are adequately capitalised.

Deleveraging

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 Irish authorities, in consultation with the the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates. *Credit Unions*

- As recommended by the interim report of the Commission on Credit Unions, the legal provision that requires credit unions to maintain an amount, under the terms of the Deposit Guarantee Scheme, in the Deposit Protection account at the Central Bank will become effective in 2012 .

- The restructuring process will take account of the interim report of the Commission on Credit Unions and any further recommendations made by the Commission on Credit Unions on the revised structure for the sector. The Irish authorities will publish legislation to

strengthen the regulatory framework, including making legislative provision for effective governance standards and prudential requirements.

Reorganisation

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

Financial Supervision

- The Irish 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.

Structural reforms

To assist in covering financing needs and to increase competition

- Based on the results of the assessment of the efficiency of the electricity and gas sectors, the authorities will further strengthen the regulatory and market reform programme in consultation with staff of the European Commission Services, with a view to increase efficiency, improve governance, strengthen competition and improve these sectors' ability to contribute towards covering Ireland's financing needs and improving its growth potential and economic recovery.

To increase competition

- Authorities will ensure that resourcing of the Competition Authority is sufficient to ensure adequate enforcement capacity of the new legislative framework on the basis of the review undertaken in Q1 2012.

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

Financial sector reforms

Deleveraging

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6th Review (Q1 – 2012).
- The Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Financial Supervision

- The Irish 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.
- Government will present to Dáil Éireann legislation to establish a statutory credit risk register.

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

Fiscal consolidation

- Government will propose a budget for 2013 aiming at 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 and including the detailed presentation of consolidation measures amounting to €3.5 billion. The following measures are proposed for 2013:
    - o Revenue measures to raise at least €1.25 billion [25] will be introduced, including:
        - A broadening of personal income tax base
        - A restructuring of motor taxation
        - A reduction in general tax expenditures.
        - An increase in excise duty and other indirect taxes.
    - o Expenditure reductions of no less than €2.25 billion, including:
        - Social expenditure reductions.
        - Reduction of public service numbers and public service pension adjustments.
        - Other programme expenditure, and reductions in capital expenditure.

Without prejudice to the minimum consolidation amount referred to in the previous paragraph and in consultation with the staff of the European Commission, the IMF and the ECB, the Government may substitute one or more of the above measures with others of equally good quality following further analysis of the recently completed CRE.

Financial sector reforms

Deleveraging

- 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 Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

[25] Inclusive of carryover from 2012

Reorganisation

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

Financial Supervision

- The Irish 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.

Structural reforms

To increase 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.

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

Financial sector reforms

PCAR 2013

- The Irish authorities will report on the evolution of the capital up to the end of December 2012, within the banks covered by the PCAR and will present and discuss its findings with the staff of the European Commission, the ECB and the IMF by end February 2013.
- The 2013 PCAR exercise will be carried out in the context of the 2013 European Banking Authority (EBA) stress tests. The Irish authorities will agree with the staff of the European Commission, IMF and ECB on the specific features of the methodology building on the strengths of the PCAR 2011.

Deleveraging

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6th Review (Q1 – 2012).
- The Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Financial supervision

- The Irish 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.

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

Financial sector reforms

PCAR 2013

- The PCAR for 2013 will be completed. Before publication, the results of the PCAR for 2013 will be assessed, together with the staff of the European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2013. Based on these results, the Irish authorities will ensure that banks are adequately capitalised.

Deleveraging

- 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 Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Financial supervision

- The Irish 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.

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

Financial sector reforms

Deleveraging

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6th Review (Q1 – 2012).
- The Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Financial Supervision

- The Irish 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.

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

Financial sector reforms

PCAR 2013

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

Deleveraging

- A final report of the banks' implementation of their deleveraging plans under the PLAR 2011 and their compliance with the LDR target will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

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

Financial Supervision

- The Irish 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 ECB and the IMF.

