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Economic Adjustment Programme for Ireland  
Summer 2012 Review



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European Commission  
Directorate-General for Economic and Financial Affairs

# **Economic Adjustment Programme for Ireland**

## **Summer 2012 Review**

## ACKNOWLEDGEMENTS

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## Executive Summary

*A joint EC/ECB/IMF mission (3-12 July 2012) for the seventh quarterly review of Ireland's EU/IMF-supported economic adjustment programme found that the programme remains on track, despite a challenging domestic and external backdrop.*

*The economy continues to develop in line with expectations, though downside risks have increased, reflecting primarily growing headwinds in main trading partners. Relative to the sixth review, the GDP growth forecast was kept broadly unchanged for 2012 (down slightly from 0.5% to 0.4%) but has been revised down more appreciably for 2013 (from 1.9% to 1.4%), though the nominal outlook is slightly better due to an upward statistical revision of past data. Unemployment remains high (14.8%), and increasingly long-term in nature.*

*Programme implementation remains strong overall. In particular, the central government cash deficit in the first half of 2012 was below expectations, mainly thanks to better-than-expected revenue. Some expenditure overruns were however recorded, mostly on welfare payments and in the health area, and the authorities have agreed to take corrective steps in the remainder of the year. On this basis, the general government deficit for 2012 as a whole is expected to remain within the 8.6% of GDP programme ceiling. At the same time, significant additional consolidation is required over the next few years to ensure that the deficit ratio is brought below 3% by 2015. Moreover, some of the health measures are temporary in nature, and may need to be replaced with more structural ones if risks to the agreed fiscal targets are to be avoided. The mission called on the authorities to consider all options in the forthcoming preparation of the 2013 budget. In particular, better targeting of the social support schemes and a further broadening of the tax base would help mitigate the adverse impact of the necessary consolidation on growth and the most vulnerable.*

*In line with the EU-wide efforts to boost growth, the authorities are exploring the scope to tap the expanded lending capacity of the EIB, combined with some resources from the national pension reserve fund, to finance new capital projects while remaining within the agreed deficit path. They are also advancing structural reforms, in particular taking steps to expand and improve activation measures and match jobseekers and employers more efficiently. Legislation to reform sectoral wage-setting mechanisms and strengthen the competition law framework have also been recently enacted. More needs to be done to alleviate or eliminate work disincentives and unemployment traps caused by some features of Ireland's benefits system (e.g., the broadly flat and open-ended unemployment benefits that do not diminish with the duration of the unemployment spell) and the recently announced plan to de-couple housing support from unemployment status would be a step in the right direction and should be rigorously pursued. In the near-to-medium term, however, growth will depend critically on export demand and performance.*

*Further progress continues to be made towards a healthier and more focused financial sector. Domestic banks have continued to divest and amortise their non-core assets and to attract new deposits, albeit at higher rates. To reduce distortions in deposit rate-setting and remove obstacles to the flow of credit to the domestic economy, while also acknowledging considerable progress towards meeting deleveraging targets to date, the programme monitoring framework for deleveraging has been modified. Thus, the reduction in non-core asset volumes will continue to be monitored according to PLAR 2011 targets but the framework will put more emphasis on monitoring banks' overall liquidity and funding of core operations, as opposed to just deposits.*

*A restructuring plan for Permanent TSB (PTSB) was submitted to the European Commission on 29 June, based on segregating the bank into three strategic business units (SBUs) including a core retail bank, the UK buy-to-let business (CHL), and a dedicated asset management unit to deal with problematic legacy loans over time. Work is continuing—also in the context of the broader restructuring of the banking sector—to ensure that a legal separation of the legacy asset management unit can be implemented in a timely manner to expedite PTSB's return to viability.*

*An overarching challenge continues to be presented by domestic banks' weak profitability, reflecting still-growing non-performing loans (NPLs), a high overall cost of funding (due to high deposit rates), low margins on new business and low-yielding legacy loans, and one-off costs for operational restructuring. Looking ahead, banks need to continue working on their restructuring plans and effectively implement their arrears resolution strategies (extending recent efforts on mortgages to their SME loan portfolios). The authorities are also actively exploring options for a gradual phasing out of the Eligible Liabilities Guarantee (ELG) scheme, which weighs heavily on banks' profitability.*

*Several draft bills were also introduced. Of these, the personal insolvency reform bill is especially important given the extent of private sector debt overhang. The bill aims at striking an appropriate balance between facilitating the resolution/restructuring of unsustainable household debts on the one hand, and upholding payment discipline and safeguarding creditors' rights on the other. Earlier concerns with the protection of creditors' rights have been addressed through strengthened appeal provisions and greater involvement of the courts in the certification of insolvency procedures. Once the law is enacted, it will be essential to intensify ongoing efforts to provide the necessary resources to ensure its smooth and timely implementation. Moreover, concerns remain with a legal gap that prevents banks from repossession collateral related to some mortgage loans, and this should be addressed as a matter of priority. Other draft bills published since the last review aim at strengthening supervision, by upgrading the regulatory framework for credit unions, and establishing an enhanced credit register and a levy to fund the credit institutions resolution fund.*

*Despite the substantial progress made so far, the programme's ultimate success remains subject to important risks, including continued uncertainties in the outlook for trading partners' growth and the complexity of the ongoing financial sector reforms. From this perspective, the June 29 statement from the Heads of State and Government of the euro area, recognising the imperative of severing the vicious circle between banks and sovereigns and mandating the Eurogroup to review the situation of the Irish financial sector with a view to enhance the sustainability of the well-performing programme, have also resulted in a substantial improvement in market sentiment towards Ireland. This has been reflected in a significant decline in Irish bond yields and the successful return by the Irish debt management office (NTMA) to the market in July, first with a EUR 500 million 3-month Treasury Bill issue and subsequently with 5- and 8-year bond issues raising in excess of EUR 4 billion of new long-term market funding amid strong demand, the bulk from foreign investors. The NTMA also issued just over EUR 1 billion in new amortising bonds targeted at Irish pension funds in late August.*

*Successful completion of this review would allow the release of EUR 1 billion from the EFSF/EFSM, EUR 0.9 billion from the IMF, and EUR 0.7 billion from other EU member states (UK, SE, DK) in the context of their bilateral loans to Ireland.*

## 1 Introduction

This report covers recent macroeconomic and financial developments, programme implementation, and the main challenges ahead, as assessed by the 3-12 July 2012 joint EC/ECB/IMF staff mission that visited Dublin in the context of the seventh review of the economic adjustment programme, as well as the associated policy discussions with the Irish authorities.<sup>1</sup>

## 2 Macro-fiscal and financial developments

**Economic activity so far in 2012 has evolved broadly in line with expectations.**

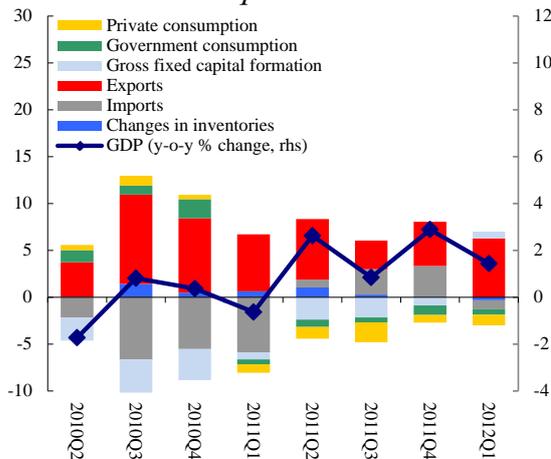
Although in the first quarter real GDP contracted by 1.1% (q-o-q), it was up 1.2% on a year-on-year basis. Exports were up by 6.1% year-on-year (against 1.4% for imports) and a strong contribution from net exports continued to offset the contraction in domestic demand (led by falls in private and government consumption, although machinery and equipment investment turned positive). Supporting the view that the economy is stabilising, the year-on-year decrease of 1.3% in real domestic demand was the smallest contraction since 2008 and in fact a small year-on-year increase in nominal domestic demand was recorded. Nominal growth was 4.3% year-on-year in the first quarter of 2012, following nominal growth of 1.6% in 2011 as a whole—a turnaround from the 2007-11 period when the nominal decline outpaced the real decline. Real GDP growth in 2011 was also revised up by 0.7 pp. (to 1.4%). Inflation on a harmonised basis averaged 1.8% in the first six months of 2012, mainly on the back of administered and energy price increases.

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<sup>1</sup> This report reflects information as of 23 August 2012.

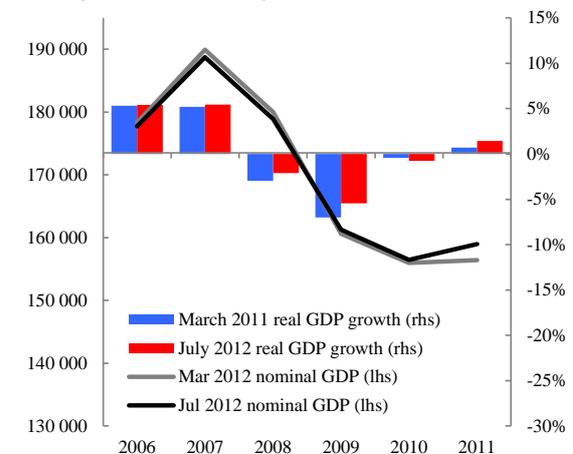
**Figure 1: Recent economic developments**

*Year-on-year growth continues in the first quarter*



Source: CSO  
 Note: Contributions are not additive due to chain-linking

*A data revision returns stronger 2011 real growth and higher nominal GDP*



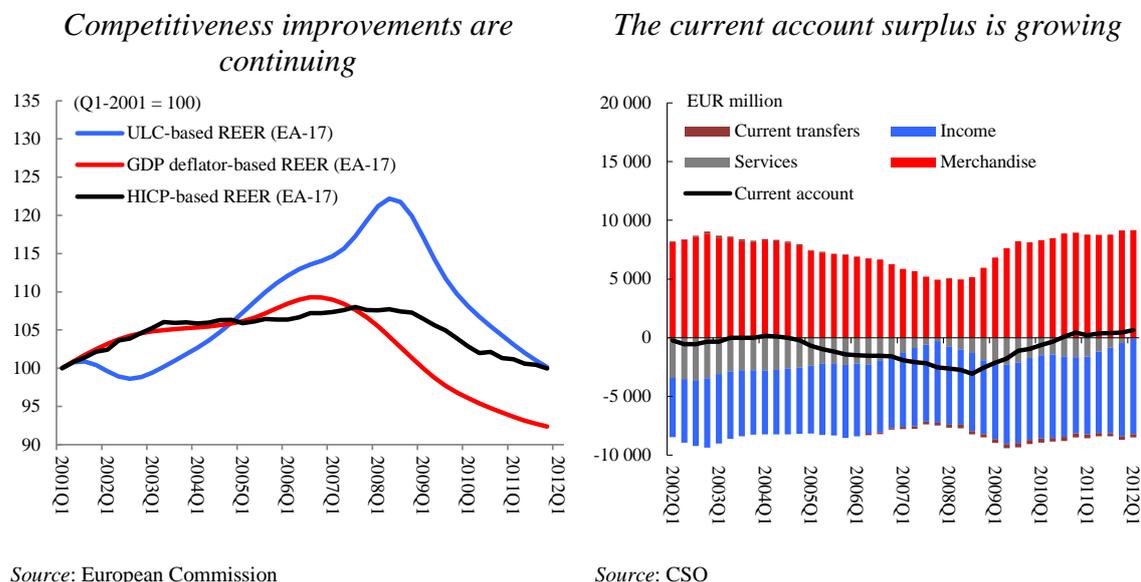
Source: CSO

**Much of the competitiveness imbalance in Ireland has been unwound.** Standard measures of competitiveness show a real effective exchange rate depreciation of between 10% and 22% from peak. This stems from a combination of factors, including a fall in average hourly labour costs of 3.7% from late 2009 to late 2011 as well as a depreciation of the euro against the currencies of Ireland's trading partners over the period. The competitiveness improvement also reflects compositional effects, as some measured productivity improvements have been concentrated in capital-intensive sectors. On the strength of improvements to date the current account balance averaged 1.7% of GDP in the year to the first quarter and the estimates for 2010 and 2011 were both revised up to 1.1% of GDP. In particular, the merchandise balance has continued to increase since 2008 and the services balance has been eliminated, both on the back of weak domestic demand over the period but also strong export growth. Some further improvement in competitiveness should result from domestic price pressures remaining low over the medium term.

**The labour market remains challenging.** Employment contracted by a seasonally adjusted 0.4% in the first quarter of 2012, and is down 1.0% year-on-year (although it is essentially flat year-on-year if one adjusts for the expected reductions in the public service, which spiked in the first quarter of 2012). Unemployment averaged 14.7% in the first seven months of 2012, as participation stabilised. Although weekly hours worked were up 1.0% year-on-year in the first quarter, nominal hourly wages are essentially flat across the economy, indicative of soft labour demand in most sectors and the large

number of unemployed. At the same time, income tax data for the first half of 2012 are some 3.1% ahead of target, which may point to some pick-up in employment performance in the second quarter.

**Figure 2: External rebalancing**



**The fiscal outturn was somewhat better than the programme profile between January and June (Table 1), though expenditure overruns have materialized in welfare and health, which are being addressed by the authorities.** Tax revenue was more than 0.1% of GDP ahead of profile, offsetting by a small margin a roughly similar expenditure overrun. On the revenue side strong personal income and corporation tax revenue more than offset some under-performance in social contributions (PRSI). Current expenditure was almost 0.2% of GDP above the authorities' target, somewhat compensated by lower-than-expected capital expenditure (less than 0.1% of GDP). The main current expenditure overruns are in the social protection and health sectors. A higher-than-anticipated number of unemployment benefit recipients accounts for most of the overrun in social protection, and has also contributed to spending pressures in the health sector, as all unemployed are entitled to medical cards, which provide free access to most health services. Other factors contributing to the spending overruns in the health sector include slippages in the delivery of some of the 2012 budget measures (see Box 2 below for more on the source of the overruns and the measures being taken to address them).

**Deposit inflows at domestic banks continued for a fourth consecutive quarter, but average funding costs for the system as a whole remain elevated.** Some

EUR 12.8 billion in cumulative net inflows have been recorded by the PCAR-covered banks<sup>2</sup> since June 2011 (Figure 3), bringing the total deposit stock to EUR 153 billion on a consolidated basis (an increase of over 9% year-on-year).<sup>3</sup> The UK subsidiaries of Irish banks have continued to drive growth in the retail segment, somewhat aided by the appreciation of sterling against the euro over the period, while corporate deposit inflows have largely originated from ROI-resident institutions. Market funding costs remain high, however. Deposit pricing continues to be dislocated<sup>4</sup> due to strong competition, despite efforts by one covered bank to drive the market lower, while higher fees associated with the ELG scheme also continue to contribute to increased bank funding costs. To address this, the authorities are working with the covered banks on a prudent strategy for the gradual phase-out of the ELG scheme, while adjustments to the programme deleveraging framework (see section 4.3 below) should help mitigate any potential distortions in deposit pricing which could have arisen from banks striving to meet the targets on loan-to-deposit (LDR) ratios.

**Bank deleveraging has also continued apace.** Total net loan balances at three covered banks (AIB, BoI and IL&P) have decreased by almost EUR 42 billion by end-April (relative to December 2010 levels). An additional EUR 11 billion of deleveraging has been completed by IBRC, bringing total system deleveraging since the beginning of the programme to EUR 53 billion. A further EUR 1.6 billion of asset disposals has been sale-agreed by end-June. BOI in particular has already met its 3-year asset disposal target of EUR 10 billion bringing its LDR down to 136% by end-June, while AIB's LDR has been reduced to 125% by end-June. Progress with deleveraging at PTSB, however, remains insufficient with just EUR 3.3 billion of loan balance reduction and no asset disposals completed to date. The bank's current LDR of circa 191% also reflects the decision to postpone the sale of CHL (which accounts for about 70% of PTSB's initially envisaged deleveraging requirement) as a result of a change in management strategy, which is being considered as part of the revised Restructuring Plan submitted at end-June.

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<sup>2</sup> The banks covered by the 2011 PCAR exercise include AIB/EBS, BOI and PTSB, henceforth referred to as PCAR-covered banks. Domestic banks, as referenced in this report, include the PCAR-covered banks plus IBRC.

<sup>3</sup> The deposit stock is now some EUR 10 billion higher than the level assumed in the Financial Measures Programme 2011, which forecast no growth in total deposit volume at the covered banks relative to the 31 December 2010 level (EUR 142.1 billion).

<sup>4</sup> The average rate on term deposits (with agreed maturity of up to 2 years) for households in Ireland is 3.66%, some 90 basis points higher than the average for banks in the euro area (Source: ECB, CBI, data as of end-May 2012).

**Table 1: Fiscal performance in January-June 2012 against targets**

EUR million	2012 Jan-Jun Outturn	2012 Jan-Jun Target	Outturn vs Forecast	Outturn vs Forecast, %	2012 Jan-Dec Target	Outturn Jan-Jun vs. 2012 target, %
<b>Revenue</b>	<b>23 418</b>				<b>47 938</b>	<b>49%</b>
<b>Tax revenue</b>	<b>20 239</b>	<b>20 024</b>	<b>216</b>	<b>1.1%</b>	<b>43 462</b>	<b>47%</b>
<i>Personal income tax</i>	7 061	6 846	215	3.1%	15 300	46%
<i>VAT</i>	5 189	5 160	29	0.6%	9 995	52%
<i>Corporation tax <sup>1</sup></i>	1 980	1 806	174	9.6%	4 020	49%
<i>Excise duties</i>	2 209	2 244	-35	-1.6%	4 815	46%
<i>Social contributions (PRSI) <sup>2</sup></i>	3 225	3 417	-192	-5.6%	7 087	46%
<i>Other taxes</i>	576	551	25	4.5%	2 245	26%
<b>Non-tax Revenue</b>	<b>1 726</b>				<b>2 730</b>	<b>63%</b>
<i>Central Bank Surplus Income</i>	958				945	101%
<i>Bank Guarantee Fees <sup>3</sup></i>	547				982	56%
<i>National Lottery Surplus</i>	105				220	48%
<i>Other</i>	116				583	20%
<b>Capital receipts</b>	<b>1 452</b>				<b>1 746</b>	<b>83%</b>
<i>EU agricultural funds (FEOGA)</i>	720				720	100%
<i>Sinking fund</i>	646				646	100%
<i>Other</i>	86				380	23%
<b>Expenditure</b>	<b>31 085</b>				<b>60 976</b>	<b>51%</b>
<b>Current voted (net)</b>	<b>24 555</b>	<b>24 273</b>	<b>282</b>	<b>1.2%</b>	<b>47 881</b>	<b>51%</b>
<i>Social Protection <sup>2</sup></i>	10 350	10 222	128	1.3%	20 474	51%
<i>Health</i>	6 529	6 361	168	2.6%	12 095	54%
<i>Education</i>	4 000	3 989	11	0.3%	7 635	52%
<i>Other</i>	3 676	3 701	-25	-0.7%	7 676	48%
<b>Current non-voted</b>	<b>5 438</b>				<b>8 630</b>	<b>63%</b>
<i>Debt Service <sup>5</sup></i>	3 866				6 403	60%
<i>EU Budget Contribution</i>	810				1 340	60%
<i>Sinking fund</i>	646				646	100%
<i>Other non-voted (ex-SF)</i>	117				241	49%
<b>Capital expenditure</b>	<b>1 092</b>				<b>4 465</b>	<b>24%</b>
<i>Exchequer capital funding (net)</i>	1 092	1 180	-88	-7.5%	3635	30%
<i>FEOGA and other EU payments</i>	0				830	0%
<b>Below-the-line financial transfers</b>	<b>1 775</b>				<b>2 544</b>	<b>70%</b>
<i>Promissory Notes <sup>4</sup></i>	25				25	100%
<i>Loans to Insurance Compensation</i>	450				450	100%
<i>Irish Life Limited</i>	1 300				1 300	100%
<i>ESM capital payment</i>					509	0%
<i>Credit Union Funding</i>					250	0%
<i>Other</i>	1				11	7%
<b>Exchequer balance <sup>5</sup></b>	<b>-9 443</b>				<b>-15 582</b>	
<i>Below-the-line financial transfers</i>					2544	
<i>Local government sector</i>					-200	
<i>Accrual adjustments and extra-budgetary funds</i>					39	
<b>General government balance <sup>5</sup></b>					<b>-13 199</b>	

Sources: End-June Exchequer statement; Stability Programme; 2012 budget; May's revision of revenue and expenditure profiles; and Commission Services estimates

Notes:

1 Corporation tax target for end-June is increased for delayed repayments, estimated by Commission staff at EUR 100 million, which are expected by the end of the year.

