ISSN 1725-3209

EUROPEAN ECONOMY

Occasional Papers 167 | December 2013

Economic Adjustment Programme for Ireland Autumn 2013 Review

Economic and Financial Affairs

Occasional Papers are written by the Staff of the Directorate-General for Economic and Financial Affairs, or by experts working in association with them. The Papers are intended to increase awareness of the technical work being done by staff and cover a wide spectrum of subjects. Views expressed in unofficial documents do not necessarily reflect the official views of the European Commission.

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KC-AH-13-167-EN-N
ISBN 978-92-79-31395-0
doi: 10.2765/29409

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European Commission
Directorate-General for Economic and Financial Affairs

Economic Adjustment Programme for Ireland

Autumn 2013 Review

EUROPEAN ECONOMY Occasional Papers 167

ACKNOWLEDGEMENTS

The report was prepared in the Directorate General for Economic and Financial Affairs under the direction of István P. Székely, Director and European Commission mission chief to Ireland, and Martin Larch, Head of Unit for Ireland, Poland and Lithuania. The report reflects information available as of 30 November, 2013.

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EXECUTIVE SUMMARY

Due to a severe banking and economic crisis, the Irish authorities requested external assistance in November 2010. The collapse of the property market bubble and measures to address large losses in the banking sector gave rise to budgetary problems, which were compounded by the global financial crisis in 2008. On the back of a loss of investor confidence the Irish authorities eventually requested financial assistance from the European Union, the Member States whose currency is the euro and the International Monetary Fund (IMF) on 21 November 2010. A week later, an economic adjustment programme of EUR 85 billion in financial assistance, including Irish funds, was agreed at the technical level by the European Commission, the IMF and ECB, and finally approved by the ECOFIN Council and the IMF Board in December 2010. The objectives of the arrangement were to address Ireland's financial sector weaknesses, put its public finances on a sustainable path, implement structural reforms aimed at lowering unemployment and, to fully regain international capital market access.

On 14 November 2013, the government announced its decision to conclude the EU/IMF programme in December without a pre-arranged precautionary credit facility. Ireland has accumulated significant cash balances under the programme. At the end of 2013, the cash balances are estimated at about EUR 20 billion, which constitute a significant backstop against internal and external risks. The return to market funding by the Irish sovereign was supported by decisions of EU partners aimed at improving the sustainability of the programme. The lending rate margins on the EFSM and EFSF were eliminated and the average maturity extended from 7.5 to 12.5 years in 2011 and again to 19.5 years in 2013, which further enhanced the sustainability of Ireland's public debt.

Ireland has performed very well under this EU/IMF-supported programme, paving the way for a successful completion of the arrangement. The correction of initially large fiscal imbalances is under way, which has facilitated the sovereign and domestically-owned banks regaining access to market funding at comparatively low rates. Unemployment has declined while the banking sector has more recently started to address in earnest the large stock of non-performing loans. The authorities' strong ownership of the programme has been key to its success and programme implementation has remained strong overall including in the last two quarters of 2013. Most conditionality in the second half of 2013 was observed with only a few delays. One health sector condition remains work in progress, while the requirement to make expenditure ceilings binding and consistent with EU rules is still under discussion.

Nonetheless, challenges remain. Further progress is required in several areas to complete the adjustment process and to further entrench balanced and sustainable growth. The government is preparing a medium-term strategy aimed at setting off a virtuous cycle of faster economic growth, healthier banks, and stronger public finances to ensure durable market access. In particular, with a public debt level at 124% of GDP in 2013, Ireland needs to continue with fiscal consolidation, reduce the private sector debt overhang, and improve bank profitability to revive lending.

Modest growth is projected in 2013, with a pick up foreseen the following year. Real annual GDP is expected to grow by 0.3% in 2013 and 1.7% in 2014, lower than projected at the last review due to relatively weak national accounts data for the first half of 2013. These latest projections envisage a rise in economic activity in the second half of 2013, as recent high-frequency data in Ireland remain positive. For example, the unemployment rate (seasonally adjusted) fell to 12.8% in the third quarter (more than two percentage points below its early 2012 peak) while employment growth picked up again to 3.2% yoy in the third quarter, the fourth positive consecutive reading. Resilience is also reflected by the services, property and retail sales indices, as well as near record readings of confidence and purchasing managers indices (PMIs).

Commission services project the 2013 fiscal deficit at 7.4% of GDP, 0.1 percentage points below the ceiling of the EDP recommendation though there are some risks. The possible statistical reclassification of Allied Irish Bank (AIB) dividends paid as ordinary shares on the government's preference shares may raise the deficit. There are also some overruns in the healthcare sector which need to be addressed by the end of 2013. While not providing clear contingency measures, the authorities

remain confident they can cover overruns in health care with savings elsewhere. They have reiterated their intention to keep overall expenditure within the budget ceilings.

The 2014 budget deficit is projected to decline further to 5.0% of GDP, below the EDP ceiling of 5.1% of GDP and entailing a decline in public debt. The authorities are targeting a budget deficit of 4.8% of GDP in 2014. Public debt would decline for the first time in several years if these projections materialise, by almost four percentage points of GDP to 120.8 percent of GDP by 2014. Overall fiscal adjustment of EUR 3.1 billion (2.0% of GDP) is projected in 2014 including discretionary measures of EUR 2.5 billion with about one third of this from higher revenues and two thirds from expenditure savings. Non-discretionary deficit-improving factors are EUR 0.6 billion and include savings and windfalls, such as revenue from the lottery licence sale and higher dividends from the central bank. Nonetheless, within the planned structural adjustment of EUR 2.5 billion, there are some concerns over the quality of some savings, particularly in the health sector.

In the financial sector, the Balance Sheet Assessment (BSA) has been completed at end-November as planned, while the banks are progressing with addressing mortgage arrears sustainably.

- *The BSA identified a significant increase in provisioning is appropriate but no immediate need for capital.* The results of the assessment indicate that higher provisioning levels are appropriate for some loan portfolios and that current capital buffers held by each institution are sufficient for their core tier 1 ratios to remain above the current regulatory threshold of 10.5% BSA. The BSA results will inform banks' financial plans including their year-end accounting exercises, also in light of the upcoming Single Supervisory Mechanism (SSM) comprehensive assessment in 2014.

- *The banks have made good progress with meeting their targets for the completion of sustainable mortgage restructures.* The audit of results for the second quarter of 2013 identified some remedies necessary to ensure the durability of proposed solutions, but found that these issues would not have resulted in any of the banks failing to reach the target for the second quarter, given the surplus level of submissions. The latest data shows that banks are starting to use more loan restructurings rather than largely using the legal route to address arrears and, for the first time since 2009, there was a decline in overall home-loan mortgage arrears in the third quarter.

- *Repossession procedures have been put in place.* This is key for incentivising borrowers to engage with their banks to agree on durable solutions for mortgages in arrears. There are still concerns that courts do not have the necessary resources to process the upcoming wave of legal cases. While the recently established expert group on repossessions is not due to report until the end of the year, the authorities have indicated that they do not see the need to establish fast-track repossession processes for buy-to-let (BTL) properties at this juncture.

- *Prospects for banks' profitability have improved though the outlook remains challenging for some institutions.* This is due to a number of factors, including the weight of low-yielding assets, such as tracker mortgages. The authorities continue to examine options to resolve this.

Implementation of structural reforms continues at a moderate but steady pace. Capacity to deliver activation services and support to the unemployed is being increased through staff redeployments, but remains short of requirements. Progress is being made to contract out some activation services. The process appears well structured and the authorities issued a request for tenders by end-November as scheduled. The authorities also completed a strategic review of further education and training provision, which provides a number of useful recommendations that could be implemented as part of the strategy for the sector to be developed by the recently-established supervisory institution (SOLAS). No genuine progress towards enacting the Legal Services Regulation Bill was reported since the previous mission. The funding model for Irish Water was communicated with a delay, but a comprehensive public

consultation paper was released at end-October with additional consultations on water charges scheduled for early 2014. The authorities did not communicate the expected levels of state support for Irish Water as this will depend on the outcome of the consultations.

The successful completion of the 12th review will trigger the final European Financial Stabilisation Mechanism (EFSM) instalment of EUR 0.8 billion. The availability period for the EFSM funds expires on 8 February 2014. In addition, the IMF will disburse an amount equivalent to SDR 579.4 million upon completion of the review, while no bilateral loans remain to be disbursed. The European Financial Stability Fund (EFSF) finalised all its disbursements following completion of the previous review, with the total amount disbursed reaching EUR 17.7 billion. This brings the total amount authorized for disbursement under the programme to the overall international assistance package of EUR 67.5 billion. On top of the loans from international lenders, the overall programme envelope also includes EUR 17.5 billion of funds provided by the Irish authorities.

