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Economic Adjustment Programme for Ireland  
Winter 2012 Review



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European Commission  
Directorate-General for Economic and Financial Affairs

# Economic Adjustment Programme for Ireland Winter 2012 Review

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## **Executive summary**

A joint EC/ECB/IMF staff mission<sup>1</sup> visited Dublin during 29 January-7 February to conduct discussions for the 9<sup>th</sup> review of Ireland's economic adjustment programme.

**Compliance with the programme remains strong overall.** At the same time, policy challenges and external risks remain important and will require continued commitment from the authorities to reforms under the programme and beyond. Addressing remaining imbalances and ensuring a smooth return to overall macro-financial stability will require persistent reform efforts beyond 2013.

**Fiscal consolidation is progressing, but implementation risks remain, particularly in the health sector.** In part thanks to one-off factors, the 2012 general government deficit is estimated at around 7¾ % of GDP—substantially below the programme ceiling of 8.6% of GDP—and other reforms are proceeding broadly according to plans. The 2013 Budget represents further welcome progress towards the objective to reduce the general government deficit below 3% of GDP by 2015, as envisaged under the excessive deficit procedure (EDP). Implementation risks do remain, however, as part of the planned savings for 2013 in the health sector requires additional legislation (originally planned for 2012) as well as the effective implementation of the agreement on working arrangements and conditions recently reached (and yet to be formalized) with public service unions.

**The framework to monitor the implementation of health measures is being improved and needs to be tested.** A detailed framework to report on the implementation of the budgeted measures was agreed, and the authorities have stepped up their own monitoring efforts (the Cabinet Committee on Health will be briefed on a monthly basis). The authorities also ought to renew their commitment to reforms that have been announced in the past, but are not progressing as timely as could be desired (in particular, as regards important eHealth measures such as the introduction of an individual health identifier). Similarly, the achievement of high level annual targets for increasing the share of generic drug usage should be closely monitored, as should the recent and on-going initiatives in support of these targets.

**The high level of unemployment is a pressing issue to be addressed forcefully.** Labour market issues continue to dominate the structural reforms agenda, reflecting Government priorities and the pressing need to put (long-term) unemployment on a sustained downward path. The authorities continue to implement business-promotion measures under the Action Plan for Jobs initiative. Private employment rose modestly in Q3 and Q4 2012, but a substantial net job creation impact from the Action Plan remains contingent upon further improvements in macro-economic prospects. Reforms to activation policy have reached a point where the capacity of institutions to deliver services to the long-term unemployed is becoming the critical bottleneck. Reforms of further education and training are progressing and will be critical to enable Ireland to re-skill its long-term unemployed population. Fast progress and closely linking training programmes to labour market needs are now essential.

**Continued advances on banks' deleveraging and funding profiles are welcome, but progress in resolving non-performing loans (NPLs) has been slow,** which weighs on the outlook for a sustained recovery. Banks have hitherto made very little use of the loan modification options designed to durably deal with unsustainable mortgage debts. This appears to reflect at least in part incentives from the provisioning guidelines, particularly in relation to the permitted reclassification of certain restructured loans as performing,

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<sup>1</sup> Hereafter referred to as the "Troika".

which in some cases is premature. The authorities requested additional time to update the provisioning guidelines so that the revision could benefit from the analysis of banks' 2012 financial statements which will be published during March 2013. They have also set targets requiring banks to treat a substantial share of their NPLs in a durable manner.

**The newly legislated personal insolvency regime is expected to begin accepting applications in the second quarter.** In view of the need to ensure that debtors' payment discipline is not weakened, the Troika welcomed the commitments by the authorities to (i) remove unintended impediments to banks' ability to recover collateral in defaulted mortgages and (ii) review the code of conduct on mortgage arrears to enable more meaningful engagement by borrowers with banks. These need to be followed on with adequate action. Separately, the authorities announced the removal of the costly Eligible Liabilities Guarantee (ELG) scheme for new liabilities from end-March. This will eliminate a sizeable contingent liability for the government and a significant cost for participating banks, improving their profitability and thus facilitating new lending to the real economy.

**Initial discussions were also held on possible strategies to underpin the successful completion of, and exit from, the programme.** Commission services underscored that, quite apart from whether a successor arrangement is warranted or desirable, it is essential that the uncertainty on banks' asset quality resulting from the high level of NPLs is dissipated prior to the end of the programme via another rigorous and credible stress test in the mould of PCAR 2011. The authorities reserved their position on this matter, as they consider that Ireland should conduct the next bank stress test in the context of the EBA EU-wide exercise. Discussion on this and other exit-related matters will continue in the next weeks and upcoming reviews.

**An important agreement was reached on the promissory notes, hitherto held by asset-recovery bank IBRC, of which the ECB governing council unanimously took note.** Following the passage of emergency legislation which liquidated IBRC, the CBI became the legal owner of the promissory notes which had hitherto served as security for emergency liquidity assistance (ELA). The CBI then agreed to swap these promissory notes for long-dated Irish government bonds, which it will gradually sell into the market according to an agreed schedule, to be reassessed depending on market conditions. Commission services estimate that the operation will result in much lower financing needs in the post-programme period (over EUR 30 bn through 2023) and reduce the deficit by about 0.7% of GDP per annum on average for ten years starting from 2014. While calls are likely to emerge to scale down the agreed consolidation efforts accordingly, Commission services consider that the budgetary benefits ensuing from the operation should be used to accelerate debt reduction, as envisaged under the EDP.

#### **Financing issues**

Successful completion of this review would trigger the release of EUR 1.6 bn from the EFSF, EUR 1 bn from the IMF, and EUR 0.7 bn from the UK, Denmark and Sweden in the context of their bilateral loans. Reflecting the better than expected cash position, the Irish authorities have not yet requested the disbursement of EUR 0.8 bn that was authorized upon successful completion of the 8<sup>th</sup> review.

## 1. Introduction

This report covers recent macroeconomic and financial developments, programme implementation, and the main challenges ahead, as assessed by the joint EC/ECB/IMF staff mission to Dublin on 29 January-7 February 2013 in the context of the ninth review of the economic adjustment programme.<sup>2</sup>

## 2. Programme implementation

*This section reviews the Irish authorities' compliance with the programme milestones for end-2012 as listed in the Seventh Update of the Memorandum of Understanding on Specific Economic Policy Conditionality (the "MoU").<sup>3</sup> The paragraph numbers in this section refers to the MoU paragraph covering the relevant programme commitment.*

**Programme implementation has remained strong overall**, with end-2012 programme milestones mostly met in a timely fashion.

- **Fiscal policy (paragraphs 5-10):** The 2012 general government deficit ceiling (8.6% of GDP) is estimated to have been comfortably observed (the outturn is estimated at about 7¾ % of GDP) in part thanks to some one-off factors. Expenditure overruns were experienced in social welfare and health services, partly as a reflection of higher-than-expected unemployment but also—as discussed in previous reviews—as a result of slippages and weak implementation of some planned measures in the health area. These were offset by savings elsewhere, such as environment and transport and through lower than budgeted debt servicing costs. The 2013 Budget is consistent with keeping the general government deficit within the 2013 programme ceiling of 7.5% of GDP. Moreover, in line with programme undertakings, the 2013 Budget is predicated on health expenditure staying within the agreed ceiling, which requires measures for about EUR 780 mn to offset overruns experienced in 2012 and other service pressures, as well as on delivering the previously planned adjustment. Notable implementation risks relate to the fact that an important share of these savings is expected to come from the recent agreement with public sector unions and/or require legislation. Thus high-frequency monitoring is warranted (see Section 5.1 below). The authorities also published a medium-term fiscal plan<sup>4</sup> compliant with the objective, under the excessive deficit procedure, of bringing the general government deficit to below 3% of GDP by 2015. Finally, an agreement was reached between the Department of Environment, Community and Local Governments (DECLG) and the Department of Public Expenditure and Reform (DPER) limiting the local governments' deficit to zero in 2013 and over the medium term. Technical discussions are continuing with the Irish authorities on

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<sup>2</sup> This report reflects information available as of 15 March 2013.

<sup>3</sup> See the report for the Autumn 2012 review, available here;  
[http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2013/op127\\_en.htm](http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op127_en.htm)

<sup>4</sup> The document is available here:  
<http://budget.gov.ie/budgets/2013/Documents/Medium%20Term%20Fiscal%20Statement%20November%202012.pdf>

the appropriateness of the protocol to enforce fiscal discipline and correction mechanism across local authorities.

- **Financial sector reforms** (paragraphs 11-20): The authorities provided their assessment of banks' progress against the relevant conditions included in the MoU: (i) the programme's deleveraging targets; (ii) net stable funding and liquidity metrics under the advanced monitoring framework, in line with the relevant Basel III requirements; and (iii) key performance indicators (KPIs) for mortgage portfolios. The banks' performance on mortgage arrear resolution has been disappointing so far—see Section 5.2 below. *Data on advanced loan modifications* were published on 13 December as part of the regular quarterly mortgage arrears report of the Central Bank of Ireland (CBI), though the latter contained no data on re-defaults given that no track record under modified loans was available at that time. These data are now expected to be published by end-Q2 2013. A set of analogous *KPIs for banks' SME loan portfolios* was developed, a first assessment of performance against which would be done by end-Q1 2013. *Bank-specific targets for reviewing new and existing arrears cases* were developed taking account of detailed loan-file reviews, and continue to be enhanced. The authorities also provided the customary *quarterly implementation reports* on (i) the reorganisation of the Credit Union sector; (ii) the CBI action plan to strengthen supervision; and (iii) banks' strategies to address arrears. They also completed the *annual reviews of the banks' models to calculate and forecast risk-weighted assets* and instructed banks to take mitigating actions where necessary. Finally, the authorities ensured that the Personal Insolvency Bill, which was passed by both Houses of the Oireachtas on 19 December 2012, included *appropriate provisions covering the regulation of Personal insolvency practitioners*.
- **Structural reforms** (paragraphs 21-25): The authorities conducted and published: (i) a *survey of SME credit demand* and (ii) a *study of the effectiveness of the Credit Review Office* as a tool to ensure that SMEs are getting the support on bank lending they require. They also published an *amendment to the Companies Bill* to designate the Circuit Courts as competent for the examinership of companies within the EU small company thresholds (balance sheet below EUR 4.4 mn), which would lower the costs of examinership for these firms. The authorities published early in January a *Water Services Bill* and provided the quarterly report on the state of play with respect to bringing *state assets identified for disposal* closer to the point of sale. An *assessment* was made of the impact of the reforms implemented under the programme to *strengthen competition law enforcement* in Ireland, though it was agreed that more time is required to allow the reforms themselves to take hold (see Section 5.3 below). Although not covered by specific programme milestones for end-2012, reforms to improve labour market policy, promote job creation and address skills mismatches continued to progress with: (i) the implementation of the Action Plan for Jobs 2012 under quarterly monitoring process; (ii) the introduction of *Intreo* offices and the phasing-in of jobseekers profiling; and (iii) the publication of the Further Education and Training (SOLAS) Bill 2013.

**This progress notwithstanding, the authorities have signalled some emerging delays** on account of certain capacity constraints, especially as regards drafting of legislation. In particular, the Legal Service Bill—published in October 2011—is still pending second

stage treatment in the Dail and the credit register may not be fully operational by end-2013 as envisaged under the programme. These reforms are nevertheless very important to, respectively, reduce still high legal service costs and eliminate a major information gap that contributed to reckless lending in the boom. It is to be hoped that adequate resources can now be mobilized to ensure their timely implementation.

**The authorities also requested additional time** to: (i) publish an update on developments in the PCAR banks relative to PCAR 2011 (initially an end-January programme milestone—see paragraph 11), in view of timing constraints related to information disclosure prior to banks' release of their 2012 financial statements and (ii) complete the review of the 2011 Impairment Provisioning and Disclosure Guidelines (paragraph 37), to reflect the lessons learned from the ongoing engagement with the banks on their end-2012 provisions policies. Deadlines for these milestones have been reset to end-February and end-May 2013, respectively. On 1 March 2013 the authorities published the update on developments in the PCAR banks relative to PCAR 2011.

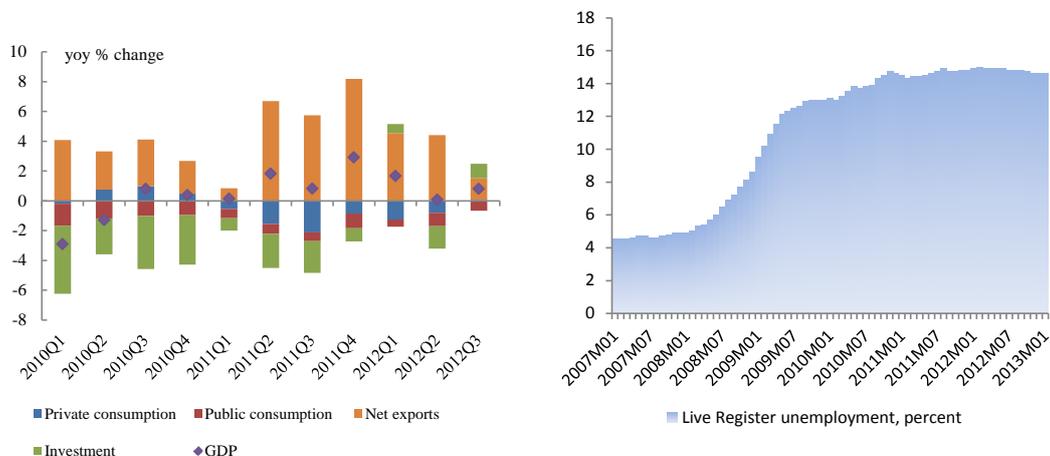
### 3. Recent economic developments

**Recent economic data were stronger than expected, despite worsening trading partner demand in the euro area.**

- National accounts data for Q3 2012 indicate that real GDP grew by 0.8% in the first three quarters compared to the same period of 2011. Growth became more broad-based with private consumption turning positive in year-on-year terms for the first time since 2010 (Figure 1). Investment grew strongly year-on-year due in part to increased equipment purchases by aircraft leasing firms, although non-aircraft investment showed its strongest improvement since before the crisis.
- High-frequency indicators suggest that services exports continued to grow strongly into Q4 2012, while goods exports were more muted due mainly to the pharmaceutical-chemical sector. This has also been mirrored by weak industrial production figures for several months, although the high import content and low employment intensity in the pharmaceutical sector suggest that the impact on GDP in Q4 2012 might be less important. Other high-frequency indicators such as tax collections, retail sales, real estate prices, and PMI data also appear to suggest a relatively resilient economic performance throughout the last few months of 2012 and the first months of 2013.
- Relative to the 8<sup>th</sup> review, real GDP growth in 2012 as a whole has been revised upwards to 0.7% (from 0.4%) on the back of stronger private consumption and investment, while nominal GDP is projected to be about EUR 0.5 bn higher in 2012 and throughout the projection period as a result of higher real GDP growth and a slight upwards revision to the GDP deflator in 2012.
- Private employment continued to grow in Q4 2012. While unemployment remains high (Figure 2) and participation is still 4 percentage points below pre-crisis levels at around 60%, Q4 data indicate that private employment is on the rise, fully offsetting policy-led reductions in public service employment. A net 6,500 jobs were added in Q4 2012 compared with the previous quarter, following 2,200 additions in Q3 (seasonally adjusted). Increases in employment were most significant for skilled people (professionals, technicians and skilled tradespeople), while employment among those with basic skills further declined. This further

highlights the need to continue efforts to re-skill the unemployed and put in place active labour market policies (see section 5.3).

**Figure 1: Real GDP growth and Figure 2: Unemployment contribution from select components**

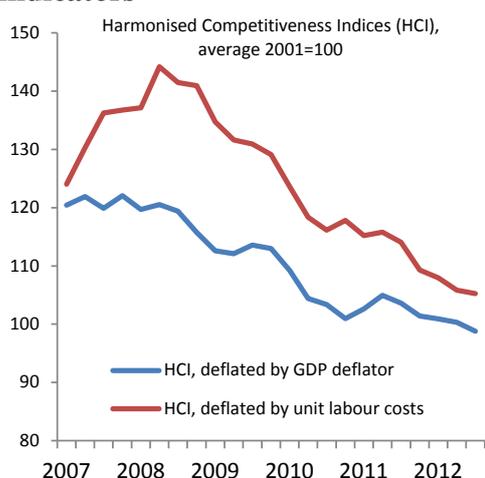


Source: CSO and Commission Services' calculations. Source: CSO calculations.

**Inflation is moderating and real earnings growth is still negative in many sectors, underpinning continued competitiveness gains.** Inflation averaged 1.9% in 2012, substantially below the euro area average (2.5%), with a moderating trend continuing into 2013. Nominal GDP nonetheless grew by 3.5% through the third quarter of 2012 on the back of strongly increasing export prices. Real competitiveness indicators have continued to improve and are now some 20%-30% better than their pre-crisis levels (Figure 3), although some of this reflects a sectoral effect as construction output has declined dramatically and capital-intensive export sectors have performed well. A more granular look at earnings data, however, reveals that, while annual growth in weekly earnings fell back into negative territory at -0.3% in Q4 2012, certain sectors (such as professional, scientific and technical activities as well as information and communication technology) have actually experienced substantially positive annual real wage growth in 2012.

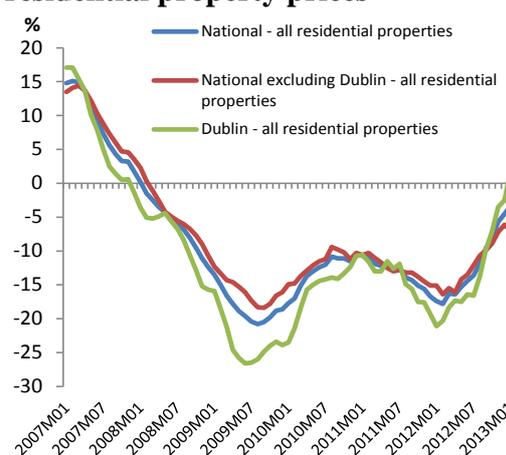
**Real estate prices have broadly stabilized although substantial regional divergences persist** (Figure 4). Recent data showed small declines in nationwide real estate prices in annual terms, which are still considered consistent with a broadly stabilizing housing market as the temporary boost from the approaching expiration of mortgage interest relief at end-2012 has subsided. Real estate prices in Dublin posted annual growth of 2.1% in January, the first year-on-year increase since 2007, amid tentative evidence of emerging shortages of family houses in the capital area. Outside major urban areas, residential property prices are still falling, albeit at declining rates, with oversupply suggesting that trend might continue yet for some months.

**Figure 3: Real competitiveness indicators**



Source: CBI, CSO and Commission Services' calculations.

**Figure 4: Annual change in residential property prices**



Source: CSO.

**In the financial sector, covered banks<sup>5</sup> have continued to access market funding at attractive terms, benefitting from improved investor sentiment towards Ireland.** Unguaranteed debt issuance secured on Irish asset collateral by AIB and BOI has totalled EUR 2.5 bn since last November, pricing at a weighted average margin of about 2.4%. PTSB has raised an additional EUR 1.0 bn in new private term funding secured on Irish and UK mortgages since the beginning of January. Secondary market yields on the AIB and BOI covered bonds have tightened by around 70-90 basis points from issue date to end-February, which compares favourably against other peripheral banks (Figure 5). In terms of unsecured debt, BOI and AIB have been issuing unguaranteed commercial paper for short maturities (up to 6 months) to a variety of investors. A total of EUR 0.3 bn has been raised from such issuance by the two banks between January and end-February, and has since increased further. Despite their relatively riskier nature, subordinated debt instruments have also been placed with international investors, as evidenced by BOI's EUR 250 mn 10-year Tier-2 issue and the successful disposal (at an above-par price) of the government's entire EUR 1 bn holding of Contingent Capital securities in BOI.