2 Social contributions (PRSI) are included among tax revenue and excluded from net Social Protection current expenditure. Net current expenditure are net of departmental own receipts (appropriations-in-aid).

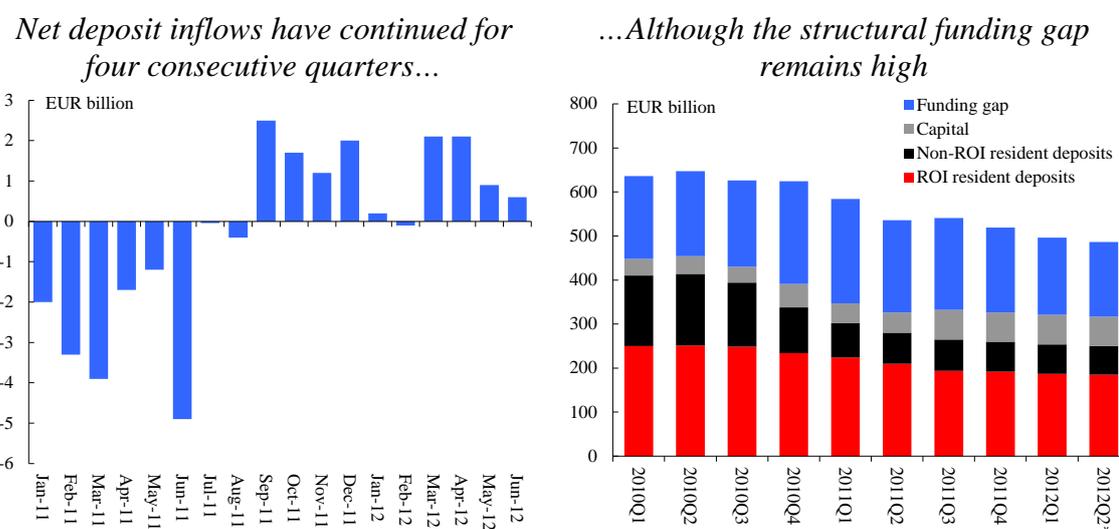
3 Revenue from bank guarantee fees are estimated to be higher than planned in the 2012 budget (EUR 800 million)

4 Excludes promissory note repayment to IBRC of EUR 3.06 billion, which was financed through a government bond placement.

5 Debt service cost, exchequer balance and general government balance are Commission Services estimates

**Despite continued deposit inflows and progress with deleveraging, the structural funding gap for domestic banks remains high** (Figure 4). Following the loss of rating-sensitive non-resident deposits in the last quarter of 2010, CBI data show that the funding gap for covered banks (ROI operations) peaked at EUR 237 billion in the first quarter of 2011. Since then, it has decreased by EUR 68 billion, as deleveraging continued apace and capital injections following the PCAR 2011 stress tests were completed. Latest available data (end-May) points to a structural funding gap (i.e., the amount of assets exceeding the volume of deposits plus capital) of EUR 169 billion, which is financed through Eurosystem operations, outstanding debt securities, and other liabilities. As wholesale funding continues to redeem (about EUR 15 billion scheduled for repayment before the end of the programme period), reliance on Eurosystem funding is slated to remain elevated (Figure 4) and to potentially increase in the short run. The limited availability of unencumbered eligible collateral on bank balance sheets is a critical challenge in this regard, which is only partially addressed through the Additional Credit Claims facility of the CBI.

**Figure 3: Net deposit flows and structural funding gap at covered banks**



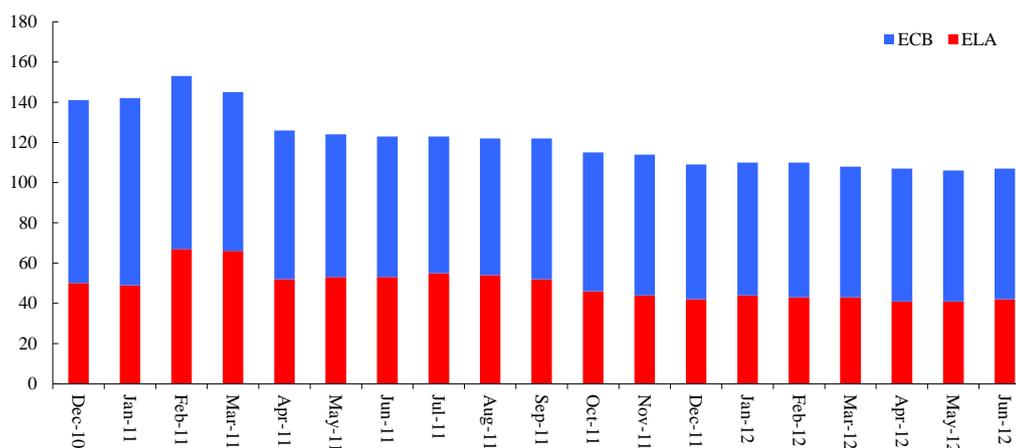
Source: Department of Finance, Central Bank of Ireland  
 Note: Figures are consolidated and include deposit inflows/outflows for foreign subsidiaries (e.g. in the UK) of PCAR-covered banks

Source: Central Bank of Ireland  
 Note: Figures refer to ROI-based operations of PCAR-covered banks

**While funding challenges for domestic banks continue to impair the flow of credit to the domestic economy, weak demand for some types of credit is also contributing to low net lending levels.** Core loan portfolios at covered banks continue to contract, with net loan balance reduction of about EUR 15.6 billion between end-December 2010 and end-April 2012 (which exceeds PLAR forecasts mostly due to higher impairments). As new lending in core portfolios is extended against lower property values, banks' mortgage

loan books are expected to continue contracting through end-2013. Indeed, the recently published Bank Lending Survey (BLS) found that credit standards on loans for house purchase had tightened during the second quarter of 2012, while demand for mortgages had increased, with reduced competition, less favourable expectations for economic activity and diminished prospects for the housing market cited as key reasons. A large proportion of banks' mortgage book reduction could be replaced by SME lending at BOI and AIB, as the pillar banks aim to meet their targets for credit to the sector. However, the demand for bank credit by Irish-resident firms remains subdued as their financing needs continue to decline due to lower levels of fixed investment, and reduced expenditure on inventories and working capital. According to the most recent Mazars survey only 38% of Irish SMEs applied for a bank loan during the October 2011-March 2012 period and the most recent BLS also reported a further drop in credit demand under unchanged credit conditions for Irish enterprises.

**Figure 4: Domestic banks' central bank funding (EUR billion)**



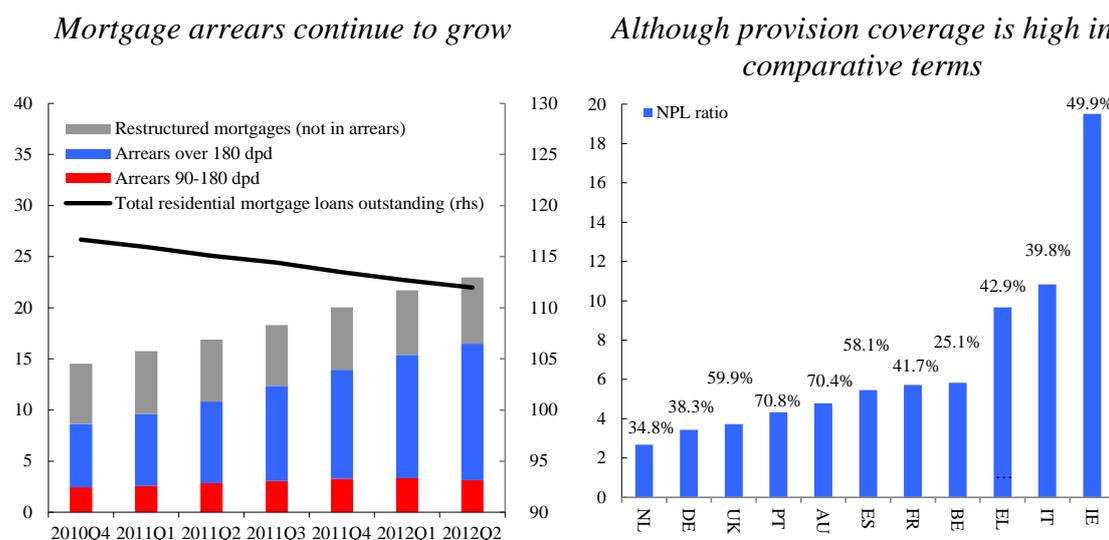
Source: Central Bank of Ireland

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

**Bank asset quality continues to deteriorate, though the pace of acceleration in mortgage arrears appears to have slowed in recent months.** The outstanding balance on owner-occupier mortgage accounts in arrears of over 90 days past-due reached EUR 16.5 billion (Figure 5), equivalent to 14.7% of the total owner-occupier mortgage loan book at end-June 2012. About 80% of this amount was in arrears for 180 days or more. However, the pace of increase in owner-occupier arrears appears to be slowing down in recent months, with a quarter-on-quarter increase in the balance of mortgages in arrears as a share of total mortgages of 1.1 pp. in the second quarter of 2012, down from 1.3 pp. in the first quarter and 1.5 pp. in the fourth quarter of 2011. Loan restructurings

continue to increase, though thus far they have tended to reflect short-term forbearance measures. Banks are expected to gradually adopt more sustainable loan modification measures as they implement their arrears resolution strategies. Asset quality is deteriorating also in other segments. The share of the balance of Buy-To-Let (BTL) mortgage portfolios represented by accounts in arrears of over 90 days past-due (which includes impaired) has reached 37.2% and 21% at AIB and BOI, respectively, as of end June, up from 31.4% and 17%, respectively, at end-2011.<sup>5</sup> About 37% of SME loan balances are in default of more than 90 days (heavily skewed towards construction and retail & leisure sectors), while more than half of banks' commercial real estate portfolios are impaired. Capitalisation levels, however, remain high (Core Tier 1 ratios at all covered banks are in excess of 15%) and coverage ratios (total provisions/NPLs) at Irish banks compare favourably with those in other European countries (Figure 5).

**Figure 5: Mortgage arrears balances and restructurings (EUR billion) and NPL ratios and provisions (%)**



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

Source: ECB, Central Bank of Ireland  
 Notes: (i) NPL ratio reflects the share of NPLs in total gross loans and advances (for all countries except IE NPL figures include doubtful loans); (ii) percentage numbers above columns represent the share of NPLs covered by provisions (coverage ratios); (iii) data for Ireland includes PCAR-covered banks only through end-December 2011; data for other countries is through end-June 2011.

**The supportive June 29 statement of the Heads of State and Government (HoSG) of the euro area has boosted confidence in Irish government bonds. Bond yields have**

<sup>5</sup> According to the two banks' interim financial statements. The CBI is expected to begin publishing industry-wide data on arrears on BTL loans later in the year.

declined steadily, with the yield on the 9-year benchmark narrowing by more than a percentage point since mid-June. Capitalising on this improved sentiment, the NTMA was able to successfully return first to the T-bill market on 5 July, the long-term bond market on 26 July, and to issue new amortising bonds on 23 August (see Section 6).

### 3 Programme implementation

#### The programme is on track:

- The quantitative fiscal target for end-June 2012 was met. Specifically, the exchequer primary deficit amounted to EUR 8.7 billion, against an adjusted ceiling of EUR 9.6 billion.<sup>6</sup>
- Outstanding bank recapitalisation was completed in accordance with PCAR 2011 requirements, following the legal separation of Irish Life from PTSB through its acquisition by the state in late June.<sup>7</sup>
- The authorities submitted a Restructuring Plan for PTSB based on reorganising the bank into three distinct business units, including a core retail bank, a legacy-asset management unit, and the group's UK mortgage operation. Work on the financial and operational restructuring of PTSB will continue in coming months, also in the context of plans for a broader restructuring and strengthening of the financial system.
- The draft Personal Insolvency Bill was introduced in the Oireachtas in late June, seeking to strike an adequate balance between protecting debt service discipline and creditors' rights, providing a non-judicial alternative to bankruptcy and safeguarding reasonable standard of living for distressed debtors.
- Agreement was reached on adjusting the programme deleveraging framework to minimise any potential deposit pricing distortions and constraints to the flow of credit to the domestic economy arising from the programme's LDR targets. Formal targeting of non-core asset disposals and amortisation in nominal volume terms was retained, which will be complemented by an enhanced monitoring

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<sup>6</sup> Ceiling adjusted for: (i) the acquisition of Irish Life Ltd from ILP for a consideration of EUR 1.3 billion and (ii) tax revenue and gross PRSI overperformance compared to TMU estimates Both the primary deficit outturn and the target include the 2012 IBRC promissory note payment as if paid in cash, although it was in fact settled with a government bond.

<sup>7</sup> The legal separation of the banking and insurance businesses of ILP allowed gains from liability management exercises conducted in 2011 to be reflected in group core tier 1 capital.

framework for banks' funding and liquidity ratios, also to facilitate the monitoring of their progress towards compliance with relevant Basel III requirements.

- In cooperation with external consultants, the authorities have completed asset quality and distressed credit operation reviews, a data integrity validation exercise, an interest income recognition and re-aging project for impaired loans and a valuation exercise on banks' securities portfolios. The results of these work streams and remedial actions to be completed by banks will serve to further refine future loan-loss estimates, feeding into the next PCAR exercise.
- Banks have launched advanced loan modification options to address rising mortgage arrears, and the authorities have developed a set of key performance indicators (KPIs) to monitor implementation, with results to be published starting from December 2012.
- The authorities provided troika staff with a minor delay in early July with a progress report on their efforts to bring to market the state assets identified for disposal by the government. Based on their due diligence, they have not identified any regulatory or legislative impediments. The authorities also provided a detailed implementation plan to guide the transfer of water services provision from local authorities to Irish Water.
- In July, the Services Pensions (Single Scheme and other Provisions) Act 2012 was enacted, providing for the reforming of the occupational pension entitlements for new entrants to the civil and public service.<sup>8</sup> Key changes include: (i) career average-based accrual of pension instead of the more expensive final salary basis (which applies to pension awards for serving staff); (ii) raising the minimum public service pension age initially to 66 years, and then on a phased basis to 67 and 68 years (in line with the legislated increase in the state pension age); (iii) a new maximum retirement age of 70 years; and (iv) linking both the in-service uprating of accrued pension amounts and the post-retirement pension increases to consumer price increases rather than changes in the pay of active public servants. These reforms will apply to newly-recruited civil and public servants, and thus savings will begin to accrue, once the Minister for Public Expenditure and Reform signs a commencement order.

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<sup>8</sup>This had been originally presented to Parliament in September 2011 (see for example footnote 10 on page 25 of the report for the 6<sup>th</sup> programme review).

One milestone, related to the establishment by the CBI of draft rules for the creation and subsequent holding of liquidity buffers by banks in preparation for the new Capital Requirements Regulation becoming effective in 2013, could not be completed since the relevant EU-wide guidelines have yet to be finalised by the Council, the European Commission and the European Parliament. This has therefore been reset to end-2012 (subject to finalisation of said guidelines at the EU level).

## 4 Policy Discussions

### 4.1 Macroeconomic outlook

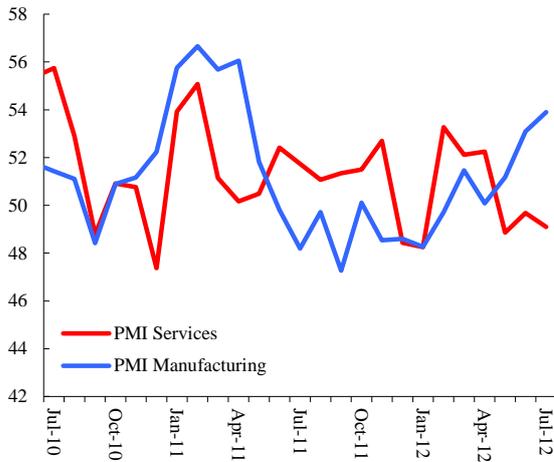
**Commission Services have left their estimates of 2012 GDP growth essentially unchanged (0.5% to 0.4%), but revised down their 2013 forecast by half a percentage point to 1.4%.** In terms of high-frequency indicators so far this year, core retail sales were down 1.5% year-on-year in the first six months of 2012, although this was in line with expectations. Ireland's relatively a-cyclical export sector seems to be holding up reasonably well, with industrial production in the 'modern'<sup>9</sup> sector up 6.0% y-o-y in the first six months of the year. Indigenous firms are facing a more difficult environment, with output in the 'traditional sector' down 3.8% in the same period. Moreover, the manufacturing PMI is continuing to hold up remarkably well (at 53.9 in July) despite a rather weak trading partner performance, although the services PMI has been in contractionary territory for the three months to July (Figure 6). Nonetheless the outlook for external demand has deteriorated somewhat since the finalisation of the last review, particularly for next year, with for example the most recent IMF WEO revising down 2013 growth estimates by, respectively, 0.6pp for UK and 0.2pp for the euro area—two key trading partners for Ireland. Commission Services have revised down export growth for 2013 from 4.2% to 3.5% as a result. A slightly larger contraction in domestic demand in 2013 is also foreseen, due to higher-than-expected unemployment and flat earnings. Nonetheless, nominal GDP for the forecast horizon is in fact slightly higher than previously projected, essentially due to the upward statistical revision to the 2011 base by 1.6%.

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<sup>9</sup> The modern sector is dominated by export-oriented multinationals and comprises chemicals and chemical products, basic pharmaceutical products and preparations, computers, electronic and optical products, electrical equipment, reproduction of recorded media, medical and dental instruments and supplies

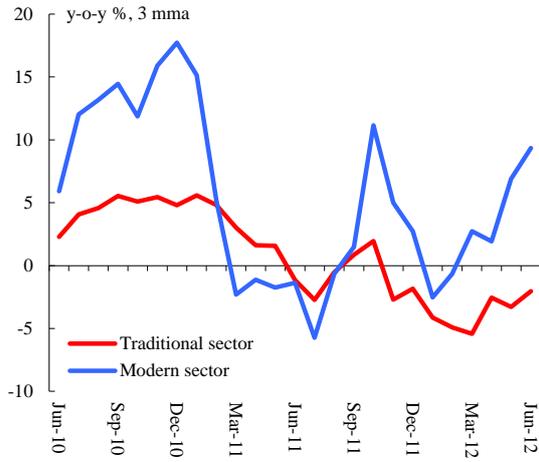
**Figure 6: High-frequency indicators**

*Services PMI dips although manufacturing remains in strong positive territory...*



Source: Markit Economics

*... though industrial production continues to show a mixed picture.*



Source: CSO

**Over the medium term, growth is expected to reach 3% on the back of a pick-up from the current very low investment levels and a return to employment growth.** The growing current account surplus—expected to peak at close to 5% over the medium term as net exports continue to drive growth—may also provide some scope for greater-than-expected domestic demand growth over time. On the downside, high unemployment and a large debt overhang may put downside pressures on private consumption over the forecast horizon. HICP inflation is set to fall from 1.4% in 2012 to 1.0% in 2013, as lower energy prices feed through while underlying inflationary pressures remain weak. These are expected to slowly increase towards 2% over the medium term, meaning more convergence toward euro area price levels is likely in the interim.