INTRODUCTION

A joint European Commission (EC)/European Central Bank (ECB)/International Monetary Fund (IMF) (henceforth, the "troika") mission visited Dublin during October 29-November 7 for the 12th review of Ireland's EU/IMF-supported economic adjustment programme. The European Stability Mechanism (ESM) also attended the meetings. Compliance with the programme milestones set for the third and fourth quarters of 2013 remained strong overall with a few minor slippages—see the compliance monitor in Annex 1 for a detailed account.

The mission discussed overall programme performance (section 1), recent economic and financial developments as well as the outlook (section 2), the main policy challenges (section 3), and the government funding situation and post-programme monitoring (section 4) ([1]). The updated Letter of Intent (LOI), reflecting the authorities' views and policy intentions beyond the programme, is included in Annex IV, together with other programme documentation.

([1]) This report reflects information available as of 30 November 2013.

1. OVERALL PROGRAMME PERFORMANCE

Ireland entered its economic adjustment programme in December 2010 in the midst of a deep banking and fiscal crisis. Banks and the sovereign were shut out from financial markets. The banking system was oversized and highly vulnerable. The fiscal and debt situation was also fragile due to the collapse of property-related tax revenues that had fuelled strong growth in public expenditure during the boom years, and the costs of bank recapitalizations prior to the programme. When the Irish government officially requested financial assistance from the European Union, the euro-area Member States and the IMF in November 2010, the economy had already suffered two years of deep recession, and the unemployment rate had tripled from pre-crisis levels. The EU/IMF-supported programme, approved by the ECOFIN Council and the IMF Board in December 2010, focused on three main areas: fiscal policy, financial sector reforms and structural reforms. The design of the programme built on the National Recovery Plan formulated by the authorities. The programme also attempted to achieve an appropriate balance between protecting growth and addressing concerns about debt sustainability. One preliminary indication that this has been achieved is that Ireland's growth performance during the programme period compares favourably with that in other European countries.

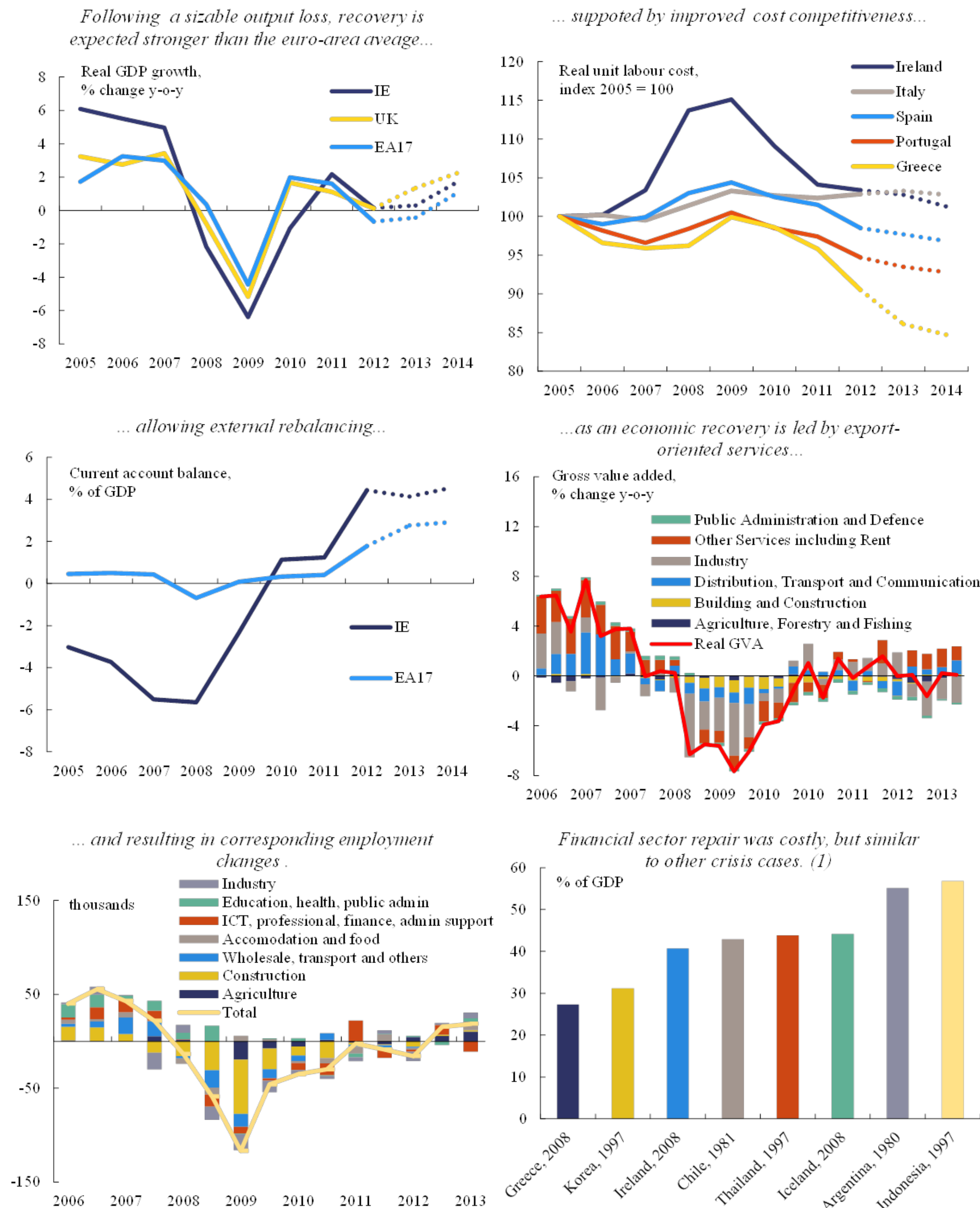
As to fiscal policy, the programme aimed at supporting the government's consolidation efforts to restore sustainability to public finances, while protecting growth and the most vulnerable in society. The Irish authorities consistently met or exceeded the headline deficit targets agreed under the programme and the Excessive Deficit Procedure (EDP), even as growth fell short of expectations and spending pressures in some areas had to be offset by savings in others. That the original consolidation path was adhered to without modification is one of the key achievements of the programme, assisted by the reduction in interest rates and lengthened maturities on the EU loans. Fiscal adjustment was mainly expenditure-based, including through public-service efficiency reforms and better-targeting of welfare spending. Revenue measures focused on broadening the tax base, while maintaining overall progressivity. Property taxation was shifted from taxing transactions to recurrent revenue based on the value of housing. Environment-friendly taxation was also expanded. Overall, the combination of the authorities' strong track record of programme implementation with respect to the agreed fiscal targets and external surveillance allowed the sovereign to regain investor confidence – a key programme achievement. As a result, yields on Irish government bonds declined dramatically and the sovereign was able to return to market borrowing ahead of expectations. The return to markets was supported by further decisions of EU partners. The lending rate margins on the EFSM and EFSF loans have been eliminated and their average maturity extended from 7.5 to 12.5 years in 2011, and further to 19.5 years in 2013, which further enhanced the sustainability of Ireland's public debt.

The financial sector component of the programme aimed at a fundamental downsizing, recapitalisation and reorganisation of the banking sector. The reorganisation of the banking system happened swiftly, with bank mergers completed ahead of schedule, followed by the ultimate resolution of a large domestic lender that initially had been transformed into an asset-recovery bank. The recapitalisation of the domestic banks was done on the basis of a rigorous stress test conducted at the start of the programme. As a result, Irish banks continue to be highly capitalised in the euro area, with sizeable buffers on their balance sheets. While the costs to the taxpayer of recapitalising the banks were high, they were significantly below what was anticipated at the start of the programme as a result of burden-sharing with subordinated bondholders, the infusion of private capital into one of the pillar banks, and the gradual recovery of state resources through income from investments in banks and from disposals of part of the state holdings to the private sector. The deleveraging process aimed at minimising the impact on the real economy by emphasising disposals of non-core assets and by avoiding fire sales. As a result, Irish banks now have smaller balance sheets and are more focused on their core businesses, funding and their profiles have also improved considerably. Notwithstanding these key successes, progress in arresting the rise in non-performing loans (NPLs) and in working through the high level of mortgage arrears has taken longer than originally anticipated. A targeting regime has been introduced for the resolution of mortgage arrears by banks, there has been a major reform of the personal insolvency regime, and a number of institutional features of the mortgage market have been modified to strengthen engagement between borrowers and

lenders. It will take some time for the effects of these various changes to be fully reflected in the stock of mortgage arrears. Overall, significant progress has been made in terms of stabilising and downsizing Ireland's financial sector under the programme, but the process of financial sector repair is not yet fully complete.