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 labour market programmes.	Quarterly, 30 working days after the end of each quarter.
F11	Report on progress achieved towards interim PLAR targets and actual and planned asset disposals.	Quarterly, 10 working days after the end of each quarter.
To be provided by the NTMA		
N.1	Monthly information on the 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 days after the end of each

		month
N.3	Data on public debt and new guarantees issued by central Government to public enterprises and the private sector.	Monthly, 30 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 central Government.	Monthly , 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and Government sectors 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	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

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

A. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

1. **The economic recovery gathered pace in the first half of 2011, but the global slowdown is expected to dampen growth through 2012**. GDP grew at 2¼ percent on an annual basis in the second quarter, reflecting strong net exports and rebuilding of stocks. However, growth is likely to be modest in 2011 and 2012, as weakening external demand is diminishing export growth prospects—although the continuing recovery in Ireland's competitiveness will provide a cushion—and domestic demand is expected to continue declining, although at a moderating rate. The current account surplus is expected to expand. Annual HICP inflation was 1½ percent in October. Inflation is expected to remain low because domestically driven inflationary pressures remain weak and the effects of higher international commodity prices will taper off.

2. **There has been a welcome improvement in market sentiment toward Ireland, yet risks remain, and we will protect and build on these gains by sustaining firm implementation of the program.** We have continued to implement the program in a determined manner, advancing the financial reform strategy we adopted in March 2011, keeping the budget on track, and moving forward with a package of structural reforms to enhance competitiveness. The welcome July 21 European agreement has substantially lowered Ireland's debt burden and rollover needs. Together with concrete signs of recovery, these factors have been reflected in a notable decline in Irish sovereign spreads in recent months. Nevertheless, amid renewed stresses in the euro area, sustained firm program implementation matched by continued strong European support will be required to underpin prospects for regaining market access at an early stage.

B. FISCAL POLICIES

3. **The substantial fiscal consolidation targeted for 2011 will be achieved.** The front-loaded package of permanent consolidation measures agreed under the programme is being implemented in full. Revenues have performed broadly on profile despite a more challenging domestic demand environment than envisaged at the time the targets were set. Moreover, aggregate spending has been kept to budgeted allocations even in the face of pressures arising from higher-than-expected unemployment. We have met all our quarterly fiscal targets this year, and the expected end-year general government deficit is within the 10.6 percent of GDP EU/IMF-supported programme ceiling.

4. **The Government remains committed to an ambitious medium-term fiscal consolidation effort to put the debt ratio firmly on a downward path.** As laid out in the Medium-Term Fiscal Statement, additional consolidation of some €12.4 billion will be implemented over the next four years to bring the general government deficit to below 3 percent of GDP by 2015, in line with the Stability and Growth Pact targets. The following table sets out the phasing and composition of the required adjustment effort. In the current

challenging external environment, with increased risk to the medium-term fiscal position, this consolidation plan strikes an appropriate balance between debt reduction imperatives and the need to preserve confidence in growth and job creation.

Budgetary Consolidation 2012-15, in €billion 1/

	2012	**2013**	**2014**	**2015**
Expenditure	2.2	2.25	2.0	1.3
Current	1.45	1.70	1.9	1.3
Capital	0.75	0.55	0.1	0.0
Revenue	1.6	1.25	1.1	0.7
Consolidation	**3.8**	**3.5**	**3.1**	**2.0**

1*/. The figures in the table above are consistent with the Medium-Term Fiscal Statement published on 4 November. The annual consolidation amounts exclude one-off items but include an element of carryover from measures implemented in previous years. In 2012, however, the expected €0.4 billion in carryover from the Universal Social Charge is not included in the €3.8 billion in consolidation.*

5. **In implementing this consolidation, we will be guided by our aim to focus government expenditure on key services while protecting the most vulnerable.** The recently completed Comprehensive Review of Expenditure (CRE) was a root and branch survey of Government that identified a range of concrete options for savings which will deliver the bulk of consolidation over the medium term. Moreover, consistent with our commitment to protect the most vulnerable, we have opted for a selective approach that aims at better targeting social support and reforming entitlements, rather than pursuing across-the-board reductions in primary social welfare rates.

6. **Underscoring our commitment to fiscal consolidation, Budget 2012 will deliver an unchanged general government deficit target of 8.6 percent of GDP.** The Budget will be submitted to the Oireachtas on December 6 (prior action). The government will adopt consolidation measures amounting to €3.8 billion comprised of expenditure savings of €2.2 billion and revenue measures contributing €1.6 billion.