**Unemployment is set to fall only gradually to 13% by 2015, and risks of a more adverse outcome prevail.** The forecast for 2013 unemployment has been revised up by over half a percentage point to 14.4% on account of the higher-than-expected starting position in the first half of 2012. Long-term unemployment continues to rise, with an increasing share of claimants of very long duration. In part this may reflect the structure of the benefits system in Ireland, whereby activation does not increase with the length of the unemployment duration nor does unemployment assistance generally decline over time. Exit rates to employment at longer durations are lower than before the crisis and it will take considerable time for the stock of unemployed to decline once employment growth resumes. A positive potential factor is the historical capacity of the Irish labour market to sustain very high rates of employment growth. On the other hand, the structural

shift whereby Irish firms can source labour abroad means that the current stock of unemployed may not come down as rapidly with employment growth as has been the case in the past. While net outward migration is forecast to persist until 2015, its impact on the labour market is likely to be smaller than in the late 1980s, when net outward migration also prevailed, as gross inflows of migrants are now higher.

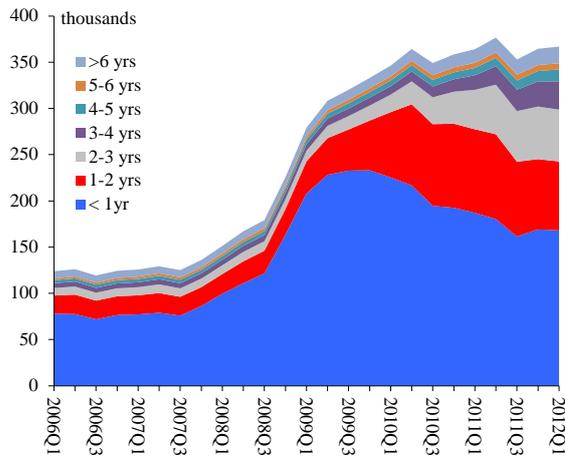
**Table 2: Updated macroeconomic framework**

	Seventh review forecasts (latest)					Sixth review forecasts (previous)				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
	% change on previous year (unless otherwise specified)									
Real GDP growth	1.4	0.4	1.4	2.5	2.8	0.7	0.5	1.9	2.6	2.9
Private consumption	-2.4	-1.9	-0.2	1.4	1.9	-2.7	-1.7	0.3	1.5	1.9
Public consumption	-4.3	-3.0	-0.7	-3.5	-3.4	-3.7	-2.9	-1.8	-4.0	-3.5
Fixed investment	-12.6	-4.0	-0.1	4.5	5.2	-10.6	-4.0	1.0	4.0	4.9
Domestic demand (contribution)	-3.4	-1.9	-0.2	0.5	0.9	-3.3	-1.7	0.0	0.5	0.9
Inventories (contribution)	0.4	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Exports	5.1	2.8	3.5	4.5	4.5	4.1	3.2	4.2	4.8	4.8
Imports	-0.3	0.8	2.5	3.5	3.6	-0.6	1.2	3.0	3.6	3.8
Net trade (contribution)	5.4	2.3	1.6	2.0	2.0	4.7	2.2	1.9	2.1	2.0
Employment	-2.1	-0.8	0.4	1.3	2.0	-2.2	-0.6	0.7	1.3	2.0
Unemployment rate (level)	14.4	14.8	14.4	13.7	13.1	14.3	14.4	13.7	13.0	12.4
GDP deflator	0.2	1.4	1.2	1.4	1.6	-0.4	1.2	1.2	1.5	1.5
HICP inflation	1.2	1.4	1.0	1.4	1.6	1.2	1.7	1.2	1.4	1.7
Current account (% of GDP)	1.1	2.1	3.3	4.6	4.7	0.1	1.5	3.1	4.4	4.5
Nominal GDP (EUR billion)	159.0	161.8	166.1	172.7	180.5	156.4	159.2	164.2	171.0	178.7

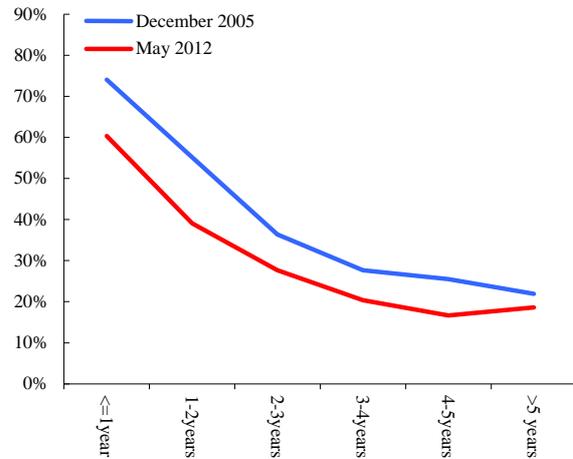
**Figure 7: Long-term unemployment**

*The share of long-term unemployment continues to increase...*

*...as exit rates to employment are lower than in the pre-crisis period.*



Source: Department of Social Protection, Commission calculations



Source: Department of Social Protection, Commission calculations

**Box 1: Sources of medium-term growth**

As mentioned in Section 2 above, Ireland has achieved significant improvement in its competitive position in recent years, providing a better foundation for sustainable export growth. Indeed, foreign direct investment inflows continue, with IDA Ireland (the government's FDI promotion agency) reporting a 4% increase in net new jobs in its supported sectors in 2011, the largest increase since 2002. Ireland continues to score favourably on a range of surveys assessing the business climate. Historical experience from the 1990s shows that Ireland is able to support high rates of growth while improving the external position.

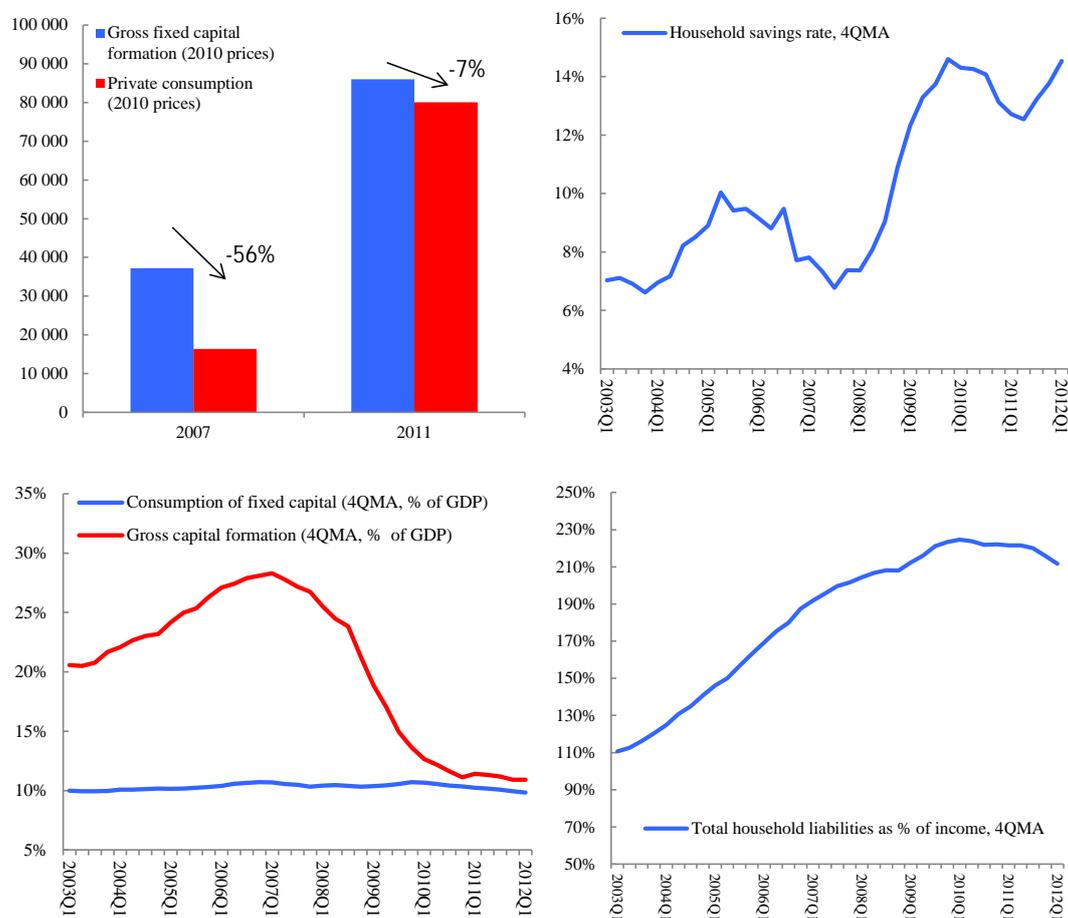
Turning to domestic demand, growth is expected to come from (i) a return to more normal levels of business investment, which has dropped by 56% since the 2007 pre-crisis peak (left panel below), and (ii) a fall in the precautionary element of savings, which is at near record-high levels ( see top right panel below).

Economy-wide investment, at just 10% of GDP in 2011, remains very low compared to other advanced economies but also on its own terms: gross capital formation is now only slightly larger than consumption of fixed capital (see top left chart above), indicative of the magnitude of the decline. Machinery and equipment investment fell 33% between 2007 and 2011 due to reduced demand in the economy but also from precautionary motives, leaving potential for it to increase quickly when confidence in the overall economic outlook solidifies, both domestically and in the euro area. In the wake of the housing boom, investment in dwellings fell 68% over the same period and new house completions are set to number about 8,000 this year, down from about 93,000 in 2006. Growth from these very low levels of housing investment is likely in the medium term. Despite recent net outward migration, population growth remains positive in Ireland. Household size is still relatively large by European standards—leaving scope for further decline and, in turn, an increase in housing demand. Although the supply of vacant dwellings is estimated to be large, many of these units date from the latter part of the boom and are situated far from amenities and labour markets. After a large fall from peak, private rents increased by 2.0% year-on-year in June which may be indicative of some tightness in better-located segments of the housing market.

Modest growth of about 10% between 2013 and 2015 from the very low current levels of investment is currently incorporated in programme forecasts. A sharper recovery should not be ruled out due to factors outlined above, although this would necessitate credit demand by households and indigenous firms to be met by adequate supply in due course.

On the household side, real private consumption fell 7% between 2007 and 2011, and is projected to grow only slightly by 2015. The risks around this forecast are more balanced. Irish household indebtedness is high relative to income (at 212%, see bottom right panel above) in the wake of the property bubble. However, this is relatively concentrated, with half of owner-occupiers (or a 36% of all

households in 2011) having a mortgage on their main property. Moreover, the household savings rate (at over 14% in the year to the first quarter) remains considerably elevated and is likely to be due to both precautionary motives and the need to pay down debt. Although the need for some households to continue deleveraging will keep their savings ratio relatively high in the medium term, once confidence takes a firmer footing precautionary savings should decline, which will support consumption growth in due course.



Sources: CSO, Central Bank of Ireland

## 4.2 Fiscal policy

*There was general appreciation for the continued observance of the programmed consolidation path, but also of important challenges still remaining. These include the still sizeable consolidation requirements, the need to provide for stable replacement of the temporary bank-related revenue (which is slated to decline over time as banks progress towards normalisation), and the emerging expenditure overruns in the health sector. The 2013 budget will, from all these perspectives, represent a key challenge.*

**The 2012 fiscal deficit is estimated at 8.4% of GDP, below the programme ceiling of 8.6% of GDP.** The baseline scenario assumes that—in spite of the revenue outperformance recorded in the first half of the year—income and corporation tax revenue will be in line with the annual target (a significant amount of tax revenue still

needs to be collected in the latter months of the year, in particular in November). Underperformance in social insurance (PRSI) revenue is assumed in staff projections to persist (around EUR 200 million). Current expenditure is expected to be contained in the second half of the year as remedial measures are introduced, in particular in the health sector (Box 2). However, unemployment benefits are expected to exceed the full-year budget by EUR 150 million. The increase in the projected fiscal deficit ratio relative to the previous review is mitigated by the upward revision of nominal GDP, which has a deficit-reducing effect of more than 0.1 percentage points of GDP.

**The authorities are taking additional measures to ensure that departmental expenditure ceilings are observed.** While some of the spending pressures arise from a higher-than-expected number of unemployed, as regards the health sector a large share of overspend is also due to the failure to manage certain services within approved levels in the 2012 service plan and slippage in the delivery of some of the measures envisaged in the 2012 Budget. In particular, legislative changes envisaged in Budget 2012 to reduce medication costs and to charge all private patients in the public hospitals have been delayed due to resistance from the pharmaceutical and private health insurance sectors, with whom negotiations continue. The inability to deliver efficiency savings in the decentralised healthcare system points to weaknesses in budget management and accountability. Top-down instructions to deliver savings have been intensified and measures improving financial management and accountability at regional and local level are being pursued. The authorities have taken additional saving measures in the health sector to contain spending to the budgetary limits (Box 2). However, some of these measures accounting for savings of EUR 277 million are one-off in nature and may need to be replaced with permanent structural measures in the coming budget to eliminate risks to the agreed deficit path over 2013-15. From this perspective, the authorities have indicated their intention to consider, in the context of Budget 2013, reforming the medical card/GMS eligibility and maximizing the flexibility under the Croke Park agreement through new working models.

**On unchanged policies, risks to the programme targets for 2013-15 have increased, but the authorities remain committed to take all the necessary measures to observe the programme and EDP deficit ceilings.** It is essential that the structural measures yielding long-lasting fiscal improvement are implemented to underpin the required adjustment over the medium-term. The scope of the required adjustment implies that all options to increase revenue and reduce expenditure need to be considered. While these

discussions will feature more prominently in the next review, Commission Services called for the authorities to pay special attention to measures that could further broaden the revenue base (including stable revenue sources such as the already planned value-based property tax) and improve the targeting of social welfare schemes.<sup>10</sup>

**The authorities have announced a package of new capital investment projects to boost the economy's productive capacity and stimulate job creation over the coming years.** The package of EUR 2¼ billion out to 2016 includes road construction and building new or improving existing education and healthcare facilities. It will be largely financed through Private Public Partnership (PPP) arrangements involving the EIB, the NPRF, domestic banks, and other private sector sources, as well as some of the proceeds of state asset sales. While through PPP arrangements the majority of risks can be shifted to the private sector—which would result in the classification of assets and liabilities outside the government sector—the resulting liability for future fee payments is economically similar to that stemming from debt. Besides ensuring value for money of each individual investment, Commission Services stressed that these additional liabilities and their implications for the sustainability of public finances must be taken carefully into account. The authorities have re-affirmed their commitment to use at least half of the proceeds from planned state asset sales for eventual debt reduction, while also reinvesting the remainder of the proceeds, once realised, in projects of a commercial nature, meeting ex-ante cost benefit criteria, enhancing employment, and preserving long-term fiscal sustainability, including programme and EDP fiscal targets.

**Box 2: Health expenditure overruns**

The 2012 budget included savings of EUR 543 million (0.3% of GDP) for the healthcare sector. To date, only 22% of the planned savings have been achieved, and the authorities are finding it challenging to deliver the remainder. In addition, higher-than-budgeted demand for services and higher-than-approved provision of some services require additional mid-year compensatory measures (see table below).

Among the measures envisaged in the 2012 budget, legislation to charge all private patients in public hospitals has been delayed, and is now envisaged to take effect only in 2013. In the meantime, a system of improved cash-flow and accelerated payment has been agreed in principle with private health insurance providers, which would provide a one-off cash flow benefit in 2012. Also, draft legislation on reference pricing and generic substitutions was published only in mid-July and thus reductions in drug costs are behind target. Composition effects resulted in higher costs from early retirements in the health sector in the first quarter of this year. The reduction of employees is producing the expected savings,

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<sup>10</sup> A document along the lines of last year's Medium-Term Fiscal Statement will be published in October, and will set out the broad budgetary strategy for the coming years. Full details of the 2013 budget will be announced in early December.

though to maintain service delivery with lower employment numbers, temporary recourse by some managers to agency and overtime in hospitals has resulted in higher-than-targeted costs.

The authorities are committed to deliver the savings for items planned in the 2012 budget and to take additional measures (outlined below) to address spending pressures from mid-year onwards. However, some of these measures are one-off in nature. To avoid risks to the agreed general government deficit ceilings in future years, these one-off savings may need to be replaced with permanent structural measures in the next budget, with appropriately supportive legislative and administrative reforms. In this context, the authorities will consider reforming medical card eligibility and introducing new work models using the flexibility envisaged under the Croke Park agreement with public service unions to put health funding on a more sustainable basis.

**Table 3: Measures to contain spending pressures in the health sector (EUR million)**

	<b>Required savings</b>	<b>Outturn to date and additional measures</b>	<b>Of which one-offs</b>	
<b>2012 Budget savings</b>	<b>543</b>	<b>503</b>	<b>125</b>	
Hospital income from private health insurance	143	125	125	
Demand Led Schemes	124	119		
Employment numbers and pay	145	135		
Long stay repayment scheme	11	11		
Efficiencies in disability, mental health & childcare	50	25		
Other measures	70	88		
<b>Emergent spending pressures since Budget time</b>	<b>317</b>	<b>357</b>	<b>152</b>	<b>Additional measures</b>
Hospital activity	150	129		Intensification of agency, overtime
Pension lump sum costs	46	46		HSE pensions
New high tech drugs	15	20		Additional savings on generic drugs costs
VAT	50	45	45	Medical Defence Union receipts
EU agency directive	15	16	16	Transitional Care Programme
Other (residual)	41	53	53	Time related savings in mental health/primary care
		10	10	Savings on National Treatment Purchase Fund expenditure
		28	28	Capital expenditure savings
		10		Other savings
<b>Total</b>	<b>860</b>	<b>860</b>	<b>277</b>	

Source: The Irish authorities and Commission Services estimates

**Efforts to strengthen the national fiscal framework continue.** The government has published a Fiscal Responsibility Bill to transpose provisions of the Treaty on Stability, Coordination and Governance into national legislation. The bill also provides a legal basis for the Irish Fiscal Advisory Council, assuring its financial and functional independence. The authorities will publish by end-September a separate legislative proposal to give a legal basis to the already-operational multi-annual expenditure ceilings. The scope to introduce further enhancements to fiscal data reporting was also discussed. The authorities have made progress towards developing an alternative presentation of the

monthly Exchequer returns and are also aiming at presenting outturns against monthly profiles for all major cash revenue and expenditure items, as well as the Exchequer balance next year. Moreover, the CSO is working towards publishing a quarterly government finance statistics publication from April 2013, increasing visibility of public finance data on a general government basis at the national level.