**Reflecting this gradual return to market funding, continued deposit inflows and progress with deleveraging, covered banks' reliance on Eurosystem funding has reached its lowest level since the beginning of the programme.** Deposits at covered banks increased by over EUR 7 bn (+4.8%) year-on-year in January 2013, though the pace of inflows has recently moderated as deposit rates continue to normalise (Figure 6). End-2012 net loan balances at covered banks were some EUR 55 bn lower than at programme inception, with about 90% of the remaining deleveraging envisaged to take place by end-2013 due to materialise through planned amortisation and asset transfers to UK subsidiaries<sup>6</sup>. As a result, Eurosystem funding continued its gradual decline and was

<sup>5</sup> Covered banks include the credit institutions covered by the 2011 PCAR stress test exercise, that is Bank of Ireland (BOI), Allied Irish Banks (AIB, now merged with EBS) and Permanent TSB (previously IL&P).

<sup>6</sup> Just EUR 0.8 bn of asset disposals remain to be completed by year-end. This excludes disposals by PTSB, which have been postponed pending conclusion of the bank's restructuring plan assessment.

lower by about EUR 18 bn year-on-year in January, and by more than EUR 45 bn since January 2011. Following liquidation of the Irish Bank Resolution Corporation (IBRC) in early February and the associated termination of Emergency Liquidity Assistance (ELA)—see Box 1 below—monetary authority funding to domestically-owned Irish banks reduced to about EUR 48 bn in February 2013 from a peak of EUR 156 bn in February 2011 (Figure 7).

**Despite these improvements in banks' funding, credit extension to the domestic economy remains weak.** Lending to households decreased at a rate of 3.9% in the year to December 2012 (reflecting a 10% decline in the consumer loan segment), following a reduction of 3.6% in November. Loans to Irish resident non-financial corporations (NFCs) declined by 3.6%, though at a slower pace than in preceding months (Figure 8). The stock of mortgage loans was 1.6% lower on an annual basis as of end 2012, though recent data released by the Irish Banking Federation<sup>7</sup> indicate gradual increases in new lending flows for house purchase in the second half of 2012 (Figure 9). The 56% annual increase reported for Q4 2012 might, however, reflect tax incentives which may have contributed to some frontloading of purchases. On the supply side, the weakness in new credit extension could partly reflect banks' profitability concerns, as they seek to enhance net interest margins by gradually increasing lending rates while reducing deposit rates (Figure 10)<sup>8</sup> However, evidence of weak credit demand is also apparent, given that drawdowns represent only a share of official sanctions by banks, particularly in the NFC segment.<sup>9</sup>

**Strong investor interest has resulted in declining yields on Irish sovereign bonds, both on primary and secondary markets.** In early January 2013, the authorities tapped the 2017 bond amid strong interest from international investors, raising EUR 2.5 bn at a yield of 3.3%. This bond had been tapped already last July, but at a yield of 5.9%. The 2.6 percentage point reduction in the yield in six months is an indication of the improved market sentiment towards Ireland and confirmed the pattern of stepwise lowered yields observed at the six T-bill auctions conducted since the summer of 2012. In March 2013 the NTMA raised EUR 5 bn through the sale of a new 10-year benchmark Treasury Bond maturing in March 2023. The funds were raised at a yield of 4.15 per cent from a well-diversified investor base.<sup>10</sup>

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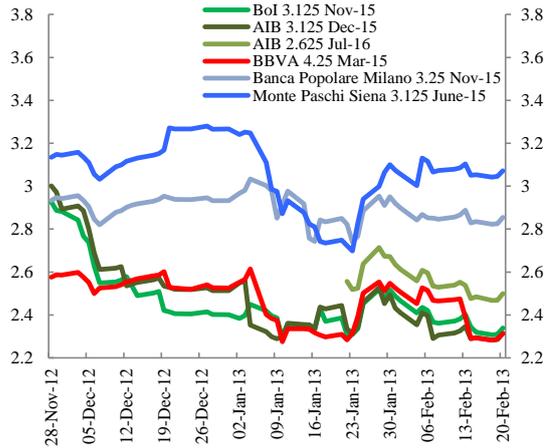
<sup>7</sup> [http://www.ibf.ie/Libraries/Research\\_Statistics/IBF-PwC\\_Mortgage\\_Market\\_Profile\\_Q4\\_2012.sflb.ashx](http://www.ibf.ie/Libraries/Research_Statistics/IBF-PwC_Mortgage_Market_Profile_Q4_2012.sflb.ashx)

<sup>8</sup> An important drag on banks' profitability will be removed from end-March, as the ELG scheme will be removed for new liabilities (see Section 5.2).

<sup>9</sup> The pillar banks report that, while over 90% of loan applications from Irish enterprises are approved, only about 50% of them are drawn down (moreover a large proportion of sanctions reflects restructuring/roll-over of existing facilities). As regards mortgage lending, some 85% of formal sanctions are drawn down.

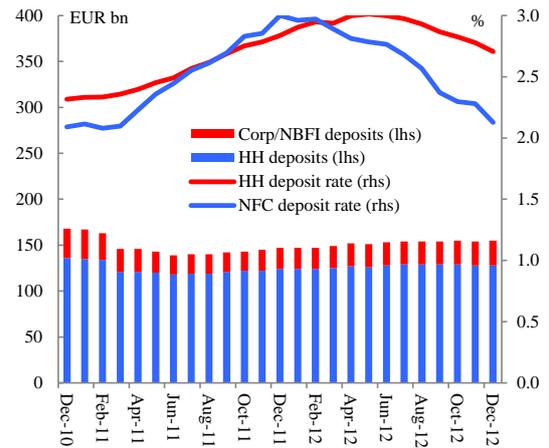
<sup>10</sup> Of the amount issued, 18 per cent was taken up by domestic investors and 82 per cent by overseas investors. The overseas investors were mainly from the U.K. (25%), Germany (12%), the Nordic region (12%), France (11%) and the U.S. (7%). There was broad investor interest in the issue with over 400 investors submitting bids, including fund managers, banks, pension funds and insurance companies. The total bids received amounted to some EUR 13 bn.

**Figure 5: Yields on select Irish and peripheral banks' covered bonds**



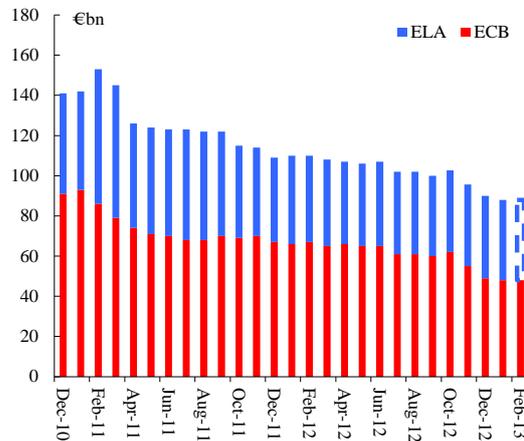
Source: Bloomberg  
 Note: Data covers daily mid yield-to-maturity (YTM) closing levels for each bond.

**Figure 6: Retail and corporate deposit flows and interest rates**



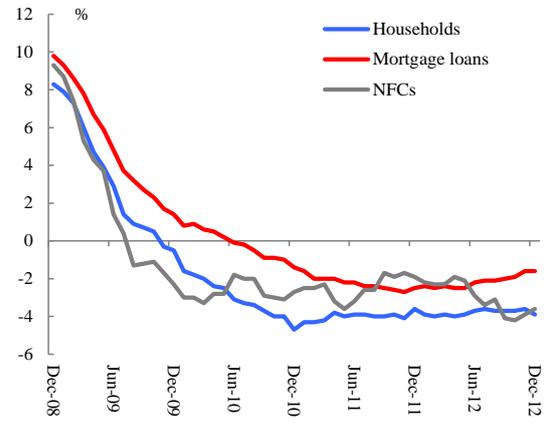
Source: Central Bank of Ireland  
 Notes: Deposit flows data covers BOI, AIB and PTSB. Deposit rates data covers all Irish resident banks. HH=household; NFC=non-financial corporates; NBFI=non-bank financial intermediaries.

**Figure 7: Eurosystem funding**



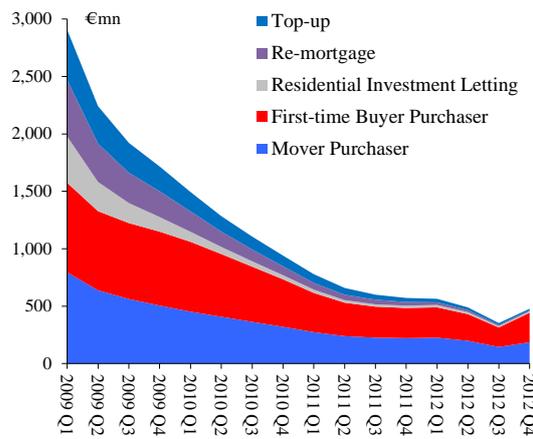
Source: Central Bank of Ireland, Department of Finance  
 Note: Data covers BOI, AIB/EBS, PTSB and IBRC; ELA is proxied by the CBI's "other assets" series through March 2012 and by "other claims on euro area credit institutions" thereafter.

**Figure 8: Lending to households and NFCs**



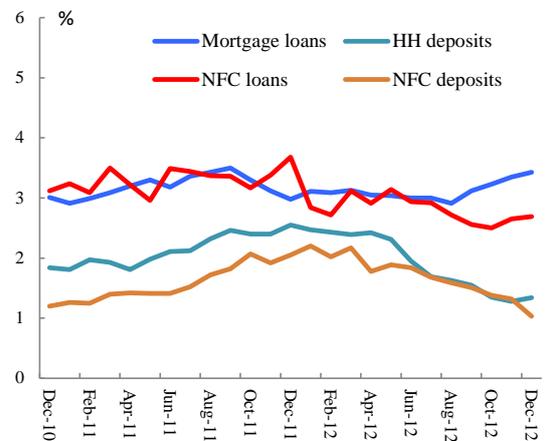
Source: Central Bank of Ireland,  
 Notes: Data for households includes mortgage loans. Figure shows annual rate of change (%).

**Figure 9: New mortgage lending flows**



Source: Irish Banking Federation (IBF)  
 Note: Figures relate to all new lending (flows) secured by residential property extended by IBF's members.

**Figure 10: New business rates: mortgage and NFC loans, HH and NFC deposits**



Source: Central Bank of Ireland  
 Notes: Data presented is a 4-quarter moving average. Rates on NFC loans are for volumes over EUR 1 mn. Rates are averages across all product categories.

**Market sentiment has been further supported by the operation conducted in early February to replace the promissory notes with long-dated government bonds.** The transaction is expected to significantly reduce financing needs in the post-programme period and to improve the general government deficit and debt paths over time. This, together with the removal of some key risks to the programme, should enhance Ireland's rating outlook (one rating agency already upgraded it to stable from negative watch and reaffirmed its investment-grade rating in response to the operation) and as such is supportive of its chances to durably rely on market funding after the programme ends (see Box 1).

**Box 1: Promissory notes operation – an impact assessment**

**In early February, the Irish government signed emergency legislation providing for the wind-up of IBRC, and conducted an operation replacing the promissory notes (PN) held by the bank with government bonds.** The liquidation triggered a number of developments in relation to IBRC's creditors, notably that eligible customer deposits and bonds will be covered in full by the two guarantee schemes applicable in Ireland. The operation also resulted in the CBI becoming the economic owner of EUR 25 bn of PN, against which it had been providing ELA. These securities were extinguished and replaced by a series of long-dated government bonds, with a weighted average maturity of over 34 years. The CBI also committed to disposing a pre-agreed amount of these government bonds from 2014, provided this does not disrupt financial stability. In parallel, the CBI became the economic owner of approximately EUR 1.3 bn of NAMA bonds and other assets which were used as security against ELA and Eurosystem borrowing, and about EUR 15 bn of residual IBRC assets, which also constituted collateral for ELA. Following an independent valuation and sale process, the remainder of these residual assets will be transferred to a new SPV owned by NAMA, against which it will issue government-guaranteed bonds (to the CBI).

**Commission Services estimate that the operation will reduce sovereign financing needs and improve the general government deficit and debt paths.** Based on current projections, government financing needs are expected to decline by a cumulative amount of over EUR 30 bn (about 18% of 2013 GDP) through 2023. This is due to (i) the difference between PN repayments (incl. interest on bonds that would have to be issued to fund these) and the interest payments on the new government bonds and (ii) higher CBI profits (by about EUR 0.3 bn p.a. until 2023), leading to an increase in dividend payable to the state.

<b>Estimated impact on public finances, 2013-2015</b>			
<b>Baseline estimates</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
Government deficit, EUR bn	-12.3	-8.6	-5.0
<i>% of GDP</i>	-7.4	-5.0	-2.8
Gross debt, EUR bn	202.5	207.4	212.4
<i>% of GDP</i>	121.5	120.1	117.8
<b>Estimated transaction impacts</b>			
Government deficit impact, EUR bn	0.2	1.3	1.2
<i>% of GDP</i>	0.1	0.7	0.7
Cumulative debt impact, EUR bn	1.3	0.0	-1.2
<i>% of GDP</i>	0.8	0.0	-0.7
<b>Post-transaction estimates</b>			
Government deficit, EUR bn	-12.1	-7.3	-3.8
<i>% of GDP</i>	-7.3	-4.2	-2.1
Gross debt, EUR bn	203.8	207.4	211.2
<i>% of GDP</i>	122.2	120.1	117.1

The general government deficit is projected to be lower by about EUR 1 bn (0.7% of 2013 GDP) p.a. as of 2014. Upfront transaction costs (related to claims under the ELG scheme) would largely offset the benefits in 2013, leaving only a small positive impact on the government balance (0.1% of GDP). The improved deficit and reduced debt level over time reflect the lower interest cost of the new government bonds (relative to the PNs), higher CBI surplus income paid as dividend to the Budget, and more efficient capital allocation across the system.<sup>11</sup>

**Benefits in addition to those for public finances are also expected.** Gone-concern bank IBRC is being removed from the financial system and annual PN payments to it have been terminated, eliminating a sensitive issue that risked undermining political stability. The structural funding gap for domestic banks has also been reduced by more than EUR 40 bn, as ELA has been terminated. The elimination of some

<sup>11</sup> Discussions are ongoing between the CSO and Eurostat regarding the statistical treatment of the liquidation of IBRC and the restructuring of the promissory notes and their impact on the general government deficit and debt.

key risks to the programme and the improved fiscal path could enhance Ireland's rating outlook, thus facilitating a full and durable return to market funding. Indeed, since the announcement of the operation, sovereign yields have declined by about 15 and 40 basis points in the two and eight-year maturities respectively, and the positive momentum supported Ireland's successful return to term bond markets with a competitively-priced new 10-year issue, amid strong demand from international investors.

**Potential risks associated with this operation concern its temporary impact on the 2013 deficit and post-programme fiscal consolidation.** One-off costs related to potential post-asset transfer shortfalls in NAMA (which need to be covered by the Budget) are uncertain at this point and could pose a risk to the 2013 deficit target. Taking into account expected fiscal savings from the operation as of 2014, domestic pressures to reduce the consolidation effort in future budgets are becoming apparent. In accordance with the Council recommendation under the Excessive Deficit Procedure, the agreed consolidation effort for the post-programme period should be adhered to, while accelerating the reduction of government debt. Though this is currently considered unlikely, as NAMA remains a non-public entity and due to the independent valuation and market-based disposal process for IBRC's assets, the risk of its potential reclassification into general government will also need to be kept under review.

#### 4. Macroeconomic outlook

**Headline growth projections for 2013 and beyond have been kept unchanged although the composition has changed marginally** compared to the 8<sup>th</sup> review (Table 1). Risks remain as outlined in previous reports<sup>12</sup> and appear broadly balanced, with domestic demand indicators at a seeming inflection point, which could lead to upside surprises, and risks to trading partner demand clearly on the downside. The growth forecasts for individual GDP components have been modified at the margin, as warranted by the latest data, with broadly off-setting effects, so that overall GDP growth rates have been kept unchanged for 2013-2015. In particular, a smoother path for government consumption is now envisaged, subtracting more from growth in 2013 and less in 2014-2015, while the contribution from net export moves in the opposite direction, reflecting marginal downward revisions in the 2013 growth forecast for exports and, slightly more so, imports. Slightly stronger employment growth and lower unemployment are projected, underpinning upside risks to domestic demand if households decide to allocate some additional income to consumption as opposed to deleveraging. Commission Services continue to believe that the Irish economy has the potential to grow around 3% per year towards the end of the projection period.

**There is substantial agreement on projections between the Troika and the authorities, although the latter are slightly more optimistic on the growth outlook.** For 2013, the Department of Finance forecasts growth of 1.5%, the CBI 1.3%, and the Troika 1.1%. For 2014, the growth forecasts are 2.2% for the Troika and 2.5% for the Irish authorities. The differences in the level of nominal GDP between the Troika and the Department of Finance in 2015 has narrowed to about EUR 1 bn, down by a third compared to the projections at the time of the 8<sup>th</sup> review due to the changes in Troika projections outlined above.

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<sup>12</sup> See Autumn 2012 Review, pp.16-19,  
[http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2013/op127\\_en.htm](http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op127_en.htm)

**Table 1: Revised macroeconomic framework**

	Ninth review forecasts (latest)					Eight review forecasts (previous)				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
	% change on previous year (unless otherwise noted)									
Real GDP growth	1.4	0.7	1.1	2.2	2.8	1.4	0.4	1.1	2.2	2.8
Private consumption	-2.3	-1.8	-0.5	1.2	1.8	-2.3	-2.1	-0.5	1.2	1.8
Public consumption	-4.3	-3.6	-2.5	-2.8	2.5	-4.3	-4.0	-1.7	-3.0	-3.3
Fixed investment	-12.2	-2.0	-1.5	3.0	5.2	-12.2	-4.0	-1.5	3.0	5.2
Domestic demand (contribution)	-3.4	-1.8	-0.9	0.4	0.9	-3.4	-2.2	-0.7	0.3	0.8
Inventories (contribution)	0.4	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0	0.0
Exports	5.1	2.6	3.0	4.2	4.4	5.1	2.8	3.2	4.2	4.5
Imports	-0.3	0.4	1.6	3.3	3.7	-0.3	0.3	2.0	3.2	3.6
Net trade (contribution)	5.4	2.4	1.9	1.8	1.8	5.4	2.6	1.8	1.9	2.0
Employment	-2.1	-1.0	0.1	0.9	2.1	-2.1	-1.2	0.0	0.9	1.9
Unemployment	14.7	14.8	14.6	14.1	13.1	14.7	14.8	14.7	14.2	13.4
GDP deflator	0.2	1.8	1.3	1.4	1.6	0.2	1.7	1.3	1.4	1.6
HICP inflation	1.2	1.9	1.3	1.3	1.6	1.2	2.0	1.3	1.4	1.6
Current account (% of GDP)	0.5	2.1	3.4	4.3	4.3	0.5	2.3	3.4	4.4	4.5
Nominal GDP (EUR billion)	159.0	162.9	166.7	172.8	180.3	159.0	162.3	166.2	172.3	179.9

Source: Commission Services' calculations.

