Economic Adjustment Programme for Ireland — Summer 2012 Review

Non-technical summary
This paper reports on the main findings of the seventh review mission to Ireland, which took place on 3-12 July 2012. It provides a detailed assessment of compliance with policy conditionality of the economic adjustment programme through end-June 2012 and an overview of remaining challenges. The paper also contains in an annex the updated programme documents.

Overall programme implementation remains strong and fiscal consolidation is on track. The general government deficit for 2012 is expected to remain within the programme ceiling (8.6% of GDP), though corrective measures by the government would be necessary to address emerging overruns in healthcare and welfare spending.

Economic activity continues to evolve in line with expectations, with the 2012 real GDP forecast broadly unchanged relative to the sixth review (down slightly from 0.5% to 0.4%). Downside risks have increased however, primarily due to weaker prospects for growth in Ireland's main trading partners, and unemployment remains high (at 14.8%) and increasingly long-term in nature.

The financial sector continues to strengthen. Deleveraging is ahead of schedule and banks recorded deposit inflows for a fourth consecutive quarter, though deposit rates were higher. To reduce potential distortions in deposit pricing and remove obstacles to the flow of credit to the economy the programme deleveraging monitoring framework was modified. Bank regulation and supervision continue to be strengthened, and important legislation was introduced to reform the personal insolvency regime facilitating the resolution of unsustainable debts. However, weak bank profitability remains a considerable challenge amid rising non-performing loans, high overall funding cost and low-yielding legacy loans. Domestic banks' reliance on funding from the Eurosystem continues to remain sizeable.

Structural reforms are progressing. Legislation to reform sectoral wage-setting mechanisms and strengthen the competition law framework has

been recently enacted, and steps are being taken to expand and improve activation measures. More needs to be done to eliminate or alleviate work disincentives and unemployment traps caused by some features of Ireland's benefits system, 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.

Boosting growth is essential for programme success. In line with EU-wide efforts, 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.

On account of this strong programme performance and improved sentiment reflecting supportive statements by European leaders in late June/early July, **Ireland successfully returned to the market** raising more than EUR 5.5 billion of new funding through Treasury bills and bonds with maturities ranging from 3 months to 35 years.

Despite this substantial progress, important **challenges** remain. These include continued uncertainties in the outlook for trading partners' growth, further financial market turbulence in the euro area, and the complexity of the ongoing financial sector reforms. To minimise vulnerabilities, continued steadfast implementation of the programme remains essential.