### 4.3 Financial sector

*As mentioned above, progress continues to be made towards a strengthened, more focused and better supervised banking sector. Concerns remain, however, on prospects for restoring bank profitability, as legacy low-yielding assets and a high cost of funding continue to compress net interest margins, while still-growing mortgage arrears foretell further increases in provisions. Dealing with these issues is a necessary prerequisite to repair the credit channel, so that banks can support the nascent recovery through the extension of profitable new lending.*

**Challenges to restoring bank profitability remain a source of concern.** After a considerable delay, all covered banks are taking steps to rationalise their operations and reduce related costs.<sup>11</sup> Yet low-yielding legacy assets such as tracker mortgages, which account for approximately 65% of PTSB's gross loan book about 18% at AIB (including EBS) and 17% at BOI, represent a major drag on profitability. To partially redress the impact on net interest income associated with these assets, banks are re-pricing back-books and increasing rates on new lending, which could act as a brake on domestic demand recovery. The high average cost of funding, as reflected in high deposit rates and elevated guarantee fees, also continues to weigh on banks' pre-provision profits. In addition, non-recurrent gains, such as from liability management exercises (LME) and lower-than-expected discounts on disposals, which were a major contributor to banks' pre-provision profits in 2011, are not expected to be sizeable in 2012. As arrears continue to rise (despite the authorities' comprehensive programme to address mortgage arrears—Box 3), a key source of risk for profitability remains the level of provisioning required, while practices on income recognition on impaired and troubled loans could be further

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<sup>11</sup> Voluntary severance, redundancy and early retirement schemes are expected to generate annualised savings of around EUR 300 million across the three institutions by end-2013, and branch reductions and other cost-saving initiatives (including staff benefits and pension adjustments, and re-negotiation of outsourcing contracts) are expected to generate a further EUR 150 million per annum.

reviewed as part of the CBI's supervisory activities to ensure sound provisioning following the application of loan modification options.

**To minimise any potential distortions of deposit rates—and attendant pressures on profitability—and mitigate possible risks to lending, the programme monitoring framework for deleveraging has been modified, reducing reliance on LDRs.**

Deleveraging completed to date is on track (though performance differs across institutions), with over 62% of the end-2013 PLAR target (EUR 70.2 billion) achieved by end-June. The pillar banks (AIB and BOI) forecast to exceed 90% of the required net loan balance reduction by end-December 2013 even if no further disposals were to materialise. Taking account of this important progress, and given possible unintended consequences of the deleveraging programme on the supply of credit and deposit pricing, it was agreed to refine the deleveraging monitoring framework.<sup>12</sup> Non-core asset disposals and amortisation (estimated at EUR 15.3 billion remaining by end-2013) will continue to be monitored against existing targets in nominal volume terms. This will be complemented by an enhanced monitoring framework for banks' net-stable-funding ratios (NSFRs), whereby enhanced reporting templates and a pre-defined set of levers influencing banks' NSFRs (with emphasis on elements within banks' control and going beyond deposits) will be developed and monitored by the CBI, also to facilitate monitoring of progress towards relevant Basel III requirements.

**The authorities are exploring avenues to gradually reduce banks' reliance on the ELG scheme.**<sup>13</sup> **Following pro-active examination by national authorities,** banks have started phasing out the coverage provided by the scheme with respect to their UK deposit-taking operations. BOI withdrew some EUR 3 billion equivalent in deposits from coverage by the scheme at end-March, and has not witnessed any outflows in its UK subsidiary. AIB (UK) and BOI's Isle of Man subsidiary also recently announced that they will exit the scheme in August. A welcome development has also been the origination of some EUR 500 million of unguaranteed corporate deposits since the beginning of the

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<sup>12</sup> This modification was mostly a preemptive move, since the degree to which undesired developments in core portfolio deleveraging and deposit pricing can be attributed to the existence of the programme LDR targets cannot be precisely determined. In particular, deleveraging pressures and competition for deposits (as the main source of funding for banks under current market conditions) are also apparent in other jurisdictions, which are not subject to such programme targets.

<sup>13</sup> Despite ELG-covered liabilities reducing from a peak of EUR 153 billion in the second quarter of 2010 to EUR 90 billion by end-June 2012, due to increased fees they continue to weigh heavily on banks' pre-provision profits, particularly at AIB/EBS.

year. As some EUR 10 billion in wholesale funding redeems over the course of 2012 with limited scope for refinancing and with some banks having opted not to extend their own-use bonds, ELG-covered liabilities are expected to decline further in 2012. There is an important fiscal dimension to this issue to be kept in mind: cash receipts from the scheme for the state were almost EUR 550 million in the first half of the year, some 8% lower than in 2011 (the full-year estimate is just under EUR 1 billion, a reduction of some 20% on 2011 although still an important source of general government revenue).

### **Box 3: The Mortgage Arrears Programme**

A comprehensive package of measures, the Mortgage Arrears Programme, has been put in place to tackle the issue of rising residential mortgage arrears. It is based on four main pillars: (i) Mortgage Arrears Resolution Strategies (MARS), (ii) a Mortgage to Rent Scheme, (iii) Mortgage Advisory Services, and (iv) the Personal Insolvency Bill.

#### **Mortgage Arrears Resolution Strategies (MARS)**

In May the covered banks provided the Central Bank with information concerning their mortgage arrears resolution strategies, currently under assessment. Banks submitted details of their forbearance and loan modification practices, a segmentation of their loan portfolios to assess the projected level of different forbearance or modification techniques and a set of key performance indicators. A pilot stage will be completed shortly. The full implementation of banks' techniques is expected by the fourth quarter at the latest.

#### **Mortgage to Rent Scheme**

The scheme, formally launched on 28 June, is specifically targeted at those low income families whose mortgage situation is unsustainable, who do not have significant positive equity, are eligible for social housing and agree to the voluntary repossession of their property. It ensures that the family remains in the home, paying rent, while ownership is transferred to an approved housing body. The goal is to transition 100 households by end 2012 and 500 in 2013.

#### **Mortgage Advisory Services**

The new government service, which is to be funded by the banks, provides distressed borrowers with a dedicated helpline (launched at the end of July), one-to-one independent advice and guidance (to be launched by September) and a media information campaign to be launched in the autumn.

#### **Personal Insolvency Bill**

The draft personal insolvency bill brings Ireland's out-dated bankruptcy laws more in line with the EU norm, in particular by reducing the time period for automatic discharge from bankruptcy to 3 years, from 12 years at present. It also introduces three out-of-court settlement arrangements between debtors and creditors, through non-judicial debt resolution processes, overseen by a new Insolvency Service: (i) a Debt Relief Notice, allowing for the write-off of qualifying debt up to EUR 20,000 subject to a three-year supervision period; (ii) a Debt Settlement Arrangement lasting up to 5 years (or, by agreement, 6 years) for unsecured debt; and (iii) a Personal Insolvency Arrangement for a period of 6 years, with possible extension to 7 years, for secured debt of up to EUR 3 million (this cap can be increased with the consent of all secured creditors) and unsecured debt.

**PTSB submitted a restructuring plan to the European Commission at end-June, and this is now under review for compliance with State aid rules.** The strategy for PTSB proposed by the authorities foresees the group operating as a single legal entity on consolidated basis, with three operational business units: (i) the core retail bank; (ii) an asset management unit to resolve problematic legacy assets; and (iii) the UK residential

mortgage operation, which will be divested as soon as conditions permit. The authorities are exploring options, also in the context of the decision of the euro area member states to review the situation of the Irish financial sector, to finance the carve out of certain problematic legacy assets remaining in PTSB, which is a key requirement for the viability of the core retail bank.

**Steps are also being taken towards implementing the strategy for the restructuring of the Credit Union (CU) sector.** A draft Credit Unions Bill was published on 28 June, taking into account the recommendations made by the Commission on Credit Unions on the need to restructure the sector to ensure the CUs' stability and viability, while preserving the identity of the CU movement and ensuring the protection of members' savings. The Bill reforms the regulatory and governance frameworks, and introduces a new stabilisation instrument, which will apply only to viable yet under-capitalised CUs, in order to minimise restructuring costs while ensuring their return to a stable operating environment. The restructuring strategy for the sector is based on an over-arching process of consolidation over time (to be completed by end-2015) and is focused on amalgamation and transfer mechanisms. A Restructuring Board will be set up with the role of assisting CUs with the preparation of restructuring plans and overseeing their implementation.

**A draft Personal Insolvency Bill was published on 29 June.** The Bill addresses some of the concerns raised by staff of the Troika on the draft heads published earlier in the year.<sup>14</sup> In particular, the Bill features new procedures to, inter alia, ensure adequate screening of potential beneficiaries and reduce the scope for opportunistic behaviour (Box 4). Next steps in the legislative process include the Committee stage in mid-September, with a view to have the Bill enacted by end-2012 and the new insolvency regime fully operational early next year. The mission underscored the importance to: (i) consider further refinements of the Bill, including on collateral valuation—an essential element in creditor voting arrangements under the primary new debt settlement processes; and (ii) redress the legal gap which prevents creditors from exercising their right to collateral on

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<sup>14</sup> This was briefly described on pages 24-25 of the Commission Services' [report](#) on the 6<sup>th</sup> review.

defaulted loans in some circumstances,<sup>15</sup> while preserving adequate protections for debtors' principal private residence.

**Important progress continues to be made with strengthening the supervisory framework.** In particular, amendments were introduced at the Committee stage to the Central Bank (Supervision and Enforcement) Bill, expected to be enacted by end-2012, to enhance the CBI's powers in new regulatory areas, including debt management and debt advisory activities. In parallel, efforts continue to ensure informed risk management decisions and prudent lending policies, including through the establishment of a Central Credit Register (Box 5). Finally, steps are being taken to introduce a levy on credit institutions, including banks and credit unions, to maintain a minimum amount of resources in a resolution fund on an ongoing basis and to allow for contributions from the Exchequer to this fund to be recouped over time (Box 6).

**Box 4: Revisions to the Heads of the Personal Insolvency Bill**

The Heads of the Personal Insolvency Bill, setting out the key principles of the legislation, were published earlier this year. Building on this and following completion of a consultation process, a draft bill was published on 28 June introducing several key changes, which aim at tightening eligibility criteria, reducing the scope for opportunistic borrower behaviour, and protecting secured creditors' rights while still allowing for efficient settlement of unsustainable debt. The key amendments set out in the draft bill specify that:

- Debtors would not be eligible for a Debt Relief Notice if 25% or more of their qualifying debts have been incurred in the six-month period ending on the application date.
- Before they can enter a Personal Insolvency Arrangement (PIA), debtors are now required to present a declaration attesting that they have co-operated with creditors for a period of at least six months, in accordance with any process approved or required by the Central Bank (e.g., the Mortgage Arrears Resolution Process). This provision provides an incentive for constructive engagement with lenders as regards a debtor's principal private residence, but would benefit from further refinement to cover also other secured debts, such as buy-to-let (BTL) mortgages.
- A PIA proposal requires the agreement of: (i) a majority of all creditors representing not less than 65% (unchanged relative to the Heads) of the total value of qualifying debt; (ii) creditors representing more than 50% (75% in the Heads) of the value of qualifying secured debt (reflecting the market value of the security); and (iii) creditors representing more than 50% (55% in the Heads) of the value of qualifying unsecured debt. The new qualified majority system is intended to facilitate voluntary agreement between creditors and a debtor by reducing individual creditors' veto powers, while also reflecting more adequately the value of security in determining voting weights.
- In addition to the issuance of the protection certificate at inception, the court is also involved with

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<sup>15</sup> Jurisprudence related to the Land and Conveyancing Law Reform Act (the so-called Dunne judgement of 25 July 2011) highlighted a loophole in the legislation which has the effect of limiting banks' ability to repossess property collateral. Justice Dunne ruled that a lending institution cannot apply for a repossession order if a mortgage was created before 1 December 2009, but a demand for full payment was not made by the lender until after that date. The authorities take the view that proposing legislation to redress this legal gap could prejudice the ongoing judicial process, with several cases pending before the Supreme Court.

the approval of the final agreement under a PIA. This second court intervention provides increased certainty for the process and ensures that EU-wide criteria for cross-border recognition of insolvency procedures are met.

- Mutual debts between a debtor and a creditor can be offset and creditors of the same class must be treated *pari passu*. These added provisions increase the efficiency of proceedings.
- Any liability arising out of tax, duty, levy or other charge owed or payable to the State cannot, unless otherwise agreed by the relevant creditor in writing, be included in any of the three debt settlement processes. This protects fiscal resources.

Other amendments introduced by the bill have a less clear rationale, in particular regarding the maximum value of debt which can be considered under a PIA. While the Heads envisaged a cap on *all* liabilities of the debtor at EUR 3 million, the draft bill specifies that this cap applies only to *secured* debt, while also allowing for its increase above that threshold with the written consent of all secured creditors. A limit for qualifying unsecured debt is no longer foreseen. This cap appears to be very high considering the average size of secured household debt in Ireland and the legislation's purpose of offering a viable alternative to bankruptcy to the most vulnerable debtors.

Staff have encouraged the authorities to continue working to strengthen the proposed reform. For example, in several cases the bill does not provide for specific implementing provisions (e.g., with respect to the methodology of the assessment of a security's market value, or to the licensing and appointing of insolvency practitioners, including with a view to regulate potential conflicts of interest). Additional safeguards against moral hazard under a PIA could also be introduced, including extending the scope of the six-month prior engagement with banks to other types of secured debt and lowering the cap on eligible debt. It is also important to ensure adequate resources are made available to the court to meet new demands resulting from the bill, especially in the early stages of the new regime when the bulk of requests could be anticipated.

#### **Box 5: Establishing a Central Credit Register**

A state-of-the-art Central Credit Register (CCR) is an essential tool to monitor credit risk in the financial system and develop rigorous borrower discipline. It provides banks with better quality information on borrowers' credit quality, thus fostering greater transparency, more prudent lending decisions and more competition between banks, while also contributing to the overall stability of the financial system.

A consultation document relating to the proposed Credit Reporting Bill was published on 8 June. The bill will require banks to report all extensions of credit in excess of EUR 500 and provide for mandatory creditworthiness checks through the CCR for all loans above EUR 2,000. Under the bill, the Central Bank will be responsible for the register and will own the data, but it may employ another company to operate the database. The Central Bank will provide lenders with credit reports and credit scores, to enable them to assess accurately the risks involved in granting credit to a given borrower. Data to be collected will include information on restructured as well as new loans.

The bill envisages safeguards to protect personal information. Data retention periods will vary with respect to different situations which can arise for each individual borrower (e.g. 60 months after the debt arrangement ceases for situations of debt relief certificates, debt settlement arrangements and personal insolvency arrangements).

Some key provisions of the bill need to be further refined/improved, including to expand the scope of the information collected, to extend the data protection retention, to lower the reporting threshold (to avoid that multiple small overdrafts go undetected) and better define some data protection issues. These refinements may be introduced during the ongoing impact assessment and public consultation process. The authorities aim to publish the bill in September and to operationalize the CCR by end 2013, following outsourcing of the service through a procurement procedure.

**Box 6: Introducing a Credit Institution Resolution Fund Levy**

In the context of the broad efforts to strengthen the Irish financial system, a resolution fund was introduced to enable the authorities to address and resolve distressed financial institutions. It was funded through a EUR 250 million loan from the Minister for Finance provided at the end of 2011 with a view to meeting then-anticipated credit union resolution costs. This loan is to be recouped from contributions made to the fund by all credit institutions – indeed, all licensed banks and registered credit unions in Ireland fall within the scope of the new legislation. In the medium to longer term, the fund is envisaged to retain up to EUR 100 million on an on-going basis to cover any future resolution costs for financial institutions.

A consultation document was published on 6 July to regulate the contribution rate to the Credit Institutions Resolution Fund, as envisaged under the Central Bank and Credit Institutions Resolution Act 2011. The regulation is expected to be adopted by end September 2012 and proposes that the contribution rate be based on a percentage (0.05%) of total assets per annum as far as credit unions are concerned, and on the capital requirements for other credit institutions.

Commission services are closely monitoring the process to ensure that the legislation is consistent with the forthcoming EU framework for the recovery and the resolution of credit institutions, and that an adequate minimum target fund level and an optimal minimum level of contribution are set.

**Despite this important progress, addressing the remaining challenges is essential to complete the restructuring of the banking sector and enable banks to fully support the incipient economic recovery.** This should be achieved in a way that minimises further burdening public debt. Commission services, in liaison with the IMF and the ECB, are studying possible options for consideration by the Eurogroup in due course.

## 5 Structural reforms

*The structural reform agenda of the programme continues to be advanced. Progress has been made on rendering the sectoral wage setting framework more responsive to economic conditions on the ground, and initial steps are being taken to strengthen activation policies, although implementation is key, given the scale of the unemployment challenge. The strengthening of the competition law framework is progressing in line with programme objectives, as is the transfer of water provision services from local authorities to the planned new water utility. Finally, the authorities continue to advance their asset disposal plans.*

**Reforms to increase labour market flexibility are advancing.** In particular, the Industrial Relations (Amendment) Bill has passed through all legislative stages and was signed into law on 24 July. The amendments introduced to the bill during the parliamentary consideration are in line with its overall objective of making sectoral wage setting arrangements more responsive to economic conditions. This is expected to facilitate the required reallocation of the labour force within and across sectors. Once in

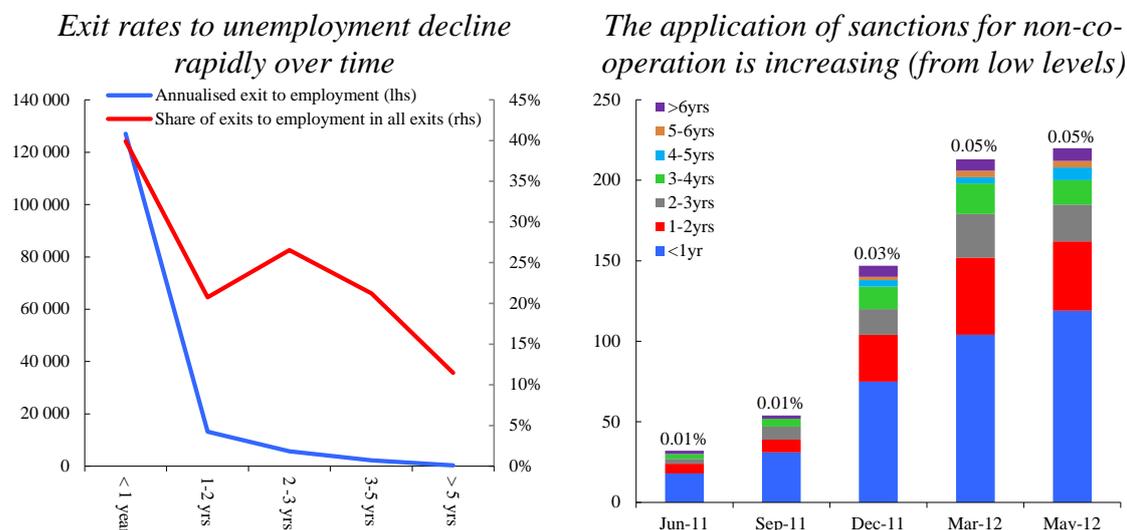
place, a formal review of all employment regulation orders (EROs) will take place before any re-negotiation under the new legislation can occur. More flexible mechanisms have been introduced to enable registered employment agreements (REAs) to be reviewed, challenged and cancelled, as appropriate. Both processes may last into next year and the authorities have agreed to report to programme partners on the impact on the labour market of the legislation during the second quarter of 2013.