Structural reforms under the programme focused on labour market reform to raise employment and measures to enhance competitiveness including in sheltered sectors. Before the programme, Ireland lacked an activation system to help it address the sharp increase in unemployment and its increasingly structural nature. A key achievement of the programme has been to establish such a system with on-going reforms to strengthen training and re-skilling opportunities for the unemployed, increase capacity to deliver activation support, including by contracting out some services, and improve the incentive structure by establishing sanctions for non-engagement. Reforms have also been adopted to enable wage-setting in certain sectors to be more responsive to economic conditions. The programme also included measures to open up sheltered sectors to competition, with a focus on the legal and medical professions. Legislation to reform the legal profession was introduced to parliament in late 2011, but has still not passed, and high legal costs continue to weigh on businesses and households. The high cost of medicines also remains a concern, although the government has begun to address this. In addition, a major reform of the water sector is on track to improve efficiency while ensuring financial sustainability through the introduction of charges for domestic users. Positive developments in unit labour costs in recent years are a key to Ireland's recovery. Reforms under the programme should support these trends. Moreover, while unemployment remains high and there is still scope for further adjustment in non-tradable prices, the decline in unemployment has been sizeable and the latest data indicate that it is gathering pace.

Graph 1.1: Rebalancing of the Irish economy



(1) Cost of banking crisis includes support from the beginning of the crisis year stated for each case up to 2012.
Source: Eurostat, Commission services' estimates, Laeven and Valencia IMF database on systemic banking crises

2. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

2.1. MACRO-FISCAL AND FINANCIAL DEVELOPMENTS

Inflation remains soft amidst signs of economic recovery, while employment continues to improve. Real GDP fell by 1.2% year-on-year (yoy) during the second quarter of 2013, following a similar annual decline during the first quarter, but increased 0.4% quarter-on-quarter (qoq) seasonally adjusted (sa) during the second quarter ([2]). Both private consumption and exports strongly weighed on annual economic growth, with signs of a possible turnaround during the second quarter. GNP, which reflects the income accruing to Irish residents, continued to develop robustly through the year. There was also an increasing divergence between GDP and employment growth, with the latter increasing by 1.8% yoy in the second quarter of 2013. This divergence is discussed further in Box 2.1 and appears to stem from the decline of the pharmaceutical sector which utilizes relatively little labour with its extremely high productivity, and a resumption of the more traditional labour-intensive manufacturing sector. Employment rose by 3.2% yoy in the third quarter of 2013, dominated by full-time jobs across the majority of economic sectors. As a result, unemployment (sa) fell to 12.8% even as the labour force grew for the second consecutive quarter. Annual core inflation at 0.6% yoy in October remained substantially below the euro area, with import goods contributing to the muted price developments, while prices of domestically produced goods and services increased somewhat.

Exports continue to be hit by the "pharma cliff", but trading partner demand and competitiveness indicators are improving gradually. The volume of export goods fell by about 6% during the first three quarters of 2013 compared to the same period the previous year, while import goods fell by 1.4% during the same period (Graph 2.1). Industrial production fell by about 2% during the same period, but positive readings of purchasing managers' indices (PMIs) and improved trading partner demand suggest that a more robust export performance can be expected toward the end of 2013. The bulk of the weak export goods' performance also related to expiring patents in the pharmaceutical sector where the service import content is also very high. Thus, the current account surplus remained at historically elevated levels, also supported by sustained factor income flows. Harmonized competitiveness indicators continued to gradually improve in the second quarter of 2013 to levels last attained a decade ago.

The domestic economy is picking up, but deleveraging appears to be dominating spending motives. Positive domestic price increases also were mirrored by the robust performance of the services index, which grew by over 2% during the first three quarters of 2013 over the same period the previous year. House prices grew strongly on annual terms from July through October, driven by sustained positive double-digit annual growth rates of Dublin property prices. As a result of the rebound in asset prices, the upward trend of household net worth still resumed during the second quarter of 2013. Household debt declined to its lowest level since 2006, but indicators of household debt sustainability improved only slightly as earnings continued to fall on annual terms through the third quarter. The debt-to-disposable income ratio also remained elevated at about 200 per cent, suggesting that the deleveraging process is likely to continue for some time. This also appears to be borne out by retail sales which were still flat during the first three quarters of 2013 compared to the same period in 2012.

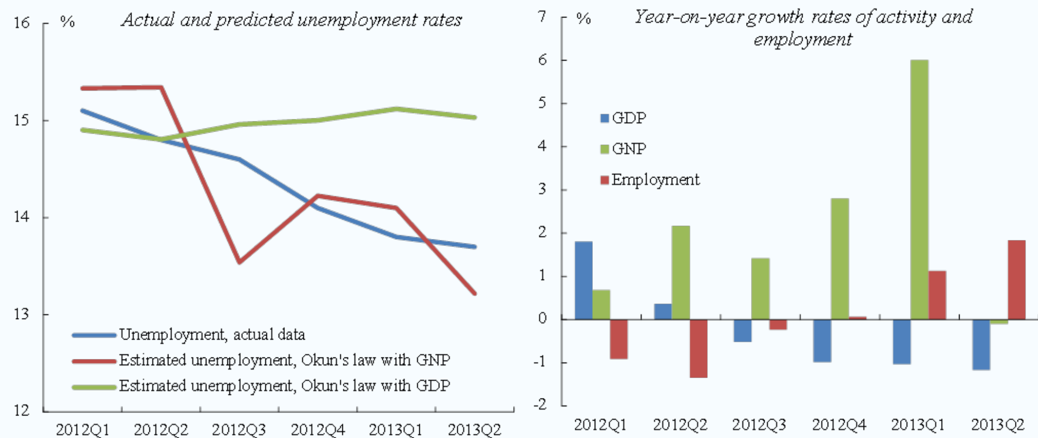
([2]) Ireland does not produce "flash" estimates of national accounts and as such no information was available for the third quarter at the time of writing the report.

Box 2.1: Okun's law and recent labour market trends

Unemployment has recently fallen steadily even as GDP growth has remained weak. A "stylized" recovery typically includes GDP growth turning positive before significant improvements in labour market indicators while unemployment and employment have instead shown more favourable trends than GDP in Ireland over the last quarters ([1]). Notwithstanding the volatility and frequent revisions to national accounts data, this raises the question whether "standard" macroeconomic relationships currently hold, such as Okun's law which relates changes in unemployment to changes in economic activity. An estimated version of Okun's law for the period 1998Q2-2012Q1, including contemporaneous and lagged values of GDP, unemployment and a constant, suggests that GDP growth of 1 percentage point in one quarter is expected to be accompanied by a fall in unemployment of about 0.2 percentage points. This relationship has been fairly stable for the last fifteen years, with the exception of 2008-2009 where a structural break in the form of rapid increases in unemployment was observed. The appropriate measure of economic activity in Okun's law might vary by country, and in the Irish context GNP may be a better gauge of domestic economic activity than GDP given that the latter might be distorted by the multinational sector, especially pharmaceuticals and chemicals, whose profits mainly accrue to non-residents. ([2]) A re-estimation of the Okun's law equation using GNP instead of GDP finds that a 1 percentage GNP growth in one quarter is associated with a 0.4 percentage point fall in unemployment over the same period, i.e. twice the impact of GDP on unemployment.