## 5. Policy outlook

### 5.1 Fiscal policies

*Progress continues to be made in securing the planned consolidation, with the 2012 deficit outturn estimated to have been substantially below the programme ceiling and the Budget for 2013 in line with programme understandings. The priority in the short term is to ensure that the measures envisaged in this year's Budget are fully implemented, especially as regards cost-containing measures in the health sector and the establishment of the new value-based real property tax. Looking beyond 2013, the credibility of the consolidation targets should be underpinned by specifying as early as possible (in the April Stability Programme) the authorities' proposed measures and reforms in the key spending areas, such as education, health and social welfare. The fiscal framework could also be further strengthened by more closely aligning the expenditure ceilings with the EU guidelines and spelling out more clearly the mechanisms for modifying them and the escape clauses.*

**Overall, the 2013 Budget targets the agreed fiscal adjustment** by introducing structural revenue and expenditure measures in the order of EUR 1.43 and 1.94 bn respectively, as well as increased dividends from state-owned companies.<sup>13</sup> Moreover, the 2012 outturn implies a positive base effect for 2013 (tentatively estimated at 0.1% of GDP as compared to an estimated over-performance of ½% of GDP), which—together with small net savings from the promissory note replacement<sup>14</sup>—should ensure that the

<sup>13</sup> In addition, the authorities agreed to take measures to address the structural overruns in the health sector in 2012, estimated at about EUR 700 million.

<sup>14</sup> The winding-up of the State-owned Irish bank Resolution Corporation (IBRC) and the replacement of the promissory notes with longer-term government bonds is estimated to have a *net* marginally positive impact on the fiscal balance of about 0.1% of GDP in 2013, as savings on the interest bill are partly offset by the one-off liquidation costs (i.e., the calls on the Eligible Liabilities Guarantee scheme, in the order of 0.6% of

deficit remains safely within the programme ceiling of 7.5% of GDP. The current forecast for the 2013 deficit is at 7.3% of GDP (Table 2), based on the assumptions that (i) only part of the corporate income tax surprise in late 2012 is likely to be permanent and (ii) expenditure plans will be in line with the allocations envisaged in the 2013 Budget.<sup>15</sup> Significant fiscal adjustment efforts in 2013 deliver only a muted improvement in the deficit due to increasing debt servicing costs and the effects of some one-off operations (Table 3).

**The key near term fiscal challenge is to ensure that the announced measures are fully implemented.** This is especially the case for the new property tax and the measures to contain health expenditures.

- The **property tax** will be based on the self-assessed market value of residential property. This may give rise to incentives to under-state the market value of properties, which the authorities are trying to minimize by having a system of bands in which the assessed tax is constant (so that only large under-valuations—which are easier for the revenue commissioners to spot—would pay off in terms of reducing the tax liability). The rationale for relying on self-assessment lies in the absence of a comprehensive register with updated property values, which is currently being developed. A valuation based on such register should be established as soon as the latter is in place. In addition, the 1-acre cap on the size of the taxable land linked to the residential property and the exclusion of other land properties reduce the base of the tax.
- Growth in the **cost of medical services** is envisaged to be contained via a series of measures, including an increase of the prescription charge for medical card holders and of the monthly household cap with a related increased co-payment of drugs, a higher Drug Payment Scheme threshold, a reduction in professional fees for health service providers (such as General Practitioners—GPs—and community pharmacists) and a replacement of a medical card with a card covering only GP visits for certain categories of beneficiaries. Some of these measures require additional legislation or other implementing steps.<sup>16</sup> Moreover, an important share of the overall savings (some EUR 308 mn out of EUR 781 mn)<sup>17</sup> are expected to result from enhanced efficiency and improved work arrangements to be delivered under the provisions of the Public Service Agreement 2010-2014 (known as the Croke Park agreement) and its recently negotiated successor. Many of these savings had been counted upon already in the context of the 2012 Budget, but in the event failed to materialise. To control the 2013

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GDP). These estimates do not account for any potential shortfall, relative to residual book value, following the sale of IBRC's assets, which the government would need to cover.

<sup>15</sup> Recall that the general government deficit is intended net of one-off deficit-increasing financial sector measures, which are excluded from the programme and EDP deficit targets.

<sup>16</sup> For example, the reduction of the income threshold for eligibility to medical cards for people over 70 years old, the implementation of some provisions under the new Croke Park agreement and the charging of private patients for the use of public beds require legislation (to be enacted by the end of Q2 2013). The reduction of professional fees and the increase of private and public inpatient charges require regulations (to be introduced in the course of 2013 ).

<sup>17</sup> The detailed breakdown of the total estimated savings of EUR 781 million is as follows: (i) EUR 323 million from primary care schemes (reduction in cost drugs, increase prescription charges, reduced professional fees. Increase DPS threshold); (ii) EUR 308 million in pay related savings (of which EUR 150 million from the new Croke Park agreement); (iii) EUR 65 million increased generation of private income; and (iv) EUR 85 million from other efficiency savings.

budget implementation, the authorities have agreed to set up an improved dedicated monitoring system to track the implementation of health consolidation measures and spending plans. The enhanced reporting requirements to the Cabinet Committee on Health and the Troika (which will get monthly briefings) should allow early detection of any slippage and timely corrective action, if necessary, so as to assist in the adherence to the overall budgetary plans. This is a first step in the right direction and should improve the chances of consolidation measures being fully implemented. Commission Services will nevertheless monitor progress closely and on a regular basis. Long-standing reform plans (in particular the introduction of a full unique patient identifier system, the full recovery of costs from treating private patients in public hospitals and the implementation of the "money-follows-the-patient"—MFTP—principle) should be given renewed momentum as well to improve the efficiency and cost-effectiveness of the sector. In this context, recent policy commitments to MFTP and new programme commitments on eHealth are welcome, but implementation of key initiatives such as an individual health identifier (see Box 2) will depend on finalisation, enhancement, and swift adoption of legislation for which renewed political commitment appears warranted.<sup>18</sup> The authorities have also agreed to setting high level annual targets for increasing the share of generic drug usage in the medium-term. Enabling measures required for the achievement of these targets—such as compulsory prescription by International Non-propriety Name (INN) where appropriate—are to be put in place. These targets, as well as the effectiveness of all recent and on-going initiatives aimed at reducing drug costs and increasing the share of generics in the Irish market, should be kept under close review.

**The government completed negotiations with the public sector unions at the end of February on an extension of the Croke Park agreement to deliver further efficiency gains.** The objective is to achieve savings of EUR 1 bn on the pay and pensions bill by 2015. These would result from longer working week for all staff, cuts to overtime and premium payments, a continued pay freeze, a suspension in the tenure-related salary increases (so-called increments) and pay cuts for higher earners. The agreement needs to be ratified, including by ballots. The actual modifications to work arrangements/terms would subsequently be implemented, including in some cases by way of legislation. The target date for entering into force is 1 July 2013. Effective implementation of the agreement will be reflected in the Revised Estimates to be published by end-March detailing the spending allocations set in the 2013 budget. The full details of the measures will be assessed at that point. As stressed on other occasions, necessary savings need to be secured while ensuring at the same time that the delivery of essential public services is not compromised.

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<sup>18</sup> Legislation to this effect, i.e. The Heads of the Health Information Bill, was published in 2009 but was not pursued further.

**Table 2: Fiscal accounts (2012-13)**

EUR million	2012			Jan-Feb Outturn	2013		
	2013 Budget estimate	Outturn	Outturn vs estimate		2013 Budget	Updated EC forecasts	EC forecasts vs budget plans
<b>Revenue</b>	<b>51 210</b>	<b>51 838</b>	<b>628</b>	<b>8 471</b>	<b>52 887</b>	<b>53 214</b>	<b>327</b>
<b>Tax revenue</b>	<b>43099</b>	<b>43 687</b>	<b>589</b>	<b>7038</b>	<b>45370</b>	<b>45710</b>	<b>340</b>
Personal income tax	15040	15 176	136	2614	15860	16000	140
VAT	10190	10 171	-19	1978	10560	10560	0
Corporation tax	4010	4 216	206	157	4135	4235	100
Excise duties	4615	4 707	92	650	4920	5020	100
Social contributions (PRSI & NTF) <sup>1</sup>	6934	7 041	107	1223	7420	7420	0
Other taxes	2310	2 377	67	416	2475	2475	0
<b>Appropriations-in-Aid</b>	<b>4 027</b>	<b>4 009</b>	<b>-18</b>	<b>349</b>	<b>3787</b>	<b>3787</b>	<b>0</b>
Health current receipts	1 496	1 494	-2	168	1460	1460	0
Education current receipts	935	911	-24	115	956	956	0
Other current receipts	1 261	1 265	4	64	1036	1036	0
Capital A-in-As	336	339	3	2	334	334	0
<b>Non-tax Revenue</b>	<b>2770</b>	<b>2 819</b>	<b>49</b>	<b>311</b>	<b>2360</b>	<b>2347</b>	<b>-13</b>
Central Bank Surplus Income	958	958	0	0	1040	1040	0
Bank Guarantee Fees	1025	1 025	0	210	433	433	0
National Lottery Surplus	220	220	0	35	220	220	0
Dividends	112	112	0	0	254	294	40
Interest on contingent capital notes	300	300	0	47	300	247	-53
Other	155	204	49	19	113	113	0
<b>Capital receipts</b> <sup>2</sup>	<b>1314</b>	<b>1 323</b>	<b>9</b>	<b>773</b>	<b>1370</b>	<b>1370</b>	<b>0</b>
<b>Below-the-line financial receipts</b>				<b>1010</b>		<b>2310</b>	<b>2310</b>
Sale of CoCos in the Bank of Ireland				1010		1010	1010
Sale of Irish Life Limited						1300	1300
<b>Expenditure</b>	<b>64 412</b>	<b>64 202</b>	<b>-210</b>	<b>10 264</b>	<b>64 926</b>	<b>66 133</b>	<b>1 207</b>
<b>Current voted (gross)</b>	<b>52314</b>	<b>52 172</b>	<b>-142</b>	<b>8619</b>	<b>51068</b>	<b>51068</b>	<b>0</b>
Social Protection	20764	20 741	-23	3331	20246	20246	0
Health	13 920	13 900	-20	2481	13627	13627	0
Education	8 551	8 534	-17	1445	8514	8514	0
Other	9079	8 997	-82	1362	8681	8681	0
<b>Current non-voted</b> <sup>2</sup>	<b>7482</b>	<b>7 471</b>	<b>-11</b>	<b>1404</b>	<b>9579</b>	<b>9786</b>	<b>207</b>
Interest	5685	5 662	-23	866	7225	7925	700
Debt management expenses	160	160	0	17	163	163	0
Promissory Notes interest	13	13	0	0	506	13	-493
EU Budget Contribution	1390	1 393	3	466	1444	1444	0
Other non-voted (ex-SF)	234	242	8	55	241	241	0
<b>Capital expenditure</b>	<b>4616</b>	<b>4 559</b>	<b>-56</b>	<b>241</b>	<b>4279</b>	<b>5279</b>	<b>1000</b>
Exchequer capital funding (gross)	3854	3 828	-26	241	3435	3435	0
FEOGA	760	730	-30	0	800	800	0
ELG claim cost (IBRC liquidation)						1000	1000
Other	1	1	0	0	44	44	0
<b>Below-the-line financial transfers</b>	<b>2528</b>	<b>2 527</b>	<b>-1</b>	<b>154</b>	<b>3361</b>	<b>794</b>	<b>-2567</b>
Promissory Notes principal <sup>2</sup>	12	12	0	0	2579	12	-2567
Loans to Insurance Compensation Fund	456	456	-1	154	272	272	0
Irish Life Limited	1300	1 300	0	0	0	0	0
ESM capital payment	510	510	0	0	510	510	0
Credit Union Funding	250	250	0	0	0	0	0
<b>Exchequer balance</b> <sup>3</sup>	<b>-15 730</b>	<b>-14 891</b>	<b>839</b>	<b>-936</b>	<b>-15 400</b>	<b>-11 403</b>	<b>3997</b>
Below-the-line financial transfers	2528	2 528			3361	794	-2567
Below-the-line financial receipts						-2310	-2310
Local government sector	-125	-125			0	0	0
Promissory Notes interest accrual adjustment	0	0			-1382	1	1383
Accrual adjustments and other below-the-line operations	-2	-2			775	733	-42
<b>General government balance</b> <sup>4</sup>	<b>-13 305</b>	<b>-12 490</b>			<b>-12 645</b>	<b>-12 185</b>	<b>460</b>
% of GDP	-8.2	-7.7	---estimate		-7.5	-7.3	

Sources: End-February 2013 Exchequer statement; 2012 Stability Programme; 2012 budget; 2013 budget and Commission Services estimates

Notes:

1 Pay Related Social Insurance (PRSI) is a social contribution, but National Training Fund (NTF) levy is direct taxation.

2 Excludes Sinking Fund transfer from current to capital account and loan/repayment to/from the Social Insurance Fund, which are the Exchequer deficit neutral.

3 In 2012, annual repayment of promissory notes in IBRC (EUR 3.06 billion) were financed by a government bond placement. In February 2013, all promissory notes in IBRC were exchanged for government bonds. This operation is estimated to reduce accrual interest expenditure by EUR 1.2 billion in 2013, partly offset by one-off ELG claim cost of EUR 1 billion. Remaining promissory notes in EBS will be repaid overtime (EUR 25 million annual payment, including principle and interest).

4 The government balance excludes one-off deficit-increasing financial sector measures.

**Table 3: Change in fiscal balance between 2012 and 2013**

% of GDP	2012	2013	change
<b>Government deficit</b>	<b>-7.7</b>	<b>-7.3</b>	<b>0.4</b>
Primary balance	-3.8	-2.4	1.4
Interest expenditure	-3.9	-4.8	-1.0
<b>Main factors explaining change in primary balance</b>			<b>1.4</b>
Fiscal adjustment measures			2.5
One-off mobile telephony license sale revenue in 2012			-0.4
Revenue from ELG fees (ELG scheme ends in March 2013)			-0.4
One-off ELG claim cost in 2013 (related to IBRC liquidation)			-0.6
Other (including growth effect, demographic pressures)			0.3

Source: Commission Services' calculations.

Note: Fiscal adjustment measures include the committed effort of EUR 3.5 bn for 2013 and measures offsetting the 2012 overruns in health sector of EUR 0.7 bn.

### **Box 2: Improving health care through the establishment of Health Identifiers**

Quite aside from the short term pressures which the cost-containing measures identified in the 2013 Budget should—if fully and timely implemented—help to address, the Irish health care sector suffers from several complex structural problems, including high prices for prescription medication, inefficient prescriber practices, high levels of duplication in data processing, and a lack of transparency and professionalism in financial management. A 2012 external report on Irish health care services commissioned by the authorities found that only 10% of HSE staff with financial management responsibilities were suitably qualified (the corresponding share for the UK was 25%).

The authorities are aware of these problems. For example, during the mission, they indicated that they plan to develop an eHealth strategy in conjunction with the HSE, including a comprehensive system of ePrescription. Moreover, in February they also published a policy paper on hospital financing aiming at introducing a "money follows the patient" MFTP funding model.

While these reforms are welcome and necessary, priority should be given to creating a system of Individual Health Identifiers (IHI), such as the PPSN, and Health Provider Identifiers (HPI), linked to a secure and dedicated health information system, in respect of applicable provisions on the protection of personal data. Such a system is a necessary first step to wider reform, and would yield, in addition to patients' safety, benefits in terms of:

- **Financial planning and control:** Tracking care by IHI and HPI would allow for a continuous monitoring of prescription practices and pharmaceutical spending, thus ensuring a clearer understanding of where resources are most needed, and where inefficiencies can be tackled
- **Financial systems reform:** Tracking and linking episodes of care for a given patient is an enabler for wider financial reforms in healthcare.
- **Other eHealth reforms:** A UPI is an essential prerequisite for the introduction of a system of comprehensive ePrescription, which should be pursued as a matter of priority in order to reduce public expenditure on medicinal products, enhance public health monitoring and improve efficiencies across the entire prescription chain.

By international comparison, Ireland is starting late on this process; by 2010, 18 EU Member States already had UPIs in place. In a way, this could be a benefit, as it will allow Ireland to learn from international best practice. However, it is imperative that existing policy commitments – such as those laid out in the Future Health strategy – be acted upon with urgency.

In a 2011 report<sup>19</sup> on the issue, the Health Information and Quality Authority (HIQA) recommended the establishment of a dedicated group of stakeholders, consisting of representatives

<sup>19</sup> [Recommendations for a Unique Health Identifier](#), (2011) Health Information and Quality Authority

from HIQA, the Department of Health and Children, the DSP, the Department of Finance and the Data Protection Commissioner, to determine the technical format, governance arrangements, costings and roadmap for implementation of the identifier.

**Medium term fiscal plans released in November 2012 are consistent with the consolidation needs under the programme, but could be further specified to eliminate residual uncertainty about the measures involved.** The authorities have reiterated their commitment to observe the annual deficit ceilings agreed under the excessive deficit procedure (EDP) and bring the deficit below 3% of GDP by 2015 (Table 4). However, they have not yet identified the specific measures that would deliver the aggregate adjustment effort in each year, although they have announced a new Comprehensive Expenditure Review starting in 2013 that will provide options for fiscal adjustment in 2014-15. The Troika has once again encouraged the authorities to spell out the policy intentions in the key spending areas of education, health, and the welfare sector to buttress the credibility of their announced consolidation path (including from the perspective of successfully exiting the programme). The upcoming 2013 Stability Programme (due in April) and the 2014 Budget—which, reflecting euro area-wide legislative changes (the "two-pack"), will be advanced to mid-October this year—will provide ample opportunity for the authorities to do so. Advances have been achieved in terms of medium-term budgeting, but additional efforts are called for to ensure that the multi-annual expenditure ceiling framework is fully aligned with the emerging EU requirements and standards (see Box 3).

**Table 4: Fiscal adjustment to 2015**

% of GDP	2011	2012	2013	2014	2015
Underlying Government balance (EDP) <sup>1</sup>	-9.1	-7.7	-7.3	-4.2	-2.1
Primary balance	-5.7	-3.8	-2.4	0.7	2.9
Interest expenditure	-3.3	-3.9	-4.8	-4.9	-5.0
EDP deficit ceilings	-10.6	-8.6	-7.5	-5.1	-2.9
Committed permanent measures <sup>2</sup>	3.5	2.7	2.1	1.8	1.1
Government gross debt	106.4	117.2	122.2	120.1	117.1

Source: Budget 2013 and Commission services estimates

Notes: <sup>1</sup> The underlying deficit excludes one-off deficit-increasing financial sector support measures of 4.3% of GDP in 2011 and possible measures over the forecast period.

<sup>2</sup> For details please see Table 2 and 3 in the Autumn 2011 review report. The adjustment in 2012 and 2013 does not account for the 2012 slippage in implementation of health sector measures, which will be realised in 2013.

**Box 3: The Irish Medium-term Expenditure Framework from the EU economic governance perspective: scope for further development**

**Significant progress has been made to ensure greater accountability in the budgetary process and to introduce an effective multi-annual framework.** The Fiscal Responsibility Act 2012 introduced rules on budget balance and debt and established the Fiscal Advisory Council on a statutory basis. The *Comprehensive Expenditure Report 2012-2014* (CER) published in December 2011 introduced “Ministerial expenditure ceilings” on an administrative basis, i.e. three-year allocations of current expenditure to each Minister/Department, which the *Ministers and Secretaries (Amendment) Bill 2013* aims to extend and put on a statutory footing. The bill would empower Government to set out an overall ceiling for aggregate expenditure for each of the following three years (on the basis of a proposal from the Minister for Finance), and to apportion the aggregate ceilings into Ministerial expenditure ceilings (on the basis of a proposal from the Minister for Public Expenditure and Reform). The subsequent annual objectives for expenditure, setting out the detailed expenditure proposals for the coming year, would have to respect the overall Government expenditure ceiling for that year.