**More remains to be done to bring down Ireland's high unemployment rate.** To deal with the challenge the authorities are implementing several measures. Housing benefits are to be reformed, which would have the effect of lowering effective replacement rates for some claimants. The Department of Social Protection has continued to implement *Pathways to Work*, the government's labour market activation plan. This includes the introduction of one stop shop pilots and close engagement with employers to encourage recruitment directly from the claimant roll. Resource levels and training needs of the new integrated employment centres are being examined and the use of private sector providers in activation is being considered. Nonetheless, the scale of the challenge of matching existing jobseekers to employment is considerable. The rate of exit for claimants to employment decreases sharply with the duration of the unemployment spell, accounting for as little as 11% of all exits at a duration of five years or more. Financial sanctions for jobseekers failing to participate in the activation process (the penalty amounts to a 23% cut in benefits) were introduced in early 2011, although these sanctions are presently being applied to only 0.05% of claimants, so that its deterrent effect may yet not be fully operational.

**The framework for competition enforcement is being strengthened as planned under the programme and reform of the regulation of legal services is under way.** The Competition (Amendment) Act 2012 came into effect on 3 July 2012. Among various provisions aiming at strengthening enforcement of the competition law, the act notably provides for commitments by an undertaking to be made a rule of court. Sanction has been given to enhance the resources of the Competition Authority by approximately 25% and an assessment of the effective resourcing will be carried out during the programme review process later in the year. The Legal Services Bill (a programme requirement) was introduced to Parliament in late 2011. After parliamentary debate, the authorities have decided to introduce amendments to, inter alia, change the proposed appointment structure for the new Legal Services Regulatory Authority to strengthen its independence. These changes remain consistent with the overall programme objectives of strengthening

competition in legal services and reduce their costs. The bill is expected to be taken to Committee stage after the summer recess. Assuming enactment of the bill in the third or fourth quarter of 2012, the new independent regulatory body is likely to be established in 2013.

**Figure 8: Exit rates to employment and penalty sanctions**



Source, Department of Social Protection, Commission calculations

Note: Annualised exit to employment is calculated as the sum of exits to employment for the January to May period multiplied by 12 and divided by 5, divided by the stock of unemployed at end-May 2012, for each duration cohort.

Source: Department of Social Protection

Note: Penalty rates by duration of employment and as a share of all claimants

**Steps continue to be taken to bring state assets identified by the government for disposal to market beginning in early 2013.** The Department of Public Expenditure and Reform has indicated that, having undertaken detailed examinations, they do not foresee any legislative or regulatory obstacles toward the commencement of the sale process in 2013. Progress toward sale of selected Bord Gáis Energy (BGE) assets has advanced and a tender for sale advisors was published in early July. The sale of selected power generation assets owned by ESB is likely to take place once the BGE sale process has been completed. The authorities outlined the steps taken to date toward the sale of the harvesting rights for some of Coillte's forestry assets as well as further reforms that would be necessary throughout the course of this year to bring the asset to market. The government had also outlined its intention to dispose of its remaining 25% stake in national carrier Aer Lingus, although the company is currently the subject of a takeover bid by Ryanair, with an initial Phase 1 deadline for a decision by the European Commission of 29 August. Preliminary discussions on the likely debt and deficit treatments of the future asset disposals will be held in the course of the next review.

**Authorities outlined their strategy for the creation of Irish Water, a new water utility, the roll-out of metering to households, and the introduction of water charging for domestic users from 1 January 2014.** A detailed implementation strategy was supplied to staff by the Department of Environment, Community and Local Government. It would see the establishment of Irish Water and the enactment of necessary legislation in the third quarter of this year. A metering survey will commence soon, followed by a procurement process and the installation of meters beginning in the third quarter of 2013. A water pricing framework and billing model will be developed over the course of next year with charging to commence at the start of 2014. The general government debt and deficit treatment of the establishment of Irish Water will be outlined by authorities during the next review. The implementation strategy provided is detailed, ambitious, designed to respect relevant Community legislation and, once in place, will help put water services on a sustainable basis while reducing ongoing fiscal costs. Nevertheless, the majority of Irish households are not currently billed for water and the introduction of charging on a sustainable and equitable basis for the remainder of households will be a considerable task.

## **6 Financing issues**

**Upon completion of this review the EFSM/EFSD will disburse EUR 1 billion to Ireland.** A further EUR 0.9 billion is foreseen from the IMF and around EUR 0.7 billion from other EU member states (UK, Sweden and Denmark) in the context of their bilateral loans to Ireland. This would bring programme disbursements so far to EUR 54.8 billion, representing 81% of the EUR 67.5 billion total international assistance.

**Cash balances remain high.** Through end June, funding needs and sources had evolved broadly in line with the forecast cash flow as of the previous mission. Specifically, retail funding was larger than expected, indeed exceeding by end June already the previously planned volume for the whole year, while commercial paper funding was somewhat smaller (all in all, the end-June cash balances, at EUR 14 billion, were about EUR 1 billion larger than forecast). Cash balances were further augmented and the financing needs profile improved through the successful return to market funding by Ireland in July. On 5 July the government issued EUR 500 million of new 3-month Treasury Bills at a better-than-expected yield of 1.8% and amid strong investor demand. In late July the NTMA returned to the term bond market for the first time since September 2010 (two months before the financial assistance programme was agreed). In

excess of EUR 5.2 billion was raised through the issuance of new 5-year and the tapping of existing 8-year bonds (at a weighted average yield of 5.95%). Of this, about EUR 4.2 billion was new money, while just over EUR 1 billion resulted from a swap of existing bonds with maturities in 2013 and 2014 for the new 2017 and 2020 offerings. This transaction further reduces the repayment hurdle in January 2014 (when a EUR 7.6 billion bond is scheduled to mature), immediately after the programme ends, and extends the average duration of Ireland's market funding.

**Plans to tap market funding over the remaining programme period are on track.** In late August amortising bonds were issued to the amount of about EUR 1 billion, with maturities of 15 to 35 years and a weighted average yield of 5.91%. These types of bonds constitute a potentially important source of sustained long-term funding; as it is designed to tap a new investor base (the domestic pension funds) with an instrument that is ideally suited to their investment needs (i.e., a long-dated amortising bond). In the remainder of 2012, the NTMA will auction more T-bills and inflation-linked bonds. The strong demand at these recent auctions (including, for those in July, from foreign investors) is a positive signal in itself, and suggests that—provided strong programme implementation continues—Ireland is on track to achieve its market funding objectives.

**Table 4: Financing requirements, in billion EUR**

	2010	2011	2012					2013					2010-2013
	Dec	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Total
A. Gross financing needs public sector 1/	7.9	28.7	10.7	5.5	5.3	5.0	26.5	6.9	12.5	0.6	3.0	23.0	86.1
B. Bank recapitalisation	0.0	16.6	0.0	1.3	0.3	0.0	1.6	0.0	0.0	0.0	0.0	0.0	18.1
C. Market financing	0.5	1.4	0.4	3.4	5.5	1.4	10.7	4.2	1.2	0.7	0.7	6.6	19.2
Net new debt issuance 2/	0.0	0.0	-0.7	3.6	3.5	0.6	7.0	2.5	0.2	0.5	0.5	3.7	10.7
<b>Net financing needs (A.+B.-C.)</b>	<b>7.3</b>	<b>43.9</b>	<b>10.3</b>	<b>3.3</b>	<b>0.1</b>	<b>3.6</b>	<b>17.4</b>	<b>2.7</b>	<b>11.3</b>	<b>0.0</b>	<b>2.3</b>	<b>16.4</b>	<b>85.0</b>
E. Use of Irish financial assets 3/	7.3	9.4	-0.2	-1.1	-5.4	2.3	-4.3	-1.4	8.4	-2.4	0.4	5.0	17.4
F. EU-IMF loan disbursement	0.0	34.5	10.5	4.4	5.4	1.4	21.7	4.1	2.9	2.4	1.9	11.3	67.5
EFSM/EFSF	0.0	21.5	6.2	2.8	3.3	0.0	12.3	2.4	1.4	1.4	1.2	6.4	40.2
Bilaterals 4/	0.0	0.5	1.1	0.2	1.2	0.5	2.9	0.7	0.5	0.3	0.0	1.5	4.8
IMF	0.0	12.6	3.2	1.5	0.9	0.9	6.5	1.0	1.0	0.8	0.7	3.5	22.5
<b>Programme financing (E.+F.)</b>	<b>7.3</b>	<b>43.9</b>	<b>10.3</b>	<b>3.3</b>	<b>0.1</b>	<b>3.6</b>	<b>17.4</b>	<b>2.7</b>	<b>11.3</b>	<b>0.0</b>	<b>2.3</b>	<b>16.4</b>	<b>85.0</b>
<b>Memorandum item:</b>													
Financial buffers, eop	12.3	12.9	13.1	14.1	19.5	17.2	17.2	18.6	10.2	12.6	12.2	12.2	12.2

Notes:

1/ Includes exchequer cash deficit, maturing long-term and short-term debt as well as contingency element.

2/ excludes roll-over financing

3/ Includes Treasury cash reserves and NPRF assets. "-" indicates an increase in cash reserves.

4/ Bilaterals include UK, Sweden and Denmark.

## 7 Risks

**A key source of risk stems from the possibility that Irish economic activity fails to expand as forecast, both in the near- and in the medium-to-longer term.** In the near term, Ireland's growth outlook is predicated on strong contributions from net exports. This year's growth forecast and, even more so, next year's are therefore vulnerable to further softening of conditions in key trading partners (the euro area, but also the US and the UK). The slowdown in China and other systemic developing countries could also be more pronounced than anticipated. Ensuring that the ongoing competitiveness gains continue would provide a buffer against this source of risk. On the upside, the recent depreciation of the euro against the currencies of Ireland's main trading partners is a source of positive risk. In the medium term, a return to a solid pace of sustained growth in the 2%-3% range (through increasing investment from current low levels and an unwinding of the precautionary element of saving) is essential to buttress the sustainability of domestic (public and private) debt and the recovery in banks' profitability. Thus, ensuring that the risk premium is sustainably reduced, reducing private sector debt overhang, and completing the outstanding structural reforms to unlock competition and facilitate increased employment are all of the essence.

**As regards financial sector reform, despite the considerable progress achieved so far, weak prospects for domestic banks' profitability remains a source of concern.** Although banks are well-capitalised, non-performing loans continue to grow, and while some signs of stabilisation in the housing market are welcome, it must be recognised that these are limited to the main urban areas. To the extent housing price declines were to continue, the value of collateral underlying banks' mortgage portfolios may decline further and impairment charges increase. The forthcoming reform of the personal insolvency regime appropriately aims at addressing situations of unsustainable debt without overburdening the courts. The authorities took great care to ensure that adequate safeguards were included in the draft legislation to avoid any possible negative repercussions on overall payment discipline. It will be important to ensure that these safeguards are maintained as the bill progresses through Parliament. Effective implementation of the new regime will also be key. While repossessions should remain a measure of last-resort, maintaining balanced incentives between mortgage borrowers and creditors may require that the existing legislative lacuna, which hinders repossession of collateral in case of default, be removed.

**Risks to the fiscal objectives also need to be closely monitored.** Any deterioration in the macro-economic backdrop would directly impact the fiscal performance, both by reducing revenue and by increasing pressures on demand-led non-discretionary outlays, such as unemployment benefits. But the expenditure overruns experienced so far in the year are also a source of concern in their own right, as they suggest that spending pressures are mounting. The risk is that these could become entrenched—for example, because of the interaction between higher-than-expected unemployment of increasingly longer duration and the wider entitlement to low-cost access to health services—unless they are promptly addressed. From this perspective, the measures being implemented to rein in overspending in the health sector are welcome and should be implemented swiftly and fully, though in some cases their effect will only be temporary, and may need to be followed and complemented by more structural measures.

**More generally, while the fiscal adjustment secured so far has been sizeable, a considerable amount remains to be done.** The 2013 budget will be a key test of the authorities' resolve to continue progressing towards the essential consolidation goals and of their ability to maintain the necessary public support. All the interlocutors of the mission agreed that there is no low hanging fruit left, and the required consolidation efforts, both in terms of reducing expenditure and increasing their efficiency (including by enhancing their targeting to the most vulnerable) and of raising new and stable revenue, are likely to require difficult political choices. The opportunities for stepped up growth- and employment-enhancing capital expenditure projects offered by the increased scope for EIB support are welcome, but utmost care must be exercised to ensure that the selected projects represent durable value for money and that they do not result in unduly high recurrent costs down the line.

**Finally, despite the strong programme implementation and the successful bond auction in late July, securing a sustained return to market funding might prove challenging** if the global backdrop fails to improve or indeed deteriorates further. The acknowledgment by the euro area Heads of State and Government on 29 June that severing the link between sovereigns and banks is critical to address the root cause of the crisis is welcome and was instrumental in generating a positive momentum in investors' perceptions of Ireland's prospects to fully leave its crisis behind. Adequately breaking this link in the case of Ireland, possibly with the help of additional support from its EU partners, will significantly enhance prospects for a timely and sustained return to market

funding on the part of both the state and the banks. But nothing can replace continued steady and resolute implementation of the difficult but necessary adjustment and reforms.

## List of abbreviations

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

REAs Registered Employment Agreements  
ROI Republic of Ireland  
SDR Special Drawing Rights  
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: Debt sustainability analysis

The programme's baseline scenario assumes a continued gradual increase in the primary surplus in the post-programme period, from 0.4% of GDP in 2014 to 2.1% of GDP in 2015 and to 4.8% in 2020, based on the programme's projections and EDP requirements until 2015 and an annual adjustment in government deficit of 0.5pp of GDP in 2016-2020 (Figure 9). This path is consistent with gross debt peaking at 119.4% of GDP in 2013-14, and declining steadily thereafter to 102% of GDP by 2020. The baseline scenario assumes nominal GDP growth of 4.4% and a marginal interest rate of 5.5% over the period 2016-2020. The growth rate is higher than the 4% potential nominal growth as calculated by the harmonised methodology for 2016. However above-potential growth is likely for several years in Ireland to allow investment to return to more normal levels (investment under the baseline is still forecast at only 12% of GDP in 2015).

The programme debt projections foresee the full drawdown of the programme financing envelope and cash balances in line with the financing plan (EUR 12 billion at end-2013, declining to EUR 10 billion at end-2014 and EUR 9 billion at end-2015). However, they assume that financing contingencies—included prudentially in the financing plan—are not used. Instead, market financing is assumed to be correspondingly reduced, so that the cash balances are kept unchanged (relative to the path in the financing plan) and debt is reduced by the amount of the contingency buffers.

A stress scenario with a 1 pp. lower GDP growth shows that, in the absence of additional consolidation measures, debt would veer away from the sustainable path. In particular, sticking to the currently agreed annual adjustment in 2013-15 in the face of lower growth, and thus missing the programme nominal deficit targets, would result in a deficit of 5.2% of GDP in 2015, well above the programme target of below 3% of GDP. Even assuming that the deficit ratio would be reduced by 0.5 pp. each year over 2016-20 would bring the deficit ratio to below 3% only in 2020, and result in a debt level of 122% of GDP in 2020, with a peak not achieved until 2016-17. If instead additional measures are taken to ensure that the programme and EDP deficit path is respected, the debt ratio would begin declining in 2015, though of course the lower growth (including as a result of the contractionary impact of additional measures) would keep the 2020 debt ratio at a higher value (around 110% of GDP) than under the baseline (Figure 10). A scenario with a substantially higher marginal interest rate (7.5%) does not materially alter the debt trajectory due to relatively low refinancing needs.

Figure 9: Debt-stabilising primary balance in baseline projections (% of GDP)

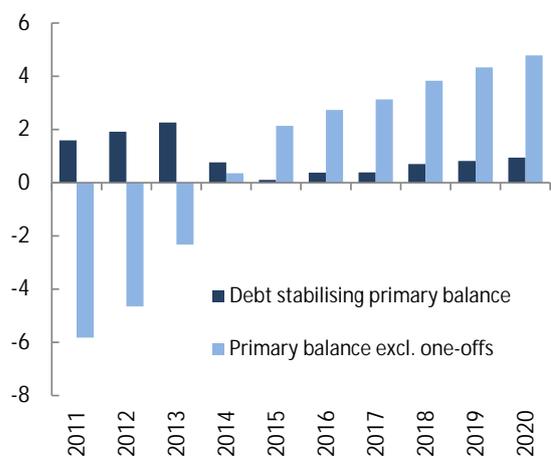
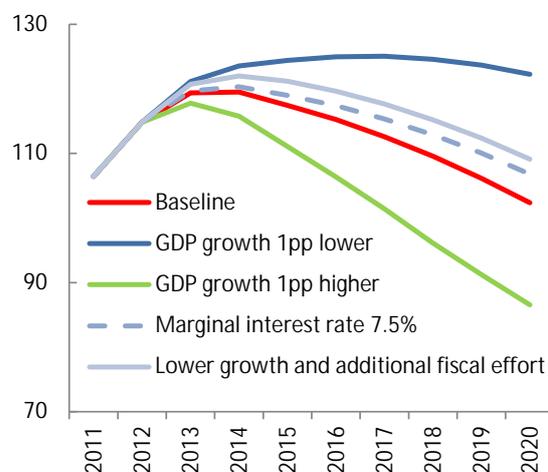


Figure 10: Government debt projections (% of GDP)



Notes:

*Baseline assumptions:* Programme projections until 2015 (including cash balances of EUR 17 billion at the end of 2012, EUR 12 billion at the end of 2013, EUR 10 billion at the end of 2014 and EUR 9 billion at the end of 2015). After 2015, general government deficit is reduced by 0.5pp annually until balance is reached; real GDP growth of 2.8% (4.4% nominal growth); marginal interest rate on new government bonds of 5.5%; cash balances of EUR 9 billion maintained in each year. Some 10% of the general government debt, including short-term debt, local government debt and other general government liabilities assumed to remain unchanged/rolled over at constant rates without contributing to analysis dynamics.

*Stress scenario assumptions:* GDP scenarios assume lower/higher nominal GDP. Positive/negative effect on fiscal balance of 0.5pp of GDP assumed (sensitivity of fiscal balance to GDP is assumed at 0.5). In the scenario with no policy response (represented by the dark blue in the figure above) the planned annual fiscal consolidation effort until 2015 is maintained, while annual fiscal deficit targets may not be met. In the scenario with additional fiscal effort (grey line in figure above), the government ensures that the fiscal deficit targets under the programme/EDP are met, even though this requires additional consolidation measures and has an additional contractionary impact on growth. For both these two latter scenarios, from 2015 onwards the general government deficit is reduced by 0.5 pps annually until balance is reached.