The GDP-based Okun's law currently appears not to hold due to sectoral reallocation, while outward migration seems less important. The chart below to the left compares actual and out-of-sample predictions for unemployment for the last six quarters using the two estimated equations. From the chart it is evident that the "classical" Okun's law relationship between GDP and unemployment has been weak over the last six quarters in Ireland: in fact rising unemployment would be predicted using that equation. One possible reason for this could be the on-going re-allocation from the pharmaceutical and chemical sector (characterised by extremely high productivity per worker) which is likely exerting downward pressure on GDP but not increasing unemployment. Employment growth in low-productivity sectors such as accommodation and food services and construction will also have a comparatively lower impact on GDP. GNP should be less affected by this reallocation, and if GNP is used to measure economic activity in the equation for Okun's law, the same downward trend in unemployment as observed in the data is obtained. Ireland also experienced extensive net outward emigration through 2012, which is likely to have contributed to falling unemployment through shrinkage of the labour force. It might also have weakened the stable relationship between economic activity and falling unemployment (as a result of job creation) recently. However, the chart to the right below shows that the expected pattern of sustained increases of economic activity eventually leading to a pick-up in employment is there – but again if the measure of activity is GNP as opposed to GDP. To sum up, the favourable labour market developments in Ireland over the last six quarters indeed seem to provide a strong signal of improving economic conditions even in the face of fragile GDP growth, and be less of a puzzle than a first glance.

Graph 1: **Recent labour market and GDP developments - a puzzle?**

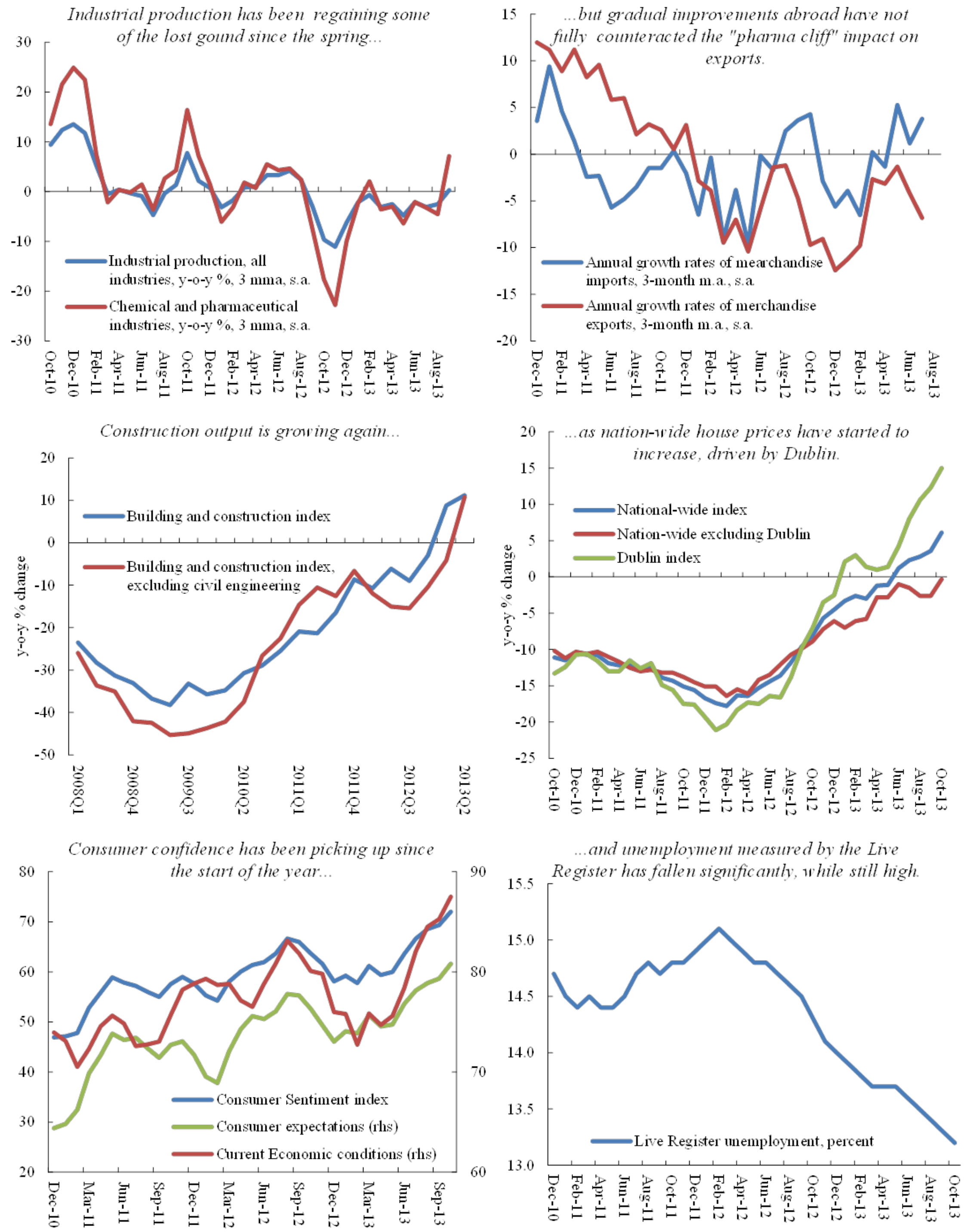


Source: Commission Services' calculations, CSO

([1]) National accounts data for the third quarter of 2013 were not available at time of writing the report.

([2]) GNP is instead affected by the activities of so-called re-domiciled plcs sa discussed in previous reports, but since the level has been more strongly affected than the growth rates during the last two years the impact on the results in this box should be contained. For further info on re-domiciled plcs see http://www.esri.ie/publications/latest_publications/view/index.xml?id=3742).

Graph 2.1: **Recent economic indicators**



Source: CSO

Public finance cash returns to end-October show mixed revenue performance, while spending is behind the monthly targets. Overall tax revenue is broadly on track with a strong performance in corporate and social contributions as well as the earlier-than-expected receipt of local property taxes off-setting shortfalls in VAT, income tax and excise. Nevertheless, under-performance of indirect and income taxes is expected to continue and the end-year tax revenue shortfall is estimated at around 0.1% of GDP (see Table A3.8). Social contributions including the Pay Related Social Insurance (PRSI) and the National Training Fund levy are ahead of plans to end-October, but the revenue is managed by spending departments and any surplus is assumed to be used in the context of overall expenditure control. Current and capital expenditure is behind plans to date, but most is expected to be spent by end-year. Expenditures are under control across the government departments in general, except for emerging slippages in the health sector, mainly due to delays in implementation of the budgetary measures.

Consequently, the 2013 deficit is estimated at 7.4% of GDP, marginally below the programme and EDP ceiling, despite slippages in the health sector. The improvement in the 2013 deficit estimate comes from the reclassification of one-off revenue (0.2% of GDP) ([3]) and interest expenditure savings (0.3% of GDP). Interest savings stem primarily from favourable interest rate developments and the decision to defer medium/long-term bond issuance until early 2014. Tax revenue is expected to record a small shortfall (less than 0.1% of GDP) as compared to the budget target. The receipt by the government of Allied Irish Bank (AIB) ordinary shares as a dividend payment may be reclassified by Eurostat as increasing the 2013 government deficit by 0.2% of GDP; Eurostat's decision is expected in April 2014. A further risk to the headline deficit is related to the possible shortfall in the sale proceeds arising from the IBRC asset sales which the government would need to compensate, although this would be treated as a financial sector measure and hence excluded from the programme and EDP deficit ceilings ([4]).

Domestic banks' funding positions continue to gradually improve as deposit-taking and market issuance progress well. On account of strong corporate and non-bank financial intermediary (NBFI) inflows (including those from the NTMA), covered banks' deposits increased by EUR 2.4 billion qoq by end-September and, at EUR 154.3 billion, were about 10% higher than their trough in the third quarter of 2011. Continued normalisation of deposit rates (Graph 2.2) contributed to some outflows in the retail segment during the first half of the year, though this trend has recently been somewhat reversed and been largely offset by increases in NBFI deposits. Deposit funding is now sufficient to support the core loan books of AIB and Bank of Ireland (BOI) at which loan-to-deposit ratios stood at 104% and 119% respectively at end-August. One rating agency recently upgraded the outlook on BOI and pricing on recent covered bond issuance by Irish banks compares favourably with European peers (Graph 2.2), reflecting increasingly buoyant market appetite for Irish risk ([5]).

As a result, and as balance sheet funding requirements decreased through managed deleveraging, banks' use of monetary authority funding continued to decline. Eurosystem borrowing by the covered banks fell to EUR 32.7 billion at end-September, down by 45% yoy, and now accounts for about 14% of total covered bank liabilities, down from a peak of over 37% in the third quarter of 2011. The share of Eurosystem funding to Irish banks fell to about 4.3% of the end-September total for the euro area, reflecting a return to 2003-2007 average levels. In percent-of-GDP, though still elevated, Eurosystem

([3]) In the latest Eurostat press release on the 2013 autumn notifications, the revenue from the 2012 sale of the mobile telephone licences (0.4% of GDP) has been reclassified to 2013. At the same time, CSO has decided to record the revenue from the National Lottery sale (0.2% of GDP) in 2014, which it was previously expected to be recorded in 2013. The impact of these statistical revisions and other changes is a worsening of the 2012 deficit by about 0.6% of GDP to 8.2% of GDP and improvements in the 2013 and 2014 budget deficits by about 0.2% of GDP.