**Commission Services have identified areas where the multi-annual expenditure framework could/should be strengthened,** as in its present form it may not adequately reflect the requirements of the EU fiscal framework Directive, the recommendations of the Economic Policy Committee and international best practice. In particular, further efforts should be made to:

- (i) *ensure consistency with the new EU fiscal surveillance framework.* The design features and provisions of expenditure rules should contribute to keeping government spending in line with the expenditure benchmark included in the preventive arm of the SGP in order to effectively sustain the achievement of the MTO. At present, the multi-year expenditure ceilings cover a somewhat different aggregate than defined by the SGP's "expenditure benchmark". Specifically, “government expenditure” in the context of the abovementioned *Ministers and Secretaries (Amendment) Bill* is defined as the expenditure voted by the Dáil each year and excludes: (i) debt service costs; (ii) non-voted expenditure financed directly from the "central fund" (judges' pay, and the budgets of the Houses of Oireachtas and the Fiscal Advisory Council); and (iii) expenditure by local governments and non-market public corporations. In contrast, the EU expenditure benchmark<sup>20</sup> is set for general government sector excluding interest expenditure, non-discretionary changes in unemployment benefit expenditure and discretionary expenditure increase fully offset by discretionary revenue-increasing measures.<sup>21</sup>
- (ii) *copper fasten the binding nature of the ceilings and spell out limited revision circumstances.* Whereas ceilings should be binding, the current proposal allows for ad hoc revisions without specific circumstances predefined in the law or clear and detailed explanation.
- (iii) *put the expenditure ceilings provisions on a legal footing.* Current arrangements are based on circulars implementing the details of the ceilings, leaving much leeway for discretionary changes to the framework.<sup>22</sup>
- (iv) *fully lay out correction and sanction mechanisms.* The consequences for non-compliance are thus far not well defined, and in particular not in the Bill itself.

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<sup>20</sup> See the revised preventive arm of the SGP ([EU Regulation 1175/2011 Art 9](#) amending EU Regulation 1466/97) introducing the expenditure benchmark.

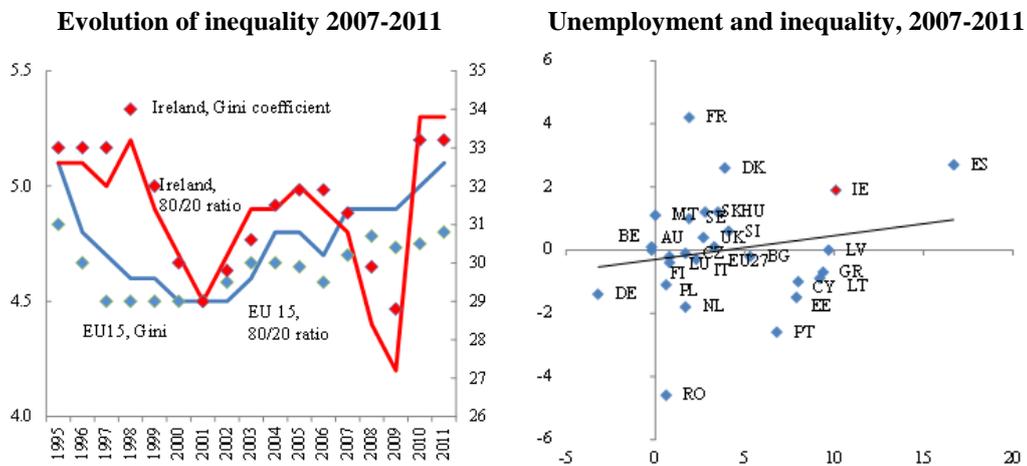
<sup>21</sup> The EU framework also allows adjusting the expenditure aggregate subject to a ceiling for the temporary effects of 'exceptional circumstances' and other one-off measures. The definition and application of 'exceptional circumstances' should be in line with the SGP. The treatment of one-off and temporary measures should follow the SGP ([Code of Conduct](#)) and EU Commission's guidelines (Public Finance in EMU, 2006, Part II, Section 4.2).

<sup>22</sup> Technical discussions are continuing on the interpretation of Irish law and the related implementation of the medium-term expenditure framework.

**Box 4: The effects of the crisis on income inequality in Ireland**

After receding in the last years of the 90's, income inequality in Ireland and elsewhere in Europe has set off on an increasing trend. While inequality in Ireland experienced a somewhat more pronounced increase through 2005-06, it declined appreciably over 2007-09, while elsewhere in Europe it continued to trend up (left chart below). This reduction in inequality in Ireland can be attributed to rapid employment and wage gains across the skills distribution during the bubble years, as well as the progressivity of early consolidation measures (e.g. tax base broadening and public service pay cuts) and generous increases in social payments (unemployment benefit rates increased by 6% in 2008 and 3% in 2009, against average wage growth rates of +5% and -1% respectively).

In the aftermath of the crisis, inequality has increased again in Ireland, basically back to the pre-reduction trend. A key factor that may explain the sharp reversal appears to be the large increase in unemployment, as shown in the right chart below. This underscores the importance of reducing unemployment and building on the recent modest employment gains (see Section 5.3 below) as well as ensuring that the burden of the necessary fiscal consolidation is fairly shared, particularly that the most vulnerable people are protected to the largest possible extent. From this perspective, and as mentioned above,<sup>23</sup> the consolidation in Ireland has, overall, been quite progressive, although the last two budgets have had—individually taken—some marginally regressive impact.



Note: Left-hand side 80/20 income quintile share ratio. Right-hand side: Gini coefficient. Source: Eurostat and Commission Services' calculations.

Note: X-axis: Increase in unemployment, Y-axis: Increase in Gini coefficient. Percentage points, Source: Eurostat and Commission Services' calculations

**Commission Services reiterated their call for the government to ensure that the burden of the remaining consolidation is spread fairly across income groups.** In Ireland, and in Europe, the crisis has resulted in increased income inequality (see Box 4). This underscores the need to carefully consider the distributional impact of consolidation measures.<sup>24</sup> Analysis from the ESRI on a subset of the 2013 Budget consolidation

<sup>23</sup> This point has been made by researchers at ESRI, see for example ["Budget 2013: Distributional Impact"](#) on the ESRI website.

<sup>24</sup> This point was forcefully made by several stakeholders during the mission, including the Society of Saint Vincent de Paul and the European Anti-Poverty Network. Both organisations stressed that, to properly understand how the most vulnerable have been impacted by different measures, it would be important to look not only at income trends but also at access to frontline public services.

measures<sup>25</sup> found that they have had overall a somewhat *regressive* impact, having reduced income proportionally somewhat more for the lowest income quintile than for the highest income quintile. An important caveat to keep in mind is that the ESRI model does not include all of the measures and there are reasons to believe that some of the measures left out of the analysis (such as capital gains taxes, the deposit interest retention tax, and the change in the universal social charge for the elderly) have a more progressive impact. Moreover, ESRI points out that Ireland's cumulative consolidation efforts, i.e. beginning with Budget 2009, have overall had a progressive effect on income distribution.

## 5.2 Financial sector policies

*Despite the important progress made in restructuring the domestic banking sector, considerable challenges remain. In particular, the high and growing level of NPLs and the uncertainty about associated potential future losses, together with low profitability, are hampering banks' ability to contribute to the recovery through extending productive lending to the economy. The authorities have stepped up their efforts in this key area, including by setting targets for durable treatment of NPLs, removing the costly ELG scheme for new liabilities from end March, and committing to publishing shortly legislation to remove unintended impediments to banks' ability to recover collateral of loans in default. Going forward, it is essential that banks' operational restructuring continues apace and that remaining uncertainty on asset quality is dispelled through a rigorous stress test (PCAR 2013) before the end of the programme. The authorities reserved their position on this matter, as they consider that Ireland should conduct the next bank stress test in the context of the EBA EU-wide exercise.*

**Long-term arrears have continued to increase underscoring the need for stepped up engagement with banks.** Loan balances in arrears for more than 360 days reached 10.8% of banks' aggregate mortgage book by end-December (up from 9.7% at end-Q3), including both PDH (primary dwelling houses) and BTL (buy-to-let or investment properties). Half of this cohort of loans has now been in arrears for 720 days or longer. Given the much reduced cure probability for these loans it is essential that banks appropriately provision for them and engage meaningfully with distressed mortgage debtors to implement durable loan modifications. In March 2013 the authorities set public targets<sup>26</sup> for the principal mortgage banks<sup>27</sup> to propose sustainable solutions to 50% of their mortgage debtors in arrears by more than 90 days by the end of 2013. This is a welcome initiative but the key test of sustainability will be whether the terms of the restructured solutions are being adhered to on an ongoing basis. In light of this, the authorities have also set a target requiring the relevant banks to ensure that from Q1 2014 the terms of the modified loan agreements would be observed for 75% of all concluded restructurings. The public target for the number of arrangements to be concluded by the end of the year is yet to be finalized (expected to be announced at the latest by Q3) and

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<sup>25</sup> [http://www.esri.ie/\\_uuid/f1394f7f-aae3-49a6-94b1-c44c5edc60ac/Budget2013\\_Distributional\\_Impact\\_7Dec12.pdf](http://www.esri.ie/_uuid/f1394f7f-aae3-49a6-94b1-c44c5edc60ac/Budget2013_Distributional_Impact_7Dec12.pdf).

<sup>26</sup> <http://www.centralbank.ie/press-area/press-releases/Documents/Approach%20to%20Mortgage%20Arrears%20Resolution%20-.pdf>

<sup>27</sup> ACC Bank, Allied Irish Bank, Bank of Ireland, KBC Bank Ireland, Permanent Tsb and Ulster Bank

will be informed by the banks' experience with the level of uptake by distressed borrowers of the proposed offers.

**The high level of loan defaults on banks' balance sheets raises concerns about potential future losses.** In particular, the high level of mortgages in default<sup>28</sup> is a persistent source of concern. The recently published PCAR 2011 review<sup>29</sup> showed that at end-June 2012 the stock of mortgage loans in default for the covered banks stood at 82% of the total stock forecast for end-December 2013 under the PCAR 2011 stress scenario. This reflects an increase of 154% in the level of default stocks on the covered banks' balance sheets over the 18-month period from December 2010. While the pace of arrears' formation appears to be slowing against a background of tentative improvement in economic sentiment (there were 1.3% and 0.9% quarter-on-quarter declines in early arrears cases for PDH and BTL, respectively, in the quarter to December), mortgage loan balances in arrears of over 90 days past due continue to increase. These elevated levels of default stock could have potential adverse implications for future bank losses.

**This underscores the need to complete a robust PCAR exercise according to schedule to eliminate a key source of uncertainty and buttress a credible exit from the programme.** Extensive preparatory work within the CBI is continuing apace, aided by external expertise from BlackRock Solutions (BRS), to develop industry-standard loan loss forecast (LLF) models for each asset class, including mortgage, consumer, SME and corporate loans (the LLF model for commercial real estate exposures will be developed by BRS). In accordance with programme requirements, the specific features of the methodology for the next PCAR exercise will be agreed with the Troika by end-June 2013, following in-depth engagement in this area during the upcoming review mission in April. The authorities have confirmed that the models will be completed by end-April, which will be followed by a rigorous process of external validation by BRS. This should enable the next PCAR stress test to be completed, and results published, by end-Q3 2013. By eliminating a potential source of uncertainty, this would underpin a credible and durable exit from the programme. However the authorities reserved their position on the timing of the next PCAR, as they consider that Ireland should conduct the next bank stress test in the context of the EBA EU-wide exercise.

**Banks' incentives to durably address NPLs also need to be strengthened, including by reviewing and modifying the existing provisioning guidelines,**<sup>30</sup> which the authorities have undertaken to do by end-May. A key concern discussed during the mission is the treatment of restructured loans, especially through short-term forbearance, such as interest-only which accounted for over 37% of all mortgage restructuring arrangements at end-December. Under the existing guidelines a forbore loan may be reclassified as performing after six months of adherence to the modified loan terms by the borrower (thus resulting in a lower provision level), even in the absence of any track record of payment of principal. This appears insufficiently prudent given that the capacity

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<sup>28</sup> Defaults are defined as CRD Default i.e. greater than 90 days past due, or otherwise classified as "unlikely to pay."

<sup>29</sup> <http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/documents/pcar%202011%20review%20final.pdf>

<sup>30</sup> <http://www.centralbank.ie/press-area/press-releases/documents/impairment%20provisioning%20guidelines-%20central%20bank%20of%20ireland%20-%20decemeber%202011.pdf>

of the borrower to fully honour both interest and principal obligations under the loan would not have been adequately demonstrated. The updated guidelines should also ensure that banks' provisioning models clearly differentiate provisioning approaches based on the durability of the modification applied and the age of arrears. The models should rely on conservative, evidence-based assumptions for key performance-related parameters (e.g., emergence periods and cure rates) and prudent, consistent assumptions for system-wide parameters (such as time to repossession and disposal costs). Importantly, amortisation of principal for a specified period should occur before the gradual release of provisions is considered.

**The reform of the personal insolvency framework should facilitate addressing unsustainable debts, and work is proceeding towards activating the new Personal Insolvency Service with the objective to begin accepting applications from eligible borrowers in Q2 2013.** The Personal Insolvency Service aims to open its office, launch its website and commence an information campaign with the issuing of publications and relevant guidelines in March, including on reasonable standards of living.<sup>31</sup> The relevant regulatory and IT frameworks required for the Service to accept and process applications for the three new debt arrangements are expected to be put in place during the second quarter of this year. Eight Specialist Judges of the Circuit Court are envisaged to be appointed to deal with the large anticipated volume of work and to facilitate the speedy consideration of insolvency applications. The authorities should consider whether these judges should also be assigned to deal with repossession cases given their expertise in the area of personal insolvency. A cadre of specialist judges could increase the efficiency of the repossession regime and ensure that cases are treated in a consistent manner.

**There are increasing signs that some features of the Irish financial system may be affecting mortgage payment discipline.** Specifically, banks report that a significant number of consumers are prioritizing unsecured debt over the repayment of their secured mortgage debt. While this may be an attempt on the part of indebted borrowers to keep access to some source of credit by repaying the smaller debts first, it may also reflect the moral hazard generated by legal uncertainty about the banks' ability to recover the collateral underpinning a mortgage in default resulting from the so-called "Dunne judgment",<sup>32</sup> which therefore needs to be promptly eliminated. The ongoing review of the Code of Conduct on Mortgage Arrears (CCMA) should also help address these problems by providing greater clarity to borrowers and lenders. In particular, the definition of non-cooperating debtors and the frequency of contacts that a lender can make need to be further clarified,<sup>33</sup> as attested by several references to the CCMA in recent judgments. The authorities have committed to do so in the context of the ongoing review of the Code, which is to be completed by the end of Q2 2013. The review will also explore the scope

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<sup>31</sup> The personal insolvency regime and Personal Insolvency Bill (enacted in December 2012) were assessed comprehensively in the Spring, Summer and Autumn 2012 reviews of the economic adjustment programme for Ireland.

<sup>32</sup> See page 28 [http://ec.europa.eu/economy\\_finance/publications/occasional\\_paper/2012/pdf/ocp115\\_en.pdf](http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp115_en.pdf)

<sup>33</sup> The authorities have provided some clarification here:

<http://www.centralbank.ie/regulation/processes/consumer-protection-code/Documents/130107%20CCMA%20clarifications%20-%20FINAL%20web%20doc.pdf>

for permitting modifications of the interest rate setting mechanism when these are advantageous to the borrower in the long term.<sup>34</sup>

**A functioning credit register needs to be established promptly to enhance transparency and reduce credit risk.** The problems which arise in the absence of such a register are well illustrated by the fact that some lenders continue to provide unsecured credit to highly indebted borrowers without adequately checking their credit worthiness.<sup>35</sup> It is regrettable that the authorities consider that the programme objective to have an operational credit register in place before year-end might prove overly ambitious given the strains on the legal drafting resources. Commission Services expressed hopes that adequate resources could be found so as to observe this important programme objective.

**The removal of the ELG scheme for new liabilities from end-March will eliminate a significant drag on banks' profitability.** Despite the gradual decrease of covered liabilities (which declined to EUR 71 bn at end-January 2013 from a peak of EUR 153 bn in Q2 2010), ELG fees considerably reduce banks' pre-provision profits (net interest income at the covered banks for the first 6 months of 2012 was reduced by about 18% due to government guarantee fees).<sup>36</sup> The removal of the scheme for new liabilities is expected to produce aggregate 12-month savings of about EUR 0.9 bn across the covered banks, though the full impact on profitability is likely to materialise only in 2014, given the maturity profile of covered liabilities. As this would reduce banks' overall funding costs, exit from ELG should also help enhance the impaired credit channel and facilitate the extension of more affordable new lending to the economy.

### 5.3 Structural reforms

*Labour market issues continue to dominate the structural reforms agenda, reflecting policy priorities and the pressing need to put (long-term) unemployment on a sustained downward path. Reforms are progressing well on the three fronts pursued by the authorities (job creation, labour activation and further education and training), but are at times slow and not wide enough. Other priority areas for structural reforms include the sale of selected state assets, competition policy, and the reform of the water sector, where the restructuring process aimed at establishing a national public utility and introducing charges for domestic users has gathered pace in recent months.*

**The Action Plan for Jobs is at the core of Government efforts to foster job creation.** The Action Plan for Jobs 2013 builds on the initiatives introduced in last year's plan

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<sup>34</sup> While the Code was modified following the recommendations of the Expert Group on Mortgage Arrears to protect borrowers from lenders' attempts to secure borrowers' consent to modification of the original terms of a mortgage which may be disadvantageous to the borrowers' interest (<http://www.finance.gov.ie/documents/publications/reports/2010/mortgagearrearsjul.pdf>) at present the Code does not allow *any* movement off a tracker for borrowers in arrears, which in many cases discourages payment discipline and even prevents the mutual agreement by debtor and lender on substantive loan modification addressing cases of unsustainable debts.

<sup>35</sup> In light of this issue the Irish Banking Federation (IBF) have published an unsecured debt protocol for its members, which envisages lenders and customers working together both to prioritise the home loan payment and to restructure the customers' remaining debts on an appropriate basis. While this protocol is welcome, there are questions on its effectiveness arising for example from the fact that it does not cover Credit Unions and utilities.

<sup>36</sup> Coverage of the ELG scheme was more extensive in Ireland than in other EU countries with guarantee schemes on bank liabilities, in that it covered also very short-term maturities and deposits.

(some 92% of which have been found to have been implemented in the course of the year), but has been prepared in much closer cooperation with business associations, trade unions and academia. It also departs from the 2012 plan in that it introduces "disruptive reforms" that the authorities seek to promote as major breakthroughs, in addition to business facilitation, promotion of FDI or sectoral initiatives. Key among the "disruptive measures" are: (i) a scheme to subsidise the recruitment of long-term unemployed to the tune of up to EUR 7,500 or EUR 10,000 per person over a two-year period;<sup>37</sup> (ii) increased availability of ICT skills (through additional training facilities and foreign recruits<sup>38</sup>); and (iii) a streamlined process to grant business licences through an integrated application system. In addition, the Action Plan 2013 will seek to catalyse up to EUR 2.5 bn of funds to SMEs (loans and capital). Implementation will again be subject to a quarterly monitoring process, with the welcome development that six senior representatives from industry will be appointed to the implementation monitoring group. Regrettably, a proper impact assessment component appears to be still missing.

***Intreo* offices are being rolled out according to plan, but capacity to engage meaningfully with the (long-term) unemployed remains short.** Around 20 offices are expected to be established in 2013, bringing the total to 30 by year-end. This is still short of nationwide coverage, which is not expected until end-2014. *Intreo* offices are phasing in the profiling of jobseekers to prioritise and target limited activation resources. New entrants to the Live Register are now systematically profiled to determine the levels of priority and engagement, with the largest efforts focused on those with greater needs and lower chances of finding new employment on their own.<sup>39</sup> Profiling has yet to be extended to the large number of long-term unemployed and is of little use beyond prioritising efforts. Yet, its use as the entry point for the engagement process makes critical that it be extended.