## Annex 2: Commission Services' macroeconomic projections

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

<i>Annual % change</i>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
1. Private consumption expenditure	-2.4	-1.9	-0.2	1.4	1.9
2. Government consumption expenditure	-4.3	-3.0	-0.7	-3.5	-3.4
3. Gross fixed capital formation	-12.6	-4.0	-0.1	4.5	5.2
<b>4. Final domestic demand</b>	<b>-4.2</b>	<b>-2.4</b>	<b>-0.3</b>	<b>0.7</b>	<b>1.2</b>
5. Change in inventories					
<b>6. Domestic demand</b>	<b>-3.7</b>	<b>-2.4</b>	<b>-0.3</b>	<b>0.7</b>	<b>1.2</b>
7. Exports of goods and services	5.1	2.8	3.5	4.5	4.5
7a. - of which goods	2.7	2.2	3.5	4.5	4.5
7b. - of which services	7.7	3.5	3.5	4.5	4.5
<b>8. Final demand</b>	<b>1.2</b>	<b>0.6</b>	<b>1.9</b>	<b>3.0</b>	<b>3.2</b>
9. Imports of goods and services	-0.3	0.8	2.5	3.5	3.6
9a. - of which goods	-2.3	0.8	2.5	3.5	3.6
9b. - of which services	0.8	0.8	2.5	3.5	3.7
<b>10. Gross domestic product at market prices</b>	<b>1.4</b>	<b>0.4</b>	<b>1.4</b>	<b>2.5</b>	<b>2.8</b>
<i>Contribution to change in GDP</i>					
11. Final domestic demand	-3.4	-1.9	-0.2	0.5	0.9
12. Change in inventories + net acq. of valuables	0.4	0.0	0.0	0.0	0.0
13. External balance of goods and services	5.4	2.3	1.6	2.0	2.0

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

<i>Annual % change</i>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
1. Private consumption expenditure	-0.9	-0.5	0.8	2.8	3.5
2. Government consumption expenditure	-2.7	-2.5	-1.0	-3.4	-2.6
3. Gross fixed capital formation	-13.9	-2.5	4.1	9.0	10.2
<b>4. Final domestic demand</b>	<b>-3.2</b>	<b>-1.3</b>	<b>0.8</b>	<b>2.2</b>	<b>3.2</b>
5. Change in inventories	-139.4	0.0	3.0	-11.0	0.0
<b>6. Domestic demand</b>	<b>-2.3</b>	<b>-2.1</b>	<b>0.8</b>	<b>2.2</b>	<b>3.1</b>
7. Exports of goods and services	5.7	4.0	4.7	5.6	5.8
<b>8. Final demand</b>	<b>-2.1</b>	<b>3.5</b>	<b>3.1</b>	<b>4.2</b>	<b>4.7</b>
9. Imports of goods and services	2.8	1.7	3.6	4.5	4.9
10. Gross national income at market prices	-1.4	-1.2	2.0	3.9	3.4
11. Gross value added at basic prices	0.9	2.6	2.7	3.8	4.5
<b>12. Gross domestic product at market prices</b>	<b>1.6</b>	<b>1.8</b>	<b>2.6</b>	<b>4.0</b>	<b>4.5</b>

**Table 3: Implicit price deflators**

<i>% change in implicit price deflator</i>	2011	2012	2013	2014	2015
1. Private consumption expenditure	1.5	1.4	1.0	1.4	1.6
2. Government consumption expenditure	1.7	0.5	-0.3	0.1	0.8
3. Gross fixed capital formation	-2.0	1.6	4.2	4.4	4.8
<b>4. Domestic demand</b>	<b>1.1</b>	<b>1.2</b>	<b>1.1</b>	<b>1.5</b>	<b>1.9</b>
5. Exports of goods and services	0.6	1.1	1.2	1.0	1.2
<b>6. Final demand</b>	<b>0.8</b>	<b>1.1</b>	<b>1.1</b>	<b>1.2</b>	<b>1.5</b>
7. Imports of goods and services	3.1	0.8	1.1	0.9	1.3
<b>8. Gross domestic product at market prices</b>	<b>0.2</b>	<b>1.4</b>	<b>1.2</b>	<b>1.4</b>	<b>1.6</b>
<b>HICP</b>	<b>1.2</b>	<b>1.4</b>	<b>1.0</b>	<b>1.4</b>	<b>1.6</b>

**Table 4: Labour market and cost**

<i>Annual % change</i>	2011	2012	2013	2014	2015
1. Labour productivity	3.6	1.2	1.0	1.2	0.8
2. Compensation of employees per head	1.3	-0.8	-0.3	0.4	0.6
3. Unit labour costs	-0.8	-2.7	-1.3	-0.6	-0.2
4. Total population	0.2	0.4	0.7	0.9	1.0
5. Population of working age (15-64 years)	-1.0	-0.9	-0.5	-0.2	0.1
6. Total employment	-2.1	-0.8	0.4	1.3	2.0
7. Calculated unemployment rate - Eurostat definition (%)	14.4	14.8	14.4	13.7	13.1

**Table 5: External balance**

<i>levels</i>	2011	2012	2013	2014	2015
1. Exports of goods (fob)	84.9	87.7	92.0	97.1	102.7
2. Imports of goods (fob)	48.3	49.1	50.9	53.2	55.8
<b>3. Trade balance (goods, fob/fob) (1-2)</b>	<b>36.6</b>	<b>38.6</b>	<b>41.2</b>	<b>44.0</b>	<b>46.9</b>
<i>3a. p.m. (3) as % of GDP</i>	<i>23.0</i>	<i>23.9</i>	<i>24.8</i>	<i>25.5</i>	<i>26.0</i>
4. Exports of services	81.9	85.7	89.5	94.5	100.0
5. Imports of services	83.6	85.0	88.1	92.0	96.6
<b>6. Services balance (4-5)</b>	<b>-1.7</b>	<b>0.7</b>	<b>1.4</b>	<b>2.5</b>	<b>3.4</b>
<i>6a. p.m. 6 as % of GDP</i>	<i>-1.1</i>	<i>0.4</i>	<i>0.9</i>	<i>1.5</i>	<i>1.9</i>
<b>7. External balance of goods &amp; services (3+6)</b>	<b>34.9</b>	<b>39.3</b>	<b>42.6</b>	<b>46.5</b>	<b>50.4</b>
<i>7a. p.m. 7 as % of GDP</i>	<i>22.0</i>	<i>24.3</i>	<i>25.6</i>	<i>26.9</i>	<i>27.9</i>
8. Balance of primary incomes and current	-33.1	-36.0	-37.1	-38.6	-41.8
<i>8a. - of which, balance of primary income</i>	<i>-31.0</i>	<i>-35.3</i>	<i>-37.1</i>	<i>-38.7</i>	<i>-41.8</i>
<i>8b. - of which, net current Transfers</i>	<i>-2.2</i>	<i>-0.6</i>	<i>0.1</i>	<i>0.1</i>	<i>0.0</i>
<i>8c. p.m. 8 as % of GDP</i>	<i>-20.8</i>	<i>-22.2</i>	<i>-22.3</i>	<i>-22.3</i>	<i>-23.2</i>
<b>9. Current external balance (7+8)</b>	<b>1.8</b>	<b>3.4</b>	<b>5.5</b>	<b>7.9</b>	<b>8.6</b>
<i>9a. p.m. 9 as % of GDP</i>	<i>1.1</i>	<i>2.1</i>	<i>3.3</i>	<i>4.6</i>	<i>4.7</i>
10. Net capital transactions	-0.4	21.2	25.7	30.8	30.4
<b>11. Net lending (+)/ net borrowing (-) (9+10)</b>	<b>1.4</b>	<b>24.5</b>	<b>31.2</b>	<b>38.7</b>	<b>38.9</b>
<i>11a. p.m. 11 as % of GDP</i>	<i>0.9</i>	<i>15.2</i>	<i>18.8</i>	<i>22.4</i>	<i>21.6</i>

**Table 6: Fiscal accounts**

	2008	2009	2010	2011	2012	2013	2014	2015
	<i>% of GDP</i>							
Indirect taxes	12.4	11.3	11.5	11.1	11.1	11.0	11.1	11.1
Direct taxes	11.5	10.7	10.5	12.0	12.6	13.0	13.3	13.5
Social contributions	6.8	7.4	7.3	6.4	6.0	5.9	5.8	5.6
Sales	2.3	2.7	3.2	3.1	2.9	2.4	2.3	2.2
Other current revenue	1.3	1.3	1.5	1.3	1.5	1.5	1.3	1.2
<b>Total current revenue</b>	<b>34.5</b>	<b>33.5</b>	<b>34.0</b>	<b>34.0</b>	<b>34.0</b>	<b>33.7</b>	<b>33.9</b>	<b>33.6</b>
Capital transfers received	1.2	1.0	1.0	0.8	0.8	0.9	0.8	0.6
<b>Total revenue</b>	<b>35.7</b>	<b>34.5</b>	<b>35.0</b>	<b>34.8</b>	<b>34.9</b>	<b>34.6</b>	<b>34.7</b>	<b>34.1</b>
Compensation of employees	11.9	12.7	12.2	11.9	11.6	11.1	10.4	9.9
Intermediate consumption	5.8	6.3	5.9	5.4	5.2	4.8	4.3	3.8
Social transfers in kind via market producers	2.2	2.3	2.5	2.4	2.3	2.1	1.9	1.7
Social transfers other than in kind	11.6	14.5	14.9	15.0	14.8	14.2	13.2	12.2
Interest paid	1.3	2.0	3.1	3.3	4.0	5.5	5.5	5.4
Subsidies	0.5	0.6	0.6	0.4	0.4	0.4	0.3	0.3
Other current expenditure	2.5	2.6	2.3	2.1	2.1	2.1	2.0	2.0
<b>Total current expenditure</b>	<b>35.9</b>	<b>41.1</b>	<b>41.4</b>	<b>40.5</b>	<b>40.5</b>	<b>40.1</b>	<b>37.8</b>	<b>35.4</b>
Gross fixed capital formation	5.3	3.8	3.6	2.6	2.1	1.7	1.6	1.5
Other capital expenditure	1.9	3.6	21.0	4.3	0.7	0.6	0.5	0.5
<b>Total expenditure</b>	<b>43.1</b>	<b>48.4</b>	<b>66.0</b>	<b>47.4</b>	<b>43.3</b>	<b>42.4</b>	<b>39.9</b>	<b>37.4</b>
<b>General Government balance (EDP)</b>	<b>-7.3</b>	<b>-13.9</b>	<b>-30.9</b>	<b>-12.7</b>	<b>-8.4</b>	<b>-7.8</b>	<b>-5.2</b>	<b>-3.3</b>
	<i>EUR billion</i>							
Indirect taxes	22.2	18.3	17.9	17.7	17.9	18.2	19.2	20.0
Direct taxes	20.7	17.2	16.5	19.1	20.4	21.6	23.0	24.3
Social contributions	12.2	12.0	11.5	10.3	9.8	9.7	10.0	10.1
Sales	4.2	4.4	5.1	4.9	4.6	4.0	3.9	4.0
Other current revenue	2.4	2.1	2.3	2.1	2.4	2.5	2.3	2.1
<b>Total current revenue</b>	<b>61.7</b>	<b>54.0</b>	<b>53.3</b>	<b>54.0</b>	<b>55.1</b>	<b>56.0</b>	<b>58.5</b>	<b>60.6</b>
Capital transfers received	2.2	1.7	1.6	1.3	1.3	1.4	1.5	1.0
<b>Total revenue</b>	<b>63.9</b>	<b>55.6</b>	<b>54.8</b>	<b>55.3</b>	<b>56.4</b>	<b>57.4</b>	<b>59.9</b>	<b>61.6</b>
Compensation of employees	21.2	20.5	19.1	18.9	18.8	18.4	18.0	17.9
Intermediate consumption	10.4	10.2	9.3	8.6	8.4	8.0	7.4	6.9
Social transfers in kind via market producers	3.9	3.8	3.9	3.8	3.7	3.5	3.3	3.1
Social transfers other than in kind	20.8	23.4	23.2	23.8	24.0	23.5	22.8	22.1
Interest paid	2.4	3.2	4.9	5.3	6.5	9.1	9.6	9.8
Subsidies	0.9	0.9	0.9	0.6	0.6	0.6	0.6	0.5
Other current expenditure	4.5	4.3	3.5	3.4	3.5	3.5	3.5	3.6
<b>Total current expenditure</b>	<b>64.2</b>	<b>66.3</b>	<b>64.9</b>	<b>64.5</b>	<b>65.5</b>	<b>66.7</b>	<b>65.2</b>	<b>63.9</b>
Gross fixed capital formation	9.5	6.1	5.6	4.1	3.4	2.8	2.7	2.7
Other capital expenditure	3.3	5.7	32.8	6.8	1.2	0.9	0.9	0.9
<b>Total expenditure</b>	<b>77.0</b>	<b>78.1</b>	<b>103.3</b>	<b>75.4</b>	<b>70.0</b>	<b>70.4</b>	<b>68.9</b>	<b>67.5</b>
<b>General Government balance (EDP)</b>	<b>-13.1</b>	<b>-22.5</b>	<b>-48.4</b>	<b>-20.2</b>	<b>-13.6</b>	<b>-13.0</b>	<b>-8.9</b>	<b>-5.9</b>

Notes Minor differences in historical national accounts and balance of payments data are due to different sources used, Central Statistics Office and Eurostat.

Fiscal forecasts for 2013-15 are based on an unchanged policy scenario. The authorities are strongly committed to the EDP deficit ceiling path and have indicated that they stand ready to take all the necessary measures to ensure that it is respected.

**Table 7: Debt developments**

	2008	2009	2010	2011	2012	2013	2014	2015
<b>EDP deficit (% of GDP)</b>	<b>-7.3</b>	<b>-13.9</b>	<b>-30.9</b>	<b>-12.7</b>	<b>-8.4</b>	<b>-7.8</b>	<b>-5.2</b>	<b>-3.3</b>
EDP gross debt (% of GDP)	44.5	64.9	92.2	106.4	117.6	119.4	119.4	117.4
<i>levels, EUR billion</i>								
<b>EDP deficit</b>	<b>-13.1</b>	<b>-22.5</b>	<b>-48.4</b>	<b>-20.2</b>	<b>-13.6</b>	<b>-13.0</b>	<b>-8.9</b>	<b>-5.9</b>
Gross debt	79.6	104.6	144.2	169.1	190.3	198.3	206.3	211.9
Change in gross debt	32.4	25.0	39.6	24.9	21.2	7.9	8.0	5.6
Nominal GDP	178.9	161.3	156.5	159.0	161.8	166.1	172.7	180.5
Real GDP	177.4	167.7	166.4	168.8	169.5	171.9	176.2	181.2
<b>Real GDP growth (% change)</b>	<b>-2.1</b>	<b>-5.5</b>	<b>-0.8</b>	<b>1.4</b>	<b>0.4</b>	<b>1.4</b>	<b>2.5</b>	<b>2.8</b>
Change in gross debt (% of GDP)	18.1	15.5	25.3	15.7	13.1	4.8	4.6	3.1
Stock-flow adjustments (% of GDP)	10.8	1.6	-5.6	3.0	4.7	-3.0	-0.6	-0.2
<i>% of GDP</i>								
<b>Gross debt ratio</b>	<b>44.5</b>	<b>64.9</b>	<b>92.2</b>	<b>106.4</b>	<b>117.6</b>	<b>119.4</b>	<b>119.4</b>	<b>117.4</b>
Change in gross debt ratio	19.5	20.4	27.3	14.2	11.2	1.7	0.1	-2.0
<i>Contribution to change in gross debt</i>								
Primary balance	6.0	11.9	27.8	9.4	4.4	2.3	-0.4	-2.1
"Snow-ball" effect	2.7	7.0	5.1	1.9	2.1	2.5	1.0	0.3
of which								
<i>Interest expenditure</i>	<i>1.3</i>	<i>2.0</i>	<i>3.1</i>	<i>3.3</i>	<i>4.0</i>	<i>5.5</i>	<i>5.5</i>	<i>5.4</i>
<i>Real growth effect</i>	<i>0.6</i>	<i>2.7</i>	<i>0.5</i>	<i>-1.3</i>	<i>-0.4</i>	<i>-1.6</i>	<i>-2.9</i>	<i>-3.3</i>
<i>Inflation effect</i>	<i>0.8</i>	<i>2.3</i>	<i>1.5</i>	<i>-0.2</i>	<i>-1.5</i>	<i>-1.4</i>	<i>-1.6</i>	<i>-1.8</i>
<b>Stock-flow adjustments</b>	<b>10.8</b>	<b>1.6</b>	<b>-5.6</b>	<b>3.0</b>	<b>4.7</b>	<b>-3.0</b>	<b>-0.6</b>	<b>-0.2</b>
<i>Implicit interest rate</i>	<i>5.0</i>	<i>4.1</i>	<i>4.7</i>	<i>3.7</i>	<i>3.8</i>	<i>4.8</i>	<i>4.8</i>	<i>4.7</i>

Notes:

The projections for gross debt incorporate the completion of the outstanding financial sector capital injections in 2012 (in the amount of EUR 1.6 billion) and other smaller financial transactions. The projections assume no use of precautionary contingencies foreseen in the programme's financing plan and cash balances declining to EUR 12 billion by the end of 2013 and to EUR 9 billion by 2015.

## **Annex 3: Programme Documents**

### **Ireland:**

#### **Letter of Intent**

Dublin, 20 August 2012

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  
Vice-President of the European Commission responsible for Economic and Monetary  
Affairs and the euro  
European Commission  
BERL 10/299  
B-1049 Brussels  
Belgium

Mr Vassos Shiarly  
Minister of Finance  
Michael Karaoli & Gregori Afxentiou  
1439 Nicosia  
Cyprus

Dear Messrs Draghi, Juncker, Rehn, and Shiarly

1. The Irish Government remains firmly committed to the programme, as illustrated by our continued strong performance in implementing the agreed policy frameworks and measures. Recently released data shows that Ireland had stronger growth than expected in 2011. We returned to the international capital markets in July 2012 with the NTMA

issuing both Treasury Bills and long-term bonds totaling €4.7 bn in new funding. In line with our growth focus, we have recently launched a multi-year (2012-2018) stimulus package worth €2.25 billion. This will be financed through Public-Private Partnerships (PPPs) with EIB and private sector participation and be used for investment in public infrastructure projects, and also support employment-enhancing and commercial projects and augment existing Exchequer investment plans. The fiscal consolidation path agreed under the Programme will not be affected.

2. The passage of the referendum allowing the ratification of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union has demonstrated Ireland's commitment to prudent policies and consolidation.

3. We welcome the June 29 statement of the Heads of State or Government of the euro area stressing the need to sever the pernicious link between the banks and the sovereigns and mandating the euro group to examine the situation of the Irish financial sector with a view to enhancing the sustainability of our well-performing programme. We are working with staff from the European Commission, the European Central Bank and the International Monetary Fund to present options to the Euro Group in the next few weeks. In the meantime, we remain committed to maintaining our strong record of programme implementation, beginning with the forthcoming preparations for the 2013 Budget.

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

- As regards our fiscal consolidation objectives, the cumulative exchequer balance through end-June 2012 was ahead of the programme profile and the 2012 general government deficit is projected to be at, or below, the 8.6% of GDP programme ceiling.
- We have continued to advance the envisaged structural reforms. In particular, we have agreed on a detailed, time-bound implementation plan for the transfer of water service provision to Irish Water, made provisions for an increase in the staffing of the Competition Authority, and assessed scope for reform of welfare payments, including to reduce any disincentives to take up work. We have also conducted a due diligence on the state assets which we have identified for disposal starting in 2013, and have identified no regulatory or legislative obstacle to bringing the assets closer to the point of sales in the weeks and months ahead.

Finally, we have presented to the Oireachtas a revised Industrial Relations (Amendment) Bill in line with the result of public consultations and programme understandings. The bill has been enacted and was commenced on August 1.

- The overarching strengthening, restructuring, and right-sizing of the domestic banking sector and the credit union sector is also progressing according to plans, including for example with the completion of the remaining capitalization of Permanent TSB and of some of the work-streams in the Financial Measures Programme (independent asset quality review, distressed credit operations review, a data integrity validation exercise, and an income recognition and re-aging project), the submission to the European Commission of a restructuring plan for Permanent TSB, and the publication of the legislation on personal insolvency reform.