([4]) According to the Council recommendation under Article 126(7) of the Treaty the deficit ceilings do not incorporate the possible direct effect of bank support measures.

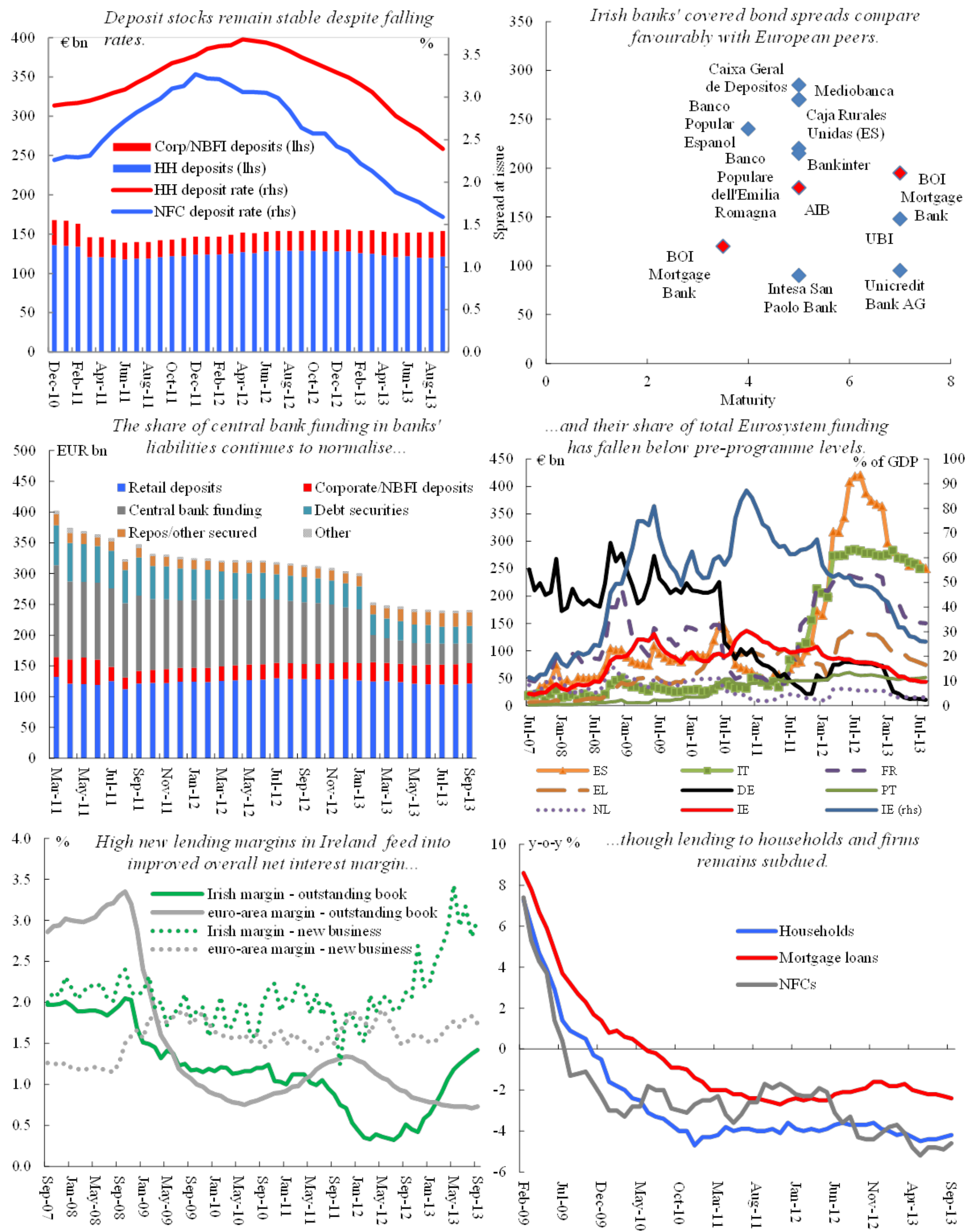
([5]) Since November 2012, covered banks have raised more than EUR 3 billion in term repo markets via private placements, EUR 5.5 billion in covered bonds/securitisations (on diverse collateral pools including Irish mortgages and credit cards), EUR 1 billion of senior unsecured bonds and EUR 250 million in subordinated debt from a wide range of international investors.

funding to domestic Irish banks([6]) has declined to below end-2008 levels reflecting an improvement of more than 60 percentage points since its peak at the beginning of the programme.

New lending to households and non-financial corporations (NFCs) in Ireland remains weak and tight credit conditions persist. From January to September lending to resident NFCs decreased at an average annual rate of 4.3%, and longer term loans continued to exhibit positive growth; loans with an original maturity of over five years grew by an average annual rate of 2.1% over the period. Lending by banks to indigenous SMEs declined by an annual rate of 5.8% at end-June with net annual credit to the sector continuing to fall despite new lending drawdowns of EUR 2 billion over the period. Nonetheless, survey evidence suggests that an increasing number of loan applications are being approved in full by banks (74% of the total, up by 4% in the six months from September 2012). Loans to Irish households fell by an average annual rate of 4.3% from January to September. Credit conditions for both firms and households remain tight. The weighted average interest rate on new mortgage loans with either a floating rate or initial fixed rate of up to one year was 3.31% at end-September, in line with the Irish twelve-month average for this and slowly converging to the euro-area average level (2.82%). New business rates for NFC loans of less than EUR 1 million increased by 17 basis points since the beginning of the year though these rates are volatile due to the low volume of new business. While demand for credit remains subdued, survey evidence suggests that credit conditions in Ireland continue to be among the tightest in the euro area. This in part reflects the drive by Irish banks' to improve profitability, as high margins on new lending feed through to increased overall margins on total loans.

([6]) These include the PCAR banks and foreign-owned banks resident in the Republic of Ireland.

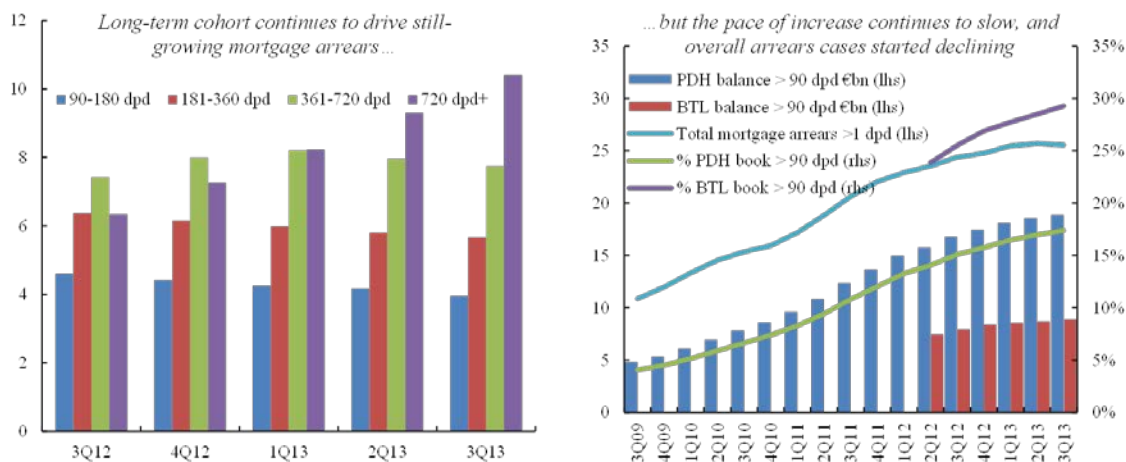
Graph 2.2: Recent financial sector developments



1/ Sources: CBI, Dept. of Finance; Notes: Deposit flows data covers BOI, AIB and PTSB. Rates data covers all Irish resident banks' deposits with fixed term <2 years.
2/ Sources: Bloomberg; Bond Radar; Notes: Spread indicated at times of issue; data covers unguaranteed covered bonds issued during 2H 2013 by banks from vulnerable or programme countries.
3/ Sources: CBI, Dept. of Finance; Notes: NBFI includes NTMA deposits; Other includes interbank borrowings, commercial paper and certificates of deposit.
4/ Source: ECB; Notes: data covers Eurosystem lending to all euro area countries in EUR mn (lhs) and as a % of GDP for IE only (rhs). Data for ES, EL, FR and NL relates to monetary policy operations and for DE, IE, IT and PT it covers total lending to domestic MFIs/not further specified.
5/ Source: ECB; Notes: NIM=net interest margin; Margins are derived from interest margins on loans to NFCs and term deposits from NFCs (all agreed maturities). Loans exclude revolving loans and overdrafts, convenience and extended credit card debt.
6/ Source: CBI; Notes: Data for households includes mortgage loans. Figure shows annual rate of change (%).
Source: Listed separately for each graph in the Notes above.