**Engagement with the unemployed under a case-management approach is gaining ground but needs to be extended more widely.** Building on the initial profiling and assignment of priorities, *Intreo* case managers have begun holding one-to-one sessions with job seekers. More detailed information on jobseekers is collected during the first session and a "personal progression plan" is drawn up. Once they join in the activation process, jobseekers are meant to engage at regular intervals with their case manager. Contact with the unemployed with a low or medium probability of exit is to be more frequent.

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<sup>37</sup> Employers recruiting off the Live Register would receive, for a maximum duration of two years, a monthly payment (in arrears) of about EUR 96 per week for jobseekers who have been unemployed for more than 24 months, or about EUR 72 per week for jobseekers who have been unemployed between 12 to 24 months. This is to be compared with a minimum wage of EUR 8.65 per hour, or EUR 346 per week for a 40-hour week. Once operational, this scheme will replace the employer job (PRSI) incentive scheme, which had very limited effect, with only around 1,000 hirings under the scheme in 2012.

<sup>38</sup> The Action Plan foresees room for the attribution of up to 700 work permits for IT specialists from outside the European Economic Area (EEA), in addition to promoting recruitment from within the EEA.

<sup>39</sup> Profiling entails the collection of basic information about jobseekers to assign them a "probability of exit". The probability of exit is used as a proxy to assess individual needs for supportive services and the level of engagement required, with those with a low or medium probability granted priority attention. The information collected at the profiling stage is too basic to be used for further activation purposes, including potentially for matching jobseekers with vacancies.

**Resources within the Department of Social Protection (DSP) need to be redeployed increasingly towards engagement.** The small number of case managers and *Intreo* offices so far means that Ireland faces difficulties in widening the scope and increasing the frequency of engagements especially for the long-term unemployed. The DSP will seek to double the number of case managers in 2013 and further increase it in 2014, entirely through redeployment of existing staff.<sup>40</sup> These critical and urgent redeployment efforts should be complemented with the provision of adequate training to case managers,<sup>41</sup> as most will have to assume tasks that are new to them, including the assessment of training needs and job-search abilities, and the need to establish long-term relationships with employers and assess their hiring requirements.

**The process to outsource additional resources for engagement activities and other activation measures needs to be accelerated.** Outsourcing provides an efficient way to complement *Intreo's* services rapidly and temporarily, as the demand for activation services will fall with the expected reduction in unemployment. The authorities have considered this option, but the process has faced repeated delays. The authorities have tasked external experts recently to advise them on contract design and will review their options on this basis in March. Timely progress is essential given the urgent need to engage with all long-term unemployed and capacity constraints within the DSP.

**Employment support schemes need to be increasingly geared towards activation.** The DSP conducted several evaluations of its schemes covering: (i) work programmes; (ii) internships; (iii) training and education; and (iv) self-employment support.<sup>42</sup> Close to 55% of around EUR 870 mn spent on employment support schemes in 2012 were devoted to work programmes, in particular Community Employment, that serve a definite social purpose but have at best an extremely weak activation and back-to-work component, and at worst trigger "subsidised employment" traps. The DSP reviews recommend reforms to enhance the market orientation of the existing schemes and boost their effectiveness in promoting a return to the open labour market. Recommendations include the amalgamation of certain schemes, increased use of referrals, imposing stronger job-search requirements and stricter duration limits. It is important that these DSP recommendations are acted upon quickly, in consultation with the relevant stakeholders, so as to ensure that the resources mobilised for activation purposes generate a proper return in terms of putting people back to non-supported work.

**Reforms to further education and training (FET) will be critical to re-skill the long-term unemployed.** Structural changes in the economy over the past few years have generated significant skills mismatches,<sup>43</sup> which makes the successful completion of the

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<sup>40</sup> The DSP reports that it had about 300 people doing case work / employment services duties as of end-2012.

<sup>41</sup> The mission had fruitful discussions on this issue with the Irish National Organisation of the Unemployed during the review.

<sup>42</sup> A Review of Department of Social Protection Employment Support Schemes (DSP, November 2012); High-Level Issues Paper Emanating from a Review of Department of Social Protection Employment Support Schemes (DSP, November 2012); Indecon's Interim Evaluation of JobBridge (Indecon, October 2012).

<sup>43</sup> The skills mismatch is particularly acute for the long-term unemployed and is reflected in figures on unemployment by education, with an unemployment rate of 25.4% for those with at most lower secondary education, 16.8% for those with upper secondary education and 6.6% for those with tertiary education.

on-going reforms of the further education and training system vital. Under a recently adopted action plan, SOLAS will provide strategic guidance to the sector and allocate funding to Education and Training Boards (ETBs), which are to be established through the amalgamation of existing Vocational Education Committees (VECs) and FÁS training centres.

**FET programmes should become increasingly client- and market-oriented under SOLAS strategic guidance.** It will be critical to ensure that FET programmes are assessed thoroughly in terms of scope, content, relevance for prospective employers, and needs, abilities and constraints of the (long-term) unemployed. The authorities' commitment to undertake a strategic review of FET provision is therefore welcome. To ensure the relevance of this review and its recommendations, it will be important to consult fully with stakeholders, including in particular the business community and the Expert Group on Future Skills Needs. Regular reviews of curricula and programmes should also be planned in the future. In addition, a stronger representation of social partners than is currently envisaged under the ETB Bill 2012 should be considered in order to adequately involve them in the design and implementation of education and training policies and properly attune training provision with labour market needs. Reforms beyond those already envisaged could also be considered, including to support businesses in the provision of continuous training to their employees.

**The course now appears firmly set to introduce water charges for domestic users in early 2014, broadly in line with the programme.** The implementation of the water reform strategy has gathered momentum in recent months. Under the interim Bill published in January 2013, Irish Water will have the legal authority to install meters (with installation expected to begin in July and to generate around 1300 jobs) for households and borrow to finance its costs<sup>44</sup>. The Bill, which is due to be enacted before end March, will also abrogate the ban on water charges for households as currently provided for in the Water Services Act 2007.

**Significant uncertainty still surrounds the future level and structure of water charges.** The CER, which will be granted regulatory oversight over the sector, will launch consultations this summer to determine the future methodology to assess water charges for households. Public acceptance will require that a fair and equitable structure of charges be devised on an assessed as well as on a metered basis, as the two systems will coexist until the installation of the meters is completed (which could take up to three years). The authorities also have yet to take a decision regarding affordability measures and the pace at which they will phase out Exchequer support to Irish Water and make it essentially self-funded. In addition to these decisions on pricing issues, the authorities also need to draft a comprehensive new Water Bill to transfer the operation of the sector from local authorities to Irish Water and vest full regulatory powers to the CER. A draft Bill should be published by Q3 2013. Major strategic, legal and operational work therefore still lies ahead for the authorities and Irish Water in order to introduce charges for households in early 2014 and complete the full restructuring of the sector by 2017.

**The Competition Authority has started making use of the enhanced enforcement powers it gained under the Competition (Amendment) Act 2012.** An agreement between the Authority and a distributor of imported footwear to put an end to resale price

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<sup>44</sup> Financing will be provided by the National Pension Reserve Fund on commercial terms.

maintenance practices was made binding and enforceable by a High Court order in February. The order means that a breach in the agreement by the distributor would constitute a contempt of court and expose it to sanctions. Although the case itself is relatively minor, it constitutes a significant precedent as it shows that the Authority is willing to make use of its new enforcement mechanisms. In addition to increased enforcement powers, the Authority has now completed the selection process for the 10 additional posts it received in 2012 (a 25% increase in staff). Three officers have already started working, while the remaining seven have been selected and should join soon.

**The establishment of the new legal services regulatory framework is experiencing further delays.** The Legal Services Regulation Bill, introduced in October 2011, is still awaiting Committee stage, where substantial amendments are expected to address *inter alia* concerns over the independence of the future Legal Services Regulatory Authority from government, legal costs and training. The authorities have attributed these delays to emerging capacity constraints, especially in terms of legal drafters. Given the importance of this reform in relation to the high legal costs in Ireland,<sup>45</sup> adequate progress should be achieved in a timely fashion.

**Progress has been made towards the sale of certain state assets identified for disposal, and consideration is being given to the future use of parts of the proceeds in support of job creation.** The most notable progress concerns Bord Gáis Energy (BGE), for which financial and legal advisers have been appointed on both sides (Government and BGE). The Electricity Supply Board has recently announced its intention to sell its 50% stake in two of its international tolling plants in the U.K. and Spain and financial advisors have been engaged. Coillte, in turn, is still subject to preparatory and technical work by outside consultants. Separately, the proposed take-over of Aer Lingus by Ryanair was blocked by the European Commission on the ground that it would have led to a monopoly or dominant position on a large number of routes out of Dublin. Ryanair, which is already the largest shareholder in Aer Lingus with a 29.8% stake, indicated that it would appeal the ruling.<sup>46</sup> This is likely to further delay the Government's attempts to sell its 25% stake in the company. Under the EU/IMF programme, the Government is committed to use at least half of the privatisation proceeds for eventual debt reduction, while the remainder could be invested in growth-enhancing projects. The authorities have begun work to identify projects on the basis of their employment impact and alignment with government priorities. They have however provided only limited information yet about the potential projects, so at this stage it is difficult to assess their likely timing and impact.

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<sup>45</sup> In addition to high costs, the European Commission's Consumer Markets Scoreboard indicates that Ireland ranks fourth from the bottom in terms of consumer assessment of the market for legal and accountancy services. The issue of high legal costs has been discussed in previous reports—see for example page 42 of Autumn 2012 review, *op. cit.*

<sup>46</sup> A separate investigation into Ryanair's stake is being carried out by the U.K. Competition Commission and could affect the ability of the Irish Government to dispose of its shares in Aer Lingus, as it may require Ryanair to divest its minority stake.

## 6. Financing issues

*Recent successful debt issuances and the sale of some assets have further strengthened the government's cash position, while the replacement of the promissory notes with longer-term debt has improved the funding outlook. The authorities remain intent on building a substantial cash buffer sufficient to cover expected financing needs for 12 to 15 months beyond the completion of the ongoing programme. Discussions were launched on options to underpin a durable return to market funding, and these are slated to continue in the weeks and months ahead.*

**The completion of this review will allow a disbursement of EUR 1.6 bn from the EFSF.** The IMF will disburse an additional EUR 1 bn and the UK, Sweden and Denmark bilateral loans of in total EUR 0.7 bn. This will bring the total of authorized disbursements so far to some EUR 60 bn, representing just under 90% of the total international assistance of EUR 67.5 bn available under the programme.<sup>47</sup>

**The authorities have already raised a significant proportion of this year's planned long-term funding, thereby strengthening their cash position.** As mentioned in Section 3 above, the authorities have raised market funding through several issuances this year. In addition, the government also raised cash through the sales of (i) its EUR 1 bn holding of Contingent Capital Notes in Bank of Ireland in early January (these securities had been acquired after the 2011 PCAR exercise; the sale at a price of 101% of the par value generated a profit of EUR 10 mn) and (ii) its stake in Irish Life in February for EUR 1.3 bn, with a dividend of EUR 40 mn paid prior to completion of the sale, which is expected in July 2013. Market conditions permitting, the NTMA plans to restart a regular bond auction programme later in the year, the authorities' funding plan (Table 5 below) targets issuance of long-term bonds for EUR 10 bn in 2013 (75% of which has already been achieved, as described above) and prudently includes provision for some contingencies from potential claims by NAMA in the context of the IBRC liquidation (see footnote 14 on page 15) and does not account for possible issuances later this year of a new round of annuities for pension funds, which is subject to the resolution of outstanding regulatory considerations. At the end of 2013, when Ireland's economic adjustment programme expires, the cash buffer of the treasury is projected to amount to EUR 22.1 bn, which exceeds the forecast funding needs for 2014.

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<sup>47</sup> Ireland has yet to request the disbursement of the EUR 0.8 bn EU instalment associated with the 8<sup>th</sup> review, reflecting its better-than-expected cash position. Ireland has indicated that it plans to request this amount in April from the EFSF.

**Table 5: Financing requirements**

	2010	2011	2012					2013					2010-2013
	Dec	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Total
<b>A. Exchequer cash deficit 1/</b>	5.4	18.4	4.3	6.9	1.7	3.5	16.4	4.8	4.7	1.8	3.3	14.7	54.8
<b>B. Debt redemption 2/</b>	2.5	9.7	6.3	-0.6	-0.7	4.4	9.4	2.6	6.7	1.5	1.5	12.3	33.9
of which: long term bonds	0.0	4.8	5.6	0.0	-0.3	0.7	6.0	0.0	5.1	0.0	0.0	5.1	16.0
<b>C. Bank recapitalisation</b>	0.0	16.6	0.0	1.3	0.0	0.3	1.6	-1.1	0.0	-1.2	0.0	-2.3	15.8
<b>D. Other Financing needs 3/</b>	0.0	0.7	0.2	-0.9	0.0	0.5	-0.2	1.0	0.5	0.0	0.5	2.0	2.5
<b>E. EU-IMF loan disbursement</b>	0.0	34.5	10.5	4.4	3.7	2.6	21.2	1.5	4.1	4.1	2.1	11.7	67.5
EFSM/EFSF	0.0	21.5	6.2	2.8	2.3	1.0	12.3	0.0	2.4	2.8	1.2	6.4	40.2
Bilaterals 5/	0.0	0.5	1.1	0.2	0.5	0.7	2.5	0.5	0.7	0.5	0.3	1.9	4.8
IMF	0.0	12.6	3.2	1.5	0.9	0.9	6.4	1.0	1.0	0.8	0.7	3.5	22.5
<b>F. Market Funding</b>	0.5	1.4	0.4	3.4	6.5	1.9	12.3	10.7	2.3	2.7	2.2	17.8	32.0
of which: long term bonds	0.0	0.0	0.0	3.1	5.1	0.0	8.1	7.5	0.5	1.0	1.0	10.0	18.1
<b>Memorandum item:</b>													
Cash balances, eop	22.3	13.0	13.2	14.3	23.5	19.3	19.3	24.1	18.5	23.1	22.1	22.1	

Notes:

1/ Includes promissory note payments

2/ Includes long-term bonds, T-bills, commercial paper and others

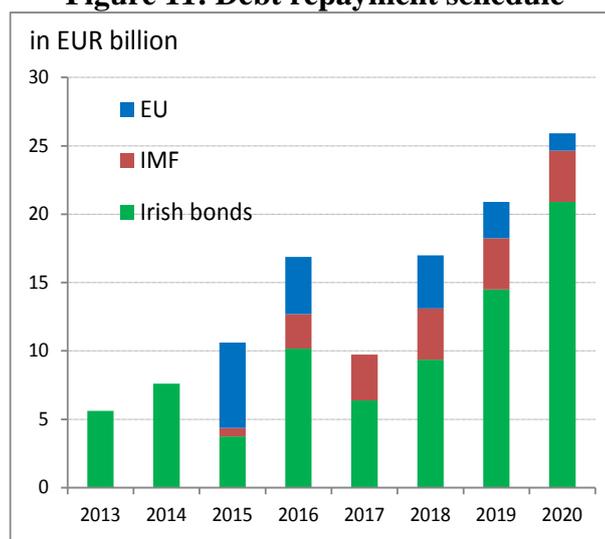
3/ Include contingencies

4/ Includes Treasury cash reserves and NPRF assets

5/ UK, Sweden and Denmark.

**Initial discussions were held during the mission on options to help Ireland regain stable market access going forward**, while noting that the projected large cash buffer can be expected to enhance market confidence and is thus the best line of defence. These discussions will continue in the weeks and months ahead. One aspect under discussion is the possibility, envisaged recently by both the ECOFIN and the Eurogroup ministries, to extend the maturities of the EU loans to both Portugal and Ireland to reduce financing needs in the post-programme period (Figure 11).

**Figure 11: Debt repayment schedule**



## 7. Risks

**Ireland is on track to successfully complete the programme. However, as signalled in previous reviews, several risks to the achievement of the employment, consolidation and reform objectives remain. These stem from:**

- **Continued uncertainty around the growth outlook.** Growth in the near term remains dependent on exports, and recent data from key trading partners (e.g., the contraction experienced by the euro area in the last quarter of 2012) suggest that external demand will remain weak in 2013. Weaker than expected growth could have adverse implications on employment, fiscal performance, debt sustainability, and the quality of banks' assets. Banks may fail to durably address their growing arrears and to return to profitability in a timely manner, which would weigh on growth and could feed a vicious circle. Long-term unemployment could become entrenched, undermining the country's growth potential, which would in turn deteriorate the outlook for debt sustainability (see Annex 1).
- **The possibility of reform fatigue.** A sense of complacency could prematurely settle in on the back of the recent successes. This is apparent for example from the many calls to use the near-term savings resulting from the replacement of the promissory notes to reduce the extent of consolidation in the next few budgets, despite the fact that Ireland's budget deficit remains among the largest in the euro area and economic growth has resumed.
- **Still fragile market sentiment.** The recent decline in spreads reflects strong programme implementation, last year's announcement by the ECB to offer OMT under certain conditions, the improved funding outlook following the replacement of the promissory notes, expectations of further programme enhancements following the supportive statements from the euro area leaders in June and July last year, as well as a broad view that the euro zone crisis is subsiding. This decline might therefore unravel if either signs of policy slippages were to emerge in Ireland, or the euro area-wide initiatives were to be substantially weakened.

## List of abbreviations

AIB	Allied Irish Bank
BOI	Bank of Ireland
BGE	Bord Gáis Energy
BTL	Buy-to-Let
CBI	Central Bank of Ireland
CER	Commission for Energy Regulation
CPI	Consumer Price Index
CSO	Central Statistics Office
dpd	Days Past Due
EC	European Commission
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EFSF	European Financial Stability Fund
EFSM	European Financial Stabilisation Mechanism
ELG	Eligible Liabilities Guarantee
ETB	Education and Training Board
GDP	Gross Domestic Product
GNP	Gross National Product
GP	General Practitioner
GVA	Gross Value-Added
HICP	Harmonised Indices of Consumer Prices
HSE	Health Service Executive
IBEC	Irish Business and Employers Confederation
IBRC	Irish Bank Resolution Corporation
IMF	International Monetary Fund
ma	Moving average
MEFP	Memorandum of Economic and Financial Policies
MOU	Memorandum of Understanding
MTFS	Medium Term Financial Statement
NAMA	National Asset Management Agency
NBFI	Non-Bank Financial Intermediary
NFC	Non-Financial Corporation
PDH	Primary dwelling house
PCAR	Prudential Capital Assessment Review
PTSB	Permanent TSB
REER	Real Effective Exchange Rate
sa	Seasonally Adjusted
SME	Small and Medium Enterprise
WHO	World Health Organisation

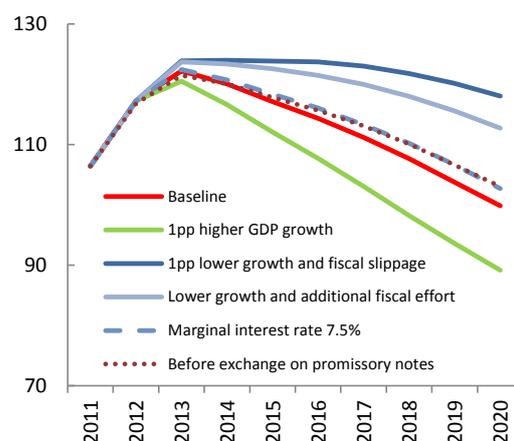
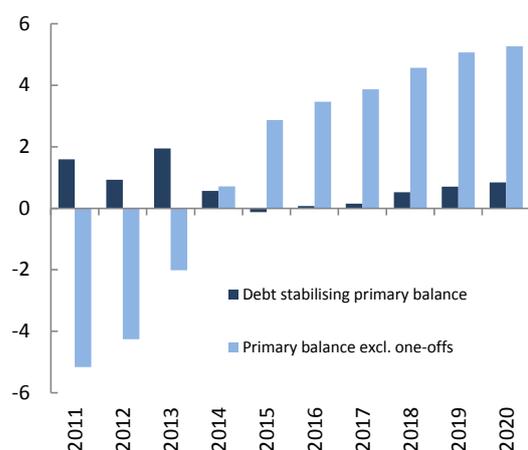
## Annex 1: Debt sustainability analysis

Ireland's debt sustainably has improved following the exchange of the promissory notes with government bonds with lower interest rates and longer maturity. This exchange has no level impact on the government debt, but it lowers the forecast debt path (by 3 percentage points of GDP by 2020 as compared to previous projections) as a result of interest cost savings over time, considering also one-off transaction costs (see Box 1).