5. In the attached sixth update of the Memorandum of Understanding of Specific Economic Policy Conditionality (the MOU), as well as in the Memorandum of Economic and Financial Policies (MEFP), we set out our plans to further advance towards meeting the objectives of our economic adjustment programme supported by financial assistance from the EU and the IMF. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request the completion of the seventh review and the release of the seventh EFSF/EFSM disbursement of EUR 1 billion.

6. Looking forward, the financing need outlook until 2013 is broadly in line with expectations at the sixth programme review, whereby our larger cash buffer provides additional comfort. We continue to move steadily towards our core goal of regaining sustainable access to the international capital markets during 2013, and have recently returned successfully to the both the Treasury Bill and bond markets with issuance which received ample demand and were favourably priced. As a result, the funding hurdle associated with a large bond redemption in January 2014 has been significantly reduced.

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

in the event that revision of the policies contained in this Letter and the attached Memoranda becomes necessary.

8. This letter is being copied to Mme Lagarde.

Sincerely,

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Michael Noonan, T.D.  
Minister for Finance

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Patrick Honohan  
Governor of the Central Bank of Ireland

**IRELAND**

**MEMORANDUM OF UNDERSTANDING**

**ON**

**SPECIFIC ECONOMIC POLICY CONDITIONALITY**

**(SIXTH UPDATE)**

**14 SEPTEMBER 2012**

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, this sixth 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 EFSM<sup>1</sup> will be subject to quarterly reviews of conditionality for the duration of the programme. Release of the instalments will be based on observance of quantitative performance criteria, respect for EU Council Decisions and Recommendations in the context of the excessive deficit procedure (EDP), and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and this updated MoU, which details and further specifies the criteria that will be assessed for the successive reviews up to the end of 2013. If targets are expected to be missed, additional action will be taken.

- For the duration of the EU/IMF financial assistance programme the Irish authorities will take all the necessary measures to ensure a successful implementation of the programme and minimise the costs to the taxpayers, while protecting the most vulnerable. In particular, they commit to:

- Rigorously implement fiscal policy consistent with the requirements of the excessive deficit procedure. In particular, the Department of Finance and the Department of Public Expenditure and Reform will continue to ensure effective tax collection and tight supervision of expenditure commitments by the line departments to ensure that the primary deficit target in cash (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

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<sup>1</sup> 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.

reduction. Moreover, the nominal value of Social Welfare pensions will not be increased.

- Continue to strengthen the fiscal framework and reporting in line with that of the EU.
- Use at least half of the proceeds from state asset sales for eventual debt reduction while also reinvesting the remainder of the total realised proceeds in projects which are of a commercial nature, meet ex-ante cost benefit criteria, enhance employment and preserve long term fiscal sustainability, including Programme and EDP fiscal targets.
- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.
- Ensure that activation services are enhanced, to tackle the high and persistent rate of long-term unemployment. In particular, the Department of Social Protection will take steps to improve the ratio of vacancies filled off the live register, focus on re-training the unemployed to reduce the risk of long-term unemployment and ensure appropriate incentives through the implementation of sanctions. Generally, the government will advance its plans to introduce new activation measures building on *Pathways to Work* (the government's strategy for institutional reform of the activation system).
- Ensure that no further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF Programme and the needs of the economy.
- Ensure that NAMA: (i) maintains the highest standards of governance with appropriate accountability and transparency arrangements; (ii) reduces the costs of its operations; and (iii) constructively contributes to the restoration of the Irish property market in the course of meeting the asset disposal targets established and monitored by the NAMA Board, including redemption of €7.5 billion worth of senior bonds by end 2013.
- Ensure that the restructuring of credit unions will underpin the financial stability and long term sustainability of the sector. The restructuring will be completed in as short a timeframe as possible under a clear plan identifying credit unions appropriate for restructuring, subject to Central Bank regulatory approval. As regards funding, the first call should be on the credit unions concerned or the sector as a whole; any Exchequer funding should be minimised, should be provided only in the context of a restructuring plan in compliance with EU state aid rules, and should be recouped from the sector over time. In parallel, the Central Bank will continue its inspections to determine the financial condition of the weakest credit unions, and will engage its resolution powers as needed, drawing on Resolution Fund resources if required.
- Ensure continued compliance with the minimum Core Tier 1 Capital ratio of 10.5 percent for all PCAR banks (AIB, BOI, and PTSB).
- Consult ex-ante with the European Commission, the ECB and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

- To facilitate programme monitoring, the authorities will provide the European Commission, the ECB and the IMF with:

- All information required to monitor progress during programme implementation and to track the economic and financial situation.
- A compliance report on the fulfilment of the conditionality prior to the release of the instalments.
- Reliable and regular availability of budgetary and other data as detailed in Annex 1.

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

### **Financial sector reforms**

#### *Deleveraging*

· The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will assess banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme. Fire sales of assets will be avoided, as will any excessive deleveraging of core portfolios, so as not to impair the flow of credit to the domestic economy.

#### *Funding and liquidity monitoring*

· The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will establish an advanced monitoring framework covering in detail all factors affecting banks' Net Stable Funding Ratio (NSFR). This will enable close monitoring of progress towards the relevant Basel III requirements.

· The authorities will provide staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.

#### *Asset quality*

· The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage portfolios in accordance with the agreed key performance indicators.

#### *Reorganisation*

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

· The authorities will publish the legislation to strengthen the credit union legislative framework taking account of the comprehensive recommendations in the Commission on Credit Unions Report.

· As recommended by the interim and final reports of the Commission on Credit Unions, regulations will introduce the requirement, under the terms of the Deposit

Guarantee Scheme, for credit unions to maintain an amount in the Deposit Protection account at the Central Bank. The authorities will also adopt regulations underpinning the Resolution Fund Levy to recoup Exchequer resources provided for the resolution of troubled credit unions.

#### *Financial Supervision*

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

### **Structural reforms**

#### *Personal debt*

- The authorities will ensure that a programme to facilitate access by distressed borrowers to professional financial advisory services, funded by banks, will be operational.

#### *State assets*

- Building on the indicative timetable for asset sales provided at end-Q2 2012, the government will provide a progress report for each asset and/or group of assets identified for disposal. This report will cover both progress achieved and remaining steps towards the point of sale.

#### *Efficient social support expenditure*

Building on the progress so far and on the data provided at end-June 2012, the Department of Social Protection will:

- continue: (i) the introduction of one-stop shops, (ii) employer engagement by the National Employment and Entitlement Services (NEES); and (iii) the roll-out of job matching;
- continuously monitor the performance of the activation system and report to the staff of the European Commission, the IMF, and the ECB on progress on:
  - Reducing the average duration of staying on the live register
  - Increasing the fraction of vacancies filled off the live register
  - Ensuring engagement with employment services as a pre-condition for receipt of jobseeker payments

- Carrying out profiling, group and individual engagement through interviews
  - Increasing the number of unemployed referred to training courses and employment supports
  - Providing data on live register broken down by continuous duration, and on probability of exit by various durations
  - Providing summary statistics on those in receipt of penalty sanctions by duration of unemployment and prioritise progress on data analysis by exit destination and length of penalty period.
- Report to the staff of the European Commission, the IMF, and the ECB on continued progress on implementing an improved data collection system to enable ongoing evaluation of activation and training policies, in light of the March 2012 external evaluation.
  - In the context of Budget 2013, the Department of Social Protection (DSP) will present options to Government for consideration, having regard, inter alia, to the results of the July 2012 actuarial review of the social insurance fund. The DECLG and DSP will also report on the housing assistance reform, in particular on the introduction of the new Housing Assistance Payment.

#### *Health sector*

- Authorities to specify quantified measures to eliminate the spending overrun by year end.

#### *Labour market reform*

- The authorities will further advance the passage of the Industrial Relations (Amendment) Bill 2011 through the parliamentary process.

#### *Utilities sector*

- Building on the high level implementation strategy provided at end-Q2 2012, the authorities will report on progress for the transfer of water services provision from local authorities to Irish Water and the roll-out of a domestic water metering programme with a view to start charging by the end of the EU-IMF programme period. The authorities will also consider and provide an update on the general government debt and deficit treatment implications of establishment of Irish Water.

### **Structural fiscal reforms**

#### *Fiscal framework*

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

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

### **Fiscal consolidation**

· Taking account of the European Semester, Government will publish a budget for 2013 aiming for a further reduction of the General Government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure.

· On the basis of the aggregate budgetary projections set out in the Medium Term Fiscal Statement (MTFS) of November 2011, consolidation measures for 2013 will amount to at least €3.5 billion. The following measures are proposed for 2013 on the basis of the MTFS:

- Revenue measures to raise at least €1.25 billion<sup>2</sup>, including:
  - A broadening of personal income tax base.
  - A value-based property tax.
  - A restructuring of motor taxation.
  - A reduction in general tax expenditures.
  - An increase in excise duty and other indirect taxes.
- Expenditure reductions necessary to achieve an upper limit on voted expenditure of €4 billion, which will involve consolidation measures of €2.25 billion on the basis of the MTFS, including:
  - Social expenditure reductions.
  - Reduction in the total pay and pensions bill.
  - Other programme expenditure, and reductions in capital expenditure.

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

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<sup>2</sup> Inclusive of carryover from 2012.

## **Financial sector reforms**

### *Capital assessment*

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

### *Deleveraging*

- The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will assess banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme. Fire sales of assets will be avoided, as will any excessive deleveraging of core portfolios, so as not to impair the flow of credit to the domestic economy.

### *Funding and liquidity monitoring*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.

### *Asset quality*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage portfolios in accordance with the agreed key performance indicators. A set of key performance indicators for SMEs will also be developed.

### *Liquidity buffers*

- Following finalisation of the Capital Requirements Directive legislative text, the authorities will establish draft guidance for the creation and subsequent holding of liquidity buffers by banks for issue in advance of the entry into force of the regulations.

### *Reorganisation*

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

### *Financial Supervision*

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

## **Structural reforms**

### *Competition*

- On the basis of a report from authorities on developments to be provided by end Q4 2012, the authorities in consultation with staff of the European Commission, IMF and the ECB will review whether sufficient progress has been made toward the goal of strengthening competition law enforcement by ensuring the availability of effective sanctions for infringements of Irish competition law and Articles 101 and 102 of the Treaty on the Functioning of the European Union and the functioning of the Competition Authority, and whether additional measures will be required.

### *Efficient social support expenditure*

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

### *State asset disposals*

- Government will complete, if necessary, relevant regulatory, legislative, corporate governance and financial reforms required to bring to the point of sale the assets it has identified for disposal. For each asset and/or group of assets, the government will provide a report to the staff of the European Commission, the IMF, and the ECB on progress achieved and remaining steps towards to the point of sale.

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

### **Financial sector reforms**

#### *Capitalisation*

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

#### *Capital assessment*

- The authorities will agree with the staff of the European Commission, the ECB and IMF on the specific features of the methodology.

### *Deleveraging*

- The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will assess banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme. Fire sales of assets will be avoided, as will any excessive deleveraging of core portfolios, so as not to impair the flow of credit to the domestic economy.

### *Funding and liquidity monitoring*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.
- In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

### *Asset quality*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators.

### *Reorganisation*

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

### *Financial supervision*

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it with the staff of the European Commission, the IMF, and the ECB.
- The authorities will report on banks' progress with the implementation of their strategies to address loan arrears and unsustainable debts in banks' mortgage, and SME loan portfolios.
- The authorities will review the implementation of the 2011 CBI Provisioning and Disclosure guidelines by the covered banks.

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

### **Financial sector reforms**

#### *Capital assessment*

- The authorities will complete the PCAR 2013. Building on the outcomes from PCAR 2011 and the FMP 2012, the authorities will conduct another rigorous stress test and this will continue to be based on robust loan-loss forecasts and a high level of

transparency. This stress test will draw on our assessment of the banks' calculation of risk weighted assets, loan loss forecasting, and capital modelling. The stress test will focus on the bank balance sheets following the implementation of technical work addressing legacy and nonperforming loans. Before publication, the results of the PCAR 2013 will be discussed with the staff of European Commission, the IMF, and the ECB and will be aligned with the timing of the next EBA exercise. The results and methodology will be published in full and on a bank-by-bank basis, and the authorities will accordingly ensure that banks are adequately capitalised.

#### *Deleveraging*

- The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will assess banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme. Fire sales of assets will be avoided, as will any excessive deleveraging of core portfolios, so as not to impair the flow of credit to the domestic economy.

#### *Funding and liquidity monitoring*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.
- The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

#### *Asset quality*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators.

#### *Reorganisation*

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

#### *Financial supervision*

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

## **Structural reforms**

### *State assets*

- The authorities will report to the staff of the European Commission, the IMF, and the ECB on the quantum of the proceeds of any realised asset sales to date. For assets yet to be disposed, the authorities will report on progress made and remaining steps.

### *Labour market reform*

- The authorities will report to the staff of the European Commission, the IMF, and the ECB on the impact on the labour market of reforms to sectoral wage-setting mechanisms undertaken under the programme.

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

### **Financial sector reforms**

#### *Capital assessment*

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

#### *Deleveraging*

- The authorities, in consultation with the staff of the European Commission, the IMF, and the ECB, will assess banks' deleveraging based on the existing nominal targets for disposal and run-off of non-core assets in line with the 2011 Financial Measures Programme. Fire sales of assets will be avoided, as will any excessive deleveraging of core portfolios, so as not to impair the flow of credit to the domestic economy.

#### *Funding and liquidity monitoring*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with a detailed assessment of banks' progress towards the relevant Basel III requirements using the advanced monitoring framework.
- In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

#### *Asset quality*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators.

#### *Reorganisation*

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

### *Financial Supervision*

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

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

### **Financial sector reforms**

#### *Deleveraging*

- The authorities will produce a final report of the banks' implementation of their deleveraging plans under the PLAR 2011. Their compliance with the asset disposal and run-off targets in nominal value terms will be discussed with the staff of the European Commission, the IMF, and the ECB.
- The authorities will produce a final report on progress towards compliance with Basel III liquidity and funding requirements by the relevant dates.
- The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

#### *Asset quality*

- The authorities will provide staff of the European Commission, the IMF, and the ECB with their assessment of banks' performance with the work-out of their non-performing mortgage and SME portfolios in accordance with the agreed key performance indicators.

#### *Reorganisation*

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

### *Financial Supervision*

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

## Annex 1. Provision of data

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

<b>To be provided by the Department of Finance in consultation with the Department of Public Expenditure and Reform as appropriate</b>		
Ref.	Report	Frequency
F.1	Monthly data on adherence to budget targets (Exchequer statement, details on Exchequer revenues and expenditure with information on Social Insurance Fund to follow as soon as practicable).	Monthly, 10 days after the end of each month
F.2	Updated monthly report on the Exchequer Balance and General Government Balance outlook for the remainder of the year which shows transition from the Exchequer Balance to the General Government Balance (using presentation in Table 1 and Table 2A of the EDP notification).	Monthly, 20 days after the end of each month
F.3	Quarterly data on main revenue and expenditure items of local Government.	Quarterly, 90 days after the end of each quarter
F.4	Quarterly data on the public service wage bill, number of employees and average wage (using the presentation of the Pay and Pension Bill with further details on pay and pension costs of local authorities).	Quarterly, 30 days after the end of each quarter
F.5	Quarterly data on general Government accounts, and general Government debt as per the relevant EU regulations on statistics.	Quarterly accrual data, 90 days after the end of each quarter
F.6	Updated annual plans of the general Government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general Government budgetary prospects.	30 days after EDP notifications
F.7	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for Non-Commercial State Agencies	Quarterly , 30 working days after the end of each quarter
F.8	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for local authorities	Quarterly , 30 working days after the end of each quarter
F.9	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months for State- owned commercial enterprises (interest and amortisation)	Quarterly, 30 working days after the end of each quarter
F.10	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in	Quarterly, 30 working days after the end of each

	labour market programmes.	quarter.
<b>To be provided by the NTMA</b>		
N.1	Monthly information on the central Government's cash position with indication of sources as well of number of days covered	Monthly, three working days after the end of each month
N.2	Data on below-the-line financing for central Government.	Monthly, no later than 15 working days after the end of each month
N.3	Data on the National Debt	Monthly, 15 working days after the end of each month
N.4	Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for the National Debt.	Monthly, 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the Exchequer Borrowing Requirement / National Debt in the next 12 months	Monthly, 30 working days after the end of each month
<b>To be provided by the Central Bank of Ireland</b>		
C.1	The Central Bank of Ireland's balance sheet.	Weekly, next working day
C.2	Individual maturity profiles (amortisation only) for each of the domestic banks will be provided as of the last Friday of each month.	Monthly, 30 working days after each month end.
C.3	Detailed financial and regulatory information (consolidated data) on domestic individual Irish banks and the banking sector in total especially regarding profitability (P&L), balance sheet, asset quality, regulatory capital; PLAR funding plan forecasts including LDR, NSFR and LCR outturns and forecasts.	Quarterly, 40 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 from the banks and deleveraging sales progress sheets, detailing pricing, quantum, and other relevant result metrics.	Monthly, reflecting committee meetings held each month
C.7	Deleveraging reports including (i) progress achieved towards deleveraging in line with the 2011 Financial Measures Programme; and (ii) actual and planned asset disposals.	Quarterly, 40 working days after the end of the reference period.

## Ireland: Memorandum of Economic and Financial Policies

### A. Recent Economic Developments and Outlook

1. **Ireland's economy returned to growth but continues to face headwinds from slowing external activity.** Real GDP grew by 1.4 per cent in 2011 on the back of a solid export performance. As a result, the current account on the balance of payments recorded a second consecutive surplus, 1.4 per cent of GNP. Domestic demand continues to decline—albeit at a slowing pace—owing to continuing household balance sheet repair and the still weak labour market. Although private sector employment grew modestly at 1.2 percent y/y, the rate of unemployment rose to 14.8 percent in the first quarter. Driven by high energy costs and administered price increases, the annual rate of HICP inflation averaged 1.8 percent in the first six months of the year. Growth prospects for the remainder of 2012 and into 2013 remain modest, with weak trading partner growth dampening export demand even as further competitiveness improvements cushion this effect. Yields on Irish sovereign bonds have fallen sharply on foot of the 28–29 June 2012 euro area Summit, and Ireland successfully returned to the Treasury Bill market.

2. **We welcome the decisions taken on 28–29 June by euro area authorities to examine the situation of the Irish financial sector with the view of further improving the sustainability of our well-performing adjustment programme.** The euro area Summit also recognised the imperative to break the vicious circle between banks and sovereigns that burdens the economic recovery in Ireland. We will work closely with EC/ECB/IMF partners to develop a plan to meet these stated objectives, for consideration by the Eurogroup. Key financial sector issues to be addressed include the financing of the carve out of legacy assets remaining in banks, especially PTSB, and the promissory notes held by IBRC. Meeting these objectives would strengthen confidence and give impetus to Ireland's economic recovery, thereby ensuring bond market access is regained in a durable manner, averting the need to continue to rely on official financial support.

### B. Financial Sector Policies

3. **We submitted to the European Commission a restructuring plan for PTSB at end-June, and we are working with our external programme partners towards the comprehensive strategy needed to ensure its viability.** Under the plan, PTSB is reorganising into three distinct units: (i) the core retail bank; (ii) an asset management unit to house certain legacy assets; and (iii) the U.K. residential mortgage operation, which will be divested as soon as conditions permit. Separate management accounts for each unit will be established by end-September, at which time quarterly performance benchmarks will be, for each unit, established by PTSB. The plan recognises that viability of the core retail bank requires the timely legal and financial separation of the asset management unit, but such a separation hinges on further sector-wide restructuring measures, the nature, timetable, and mechanics of which are yet to be specified. Accordingly, we are exploring options in the context of the decision of the euro area member states to examine the situation of the Irish financial sector with the view of

further improving the sustainability of our well-performing adjustment programme. In the interim, work on financial and operational restructuring of PTSB will continue.