Mortgage arrears overall decreased in the third quarter and the rate of decline in arrears formation is accelerating, though arrears over 90 days past due (dpd) continue to increase. For both primary-dwelling-home (PDH) and buy-to-let (BTL) mortgages, diverging trends in short- and long-term arrears continued in the third quarter, with the increase in over 90 days' arrears being driven wholly by the long-term segment (720 dpd) in each category (Graph 2.3). During the same period, the declining trend in arrears formation (0-90 dpd) accelerated as the *number* of PDH mortgages in short-term arrears (i.e. less than 90 dpd) declined by 6% qoq, following a decrease of 3.3% qoq in the second quarter ([7]). Arrears *balances* for PDH mortgage loans also fell in the third quarter, by 0.5% qoq, for the first time since the series began in September 2009. Overall, the outstanding balance on accounts in arrears for more than 90 days accounted for 17.4% of all PDH mortgage loans (0.4% qoq) and for 29.3% of total BTL mortgage loans (0.8% qoq) at end-September.

Graph 2.3: Mortgage arrears developments



1/ (LHS) Data shows the evolution of aggregated PDH and BTL arrears balances (> 90 dpd) in EUR bn, by duration of arrears.
2/ (RHS) Data shows the qoq growth in arrears balances (> 90 dpd) for PDH and BTL mortgages in EUR bn (bars) and in percent of banks' total outstanding mortgage loan books (lines).
3/ Arrears cases outstanding (balances) include all arrears, including 0-90 dpd and > 90 dpd.
Source: CBI

2.2. MACROECONOMIC OUTLOOK

Near-term forecasts have been revised down modestly. Real GDP is now expected to grow by 0.3% in 2013 and 1.7% in 2014, compared to 0.6% and 1.8% at the time of the last review (Table 2.1), on the

([7]) According to a new data series compiled by the Department of Finance for the six main lenders, both the total number of PDH mortgage *accounts* in arrears (from 1 dpd) and those in arrears of over 90 days declined in the third quarter.

back of relatively weak national accounts data for the first half of 2013. As suggested by recent high-frequency data in Ireland and abroad, a pick-up of economic activity during the second half of the year is built into these projections given the negative carry-over of -0.7% after the second quarter. The weakness of nominal aggregates, both HICP inflation and deflators for different expenditure categories, have also surprised on the downside since the time of the last review. These developments are rather persistent both for Ireland and other euro-area countries, and HICP inflation and the GDP deflator have been revised down accordingly, notwithstanding the recent 25 basis point interest rate cut by the ECB in early November. The current-account surplus has been revised up to remain at historically very high levels, supported initially mainly by elevated factor income inflows and later also by improving net exports. The unemployment rate is forecast to decline faster than previously projected.

There are some differences in views on the composition of growth going forward. Commission Services' assessment of the composition of growth remains as during previous reviews despite the modest revisions to headline GDP growth, with fully balanced growth to be reached towards the end of the projection period. The Department of Finance's (DoF) economic forecast underpinning the 2014 budget projects a stronger contribution from domestic demand in the near term, supported by a more positive view on job creation, but also stronger negative headwinds to exports from the expiration of pharmaceutical patents during the coming years([8]). Taken together this leaves headline GDP growth similar between the two institutions for the remainder of the forecast period with the exception of 2014, when the DoF forecasts somewhat higher growth of 2.0%. The Irish Fiscal Advisory Council (IFAC) also found the DoF forecast of developments to 2014 plausible, and that they could comfortably endorse it ([9]).

Table 2.1: Revised macroeconomic framework

	Twelfth review forecasts (latest)						Eleventh review forecasts (previous)					
	2011	2012	2013	2014	2015	2016	2011	2012	2013	2014	2015	2016
	% change on previous year (unless otherwise noted)						% change on previous year (unless otherwise noted)					
Real GDP growth	2.2	0.2	0.3	1.7	2.5	2.8	2.2	0.2	0.6	1.8	2.5	2.8
Private consumption	-1.6	-0.3	-0.6	0.5	1.0	1.3	-1.6	-0.3	-0.3	0.5	1.0	1.3
Public consumption	-2.8	-3.7	-1.0	-2.8	-2.5	0.3	-2.8	-3.7	-0.9	-2.8	-2.5	0.3
Fixed investment	-9.5	-0.8	2.9	4.4	5.4	5.2	-9.5	-0.8	2.0	3.6	5.5	5.4
Domestic demand (contribution)	-3.6	-1.5	-0.2	0.2	0.7	1.3	-3.5	-1.5	-0.1	0.1	0.7	1.3
Inventories (contribution)	2.1	0.3	0.2	0.0	0.0	0.0	2.1	0.3	0.0	0.0	0.0	0.0
Exports	5.3	1.6	0.5	2.5	3.7	4.1	5.3	1.6	1.1	2.9	4.1	4.4
Imports	-0.4	0.0	0.2	1.4	2.7	3.5	-0.4	0.0	0.6	1.8	3.2	4.0
Net trade (contribution)	5.7	1.6	0.3	1.5	1.8	1.5	5.7	1.6	0.7	1.6	1.8	1.5
Employment	-1.8	-0.6	1.2	1.3	1.3	1.5	-1.8	-0.6	0.7	0.9	1.7	2.1
Unemployment (percent)	14.9	14.7	13.3	12.3	11.7	11.3	14.9	14.7	13.7	13.3	12.8	12.3
GDP deflator	0.7	0.7	0.7	0.8	1.1	1.2	0.7	0.7	1.0	1.2	1.4	1.6
HICP inflation	1.2	1.9	0.8	0.9	1.2	1.4	1.2	1.9	1.0	1.2	1.4	1.6
Current account (% of GDP)	1.2	4.9	4.1	4.6	4.9	4.6	1.2	4.9	2.3	3.3	3.5	3.1
Nominal GDP (EUR billion)	162.6	163.9	165.7	169.9	176.1	183.1	162.6	163.94	166.6	171.6	178.4	186.4
	level as % of GDP						level as % of GDP					
General government												
Government balance	-13.1	-8.2	-7.4	-5.0	-3.0	-2.4	-13.1	-7.6	-7.6	-4.8	-2.8	-2.4
Primary balance	-9.9	-4.5	-2.8	-0.2	2.0	2.3	-9.8	-3.9	-2.6	0.2	2.3	2.6
Interest expenditure	-3.3	-3.7	-4.6	-4.8	-5.0	-4.7	-3.3	-3.7	-4.9	-5.0	-5.0	-5.0
Gross debt	104.1	117.4	124.4	120.8	119.1	115.9	104.1	117.4	125.4	121.5	119.5	116.2

Source: Commission Services

Uncertainty around the baseline scenario remains, but risks appear balanced. Uncertainty over the timing and magnitude of the negative effects from the expiring pharmaceutical patents constitute a downside risk to export performance over the projection period. However, the improving labour and property market situation should gradually allow for both continued deleveraging and increased private consumption, which is therefore subject to upside risks. Although core investment (excluding aircraft) has

([8]) Dalton, M, Enright, S (2013) "The Impact of the Patent Cliff on Pharma-Chem Output in Ireland", Department of Finance Working Paper 2013:1, link

([9]) This was the first time the IFAC carried out this function, as required by euro-area "two-pack" legislation (Regulation (EU) 473/2013) .

started to expand again, the investment-to-GDP ratio remains historically very low which also suggests scope for further expansion, especially in the non-cash constrained multinational sector. Some concerns have emerged regarding near-term falling productivity, as high value-added sectors with relatively low employment such as the pharmaceutical one are shrinking, while high employment sectors with lower value added such as traditional manufacturing and non-tradable services are picking up. Nonetheless, these effects should be temporary and not mark a return to the unsustainable situation prior to the crisis.