7. **We have designed the measures underpinning the 2012 consolidation with a view to enhancing public sector efficiency, while protecting growth and employment:**

- **Spending measures:** Our €1.45 billion current expenditure adjustments are based on targeted savings in (i) the wage bill arising mainly from public service numbers reductions of 7,000; (ii) social welfare, where we are reforming entitlements,

reducing unemployment traps and improving the targeting of our social supports; and (iii) departments' non-pay budgets by focusing spending on high-priority programs, reducing input costs, eliminating subsidies, and placing the funding for government services on a more sustainable footing. In addition, reductions in the capital budget of €0.75 billion will be achieved through deferring a number of large and expensive capital intensive projects, while protecting essential outlays for schools and hospitals. These measures will be supported by the recently announced Public Service Reform programme which aims at rationalising state bodies, reducing decentralisation-related project commitments, and maximising efficiencies through procurement reform, shared services and a greater use of IT services.

- **Revenue measures**: After successive budgets in which income tax burdens were raised significantly, and given the already large carryover of some €0.6 billion into 2012 from income tax increases in 2011, we have decided to focus on indirect tax increases to deliver the bulk of the €1 billion additional tax effort required in 2012. To this end, the VAT rate is being raised by 2 percentage points to 23 percent, which will be supplemented by increases in carbon and motor taxes. We are also taking the first steps toward a value-based property tax, by introducing an interim uniform household charge on primary residences, which will provide a stable funding source for local governments in the years ahead.

8. **Budget 2012 will detail high-quality measures to deliver our planned medium-term consolidation, along with binding medium-term expenditure envelopes.** To bolster the credibility of our medium-term plan and reduce uncertainty about future fiscal measures, we will set out on Budget Day revenue and expenditure measures for 2013-15 and their fiscal impact. Over one-quarter of the almost €5½ billion in planned expenditure effort for this period will arise from the substantial carryover of savings from public service numbers reductions and from entitlement reforms in social welfare due for implementation in 2012. An additional reduction in public service numbers of 11,500, and efficiency and equity-enhancing adjustments to the welfare system will deliver the new savings, with contributions also from non-pay programs and from the capital budget, as already indicated in the Infrastructure and Capital Investment Plan 2012-16. To anchor this consolidation, Budget 2012 will set out binding nominal expenditure ceilings for all Departments for 2012-14 (end-December 2011 structural benchmark). On the revenue side, we will target a further €3 billion effort through further strengthening carbon, excise and vehicle taxation; replacing the interim uniform household charge with a value-based property tax; and tightening various capital gains, VAT, PRSI and income tax expenditures.

9. **Institutional reforms are underway to support fiscal consolidation in the medium term and to underpin the soundness of fiscal policy on an ongoing basis.** A Fiscal Responsibility Bill, which will give effect to key articles of the recently adopted EU Directive on requirements for budgetary frameworks, will be submitted to the Oireachtas by end-March 2012. The Bill will establish a fiscal rules framework to ensure that public finances are managed in a prudent and sustainable manner, and in accordance with the requirements of the Stability and Growth Pact. The Bill will also provide for the

establishment of the Irish Fiscal Advisory Council on a statutory basis. The Bill will assure the Council's independence through clear arrangements for Council memberships, including consultation with a relevant Committee of the Oireachtas for nomination, appointment, extension and termination (end-March 2012 structural benchmark). The Government will ensure that the Council is adequately funded over time.

C. FINANCIAL SECTOR POLICIES

10. **We have made substantial progress in restoring the health of the Irish financial system, and will continue to press forward with reforms to protect these gains and address the challenges remaining.** The recapitalisation of the banking sector has been substantively completed at lower fiscal cost than expected due to private participation and burden-sharing. Improved confidence is reflected in the ability of banks to secure term funding. Deleveraging is advancing despite challenging conditions and it is likely the domestic banks will meet their disposal objectives for end-2011 though transaction risks remain. The priorities now are to strengthen bank balance sheets, expand their access to market funding, and develop banks' capacity to lend soundly in order to support the recovery.

Enhancing quality and transparency of banks' balance sheets

11. **Enhancing the quality of banks' balance sheets is critical to bringing private funding and ownership back to the financial system.** An immediate priority is to strengthen banks' disclosure and provisioning practices. In addition, tools are being put into place to facilitate private sector debt restructuring while preserving payment discipline, which will reduce uncertainty around the value of bank assets**.**

12. **To build confidence in bank assets, we will align disclosure guidance with international best practices.** By end-December 2011, we will issue disclosure guidance to banks that will cover items such as: standardised definitions related to troubled loans including arrears, default, and restructuring. We will ensure that the principles governing these disclosure guidance are made transparent so as to ensure that bank reporting is fully understood. These requirements will be reflected in the 2011 published financial statements, and we will continue to monitor adherence.