4. **The CBI is streamlining the deleveraging framework to minimise risks to lending and deposit pricing distortions while introducing advanced monitoring of liquidity.** Deleveraging has progressed well and will henceforth be assessed based on the existing nominal targets for disposal and run-offs of non-core assets in line with the 2011 Financial Measures Programme while avoiding fire sales of assets. To prepare banks for the scheduled implementation of Basel III liquidity ratios under CRD IV, we will supervise developments in banks' net stable funding ratio with an emphasis on elements under banks' direct control.

5. **We will continue to phase out the ELG Scheme in an orderly manner.** This important measure helped preserve financial stability through a tumultuous period but could be phased out gradually as the stability of the banking system becomes increasingly assured, which would also enhance bank profitability. An inter-agency working group led by the Department of Finance will by end-2012 develop a roadmap for weaning the banking system off the scheme while preserving financial stability and respecting fiscal deficit targets.

6. **In parallel, we are actively working towards another rigorous stress test.** In preparation for the stress test, and in order to further refine future loan loss forecast estimates the CBI is developing credit data and documentation remediation actions for the PCAR banks as part of their risk mitigation plans. The risk mitigation plans will be updated by end September 2012. We will also revise collateral valuation guidelines by end-December 2012. In relation to mortgage and SME loan arrears, and consistent with our recently implemented Guidelines on Provisioning, we will continue to ensure robust provisioning following the application of loan modification options. In particular, where loans arrears are subject to capitalisation we will require that the loan is not re-set to performing status and that the provisions are held against this part of the portfolio until such time as an appropriate repayment track record (i.e., a minimum of 6 months) has been achieved.

7. **We continue to enhance our supervisory framework.** Supervisory reviews will continue to be conducted on an annual basis for the PCAR banks in line with PRISM, our risk based supervisory engagement model. As part of our ongoing supervision, the CBI is also enhancing its approach to Credit Risk, Risk Weighted Asset (RWA) supervision including conducting annual model performance reviews, assessing RWA calculation and reviewing banks' approaches to RWA forecasting and stress testing in advance of PCAR 2013. Supervisory powers will be further strengthened with the enactment of the Supervision and Enforcement Bill, which will be enhanced at the Committee stage.

8. **We are pressing forward in restoring the viability and solvency of our credit union sector.** We are preparing regulations for the Resolution Fund levy to be adopted by end-September (structural benchmark). Following consultations with key stakeholders,

we published the general scheme of a bill strengthening the regulatory framework for credit unions in late June. It provides for the establishment of a Restructuring Board with strong representation from the sector; administrative preparations to that end are underway. The Board will work with credit unions to deliver agreements on restructuring proposals, which will be subject to CBI regulatory approval and will assist in their implementation. The CBI will engage its resolution powers as needed, drawing on Resolution Fund resources if required.

9. **By year-end, banks will roll out options to address loan arrears and unsustainable debts under the Mortgage Arrears Resolution Strategy (MARS).** The CBI has reviewed loan modification options for residential mortgages and has given feedback to banks. As part of the MARS process, the CBI will communicate to individual banks to ensure appropriately conservative regulatory and accounting treatment of loan modification options is applied. Banks are preparing to roll out a complete set of loan modification options by year-end, with pilots for a number of options set out in the recommendations of the Inter-Departmental Mortgage Arrears Working Group. To provide a free consultation for distressed borrowers, we will augment the Mortgage Advisory Services by end-September with independent financial advisers, funded by banks.

10. **Implementation of banks' loan modification strategies will be subject to intensive bilateral engagement with supervisors to monitor progress.** The CBI is developing a set of key performance indicators to track the banks' implementation of mortgage arrears resolution strategies, which the CBI plans to collect, analyse and publish on a quarterly basis starting at end-December 2012. A set of key performance indicators for SMEs will also be developed by end-December 2012.

11. **We will establish a new insolvency framework that facilitates the resolution of unsustainable personal debt.** We introduced the Personal Insolvency Bill to the Oireachtas in June to establish a new debt settlement regime in order to address personal financial distress, including on residential mortgages. We recognise the importance of protecting creditors' rights and debt-servicing discipline by subjecting the primary new debt settlement processes – the Debt Settlement Arrangement (DSA) and the Personal Insolvency Arrangement (PIA) to a creditor vote by a qualified majority and by requiring court approval, while safeguarding reasonable standards of living for the debtors. The Bill will also modernise the Bankruptcy Act 1988 by shortening the automatic discharge period in line with evolving international practice. We continue to consider further refinements of the Bill, such as pertaining to the valuation of assets, ahead of its enactment.

12. **In parallel, we are advancing preparations to implement the new personal insolvency framework.** We expect soon to appoint a Director-Designate of the Insolvency Service to oversee the establishment of the Service and contribute to the fine-tuning of the law. A significant number of legal and operational issues require to be addressed in finalising the Bill during the Autumn session commencing in September as

to permit the Insolvency Service to become operational in January 2013 or very shortly thereafter. These issues include the licensing and supervision of personal insolvency practitioners and the evolution of reasonable household expenses and necessary trade or business expenses guidelines for debtors. Such guidelines to be prepared by end-year will be crucial for the approved intermediaries in the operation of the Debt Relief Notice process and, will also be of use to personal insolvency practitioners in the negotiation of a DSA or PIA. We will also review the measures necessary for implementation of the framework.

### C. Fiscal Policies

13. **We are on track to deliver a budget deficit within the 8.6 percent of GDP target for 2012.** Implementation of Budget 2012 has safely met the end-June performance criterion on the exchequer primary balance and the indicative target on net debt, further extending our track record of consistently achieving the programme's fiscal targets. Despite the weakening external environment and higher unemployment, strong collection efforts have brought in revenues ahead of profile. At the same time, we are alert to pressures in health and social protection spending, and will continue to manage expenditure to remain within budget.

14. **We continue to make the public service leaner and more effective.** As noted in the Second Implementation Report of the Public Service ("Croke Park") Agreement, the personnel reduction targets for 2012 have been surpassed, with the public workforce now 9 percent smaller than the peak at end-2008. Re-deployments of personnel are gathering pace, and we expect to be able to lock in some of the additional reductions in personnel numbers without compromising critical service delivery. However, some recruitment flexibility may be needed in situations where retirements have created particular skills shortages, or where public service needs have risen.

15. **We are monitoring the public service paybill, including non-core pay elements.** In this regard, we are reining in the cost of overtime through enhanced workforce planning and management, and have completed comprehensive reviews of sick pay and allowance policies as the basis for further cost-saving reforms.

16. **We have begun preparations for Budget 2013 with the aim of further underpinning the credibility of our medium-term fiscal goals.** We are currently finalising a new Employment Control Framework, which will fix departmental resource allocations for next year. In mid-October, we will publish an updated Medium-Term Fiscal Statement setting out our macroeconomic and fiscal projections out to 2015, and the underlying consolidation amounts and composition needed to credibly deliver a consolidation path in line with the Excessive Deficit Procedure, bringing the general government deficit below 3 percent of GDP by 2015.

17. **To ensure that this consolidation protects growth and is equitable and durable, we are analysing a range of strategic reform options.** On the spending side,

we are seeking to better target our social supports and subsidies, attenuate work disincentives arising from the structure and interaction of social assistance payments, and contain ageing-related spending pressures. On the tax side, we are looking to broaden the base and develop additional stable revenue sources, including through the introduction of a value-based property tax. Core features of its design and collection will be included in draft legislation at the time of Budget 2013.

**18. We are strengthening our national fiscal framework in line with EU rules and further enhancing budgetary transparency and reporting.** The approval of the end-May referendum cleared the way for parliamentary ratification of the Treaty on Stability, Coordination and Governance. We have published the draft legislation to implement the Treaty, which will enshrine the independence of the already-established Irish Fiscal Advisory Council and ensure its adequate resourcing. This legislation will also include the automatic correction mechanism that would apply in cases of deviations from fiscal targets. Furthermore, we will publish legislation to give statutory basis to the already-operational multi-annual expenditure limits by end September. We have begun preparatory work to enhance our regular fiscal reporting on an exchequer and general government basis. Taking into account the recommendations of the External Review of the Compilation of General Government Debt Statistics, we will consolidate the appropriate responsibilities for debt reporting at the CSO, while also refining the methodology for general government debt forecasting in the Department of Finance.

## D. Growth and Structural Reforms

**19. Generating growth and jobs on a sustainable basis remains a critical priority.** We welcome the decision by European leaders to increase the capacity of the European Investment Bank (EIB) to address Europe's growth and investment challenges. We plan to avail of this opportunity to supplement our exchequer capital programme through PPP projects with non-Exchequer sources of funding including EIB. The projects will be in a range of sectors including education, transport and health care. Our plans for the disposal of state assets in the energy generation, aviation, and forestry sectors are advancing as envisioned, with no regulatory or legislative obstacles to the commencement of the sales process in 2013 having been identified. We will use at least half of these proceeds to reduce public debt in due course, with the details on timing and implementation to be agreed, and, once realised, the remainder will be reinvested in job-rich projects of a commercial nature consistent with our fiscal targets.

**20. We are taking further steps to tackle the unacceptably high unemployment rate.** As envisaged under our *Pathways to Work* activation strategy, we are progressively rolling out an integrated services system for the unemployed, where the profiling of clients, development of individual career progress plans, and granting of benefits are carried out by case workers. Pilot programs are currently underway in four locations, with a plan to implement them at ten further sites across the country by year-end. To ensure an adequate level of services, we are currently examining resource levels and training needs of the new integrated employment centres. We are also considering the engagement of

private sector firms in the provision of activation services, especially for the long-term unemployed. We will prepare an update on both of these issues by end-September 2012. We are also intensifying our engagement with employers, aiming to increase the notification of vacancies to the employment service and to encourage recruitment of the unemployed from the Live Register.

**21. As we move into more-active engagement with the unemployed, we are reforming the structure of welfare payments to reduce disincentives to work.** In this context, we will transfer responsibility for the provision of rental assistance for persons with a long-term housing need from Department of Social Protection to housing authorities using a new Housing Assistance Payment. A commencement date for the new arrangements of 1 January 2013 has been agreed subject to further consideration of legal and administrative issues by Government. This initiative will help reduce net replacement rates for some groups of long-term unemployed. The DECLG and DSP will also report on the housing assistance reform, in particular on the introduction of the new Housing Assistance Payment by end September 2012.

## E. Programme Financing and Monitoring

**22. The programme remains adequately financed.** Building on our strong record of programme performance, we have returned to the Treasury Bill market for the first time since September 2010, raising €500 million through Treasury Bill issuance and €4.2 billion by selling long-term bonds on favourable terms from a broad investor base in July. We are maintaining close contacts with a wide range of market participants with the aim of regaining sustainable bond market access in 2013 and are examining alternative funding sources, including the sale of amortising bonds to pension funds. In view of the external risks to our financing strategy, we continue to maintain a prudent cash buffer. The euro area leaders' commitment to meet financing needs until market access is regained, providing that the programme remains on track, offers a further valuable backstop in the event that financial market conditions in the euro area were to deteriorate.

**23. Implementation of the policies under the programme will continue to be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews, as envisaged in our Letters of Intent since the inception of the arrangement on 3 December 2010 along with this letter.** The programme also continues to be in compliance with requirements under the Memorandum of Understanding on Specific Policy Conditionality. The attached Technical Memorandum of Understanding defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer primary balance are monitored through quarterly performance criteria and net central government debt is an indicative target (Table 2). As is standard in EU/IMF arrangements, there is a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms is monitored through structural benchmarks (Tables 1 and 3).

**24. We authorise the IMF and the European Commission to publish the Letter of Intent and its attachments, and the related staff report.**

Table 1. Programme Monitoring

Measure	Date	Status
<b>Quantitative Performance Criteria</b>		
Cumulative exchequer primary balance	End-March 2012	Observed
<b>Indicative Target</b>		
Ceiling on the stock of central government net debt	End-March 2012	Observed
<b>Continuous Performance Criteria</b>		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
<b>Structural Benchmarks</b>		
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, Bol and EBS) to achieve a capital ratio of 12 percent core tier 1.	End-February 2011	Not observed <sup>1/</sup>
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed <sup>2/</sup>
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 <sup>3/</sup>
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book.	End-December 2011	Observed
Finalise a strategy to guide the development of broader legal reforms around personal insolvency, including significant amendments to the Bankruptcy Act 1998 and the creation of a new structured non-judicial debt settlement and enforcement system.	End-December 2011	Observed
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets.	2012 Budget day in early December 2011	Observed
Updated restructuring plan for the PTSB detailing the actions needed to ensure viability of its core businesses.	End – June 2012	Observed
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence.	End-September 2012	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 21 of the MEFP, as the Dáil was dissolved owing to the elections.

3/ Effective end-October 2011 and posted on November 8, 2011.

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

	30-Sep-11		31-Dec-11		31-Mar-12		30-Jun-12		30-Sep-12	31-Dec-12	31-Mar-13
	Target	Outcome	Target	Outcome	Target	Outcome	Target	Outcome	Target	Target	Target
	1/		1/		1/		1/				
	(In billions of Euros)										
	Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion	Indicative Target	Indicative Target 4/
1. Cumulative exchequer primary balance 2/	-20.2	-18.3	-22.3	-21.0	-6.9	-5.7	-9.6	-8.7	-10.6	-11.2	-3.6
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 3/	0	0	0	0	0	0	0	0	0	0	0
	Indicative Target		Indicative Target		Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt 1/	115.9	111.7	117.2	115.7	125.0	123.0	130.1	128.2	132.5	136.0	141.7

1/ Adjusted.

2/ Measured by the exchequer balance excluding interest payments. Cumulative from the start of the relevant calendar year.

3/ Applies on a continuous basis.

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

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

Measure	Date	Status
<b>Financial sector policies</b>		
Publish legislation to strengthen the regulatory framework for credit unions, including making legislative provision for effective governance standards and prudential requirements (MEFP Nov. 28, 2011, ¶19).	End-September 2012	Structural benchmark
Approve regulations to establish a charge levied across credit institutions to recoup over time the costs of resolving vulnerable institutions (MEFP Feb. 10, 2012, ¶9).	End-September 2012	Structural benchmark

## Technical Memorandum of Understanding (TMU)

August 20, 2012

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to performance criteria and indicative targets under the arrangement supported by the Extended Fund Facility (EFF). These performance criteria and indicative targets are reported in Table 2 attached to the Memorandum of Economic and Financial Policies (MEFP). This TMU also describes the methods to be used in assessing the programme performance and the information requirements to ensure adequate monitoring of the targets.

2. For programme purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “programme exchange rates”, with the exception of the items affecting the government fiscal balances, which will be measured at current exchange rates. The programme exchange rates are those that prevailed on December 30, 2011 as shown on the IMF’s website ([http://www.imf.org/external/np/fin/data/rms\\_five.aspx](http://www.imf.org/external/np/fin/data/rms_five.aspx), accessed 19 January 2012), in particular, €1 = 1.2939 U.S. dollar and €1 = 0.842786 SDR.

### I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

#### Floor on the Exchequer Primary Balance

3. The Exchequer balance is the traditional domestic budgetary aggregate which measures the net surplus or net deficit position of the Exchequer Account. The Exchequer Account is the single bank account of the Central Fund and is held at the Central Bank of Ireland. The annual audited accounts of the Exchequer Account produced by the Department of Finance are known as the Finance Accounts. An unaudited summary known as the Exchequer Statement is produced at the end of each month. Under the Irish Constitution, all Government receipts are paid in to the Central Fund and all Government expenditure is funded from it, unless provided otherwise by law.<sup>1</sup> 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

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<sup>1</sup> 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.

other capital receipts) minus capital expenditure (voted and non-voted expenditure). The Sinking Fund provision is a transfer from the current account to the capital account to reduce national debt and has no effect on the overall Exchequer balance.

4. The performance criteria are set on the Exchequer primary balance (the Exchequer balance excluding net debt interest payments in the service of the National Debt, but including debt issued to IBRC to settle Promissory Note payments).<sup>2</sup>

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.

6. The floor on the Exchequer primary balance (quantitative performance criterion) in each year will be measured cumulatively from the start of that calendar year.

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2012:	
End-September 2012 (performance criterion)	-10.6
End-December 2012 (performance criterion)	-11.2
From January 1, 2013	
End-March 2013 (indicative target)	-3.6 <sup>3</sup>
End-June 2013 (indicative target)	-7.2

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

<sup>2</sup> Net debt interest payments are as per the end-month Exchequer Statements.

<sup>3</sup> The indicative Exchequer primary balance and Central Government net debt targets for 2013 assume the IBRC Promissory Note payment is executed in April 2013 with a cash payment from the Exchequer.

(PRSI) and national training fund contributions against the current projection which is listed below:<sup>4</sup>

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2012:	
End-September 2012 (projection)	30.7
End-December 2012 (projection)	44.1
From January 1, 2013	
End-March 2013 (projection)	10.2
End-June 2013 (projection)	20.9

8. Any policy changes, including in administration and enforcement of taxes, which impact the revenue projection set out in paragraph 7 will lead to a reassessment of the adjustor in the context of program reviews.

### **Ceiling on the Stock of Central Government Net Debt**

9. The stock of net central government debt, for the purposes of the programme, is defined as the National Debt less liquid assets of the National Pensions Reserve Fund (NPRF). The National Debt is defined as the total outstanding amount of principal borrowed by central government and not repaid as of the test date, less liquid assets available for redemption of those liabilities at the same date. These liquid assets comprise the Exchequer cash balances (including cash in the Capital Services Redemption Account), Exchequer deposits with commercial banks and other institutions, and investments in investment grade sovereign bills. For the purposes of the programme, NPRF liquid assets include the asset classes listed above, and also all marketable securities such as equities, government bonds and other listed investments. NPRF shares in domestic Irish banks, as well as the NPRF's non-liquid discretionary portfolio are excluded from the definition of liquid assets.

10. For the purposes of the programme, the ceiling on the central government net debt (indicative target) will be adjusted upward by debt arising from payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. These payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation); unrequited recapitalisation; and purchases of troubled assets, which are carried out in line with programme objectives. The ceiling will also be

<sup>4</sup> 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.

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

11. The ceiling on the outstanding stock of central government net debt will be adjusted upward (downward) by the amount of any final upward (downward) revision to the stock of end-June 2012 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-June 2012 (provisional)	128.2
End-September 2012 (indicative target)	132.5
End-December 2012 (indicative target)	136.0
End-March 2013 (indicative target)	141.7
End-June 2013 (indicative target)	148.7

## **Non-accumulation of External Payments Arrears by Central Government**

12. The central government will accumulate no external payments arrears during the programme period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the central government on its contracted or guaranteed external debt that has not been made within five business days after falling due, excluding any contractual grace period. The performance criterion will apply on a continuous basis.

13. The stock of external payments arrears of the central government will be calculated based on 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.

- The Department of Finance will report to the EC, IMF and ECB staff, with a lag of no more than seven days after the test date the following data: the Exchequer primary balance, Exchequer tax revenues, payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy,

proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer receipts, Exchequer outlays for the resolution of credit unions, any return of such outlays to the Exchequer and also for the recoupment of such outlays by the Exchequer from the Resolution Fund.

- The National Treasury Management Agency will provide provisional figures on the outstanding stock of net government debt, including an unaudited analysis of NPRF holdings, 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, 40 working days after the end of each quarter.