3. POLICY ISSUES

3.1. FISCAL POLICY

Fiscal consolidation is set to continue with the underlying government deficit projected at 5.0% of GDP in 2014, while the authorities' target 4.8% of GDP, and the deficit is forecasted at 2.9% of GDP in 2015. Nonetheless, consolidation may prove more demanding if growth does not pick up to projected levels. Sustaining investor confidence will require adhering to announced fiscal targets under the EDP. Challenges ahead include implementing structural reforms in main spending areas, especially in the health sector. This, along with further strengthening of the medium- term expenditure framework should help ensure that consolidation is undertaken in a durable, fair, and as growth-friendly manner as possible.

The Commission Services forecasts the 2014 budget deficit to decline to 5.0% of GDP. The authorities target a 2014 budget deficit of 4.8% of GDP, below the 5.1% of GDP deficit ceiling under the EDP. The difference between the Commission services' deficit forecast and the authorities' mainly stems from different macroeconomic assumptions, in view of their higher growth projections of real GDP and domestic demand. Overall fiscal adjustment of EUR 3.1 billion (1.8% of GDP) for 2014 includes discretionary measures of EUR 2.5 billion and non-discretionary deficit-improving factors of EUR 0.6 billion (Table 3.1). While the overall adjustment is in line with the April 2013 stability programme, the somewhat lower discretionary effort is compensated by new savings and windfalls. For example, revenue from the lottery licence sale and higher dividends from the central bank are one-off, while part of the other measures could end up being temporary, such as interest savings or lower unemployment benefits. The temporary nature of some the deficit-improving factors in 2014 implies a need for a higher structural effort the following year in order to ensure a timely correction of the excessive deficit.

Table 3.1: Consolidation measures for 2014

EUR billion		
Discretionary measures	**2.48**	
Revenue measures	0.88	
New measures		*0.35*
Carry over		*0.53*
Current expenditure measures	1.50	
Saving measures		*1.40*
Carry over		*0.10*
Capital expenditure measures	0.10	
Non-discretionary measures	**0.60**	
One-off lottery licence sales revenue		*0.41*
Transfer of capital costs to Irish Water		*0.24*
Interest savings		*0.20*
Unemployment savings		*0.15*
Higher profit of the Central Bank		*0.10*
Capital stimulus measures		*-0.20*
Other costs		*-0.30*
Total adjustment	**3.08**	

Source: The 2014 budget, Commission services' estimates

Delays in the 2013 health sector measures endanger the 2014 health budget. Around one-third of the health savings planned for 2013 will not be achieved (0.2% of GDP) due to implementation delays (Table 3.2). The emerging gap is expected to be only partly covered by temporary contingency measures within the sector, and savings from other departments are necessary to keep the overall expenditure in line with

original plans. Moreover, control over the cost-containment plans in the health sector could be strengthened as demand for health services is strong and exceeds budget allocation plans. The main budget implementation shortcomings are in the following areas: (i) savings in the Primary Care Reimbursement Scheme (PCRS) suffer from delays in implementation of the necessary legislation; (ii) lower wage bill savings arise from a difficult transition between the two public sector pay agreements – the Croke Park and Haddington Road Agreement; and (iii) legislation enabling income generation has been postponed to 2014, while was originally planned in 2012.

Table 3.2: Implementation of the 2013 health budget measures

EUR million

Savings Measures	Budget 2013	Estimated end-year shortfall
Reduction in Cost of Drugs and Other Prescribed Items	160	24
Increase DPS threshold to €144 per month	10	0
Increase prescription charges for medical card holders	51	4
Reduce professional fees	70	33
Changes to Primary Care Schemes - Medical Cards	32	0
Public Service Agreement Related Savings	308	135
Procurement Measures	20	0
Increased Private Income	70	65
Total HSE	721	261
Savings on Department of Health Vote	60	
Total Savings in Health Group	**781**	**261**

Source: Commission services

Though the majority of adjustment measures are solid, the quality of some of the discretionary measures in 2014 could be improved. Expenditure measures account for almost two thirds of the adjustment. The revenue effort is lower than previously planned (by 0.2% of GDP) largely due to the retention of the reduced VAT rate for the hospitality sector, which was introduced in 2011 and was set to expire at end-2013. Expenditure savings in 2014 result from both (i) hard policy measures such as pay cuts, discontinuation or reduction of benefits, increased co-payments and (ii) soft measures such as efficiencies from better work organisation due to new working time arrangements, eligibility controls of social and health care payments, and lower demand in some areas. Savings from soft measures are more difficult to quantify and their outturn can be less predictable. The health sector, in particular, relies on soft saving measures and some specific actions still remain to be defined in the health service plan.

Table 3.3: Main discretionary measures for 2014

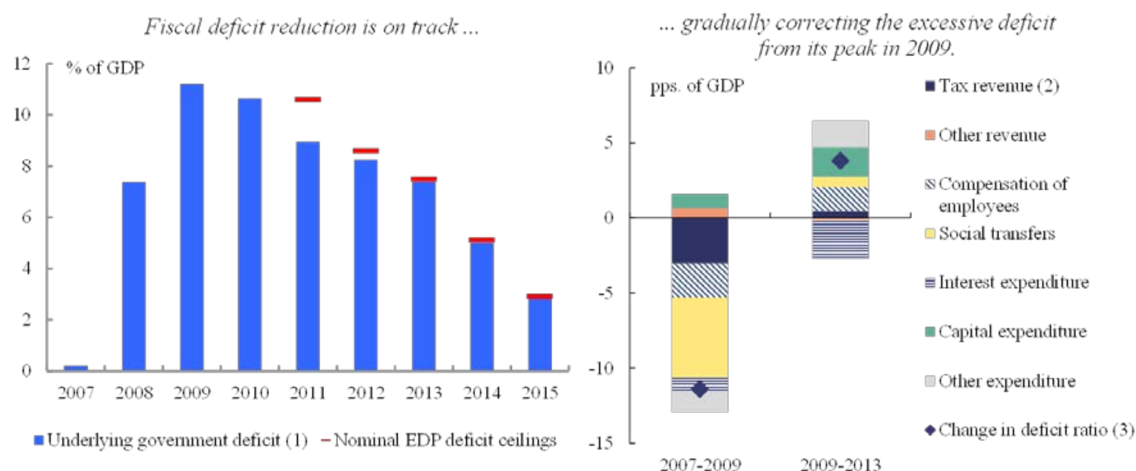
% of GDP

Revenue measures		Expenditure measures	
Deposit Interest Retention Tax DIRT and exit tax on life insurance policies and investment funds set at 41%	0.1	Pay bill savings	0.3
New levy on financial institutions	0.1	Social benefit cuts and control measures	0.2
Increased levy on pension fund assets	0.1	Drug cost savings, increased income collection, co-payments and control measures in heath sector	0.2

Source: The 2014 budget

The authorities have reconfirmed their commitment to bring the government deficit below 3% of GDP by 2015. However, this target is not yet underpinned by broad policy measures, and relies on the assumption of fiscal adjustment of around EUR 2 billion (1.1% of GDP). Based on the Troika's forecast, a larger fiscal adjustment of around EUR 2.5 billion (1.4% of GDP) is required to reach the deficit

Graph 3.1: Government deficit and its adjustment



(1) Underlying government deficit excludes deficit-increasing financial sector measures.
(2) Tax revenue includes direct and indirect taxes, and social contributions.
(3) Minus sign signifies worsening of the government deficit.

Source: Commission services

target ([10]).The absence of a specific medium-term budgetary plan is motivated by the authorities' intention to carry out a comprehensive expenditure review in 2014, which will inform the 2015 budget and the medium-term fiscal strategy. In order to comply with the EU budgetary framework requirements, the next stability programme should provide details of the medium-term budgetary plans, though the government's spending priorities may change following the expenditure review.