13. **Loan provisioning is being put on a more prudent and forward-looking basis, while remaining in compliance with IFRS.** We will issue guidance to banks for the recognition of accounting losses in their loan books (end-December 2011 structural benchmark). Whilst recognising the differences between provisions and loan loss forecasts for the end-December 2011 financial accounts, the banks are expected to bring forward a substantial proportion of loan losses originally envisaged to be booked in the period through 2013 in the 2011 PCAR. We will ensure that the principles governing these loan provisioning guidance are made transparent so as to ensure that bank reporting is fully understood.

14. **To guide the process of dealing with SMEs in financial difficulties, we have finalised revisions to the Code of Conduct for Business Lending to Small and Medium Enterprises which provide for a framework for how lenders deal with SMEs in financial difficulties.** The new SME Code was published on 4th of November 2011 and will become effective on 1st of January 2012. The revised SME Code reflects consultations with stakeholders and seeks to facilitate balanced negotiations between SMEs and lenders by requiring lenders to have proper procedures in place for dealing with borrowers facing financial difficulties (including minimum communication and information standards), where borrowers show willingness to cooperate and engage in a fair bilateral process for alternative repayment arrangements to be put in place. The Code makes clear that lenders retain their rights with respect to liquidation or other insolvency procedures. Banks will be required to submit their strategies for addressing arrears in their SME portfolios to the CBI by end-June 2012.

15. **The framework to enable households and creditors to deal with unsustainable debt burdens is being strengthened.** Orderly negotiations between lenders and distressed borrowers are critical to addressing unsustainable household debts while preserving Ireland's strong payment culture. To this end, we will continue to monitor implementation of the Code of Conduct on Mortgage Arrears. An Inter-departmental Mortgage Arrears Working Group recommended a range of options to address households in different financial situations. The Government is considering the recommendations and has committed to begin placing independent mortgage advisors in the field by end-March 2012. The CBI is exercising their supervisory powers to encourage banks to address the issue proactively.

16. **The Government is preparing its strategy for reform of the personal insolvency regime, which is important to underpin this resolution process.** We are on track to finalise a strategy by end-2011 to amend the Bankruptcy Act and create a new structured non-judicial debt settlement and enforcement mechanism (structural benchmark end-December), and intend to publish draft legislation by end-March 2012. In parallel, we will prepare plans to implement the institutional infrastructure needed to support out-of-court settlements by end-March 2012.

Strengthening the resilience of the financial sector

17. **We will continue to ensure the adequacy of bank capital.** In the 2012 Prudential Capital Assessment Review we will maintain the conservative and prudent approach underpinning the 2011 exercise, including independent loan loss forecasts, in the context of the EBA stress tests.

18. **We are acting to underpin the solvency and viability of the credit union sector, while protecting the public purse.** As an immediate step, we will proceed with actions to deal with weaknesses in the most troubled institutions while protecting depositors to ensure financial stability. The costs of transfer will be contained through a competitive process, in

so far as practicable. A commitment to initial resolution funding of €250 million will be made from the Exchequer in Q4 2011 which will be based on a principle of recoupment over the medium term via a levy under the Central Bank and Credit Institutions (Resolution) (No.2) Act 2011. Further funding, up to an amount to be agreed to with our external partners, will be made available in 2012, if required, for either resolution or stabilisation once the 2012 Credit Union amendment legislation is in place. As recommended by the interim report of the Commission on Credit Unions, the legal provision that requires credit unions to maintain an amount, under the terms of the Deposit Guarantee Scheme, in the Deposit Protection account at the Central Bank will be commenced in 2012.

19. **The restructuring process will take account of the interim report of the Commission on Credit Unions and any further recommendations made by the Commission on the revised structure for the sector.** We will publish legislation to strengthen the regulatory framework including making legislative provision for effective governance standards and prudential standards by end-June 2012 (proposed structural benchmark). The foregoing strategy to restructure the credit union sector and strengthen the regulatory and governance framework will help to ensure its' viability while protecting financial stability and containing fiscal costs. On this basis, we request that the adjustor in respect of payments for bank restructuring be extended to include resolution costs for credit unions, for both the performance criterion on the exchequer primary balance and the indicative target on net central government debt.