The programme's baseline scenario includes positive effects from the exchange of the promissory notes and better-than-projected 2012 outturn. Moreover, the fiscal consolidation effort until 2015 is expected to be implemented as planned, reducing the government deficits well below the programme's and EDP deficit ceilings in each year and reaching a deficit of 2.1% of GDP in 2015. After 2015, government deficit is assumed to be reduced by 0.5pp of GDP annually until reaching a balanced position in 2020. This path is consistent with gross debt peaking at 122% of GDP in 2013, and declining steadily thereafter to 100% of GDP by 2020. The debt at the 2013 peak includes sizable liquid assets, which are projected to decline by some 3% of GDP by 2015 and remain unchanged over the period 2016-2020. The programme debt projections foresee the full drawdown of the programme financing envelope. 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, reflecting an assumed faster growth in investment, allowing the latter to return to more normal levels (investment volume under the baseline is still forecast at only 12% of GDP in 2015).

A stress scenario with a 1 pp. lower GDP growth foresees missing the programme nominal deficit targets and a deficit of 3.9% of GDP in 2015, above the programme target of below 3% of GDP, in the absence of additional consolidation measures. Given improved starting position (baseline) with higher headroom to the deficit ceiling, severity of the stress scenario is lower than in the corresponding scenario analysis as of the 8<sup>th</sup> review. Assuming that the deficit ratio would be reduced by 0.5 pp. each year over 2016-20, the deficit ratio would fall below 3% in 2017, and result in a debt level of 118% of GDP in 2020. If instead additional measures are taken to ensure that the programme and EDP deficit path is respected, the debt ratio would decline to 112% of GDP by 2020. 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 12: Debt-stabilising primary balance in baseline projections (% of GDP)      Figure 13: Government debt projections (% of GDP)



Source: Commission service's estimates

Notes:

*Baseline assumptions:* Programme projections until 2015 (including Exchequer cash balances of EUR 15.3 bn at the end of 2012, EUR 15 bn at the end of 2013, EUR 10 bn at the end of 2014 and EUR 9 bn 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 bn 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, and a 0.5 sensitivity of fiscal balance to GDP. 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. The budget deficit in this scenario would be 3.9% of GDP in 2015 and 1.4% of GDP in 2020. 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: Supplementary tables

**Table A1: Use and supply of goods and services (volume)**

<i>Annual % change</i>	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	0.5	-2.3	-1.8	-0.5	1.2	1.8
2. Government consumption expenditure	-4.6	-4.3	-3.6	-2.5	-2.8	-2.5
3. Gross fixed capital formation	-22.7	-12.2	-2.0	-1.5	3.0	5.2
<b>4. Final domestic demand</b>	<b>-5.0</b>	<b>-4.2</b>	<b>-2.3</b>	<b>-1.1</b>	<b>0.5</b>	<b>1.3</b>
5. Change in inventories						
<b>6. Domestic demand</b>	<b>-4.4</b>	<b>-3.7</b>	<b>-2.3</b>	<b>-1.1</b>	<b>0.5</b>	<b>1.3</b>
7. Exports of goods and services	6.2	5.1	2.6	3.0	4.2	4.4
7a. - of which goods	5.3	2.7	1.9	3.0	4.2	4.4
7b. - of which services	7.2	7.7	3.4	3.0	4.2	4.5
<b>8. Final demand</b>	<b>1.1</b>	<b>1.2</b>	<b>0.6</b>	<b>1.3</b>	<b>2.7</b>	<b>3.2</b>
9. Imports of goods and services	3.6	-0.3	0.4	1.6	3.3	3.7
9a. - of which goods	-1.1	-2.3	0.4	1.6	3.3	3.7
9b. - of which services	6.5	0.8	0.4	1.6	3.3	3.7
<b>10. Gross domestic product at market prices</b>	<b>-0.8</b>	<b>1.4</b>	<b>0.7</b>	<b>1.1</b>	<b>2.2</b>	<b>2.8</b>
<i>Contribution to change in GDP</i>						
11. Final domestic demand	-4.3	-3.4	-1.8	-0.9	0.4	0.9
12. Change in inventories + net acq. of valuables	0.6	0.4	0.0	0.0	0.0	0.0
13. External balance of goods and services	2.9	5.4	2.4	1.9	1.8	1.8

**Table A2: Use and supply of goods and services (value)**

<i>Annual % change</i>	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-1.6	-0.8	0.1	0.8	2.7	3.4
2. Government consumption expenditure	-8.8	-1.8	-1.7	-1.5	-1.9	-1.8
3. Gross fixed capital formation	-26.9	-13.9	-0.9	2.6	7.4	10.2
<b>4. Final domestic demand</b>	<b>-8.0</b>	<b>-3.0</b>	<b>-0.5</b>	<b>0.5</b>	<b>2.3</b>	<b>3.2</b>
5. Change in inventories	-66.1	-139.4	-2.0	3.0	-11.0	0.0
<b>6. Domestic demand</b>	<b>-7.4</b>	<b>-2.7</b>	<b>-0.3</b>	<b>0.5</b>	<b>2.3</b>	<b>3.2</b>
7. Exports of goods and services	7.8	5.7	5.5	4.1	5.2	5.7
<b>8. Final demand</b>	<b>2.5</b>	<b>-1.9</b>	<b>5.1</b>	<b>2.6</b>	<b>4.0</b>	<b>4.7</b>
9. Imports of goods and services	6.6	2.8	3.5	2.9	4.5	5.0
10. Gross national income at market prices	-3.3	-2.2	0.8	1.6	3.5	3.2
11. Gross value added at basic prices	-1.9	2.4	1.6	2.4	3.4	4.3
<b>12. Gross domestic product at market prices</b>	<b>-3.0</b>	<b>1.6</b>	<b>2.5</b>	<b>2.3</b>	<b>3.6</b>	<b>4.4</b>

**Table A3: Implicit price deflators**

<i>% change in implicit price deflator</i>	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.1	1.5	1.9	1.3	1.5	1.6
2. Government consumption expenditure	-4.3	2.6	2.0	1.0	1.0	0.8
3. Gross fixed capital formation	-5.4	-2.0	1.1	4.2	4.3	4.8
<b>4. Domestic demand</b>	<b>-3.1</b>	<b>1.3</b>	<b>1.8</b>	<b>1.6</b>	<b>1.7</b>	<b>1.8</b>
5. Exports of goods and services	1.6	0.6	2.8	1.1	1.0	1.2
<b>6. Final demand</b>	<b>-0.6</b>	<b>0.9</b>	<b>2.4</b>	<b>1.3</b>	<b>1.3</b>	<b>1.4</b>
7. Imports of goods and services	2.9	3.1	3.1	1.3	1.1	1.3
<b>8. Gross domestic product at market prices</b>	<b>-2.2</b>	<b>0.2</b>	<b>1.8</b>	<b>1.3</b>	<b>1.4</b>	<b>1.6</b>
<b>HICP</b>	<b>-1.6</b>	<b>1.2</b>	<b>1.9</b>	<b>1.3</b>	<b>1.3</b>	<b>1.6</b>

**Table A4: Labor market and labor costs**

<i>Annual % change</i>	2010	2011	2012	2013	2014	2015
1. Labour productivity	3.6	3.6	1.6	1.0	1.3	0.6
2. Compensation of employees per head	-2.8	0.2	0.7	0.3	0.2	0.3
3. Unit labour costs	-6.7	0.3	0.0	-0.7	-0.8	-0.4
4. Total population	0.3	2.3	0.4	0.8	0.9	1.0
5. Population of working age (15-64 years)	-0.8	2.1	-0.6	-0.6	-0.1	0.1
6. Total employment	-4.2	-2.1	-1.0	0.1	0.9	2.1
7. Calculated unemployment rate - Eurostat definition (%)	13.9	14.7	14.8	14.6	14.1	13.1

**Table A5: External balance**

<i>levels</i>	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	82.6	84.9	88.9	92.8	97.6	103.1
2. Imports of goods (fob)	46.9	48.3	50.0	51.5	53.8	56.4
<b>3. Trade balance (goods, fob/fob) (1-2)</b>	<b>35.8</b>	<b>36.6</b>	<b>38.9</b>	<b>41.3</b>	<b>43.8</b>	<b>46.7</b>
<i>3a. p.m. (3) as % of GDP</i>	22.8	23.0	23.9	24.8	25.4	25.9
4. Exports of services	75.2	81.9	87.1	90.5	95.2	100.6
5. Imports of services	81.5	83.6	86.6	89.1	93.1	97.8
<b>6. Services balance (4-5)</b>	<b>-6.3</b>	<b>-1.7</b>	<b>0.5</b>	<b>1.4</b>	<b>2.1</b>	<b>2.8</b>
<i>6a. p.m. 6 as % of GDP</i>	-4.0	-1.1	0.3	0.8	1.2	1.6
<b>7. External balance of goods &amp; services (3+6)</b>	<b>29.5</b>	<b>34.9</b>	<b>39.5</b>	<b>42.7</b>	<b>46.0</b>	<b>49.5</b>
<i>7a. p.m. 7 as % of GDP</i>	18.8	22.0	24.2	25.6	26.6	27.4
8. Balance of primary incomes and current	-27.5	-34.2	-36.1	-37.0	-38.5	-41.7
<i>8a. - of which, balance of primary income</i>	-25.2	-32.0	-35.0	-36.8	-38.3	-41.5
<i>8b. - of which, net current Transfers</i>	-2.3	-2.2	-1.1	-0.2	-0.2	-0.2
<i>8c. p.m. 8 as % of GDP</i>	-17.6	-21.5	-22.1	-22.2	-22.3	-23.1
<b>9. Current external balance (7+8)</b>	<b>2.0</b>	<b>0.7</b>	<b>3.4</b>	<b>5.7</b>	<b>7.4</b>	<b>7.8</b>
<i>9a. p.m. 9 as % of GDP</i>	1.3	0.5	2.1	3.4	4.3	4.3
10. Net capital transactions	-0.7	-0.4	-0.1	-1.8	-0.6	0.1
<b>11. Net lending (+)/ net borrowing (-) (9+10)</b>	<b>1.3</b>	<b>0.3</b>	<b>3.3</b>	<b>3.9</b>	<b>6.8</b>	<b>7.8</b>
<i>11a. p.m. 11 as % of GDP</i>	0.8	0.2	2.0	2.3	4.0	4.3

**Table A6: Fiscal accounts**

	2008	2009	2010	2011	2012	2013	2014	2015
	<i>% of GDP</i>							
Indirect taxes	12.4	11.3	11.5	11.1	11.2	11.1	11.3	11.3
Direct taxes	11.5	10.8	10.7	12.1	12.8	13.2	13.7	14.1
Social contributions	6.8	7.4	7.3	6.4	5.8	5.9	5.8	5.6
Sales	2.3	2.8	3.3	3.2	2.6	2.1	2.0	1.9
Other current revenue	1.3	1.3	1.4	1.3	1.5	1.5	1.4	1.4
<b>Total current revenue</b>	<b>34.5</b>	<b>33.7</b>	<b>34.2</b>	<b>34.2</b>	<b>33.9</b>	<b>33.8</b>	<b>34.2</b>	<b>34.3</b>
Capital transfers received	1.2	1.0	1.0	0.7	0.7	0.7	0.7	0.4
<b>Total revenue</b>	<b>35.7</b>	<b>34.7</b>	<b>35.2</b>	<b>34.9</b>	<b>34.6</b>	<b>34.5</b>	<b>34.9</b>	<b>34.7</b>
Compensation of employees	11.9	12.8	12.3	12.0	11.5	11.2	10.6	10.1
Intermediate consumption	5.8	6.4	6.0	5.6	5.5	5.0	4.6	4.2
Social transfers in kind via market producers	2.2	2.3	2.5	2.4	2.2	2.0	1.9	1.7
Social transfers other than in kind	11.6	14.5	14.8	15.0	14.3	13.7	12.9	12.1
Interest paid	1.3	2.0	3.2	3.3	3.9	4.8	4.9	5.0
Subsidies	0.5	0.6	0.6	0.4	0.3	0.3	0.2	0.2
Other current expenditure	2.5	2.6	2.3	2.1	2.1	2.0	2.0	1.9
<b>Total current expenditure</b>	<b>35.9</b>	<b>41.3</b>	<b>41.6</b>	<b>40.9</b>	<b>39.7</b>	<b>39.1</b>	<b>37.1</b>	<b>35.2</b>
Gross fixed capital formation	5.3	3.8	3.5	2.5	2.0	1.6	1.5	1.5
Other capital expenditure	1.9	3.6	21.0	4.8	0.5	1.1	0.5	0.1
<b>Total expenditure</b>	<b>43.1</b>	<b>48.7</b>	<b>66.1</b>	<b>48.2</b>	<b>42.3</b>	<b>41.8</b>	<b>39.1</b>	<b>36.8</b>
<b>General Government balance</b>	<b>-7.4</b>	<b>-13.9</b>	<b>-30.9</b>	<b>-13.4</b>	<b>-7.7</b>	<b>-7.3</b>	<b>-4.2</b>	<b>-2.1</b>
<b>Underlying Government balance (EDP)</b>	<b>-7.4</b>	<b>-11.5</b>	<b>-10.7</b>	<b>-9.1</b>	<b>-7.7</b>	<b>-7.3</b>	<b>-4.2</b>	<b>-2.1</b>
	<i>EUR billion</i>							
Indirect taxes	22.2	18.3	17.9	17.7	18.2	18.5	19.5	20.3
Direct taxes	20.7	17.4	16.7	19.2	20.9	22.0	23.7	25.3
Social contributions	12.2	12.0	11.5	10.3	9.4	9.8	10.0	10.1
Sales	4.2	4.5	5.2	5.1	4.3	3.6	3.5	3.5
Other current revenue	2.3	2.1	2.2	2.1	2.4	2.6	2.4	2.5
<b>Total current revenue</b>	<b>61.7</b>	<b>54.3</b>	<b>53.6</b>	<b>54.3</b>	<b>55.2</b>	<b>56.4</b>	<b>59.1</b>	<b>61.8</b>
Capital transfers received	2.2	1.7	1.6	1.1	1.1	1.2	1.2	0.8
<b>Total revenue</b>	<b>63.9</b>	<b>56.0</b>	<b>55.1</b>	<b>55.4</b>	<b>56.4</b>	<b>57.6</b>	<b>60.3</b>	<b>62.6</b>
Compensation of employees	21.2	20.7	19.3	19.1	18.8	18.6	18.3	18.3
Intermediate consumption	10.4	10.4	9.3	8.9	8.9	8.3	7.9	7.5
Social transfers in kind via market producers	3.9	3.8	3.9	3.8	3.5	3.4	3.2	3.0
Social transfers other than in kind	20.8	23.4	23.2	23.8	23.4	22.9	22.2	21.8
Interest paid	2.4	3.3	5.0	5.3	6.3	8.1	8.5	9.0
Subsidies	0.9	0.9	0.9	0.6	0.5	0.5	0.4	0.4
Other current expenditure	4.5	4.3	3.5	3.4	3.4	3.4	3.4	3.4
<b>Total current expenditure</b>	<b>64.2</b>	<b>66.7</b>	<b>65.1</b>	<b>65.0</b>	<b>64.8</b>	<b>65.1</b>	<b>64.1</b>	<b>63.4</b>
Gross fixed capital formation	9.5	6.1	5.5	4.0	3.2	2.7	2.7	2.7
Other capital expenditure	3.3	5.7	32.8	7.6	0.9	1.9	0.9	0.3
<b>Total expenditure</b>	<b>77.0</b>	<b>78.5</b>	<b>103.4</b>	<b>76.7</b>	<b>68.9</b>	<b>69.7</b>	<b>67.6</b>	<b>66.4</b>
<b>General Government balance</b>	<b>-13.2</b>	<b>-22.5</b>	<b>-48.3</b>	<b>-21.3</b>	<b>-12.5</b>	<b>-12.1</b>	<b>-7.3</b>	<b>-3.8</b>
Deficit-increasing financial sector measures		4.0	31.6	6.8	0.0	0.0	0.0	0.0
<b>Underlying Government balance (EDP)</b>	<b>-13.2</b>	<b>-18.5</b>	<b>-16.7</b>	<b>-14.4</b>	<b>-12.5</b>	<b>-12.1</b>	<b>-7.3</b>	<b>-3.8</b>

**Table A7: Debt developments**

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Government deficit (% of GDP)</b>	<b>-7.4</b>	<b>-13.9</b>	<b>-30.9</b>	<b>-13.4</b>	<b>-7.7</b>	<b>-7.3</b>	<b>-4.2</b>	<b>-2.1</b>
Government gross debt (% of GDP)	44.5	64.9	92.2	106.4	117.2	122.2	120.1	117.1
<i>levels, EUR billion</i>								
<b>Government deficit</b>	<b>-13.2</b>	<b>-22.5</b>	<b>-48.3</b>	<b>-21.3</b>	<b>-12.5</b>	<b>-12.1</b>	<b>-7.3</b>	<b>-3.8</b>
Gross debt	79.6	104.6	144.2	169.2	191.0	203.8	207.4	211.2
Change in gross debt	32.3	25.0	39.6	25.0	21.8	12.8	3.6	3.8
Nominal GDP	178.9	161.3	156.5	159.0	162.9	166.7	172.8	180.3
Real GDP	177.4	167.7	166.4	168.8	169.9	171.7	175.4	180.3
<b>Real GDP growth (% change)</b>	<b>-2.1</b>	<b>-5.5</b>	<b>-0.8</b>	<b>1.4</b>	<b>0.7</b>	<b>1.1</b>	<b>2.2</b>	<b>2.8</b>
Change in gross debt (% of GDP)	18.0	15.5	25.3	15.7	13.4	7.7	2.1	2.1
Stock-flow adjustments (% of GDP)	10.7	1.6	-5.6	2.4	5.7	0.4	-2.1	0.0
<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>117.2</b>	<b>122.2</b>	<b>120.1</b>	<b>117.1</b>
Change in gross debt ratio	19.4	20.4	27.3	14.3	10.8	5.0	-2.2	-2.9
<i>Contribution to change in gross debt</i>								
Primary balance	6.0	11.9	27.7	10.0	3.8	2.4	-0.7	-2.9
"Snow-ball" effect	2.7	7.0	5.2	1.9	1.3	2.2	0.7	0.0
of which								
<i>Interest expenditure</i>	<i>1.3</i>	<i>2.0</i>	<i>3.2</i>	<i>3.3</i>	<i>3.9</i>	<i>4.8</i>	<i>4.9</i>	<i>5.0</i>
<i>Real growth effect</i>	<i>0.6</i>	<i>2.7</i>	<i>0.5</i>	<i>-1.3</i>	<i>-0.7</i>	<i>-1.2</i>	<i>-2.5</i>	<i>-3.2</i>
<i>Inflation effect</i>	<i>0.8</i>	<i>2.3</i>	<i>1.5</i>	<i>-0.2</i>	<i>-1.9</i>	<i>-1.4</i>	<i>-1.7</i>	<i>-1.8</i>
<b>Stock-flow adjustments</b>	<b>10.7</b>	<b>1.6</b>	<b>-5.6</b>	<b>2.4</b>	<b>5.7</b>	<b>0.4</b>	<b>-2.1</b>	<b>0.0</b>
<i>Implicit interest rate</i>	<i>5.1</i>	<i>4.1</i>	<i>4.8</i>	<i>3.7</i>	<i>3.7</i>	<i>4.2</i>	<i>4.2</i>	<i>4.3</i>

## Notes:

The projections assume no use of precautionary contingencies foreseen in the programme's financing plan. Stock-flow adjustments include an assumed reduction in liquid assets by some 3% of GDP by 2015 and other smaller financial transactions.

## Annex 3: Updated programme documents

### Letter of Intent



An Roinn Airgeadais  
Department of Finance

Dublin, 12 March 2013

Mr. Mario Draghi  
President  
European Central Bank  
Kaiserstrasse 29  
60311 Frankfurt am Main  
Germany

Mr. Jeroen Dijsselbloem  
Minister van Financiën  
Ministerie van Financiën  
Korte Voorhout 7  
Postbus 20201  
2500 EE Den Haag  
The Netherlands

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 Uwe Corsepius  
Secretary-General  
General Secretariat of the Council of the European Union  
Rue de la Loi 175  
1048 Brussels  
Belgium

Dear Messrs Draghi, Dijsselbloem, Corsepius and Rehn

1. As we are now in the final year of our programme, the focus of Government is on ensuring that attention is fully turned to the measures necessary to achieve a successful exit from the Programme and measures that will underpin a durable and sustainable return to

market based funding. We believe that the Irish Government's performance in terms of commitment to the Programme remains firm as is clearly illustrated by our continued strong record in implementing the agreed policy frameworks and measures.

There have been a number of positive developments, in a climate of persistent weakness in economic activity in our main trading partners in Europe. Our gradual return to the financial markets continued and the successful bond sale in January, the sale of contingent capital instruments in one of the pillar banks at a slight profit, the recently announced sale of Irish Life, the continuing fall in our bond yields, are all strong positive indicators of our success. The real economy has also shown some improvement, with continuing growth, albeit at low levels, stabilisation in the still high unemployment level, and the better than expected budget outturn for 2012. The resolution of the promissory note discussions and the enactment of legislation to liquidate IBRC has reinforced these positive developments. Allied to this, the benefits of the ECB's decision on Outright Monetary Transactions remain evident. Finally, once the implementation of the 2010 quota reforms is agreed the effective interest rate on our IMF borrowings will be significantly reduced. Progress is expected with respect to other issues, most notably the delivery of the Euro Area Heads of State and Government commitment on breaking the vicious circle between banks and the sovereign in the EU and to examine how to improve the sustainability of our well performing Programme. Furthermore, our recent request for an extension of maturities on EU funding is an important ongoing issues.

Our preparations for exiting our Programme continue to take place against this mixed backdrop. Notwithstanding the external risks, our policy efforts are aimed at further deepening our access to market funding during 2013 in order to exit from reliance on official financing. Timely implementation of the Euro Area Leaders' commitments would greatly support the effectiveness of these efforts. We are sure that we can rely on the continued support of our external partners and fellow Member States in this endeavour.

2. For the ninth review, we have once again met our commitments (with over 190 actions completed) under the EU/IMF supported Programme in terms of policy reforms as well as quantitative targets:

- The 2012 general government deficit is expected to be below 8% of GDP, well within the programme ceiling (8.6% of GDP). We have also a budget in place for 2013 which is consistent with observing the 7.5% of GDP ceiling on the general government deficit for this year.
- We have taken measures to offset cost overruns in the health sector in 2012 and to ensure that expenditures in this important area remain within the allotted ceiling this year. Some of the measures require additional steps for their full implementation and we have established a Cabinet Committee on Health which will be informed in a timely manner of any slippages or problems that might arise so as to ensure prompt remedial action.
- We have enacted the Personal Insolvency Act 2012, which provides the most radical and comprehensive reform of our insolvency and bankruptcy law and practice since the foundation of the State. We have established the Personal Insolvency Service and are now putting in place the necessary infrastructure and regulatory framework to accept applications from eligible borrowers in the second quarter of 2013.
- We are advancing work aimed at resolving the stock of non-performing loans in the banking sector. Progress on this front is instrumental in removing important uncertainties for households and firms in debt distress and to allow banks to fully resume lending activities.
- We continue to advance structural reforms with the view to strengthening the fundamentals of the Irish economy and promoting a job-rich recovery. We are forcefully implementing our Action Plan for Jobs to promote job creation and are making progress in improving our labour market activation policies and institutions, including through increased engagement with the long-term unemployed. We are also advancing the process of reforming our further education and training system to enhance its relevance in retraining the unemployed and providing the skills our economy needs. Needless to say this will remain a priority focus of the Government in the weeks and months ahead.
- We have further strengthened the power and capacity of our competition authority.

- We are moving ahead with the reform of the water sector, including laying the groundwork for the introduction of domestic water charges.

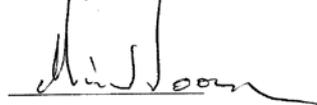
3. In light of our performance under the programme and our continued commitment to it, we request the completion of the ninth review and the release of the ninth disbursement of EUR 1.6 billion from the EFSF.

4. In the attached eighth 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. We also continue to work with staff of the European Commission, the European Central Bank and the International Monetary Fund on the follow-up to the 29 June statement by the Heads of State and Government of the euro area.

5. 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 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.

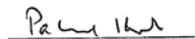
6. As Ireland currently holds the EU Presidency, it was deemed more appropriate to address this letter to the Secretary General of the Council. This letter is being copied to Mme Lagarde.

Sincerely,



Michael Noonan, T.D.

Minister for Finance



Patrick Honohan

Governor of the Central Bank of Ireland

**Ireland**  
**Memorandum of Understanding**  
**On**  
**Specific Economic Policy Conditionality**  
**(Eighth Update)**  
**12 April 2013**

1. 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 eighth 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.
2. 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.
3. 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

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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.

achieved. Any additional unplanned revenues must be allocated to debt reduction. Moreover, the nominal value of Social Welfare pensions will not be increased.

- Continue to strengthen the fiscal framework and reporting in line with EU requirements.
- 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 and on a sustainable basis.
- 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, via the Credit Union Restructuring Board, 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.
  - The authorities will report quarterly 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.
  - Ensure continued compliance with the minimum Core Tier 1 Capital ratio of 10.5% 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.
4. 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 tenth review (actions to be completed by end Q1-2013)**

### **Financial sector reforms**

#### *Capital Assessment*

5. The authorities will provide the staff of the European Commission, the ECB and the IMF a review of developments in the PCAR banks relative to PCAR 2011. Overall results of this work will be published by end February 2013. The authorities will agree with the staff of the European Commission, the ECB and the IMF on the specific details of the review.

#### *Deleveraging*

6. 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*

7. 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*

8. 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. The authorities will monitor each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
9. The authorities will publish banks' reported data on loan modifications, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.
10. The authorities will establish by end March a public target requiring the principal mortgage banks to offer durable restructuring arrangements for a substantial share of problem mortgage loans during 2013.
11. Having secured adequate protections for debtors' principal private residence through the enactment of the Personal Insolvency Bill, the authorities will introduce legislation remedying the issues identified by case law in the 2009 Land and Conveyancing Law Reform Act, so as to remove unintended constraints on banks to realise the value of loan collateral under certain circumstances.

### *Financial supervision*

12. 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.
13. 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.
14. The authorities will engage with each bank to ensure appropriately prudent provisioning including on key inputs, such as for estimating cure rates for originally performing, forborne, and modified loans, to ensure these cures reflect durable modifications.
15. Following completion of annual model performance reviews assessing banks' risk-weighted asset calculations forecasting and stress testing in advance of PCAR 2013, the authorities will report to the staff of the European Commission, the IMF and the ECB on progress with implementation of the findings from the credit regulatory capital review process and with the specific mitigating actions communicated to the banks.

## **Structural reforms**

### *Health sector*

16. The authorities will conduct a study to compare the cost of drugs, prescription practices and the usage of generics in Ireland with comparable EU jurisdictions.

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

### **Financial sector reforms**

#### *Capital assessment*

17. The authorities will report by end of May 2013 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.
18. The authorities will agree with the staff of the European Commission, the ECB and IMF on the specific features of the methodology for the PCAR 2013 stress test exercise.

#### *Deleveraging*

19. 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*

20. 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*

21. In consultation with staff of the EC, ECB, and IMF, the authorities will update, where necessary, by end-May 2013 the 2011 Impairment Provisioning and Disclosure Guidelines setting out clear definitions and principles underpinning banks' provisioning models. This review will take account of the assessment of the application of the current guidelines and existing provisioning methodologies and assumptions employed by the banks
22. 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. The authorities will monitor each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
23. The authorities will publish banks' reported data on loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.

24. The authorities will propose a public target requiring the principal mortgage banks to complete durable restructuring arrangements on a substantial share of problem mortgage loans during 2013.
25. The authorities will establish individual bank targets requiring them to complete a substantial share of durable restructuring arrangements for SME loans in arrears in 2013.
26. The authorities will undertake a review of progress in addressing mortgage arrears.
27. While ensuring that balanced incentives and debtors' sustainability are maintained, the authorities will complete a review of the Code of Conduct on Mortgage Arrears (CCMA). The review will, among other things, explore: (i) reforming and streamlining the restrictions on contacts; (ii) amending the definition of a non-cooperative borrower; and (iii) permitting modifications of the interest rate setting mechanism where the lender has offered an alternative arrangement which is advantageous to the borrower in the long-term.

#### *Financial supervision*

28. 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.
29. 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.
30. The authorities will review the implementation of the 2011 CBI Provisioning and Disclosure guidelines by the covered banks with reference to the end-2012 published financial statements.
31. Upon publication of the EU directive establishing a framework for the recovery and resolution of credit institutions and investment firms, the authorities will review the Resolution fund levy regulation.

### **Structural reforms**

#### *State assets*

32. 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*

33. 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.
34. The authorities will prepare an action plan aimed at increasing the effectiveness of training and activation supports, building on the recommendations of the DSP Review of Employment Support Schemes and the evaluation of JobBridge by end-April 2013. The authorities will also review the progress in the rolling out of Intreo offices and

define measures to address potential shortcomings. The authorities will communicate a timetable for the process of procuring activation services for the long-term unemployed from private providers.

35. The authorities will continue to redeploy and train staff from within the Department of Social Protection in order to significantly increase the number of *Intreo* case managers, substantially increase the number and proportion of group and one-to-one engagements with the long-term unemployed and provide them with adequate activation services. The authorities will report on progress in achieving the DSP objective of doubling of case managers by end-2013. They will also assess the skills adequacy of case managers and report on training needs and plans.

#### *Water services reform*

36. The Commission for Energy Regulation (CER) will carry out consultations to determine the framework for household water charges with a view to start charging by the end of the EU-IMF programme period. The CER will also conduct consultations in due course to determine the pricing methodology for the non-domestic sector.
37. The Government will publish the General Scheme of a Water Services Bill with the aim of defining the regulatory framework for the water sector under a national public utility setting and providing for the establishment of Irish Water in its final form. There will be prior engagement with the European Commission as appropriate, in developing the legislative arrangements.

#### *Health sector*

38. The authorities will develop an eHealth Strategy in conjunction with the HSE by end Q2 2013. This will serve as a time-bound action plan for the implementation of eHealth systems, including a comprehensive system of ePrescription which uses a unique patient identifier, such as the PPSN – to support and enable the delivery of integrated patient care under the reform agenda.

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

#### **Financial sector reforms**

##### *Capital assessment*

39. 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 an assessment of the banks' calculation of risk weighted assets, loan loss forecasting, and capital modelling. 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.

40. 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*

41. 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*

42. 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*

43. The authorities will keep under review the effectiveness of statutory repossession arrangements in Ireland based on ongoing experience with repossession actions. Issues such as length, predictability and cost of proceedings, systems for dealing with non-cooperative borrowers and investment property debts will be included in this review. Where necessary appropriate measures will be brought forward quickly to deal with any problems arising
44. 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. The authorities will monitor each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
45. The authorities will publish banks' reported data on loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.
46. Following consultation with the staff of the European Commission, the ECB and the IMF the authorities will establish a public target requiring the principal mortgage banks to complete durable restructuring arrangements on a substantial share of problem mortgage loans during 2013. A public target will also be set for the share of concluded arrangements for which the terms are being met to ensure the quality and durability of such arrangements.

#### *Financial Supervision*

47. 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.

48. 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**

### *Access to SME credit*

49. Based on experience of the operation of the Insolvency Service in the personal insolvency reform, the authorities will consider the appropriateness of further enhancements to the company law framework to facilitate restructuring, especially in multi-creditor cases, reduce costs and achieve efficiency gains, including the potential for an administrative body to facilitate SME restructuring.

### *Water services reform*

50. The Government will publish, as early as possible in Q3 2013, a Water Services Bill with the aim of defining the regulatory framework for the water sector under a national public utility setting and providing for the establishment of Irish Water in its final form. There will be prior engagement with the European Commission as appropriate, in developing the legislative arrangements.
51. The Government's budgetary perspective will be based on Irish Water becoming substantially self-funded over time.

### *Further education and training*

52. The authorities will conduct by September 2013 a strategic review of the training and education provision offered by Education and Training Boards (ETBs) to guide the strategic work of SOLAS and the FET provision by ETBs. The review will evaluate the FET provision in terms of its relevance for labour activation purposes, i.e. whether it is suited to the needs and abilities of the large pool of unemployed, in particular the long-term unemployed, and to the prospective skills needs of the economy. The review will provide an assessment of the existing provision as well as recommendations to enhance their relevance for activation purposes.

### *Health*

53. The authorities will set high level annual targets for increasing the share of generic drug usage in the medium-term. Enabling measures – such as compulsory prescription by International non-propriety name (INN) by end 2013, where appropriate – required for the achievement of these targets will be put in place and kept under further review.

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

### **Financial sector reforms**

#### *Deleveraging*

54. 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.
55. The authorities will produce a final report on progress towards compliance with Basel III liquidity and funding requirements by the relevant dates.

#### *Asset quality*

56. 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. The authorities will monitor each PCAR bank's performance relative to already-defined key performance indicators for progress in resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.
57. The authorities will publish banks' reported data on loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.

#### *Financial Supervision*

58. 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.
59. 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.
60. The authorities will ensure, subject to the enactment of the Credit Reporting Bill and the completion of project due diligence, that the Central Credit Register is at an advanced stage of development. The authorities will also present a final comprehensive report on progress in implementing the Central Credit Register and discuss it together with the European Commission, the IMF, and the ECB.

### **Structural reforms**

#### *Labour market reform*

61. The authorities will report on compliance with the action plan to double the number and ensure adequate training of Intreo case managers.

*Water services reform*

62. The CER will establish the framework to assess water charges for households, including those without meters. Irish Water, in association with the authorities and the CER, will inform the public on the level of water charges and launch a communication campaign building on the one initiated in February 2013.

## 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, 105 days after the end of each quarter
F.6	Updated annual plans of the general Government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general Government budgetary prospects.	30 days after EDP notifications
F.7	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for Non-Commercial State Agencies	Quarterly, 30 working days after the end of each quarter
F.8	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for local authorities	Quarterly, 30 working days after the end of each quarter
F.9	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months for State- owned commercial enterprises (interest and amortisation)	Quarterly, 30 working days after the end of each quarter
F.10	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.	Quarterly, 30 working days after the end of each quarter.
F.11	Report on implementation of budgetary measures in the health sector, covering inter alia assessment of timeliness and effects vis-à-vis 2013 Budget plans and explanation for any delay/shortfall, as well as update on status of any remaining actions required for effective implementation.	Monthly, 30 working days after the end of each month.
F.12	Report comparing, against the monthly targets: (i) health expenditure by mains service areas, (ii) pay and non-pay element of current expenditure, (iii) capital expenditure and (iv) income collected.	Monthly, 7 working days after the end of each month.
F.13	Report on pharmaceutical prescriptions and expenditure, including information on value and volume of drugs and the extent of the	Quarterly, 30 working days after the end of

	use of generics and off-patent drugs.	each 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

*Our policy efforts are firmly oriented toward durable exit from official financing under the EU-IMF supported programme at the end of 2013. Building on our consistent strong policy implementation, we will continue the intensive work in progress on financial sector health, budget implementation and fiscal framework, and structural reforms, to support Ireland's economic recovery and lay solid foundations to graduate from official financing in 2013.*

### A. Recent Economic and Financial Developments and Outlook

- 1. The Irish economy continues to gradually recover and the outlook is for a modest pickup in growth.** Final domestic demand rose in the third quarter of 2012, the first quarterly increase since early 2008, lifting real GDP growth to 0.8 percent y/y in the first three quarters of 2012. Net exports remained the main engine of growth, with the strong performance of the services sector outweighing a slowdown in goods exports. The latter reflected a weaker external environment and likely the “patent cliff” in the pharmaceutical industry. GNP growth of 3 percent y/y in the first three quarters of 2012, and the current account surplus of over 4 percent of GDP during the same period, each benefited from a decline in net factor income outflows. Inflation abated at year-end, bringing the annual average rate to 1.9 percent, and the unemployment rate eased to 14.6 percent in recent months from 15 percent a year earlier. Looking ahead, a gradual economic recovery is expected on the back of domestic demand stabilising and then returning to expansion, with GDP growth firming to over 1 percent in 2013 and over 2 percent in 2014. A recovery in trading partners remains key for export growth, and resolution of non-performing loans is crucial to ensuring a more durable revival in domestic demand.
- 2. Recent developments in sovereign and bank funding markets have also been favourable.** Demand for Irish sovereign debt has continued to broaden, driving bond yields down to their lowest level since April 2010. Our most recent 5 year issuance was at a yield of 3.32 percent and Treasury bill yields recently fell to 0.2 percent, down from 1.8 percent when we returned to the bill market last summer. On foot of developments in sovereign yields, guaranteed bank bond yields have also declined, and banks recently issued non-guaranteed covered bonds on favourable terms. Average rates on new bank deposits have declined to 1 percent even as deposit inflows have continued, and there are signs that bank lending may be turning a corner, associated with a potential bottoming out in housing prices in 2012.
- 3. Building on our continued strong programme implementation, as well as supportive European policy initiatives, we are determined to successfully exit the programme.** We are engaged in a constructive dialogue with programme partners on a number of issues to facilitate a sustainable return to market financing. Initial discussions on an exit strategy took place during this review and we are further developing this work with our external partners. Alongside our strong programme implementation, European policy

developments have been key to improved market confidence, including the commitment by euro area leaders to break the vicious circle between banks and sovereigns and examine the situation of Ireland's financial sector with a view to further improving the sustainability of Ireland's well-performing adjustment programme.

## **B. Financial Sector Policies**

### **4. To allow Ireland's economic recovery to be supported by a healthy flow of new bank credit, we will ensure decisive progress in resolving distressed assets in 2013.**

Banks have been recapitalized but their high nonperforming loan ratios reflect the distress of many households and SMEs facing a still weak economy. After making substantial technical and legislative preparations in 2012, we will drive forward the implementation of loan resolution in 2013, ensuring that banks proactively achieve lasting solutions for impaired assets. By bringing greater certainty and sustainability to household and SME balance sheets and deepening market confidence in banks, this process will help unlock bank credit for sound and productive purposes, thereby bolstering the potential for domestic demand to contribute to sustained job-creating recovery.