20. **While proceeding to evaluate the bids for ILP's insurance arm, an action plan is being developed to address the challenges facing the banking group.** We have reviewed the ILP restructuring plan that was submitted to the European Commission in July. As a follow-on action, we are working with the institution and its advisors to assess options to strengthen the restructuring plan. By end-December 2011 we will complete an assessment of these options.

Upgrading supervision and the financial framework

21. **We are taking further actions to strengthen supervision.** We will continue to implement and report on progress with the Central Bank's action plan for strengthening supervision of credit institutions. As part of next year's supervisory work, we will, amongst other things, roll out a new risk assessment framework (PRISM), assess banks risk weighted asset calculations and the on-going accuracy of banks' internal models, continue training and development initiatives for Central Bank staff, further embed new operational structures to support cultural and engagement model changes, and continue to monitor banks deleveraging targets. The Supervision and Enforcement Bill will commence second stage in the Dáil shortly and is expected to continue its passage through the Oireachtas in early 2012.

22. **Legislation will be published by end-September 2012 in respect of a new Central Credit Register.** The proposed new credit register will support more informed lending decisions and development of improved insolvency procedures, while also providing an important tool for banking supervision. The data set to be collected is still being finalised, but will be comprehensive in scope, will include information on restructured as well as new

loans, and will be covered by robust measures to protect personal information. We will work to ensure that an effective system is in place to deliver comprehensive and accurate data unique to each borrower. We plan to submit legislation to the Oireachtas to implement this approach by end-September 2012.

23. **We are strengthening the crisis management framework and imposing a levy to finance a resolution fund for credit institutions.** The Central Bank and Credit Institutions (Resolution) (No. 2) Act was passed by the Oireachtas in October 2011. This new steady-state regime establishes a resolution fund and provides for a range of resolution tools, most importantly the ability to transfer assets and liabilities to other institutions and the establishment of bridge banks (where the latter is in the public interest). The parameters of the levy noted in paragraph 18 will be determined by end-December 2011.

D. STRUCTURAL REFORMS

24. **Reforms to sectoral wage agreements are being prepared consistent with the time-bound action plan completed at end-September.** On July 28, the Government outlined proposed changes to Employment Regulation Orders (EROs) and Registered Employment Agreements (REAs) aimed at increasing employers' willingness to hire, in particular in sectors hard-hit by the crisis, and to facilitate the necessary cross sector adjustment. These announcements took into consideration the implications of the 7 July 2011 High Court ruling which found that sections of the legislation governing wage-setting mechanisms within Joint Labour Committees are unconstitutional. The reforms will allow the targeted abolition of some EROs; greatly streamline the number of minimum wages set; require consideration of economic conditions such as unemployment, wage trends, and international competitiveness in setting wage rates; allow greater flexibility to deviate from EROs for companies facing financial difficulties; and will no longer include conditions of employment covered in existing legislation, such as compensation for working on Sunday. The reforms also will establish a time-bound process by which REA terms may be varied without consent of all parties, clarify the representativeness of parties necessary to register an REA, and clarify when REAs may be cancelled. Legislation will be submitted to the Oireachtas by end-December 2011.

25. **We will strengthen activation and training policies to help jobseekers get back to work.** We will commission and publish an external evaluation of the revised national employment action plan to ensure:

- that the large numbers of unemployed across all regions, including the long-term unemployed, have adequate incentives and skills needed to return to work; and
- the data and reporting systems required to ensure more effective interventions are put in place, including:
  - group intervention statistics (3 to 6 months);

- ongoing intervention statistics (post 6 months) including numbers and level of penalty sanctions.

Based on its recommendations we will prepare an implementation plan by end-March 2012.