### **5. We will hold banks to ambitious targets to address troubled residential mortgages in a manner that will ensure durable reductions in arrears.**

To underscore the centrality of this task, we will establish a public target requiring the principal mortgage banks to offer a substantial share of restructuring arrangements during 2013 (proposed structural benchmark, end March). In addition, we will propose by end-June targets to also complete a substantial share of restructuring arrangements during 2013. In consultation with the staff of the EC, ECB, and IMF, we will establish such targets soon thereafter, before completion of the eleventh review at the latest. To ensure the quality of such arrangements and the achievement of this target we will monitor each bank's progress closely, including through a public target for the share of concluded arrangements for which the terms are being met. To count towards these targets, restructuring arrangements must be expected to durably address arrears. We will also publish re-default rates as part of banks' key performance indicators.

### **6. To facilitate effective engagement with residential mortgage borrowers in arrears, we will complete a review of, and modify where appropriate, the Code of Conduct on Mortgage Arrears by end-June 2013.**

In December 2012 we clarified the interpretation of the Code, including the restrictions on contacting borrowers. A full review is now underway, which includes a public consultation, to build on these clarifications and take into account developments such as the Personal Insolvency Act and bank's mortgage arrears resolution strategies. The review will, among other things, explore : (i) reforming and streamlining the restrictions on contacts to facilitate constructive engagement while ensuring essential consumer protections remain in place; (ii) amending the definition of a non-cooperative borrower such that key protections extend only to borrowers that engage with lenders in a timely manner that is consistent with addressing their arrears; and (iii) permitting modifications of the interest rate setting mechanism where the lender has offered an alternative arrangement which is advantageous to the borrower in the long-term.

7. **Resolving nonperforming loans will also require repossessions in some cases, and it is important that these legal procedures be efficient.** We will keep under review the effectiveness of statutory repossession arrangements in Ireland based on ongoing experience with repossession actions. Issues such as length, predictability and cost of proceedings, systems for dealing with non-cooperative borrowers and investment property debts will be included in this review. Where necessary appropriate measures will be brought forward quickly to deal with any problems arising.
8. **We will soon activate the new personal insolvency framework.** Arising from the passage of the Personal Insolvency Act last December, we will finalize arrangements for the appointment of specialist judges and the licensing and regulation of personal insolvency practitioners by end-March. Within the same time frame, we will also publish guidelines for reasonable allowable household expenditures for debtors, to provide clear expectations for borrowers in financial distress. We expect the newly established Insolvency Service will begin to accept applications from eligible borrowers in the second quarter of 2013.
9. **Given the lead role of SMEs as an employment generator, we will also press forward the timely resolution of SME loan arrears.** Bank-by-bank restructuring targets will be established by end-June, in order to complete a substantial share of restructuring arrangements during 2013. We will track progress based on the key performance indicators in this area developed in coordination with the banks. On-site supervisory reviews will help in assessing the effectiveness of restructuring solutions implemented.
10. **We will continue to ensure that banks apply conservative loss provisioning practices based on justifiable estimates of the risk of their loan portfolios.** By end-March 2013, the CBI will engage with each bank to ensure appropriately prudent provisioning including on key inputs, such as for estimating cure rates for originally performing, forbore, and modified loans, to ensure these cures reflect durable modifications. In consultation with staff of the EC, ECB, and IMF, the CBI will update, where necessary, by end-May 2013 the 2011 Impairment Provisioning and Disclosure Guidelines setting out clear definitions and principles underpinning banks' provisioning models. This review will take account of the assessment of the application of the current guidelines and existing provisioning methodologies and assumptions employed by the banks (**proposed structural benchmark**).
11. **Permanent TSB is implementing its restructuring, yet steps beyond the purview of its management remain important for long-term profitability.** The bank is divided into three distinct internal strategic business units and is forcefully implementing its restructuring, especially by stemming the flow of new arrears. Nonetheless, the separation of certain asset portfolios from the bank would underpin its return to profitability. We will continue to work with our external partners with the aim of achieving an appropriate solution as part of examining the situation in the Irish financial sector with a view of further improving the sustainability of the well-performing adjustment programme, as stated by euro area leaders.

12. **We continue to prepare for Prudential Capital Assessment Review (PCAR) 2013.** This rigorous stress test exercise will build on already completed data validation and asset quality review work. The CBI, supported by consultants, is developing loan loss forecasting models that will be subject to external validation. We will ensure that banks implement the findings of the credit regulatory capital review process on banks' risk-weighted asset calculations, forecasting and stress testing, in advance of PCAR 2013. We will report to the staff of the European Commission, the IMF and the ECB on progress with the implementation of the specific mitigating actions communicated to banks and consult with them on the specific features of the PCAR 2013 methodology. We will aim to align the timing of the publication of PCAR 2013 results with that of the next EBA exercise.

### C. Fiscal Policies

13. **In 2012 we extended our track record of meeting the fiscal targets by a significant margin.** The 2012 general government deficit is expected to come in below 8 percent of GDP, well within the 8.6 percent ceiling. This performance is the result of a determined fiscal consolidation effort, reflected in robust revenue collection across the major tax heads and in effective management of aggregate expenditure within budgetary limits, and some favourable one-off developments. Importantly, overspends in health and social protection, which were partly linked to higher-than-expected unemployment, were offset by non-interest expenditure savings in other areas.

14. **We are implementing Budget 2013 in the same prudent manner.** The bulk of the measures comprising the €3.5 billion consolidation effort have been enacted, including the introduction of the property tax and the social welfare package. We are in the process of implementing the remaining key pieces of the budget package: legislating to effect higher charging for private patients in public hospitals and to mandate greater generic drug use (by end-June); seeking an agreement with public sector unions on reductions in the pay and pension bill (by end-February, as discussed below); and preparing for the roll-out of the property tax on July 1. Moreover, we have decided that the Health Service Executive and the Department of Health will report to the Cabinet Committee on Health on the implementation of the health sector measures on a monthly basis to actively prevent renewed slippages. Taking into account a higher revenue base in 2012, we expect to safely deliver a general government deficit within the 7.5 percent of GDP ceiling in 2013.

15. **Public service reforms are moving to a new phase.** Building on the budgetary savings and efficiencies delivered under the 2010 Croke Park Agreement, we have recently launched negotiations on a successor agreement with public service unions focused on achieving a substantial further reduction in the pay and pension bill for the public service, as well as long term productivity and workplace reforms. If successful, this arrangement will deliver the additional €1 billion in durable net pay and pension savings targeted by 2015. We have also recently announced targeted voluntary redundancy as a tool to help reduce public service numbers to 282,500 by end 2014—a 12 percent fall from their 2008 peak—while protecting core public services. These efforts are being complemented by other efficiency enhancing reforms, including the development of performance-based budgeting across all sectors and the deployment of shared services in human resources and

pension administration. In combination, these reforms will support the sustained provision of high quality public services at affordable cost.

16. **We are further strengthening our fiscal institutions, medium-term budgetary framework, and fiscal transparency, which will help underpin successful exit from the EU/IMF supported programme.** The recently enacted Fiscal Responsibility Act enshrined the independence of the fiscal council and established rules to ensure prudent fiscal policy. Legislation to give statutory basis to the already operational ceilings on aggregate and departmental expenditure—which will be set on a 3-year rolling basis, ensuring compliance with the Stability and Growth Pact—is now before the Oireachtas. We are continuing to enhance fiscal transparency, including through the dissemination of public service performance indicators via the recently launched *Ireland Stat* website and publication of the Government Financial Statistics Report by the CSO in April.

17. **We will take additional steps to bolster market confidence in the achievement of our medium-term fiscal consolidation and debt reduction goals.** In our April 2013 Stability Programme, we will set out revenue and expenditure paths extending to 2016, consistent with the provisions of the Stability and Growth Pact. The structural budgetary reforms and improved processes that have been put in place in recent years e.g. comprehensive expenditure reviews, position us well to design and implement reforms to ensure strong delivery of public services within medium-term resource envelopes. Budget 2014 will provide a further opportunity to articulate these reform policies, especially in relation to health, education and social protection.

#### **D. Structural Reforms**

18. **We are continuing to advance investment projects to promote job creation and growth.** Projects have been identified—including education facilities, roads, primary health care centres, courthouses, and police headquarters—that we will develop through public-private partnerships with the European Investment Bank, the National Pension Reserve Fund (NPRF), and private investors. We are working with the National Development Finance Agency to streamline the tender process and accelerate project delivery, and intend to initiate tenders for education and justice projects in the third quarter of 2013, with the road and primary care centre projects to follow by year end. The implementation of state asset disposal plans for 2013 in the energy generation and forestry sectors is also progressing. We will use at least half of the resulting proceeds to reduce public debt in due course, with the details on timing and implementation to be agreed. Once realised, the remaining proceeds will be invested in job-rich projects of a commercial nature, consistent with our fiscal targets. We will also continue our efforts to improve the business environment and foster job creation under the Action Plan for Jobs, with 2013 measures to be announced in February.

19. **Addressing long-term unemployment is a top priority and we are committed to accelerating the implementation of our *Pathways to Work* strategy and monitor its effectiveness, with the ultimate objective of leaving no-one outside of the activation system.** In order to achieve these objectives, we will:

- Ensure that *Intreo* offices are established as scheduled, with a full roll out by the end of 2014 or earlier if possible.
- Redeploy and train staff from within the Department of Social Protection to boost direct engagement with the long-term unemployed and provide them with adequate activation services. We will substantially increase the number and proportion of group and one-to-one engagements with the long-term unemployed. With this objective in mind, we will seek to achieve a doubling of case workers by the end of 2013 through internal redeployment, with further increases in 2014.
- Following the review of the process with our consultants, by end-April 2013 we will decide on a timetable for the process of procuring activation services for the long-term unemployed from private providers, with the aim of issuing a tender for the provision of services by end-June 2013.
- Encourage employers to hire long-term unemployed persons by reviewing the Employer PRSI Refund and Revenue Job Assist schemes by end-June 2013, with the aim of promoting better take-up among firms.

**20. We will deepen the reform of the further education system and better align training and activation policies with labour market needs:**

- *Reform of the further education system.* By end-June 2013, we aim to establish the Education and Training Boards (ETBs) and the Further Education and Training Authority (SOLAS), and by end-December 2013 we aim to have transferred six of the FAS training centres to the local ETBs. Recognizing the need to best align the provision of further education and training with labour market needs and the specific needs of the long-term unemployed, we will prepare a strategic review of training and further education provisions by end-September 2013. This review will guide ETBs and SOLAS in establishing the course framework offered to the jobseekers. We will put in place procedures to regularly evaluate training and activation outcomes to ensure that they respond to labour market needs and are cost effective.
- *Activation and training schemes.* We have recently completed a Review of Employment Support Schemes under the Department of Social Protection, and following the consultation process with the stakeholders, we will prepare by end-April 2013 an action plan aimed at increasing the effectiveness of training and activation support schemes. We will also improve the targeting of these schemes by ensuring that participation by jobseekers is increasingly guided by case workers and that priority is given to the long-term unemployed.

**21. Addressing challenges faced by SMEs is critical to unleash their capacity to invest and create jobs.** We will therefore intensify our efforts to facilitate lending and equity financing to eligible SMEs and to improve their business environment:

- On top of the €4 billion lending target assigned to pillar banks in 2013 for the SME sector, a range of new government initiatives under the aegis of Enterprise Ireland and the European Investment Bank will help channel long-term funds towards the sector. We have earmarked €350 million of budget resources to leverage private sector funding with the objective of providing more than €1 billion of venture capital and equity financing to high potential innovative SMEs.
- To facilitate SME restructuring, especially in multi-creditor cases, we will consider by end-September the appropriateness of additional legislative amendments to further enhance the SME examinership legal framework to reduce costs and achieve efficiency gains drawing on experience with the operation of the Insolvency Service in the personal insolvency reform and recommendations in the Company Law Review report, including the potential for an administrative body to facilitate SME restructuring.
- The Authorities intend to establish a strategic investment fund (redeploying NPRF resources) with an Ireland focused investment mandate to invest in areas of strategic importance on a commercial basis, supporting economic growth and employment. In January 2013 the NPRF announced that it will invest up to €500m in three new SME funds which will make up to €850m available to SME's through the provision of equity, credit and restructuring/recovery investment. The NPRF will continue to work on supporting the delivery of additional funds that will complement those already announced and provide financing for SME's.
- In 2013 a detailed work programme to ensure that all financing initiatives reach their full potential will be prepared by the SME State Bodies Group, an inter-agency coordination body consisting of representatives from the Departments of Finance and Jobs, Enterprise and Innovation, as well as other agencies. This group will also ensure the cohesion of policies on access to funding for SMEs across the government and evaluate the effectiveness of recent measures.
- Our 10 point tax reform plan will help support small companies' cash flow position, access funding more easily, export capacity and reduce the cost of tax compliance.

## **E. Programme Financing and Monitoring**

**22. The programme is adequately financed and our financing strategy aims to further strengthen the basis for our successful return to reliance on market funding.** In January we raised €2.5 billion through a tap of our bond maturing in 2017 at a yield of 3.32 percent. This issue was significantly over subscribed and attracted a diverse investor base. More than 200 institutional investors – including fund managers, pension funds, bank treasuries and insurance companies placed orders with strong demand from the UK, the

Nordic countries and mainland Europe. We have also continued our programme of regular three-month Treasury bill auctions, with yields declining to 0.2 percent at the recent January auction. Building on this progress, we aim to seek further opportunities to issue medium to long term debt ahead of a potential return, market conditions permitting, to more regular bond issuance later this year. Following the sale of contingent capital claims of €1 billion on Bank of Ireland, we will seek further recovery of bank support costs, including through the sale of Irish Life if market conditions permit. In view of the external risks to our financing, we will maintain a prudent cash buffer and aim to end the programme with a buffer covering around one year of financing needs to support market confidence. Moreover, in a medium to longer term context, a lengthening of maturities on EFSF/EFSM loans is under discussion.

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

## Ireland: Technical Memorandum of Understanding (TMU)

March 12, 2013

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 other capital receipts) minus capital expenditure (voted and non-voted expenditure). The Sinking

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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.

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 which is the Exchequer balance excluding net debt interest payments in the service of the National Debt. From January 2013 all payments related to the IBRC promissory notes are excluded from the Exchequer primary balance measure used for programme monitoring purposes.<sup>2</sup>

5. For the purposes of the programme, the floor on the Exchequer primary balance (quantitative performance criterion) will be adjusted

- (i) 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,
- (ii) upward by the amount of proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer receipts,
- (iii) upward by the amount of receipts from disposals of state assets specified in the paragraph 21 of the MEFP dated 29 November 2012,
- (iv) downward by the amount of these receipts spent on growth-enhancing projects not included in Budget 2013, up to no more than half of these receipts,
- (v) downward for Exchequer contributions to the Resolution Fund for the resolution of credit institutions, and upward for any Exchequer recoupment from the Resolution Fund, of such outlays.
- (vi) Upward for any recoupment of Exchequer contributions from the Credit Union Fund.

Any other financial operation by Government to support banks or other credit institutions including credit unions, 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.

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

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2013	
End-March 2013 (performance criterion)	-3.7
End-June 2013 (performance criterion)	-4.2
End-September 2013 (indicative target)	-4.8

7. The performance criterion on the Exchequer primary balance (floor) will be adjusted upward (downward) for the full amount of any over-performance (under-performance) in Exchequer tax revenues, pay-related social insurance contributions (PRSI) and national training fund contributions against the current projection which is listed below.<sup>3</sup>

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2013	
End-March 2013 (projection)	10.2
End-June 2013 (projection)	21.1
End-September 2013 (projection)	32.5

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 adjutor 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.

<sup>3</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 and property tax (from 2013).

10. For the purposes of the programme, the ceiling on the central government net debt (indicative target) will be adjusted

- (i) upward by debt arising from payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy.<sup>4</sup> 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,
- (ii) 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,
- (iii) downward by the amount of receipts from disposals of state assets specified in the paragraph 21 of the MEFP dated 29 November 2012,
- (iv) upward by the amount of these receipts spent on growth-enhancing projects not included in Budget 2013, up to no more than half of these receipts,
- (v) upward for Exchequer contributions to the Resolution Fund for the resolution of credit institutions, and downward for any Exchequer recoupment, from the Resolution Fund, of such outlays.
- (vi) downward for any recoupment of Exchequer contributions from the Credit Union Fund.
- (vii) downward by the amount liquidated from the NPRF non-liquid discretionary portfolio.
- (viii) downward (upward) by valuation gains (losses) in the NPRF liquid portfolio. The programme exchange rates will apply to all non-euro denominated debt.
- (ix) upward by the amount of cumulative drawings on NPRF's SME focussed funds up to €500 million.

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

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<sup>4</sup> This includes the exchange of the outstanding IBRC promissory notes, which were not part of the national debt, with government bonds, which are part of the national debt. An according revision is carried out for indicative targets for central government net debt from March 2013 onwards.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-December 2012 (provisional )	133.7
End-March 2013 (indicative target)	168.1
End-June 2013 (indicative target)	171.3
End-September 2013 (indicative target)	172.5

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

11. 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.

12. 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**

13. Performance 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, receipts from disposals of state assets specified in the paragraph 21 of the MEFP dated 29 November 2012 and associated outlays on growth-enhancing projects not included in Budget 2013, Exchequer outlays for the resolution and restructuring 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 and the Restructuring and Stabilisation 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

staffs, 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.

Table 1. Programme Monitoring

Measure	Date	Status
<b>Quantitative Performance Criteria</b>		
Cumulative exchequer primary balance	End-December 2012	Observed
<b>Indicative Target</b>		
Ceiling on the stock of central government net debt	End-December 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, BoI 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

Table 1. Programme Monitoring (concluded)

Measure	Date	Status
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
Publish legislation to strengthen the regulatory framework for credit unions, including making legislative provision for effective governance standards and prudential requirements.	End-September 2012	Observed
Approve regulations to establish a charge levied across credit institutions to recoup over time the costs of resolving vulnerable institutions.	End-September 2012	Observed
Request an external BCP assessment in support of efforts to strengthen financial supervision and regulation.	End-March 2013	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

	31-Dec-11		31-Mar-12		30-Jun-12		30-Sep-12		31-Dec-12		31-Mar-13	30-Jun 13	30-Sep-13
	Target 1/	Outcome	Target 1/	Outcome	Target 1/	Outcome	Target1/	Outcome	Target1/	Outcome	Target	Target	Target
(In billions of Euros)													
	Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target
1. Cumulative exchequer primary balance 2/	-22.3	-21.0	-6.9	-5.7	-9.6	-8.7	-11.4	- 10.1	-13.2	-12.3	-3.7	- 4.2	- 4.8
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	0	0
	Indicative Target		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/	117.2	115.7	125.0	123.0	130.1	128.2	132.5	130.0	135.8	133.7	168.1	171.3	172.5

1/ Adjusted.

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

3/ Applies on a continuous basis.

Table 3. Structural Benchmarks Under the Programme

Measure	Date	Status
<b>Financial sector policies</b>		
Establish a public target requiring the principal mortgage banks to offer a substantial share of restructuring arrangements during 2013 (MEFP ¶5).	End-March 2013	Proposed structural benchmark
Publish an update, where necessary, of the 2011 Impairment Provisioning and Disclosure Guidelines by end-May 2013 (MEFP ¶10).	End-May 2013	Proposed structural benchmark
Undertake a review of progress in addressing mortgage arrears (MEFP ¶12, 8 <sup>th</sup> review).	End-June 2013	Structural benchmark