26. **We are advancing a substantial body of legislation to lower costs in sheltered sectors and strengthen competition law, thereby enhancing economic efficiency and Ireland's growth potential.** In October, the Government submitted to the Oireachtas the Legal Services Regulation Bill, which will increase transparency on legal costs, better protect consumers of legal services, and create independent oversight bodies for professional misconduct and disputes over legal costs that cover both solicitors and barristers. In September, the Government submitted legislation to make it easier for general practitioner doctors to obtain contracts under the General Medical Services Scheme. To improve enforcement of competition provisions, the Government submitted the Competition (Amendment) Bill to increase penalties under existing statutes for violations of competition law, allow recovery of investigation and court proceeding costs, and make it easier for private individuals to prove an action once public enforcement proceedings have been taken successfully. We will continue to engage with the staff of the European Commission on the effectiveness of competition enforcement. We will seek the timely enactment and implementation of this legislation.

27. **We are preparing an ambitious programme of state asset disposals and associated regulatory reforms.** We are considering options for asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. Our draft programme of asset disposals will be discussed with the European Commission, the IMF and the ECB by end-December 2011, in advance of taking final decisions on the programme to be pursued. The draft programme will identify potential assets for disposal and any necessary regulatory changes, including those needed to be consistent with relevant EU legislation, that would have to be made in advance of such disposals. The timetable for implementation will take into account the need for an orderly process that avoids fire sales and allows time to implement regulatory reforms.

E. PROGRAMME FINANCING

28. **The program remains well financed and improvements in the terms of EU lending have strengthened Ireland's financing and debt outlook.** The combined effect of the very welcome significant reductions in interest rates and longer maturities on EFSM, EFSF and bilateral loans, along with quota related reductions in IMF lending rates, could reduce our interest bill by around €10 billion over the full period to maturity. We look forward to final implementation of these important commitments. The first disbursement under the UK bilateral loan in the amount of €0.5 billion was made in early October in the context of the completion of the third review of the IMF-supported program. Bilateral discussions with Sweden and Denmark are ongoing, with completion of the loan documentation pending final agreement on the new EFSF terms.

F. PROGRAMME MONITORING

29. **Progress in the 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 the Letters of Intent of 3 December 2010, 28 April 2011, 28 July 2011 and 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).

30. 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-September 2011	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-September 2011	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

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 (http://www.finance.gov.ie/documents/publications/reports/2011/bankMOU.pdf).

Table 2. Ireland: Quantitative Performance Criteria and Indicative Targets under the Economic Programme for 2011–12

	June 30, 2011		September 30, 2011		December 31, 2011	March 31, 2012	June 30, 2012	September 30, 2012
	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
	(In billions of Euros)							
	Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-10.1	-8.4	-20.2	-18.3	-15	-7.5	-9	-11
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
	Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	94.6	91.7	115.9	111.7	116.9	126.2	129.9	132.4

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

Table 3. Ireland: Upcoming Prior Action and Structural Benchmarks under the Programme for 2011-2012

Measure	Date	Status
Financial sector policies		
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book (MEFP, ¶13).	End-December 2011	Structural benchmark
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 (MEFP, ¶16).	End-December 2011	Structural benchmark
Publish legislation to strengthen the regulatory framework including making legislative provision for effective governance standards and prudential requirements for credit unions. (MEFP, ¶19).	End-June 2012	Proposed structural benchmark
Fiscal policies		
Submit the 2012 Budget to the Oireachtas (MEFP, ¶6).	06-Dec-11	Prior action
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets (MEFP, ¶8).	2012 Budget day in early December 2011	Structural benchmark
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence (MEFP, ¶9).	End-March 2012	Structural benchmark

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

28 November 2011

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 November 24, 2010 as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 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.[26] 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 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.

[26] 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.

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).[27]

5. For the purposes of the programme, the floor on the 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.

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

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, 2011:	
End-December 2011 (performance criterion)	-15.0
From January 1, 2012:	
End-March 2012 (performance criterion)	-7.5
End-June 2012 (indicative target)	-9.0
End-September 2012 (indicative target)	-11.0

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: [28]

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2011:	
End-December 2011 (projection)	42.4
From January 1, 2012:	
End-March 2012 (projection)	9.7
End-June 2012 (projection)	19.7
End-September 2012 (projection)	30.7

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 are excluded from the definition of liquid assets.

[28] 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 be adjusted 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. The ceiling will also be adjusted 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. 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-September 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-September 2011 (provisional)	111.7
End-December 2011 (indicative target)	116.9
End-March 2012 (indicative target)	126.2
End-June 2012 (indicative target)	129.9
End-September 2012 (indicative target)	132.4

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 the 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.

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