Further improvement of the medium-term expenditure framework is necessary to limit risks to the fiscal targets. An administrative circular outlining operational detail of the government expenditure ceilings was published in early October 2013. It spells out the adjustment criteria for the ceilings, while the multi-annual correction process is not yet developed. The choice of legal instruments governing the expenditure ceilings, the Ministers and Secretaries (Amendment) Act 2013 and the circular, may not be sufficiently robust to ensure the binding nature of the expenditure ceilings in national legislation. The weakness of the current expenditure framework is illustrated by the discretionary increase in the 2014 expenditure ceiling outside limited circumstances spelled out in the circular and using some of the headroom to the nominal deficit ceiling ([11]). Specifically, the government's previous expenditure ceiling for 2014 included current expenditure adjustment of EUR 1.9 billion, but the 2014 budget relaxed both the ceiling and expenditure effort by some EUR 0.4 billion. This loosening is compensated by largely temporary non-discretionary factors, while structural expenditure adjustment is postponed. Therefore, the binding nature of the government expenditure ceiling should be strengthened by embedding the adjustment criteria in ordinary law rather than in an administrative circular, which is not legally binding and gives leeway for discretionary changes to the ceiling.

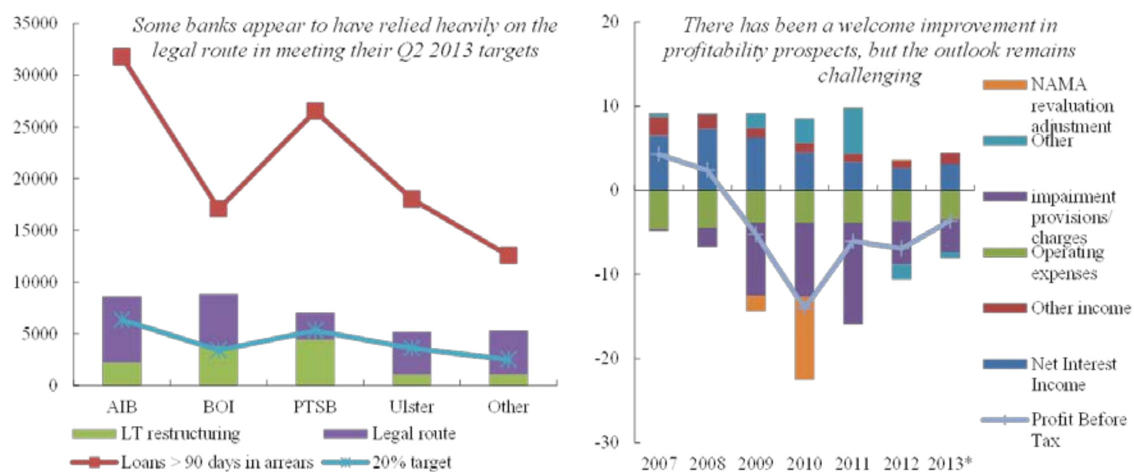
([10]) The 2015 headline deficit forecast of 3% of GDP includes one-off deficit-increasing financial sector measures for credit unions (EUR 100 million). Such measures are excluded from the EDP deficit ceiling, and the underlying deficit in 2015 is projected at 2.9% of GDP.
([11]) The circular sets out the limited circumstances under which the government may vary government and ministerial expenditure ceilings and specifies that any change to the government expenditure ceiling is subject to compliance with the overall European and national fiscal rules.

3.2. FINANCIAL SECTOR POLICY

Banks are increasing their capacity to assist mortgage holders in arrears but considerable work remains. Initially, banks appeared overly reliant on the legal route in meeting second quarter 2013 targets, but the approach appears to have been more balanced in the third quarter. Data for this quarter also shows that for the first time since 2009, overall mortgage arrears declined. Significant regulatory challenges have been addressed, such as the remedying of the legal lacuna created by the "Dunne" judgment ([12]) and the revision of the Code of Conduct on Mortgage Arrears. The authorities have completed their Balance Sheet Assessment (BSA) in line with MOU requirements. The exercise found that a substantial increase in provisioning would be warranted for some loans but no immediate need for capital. The results have been communicated to the banks to inform financial planning and to prepare for the upcoming EU-wide SSM exercise.

All banks observed, and in some instances exceeded, their third quarter 2013 Mortgage Arrears Restructuring Targets (MART). The banks' second quarter submissions had indicated that 62% of all proposed solutions involved the surrender or repossession of the property, but in the third quarter the mix of proposals has become more balanced ([13]) between restructurings and adopting the legal route. The sustainability of an arrangement is essential to the success of these targets; solutions should be affordable for the borrower over the long term, and clearly set out the assumed treatment of collateral at maturity. In particular, it is questionable whether an interest only (IO) arrangement for a long period of time, particularly for a principal dwelling home (PDH), is sustainable. Based on the review of a sample of results the auditors have concluded that the banks have met their third quarter targets but several issues relating to the durability of proposed solutions have been identified that will form the basis for on-going dialogue between the central bank and the relevant institutions.

Graph 3.2: Financial Sector Developments



RHS graph:
(1) 2013 data is annualised
(2) "Other" includes income from LMEs
Source: (LHS) Banks' submissions to the Oireachtas Committee on Finance, Public Expenditure and Reform; (RHS)PCAR banks' Annual reports and Interim Financial Statements

Concerns remain regarding the capacity of the courts to deal with the expected large increase in legal proceedings. At the end of the second quarter of 2013, the banks had made over 21,500 proposals

([12]) See page 28 for explanation of Dunne judgement in, ,
http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp115_en.pdf
([13]) Based on the banks' submissions the proportion of legal route had fallen from 62% in the second quarter to 55% in the third quarter

which involved either a legal or voluntary surrender of the property. While a large number of these legal proposals are not expected to advance to court, the numbers raise concerns regarding the capacity of the courts system to deal with the potential demand ([14]). An expert group has been established to review the repossession system and is examining issues such as length, predictability and cost of proceedings, including relative to peer jurisdictions, as well as systems for dealing with non-cooperative borrowers. In line with programme commitments the authorities have assessed the possibility of establishing a "fast track" system for repossessions of buy-to-lets (BTLs) and of appointing specialist judges to deal with repossessions. The authorities concluded that the introduction of such a system is not necessary or justifiable. As to the appointment of specialist judges, the authorities are of the view that this is not warranted since there is yet no indication that the normal court process will be unable to deal with the increased volume of repossession cases. Nonetheless, given the clear evidence of an increase in demand, these options should be kept under active consideration and capacity of the courts should be closely monitored as current arrangements may prove incapable of managing the increased workload efficiently.

While there has been a welcome improvement in banks' profitability, the outlook remains challenging for some banks. The banks' interim results show improvements in their Net Interest Margins (NIM) driven by a reduction in funding costs and lower deposit pricing (Graph 3.2). Both AIB and BOI have indicated improvements in their NIM in the third quarter of 2013. Given the high share of deposit funding in Irish banks' total liabilities (about 64% at end-September), their profitability outlook is highly sensitive to any increase in deposit interest rates. While banks have reduced their cost base, they are likely to remain large relative to gross operating income, given the drag of low-yielding legacy assets and limited prospects for increasing non-interest income. In this regard, the authorities are continuing to explore options to lower the drag associated with banks' "tracker" portfolios ([15]) including through various mechanisms of credit enhancement aimed at increasing liquidity advancement rates and reducing marginal funding costs. Market-based solutions could become available amid continually falling secured issuance costs. Other ways to improve bank profitability can also be explored, and the authorities are conducting an external review of bank fees and charges in comparison to a select peer group of European banks.

NAMA is making progress in reducing its loan book but the impact of the loan transfer from IBRC will not be known until early 2014. Since its inception, NAMA has overseen the sale of over 7,000 individual properties, which has generated EUR 10 billion in asset sales and a further EUR 4 billion in non-disposal income, mainly rental income. In light of this, NAMA is on course to meet its target for the repayment of EUR 7.5 billion of senior bonds by the end of 2013, in line with programme commitments. The sale of the IBRC loan book is underway in several tranches and early indications reveal considerable market interest in the loans ([16]). However, it is too early to quantify the potential size of the portfolio that may transfer to NAMA. In order to facilitate a smooth transition, NAMA is establishing additional operational capacity to deal with the entire loan portfolio, though it is expected that a sizeable portion of the book will not transfer to NAMA but will be disposed of as part of the ongoing sales process.

The BSA found that a significant increase in provisioning is appropriate but no immediate need for capital. The BSA has been finalised and the results have been communicated to the banks to inform financial planning. Considerable work has been undertaken since the summer in completing the BSA (Box 3.1). The authorities are now engaging with the banks and have advised them that the results of the

([14]) Submissions by the three largest mortgage lenders indicate that included in this number were over 3,100 instances where court proceedings had been initiated; a substantial increase relative to 2012 when the Circuit Court made a total of 258 orders for possession

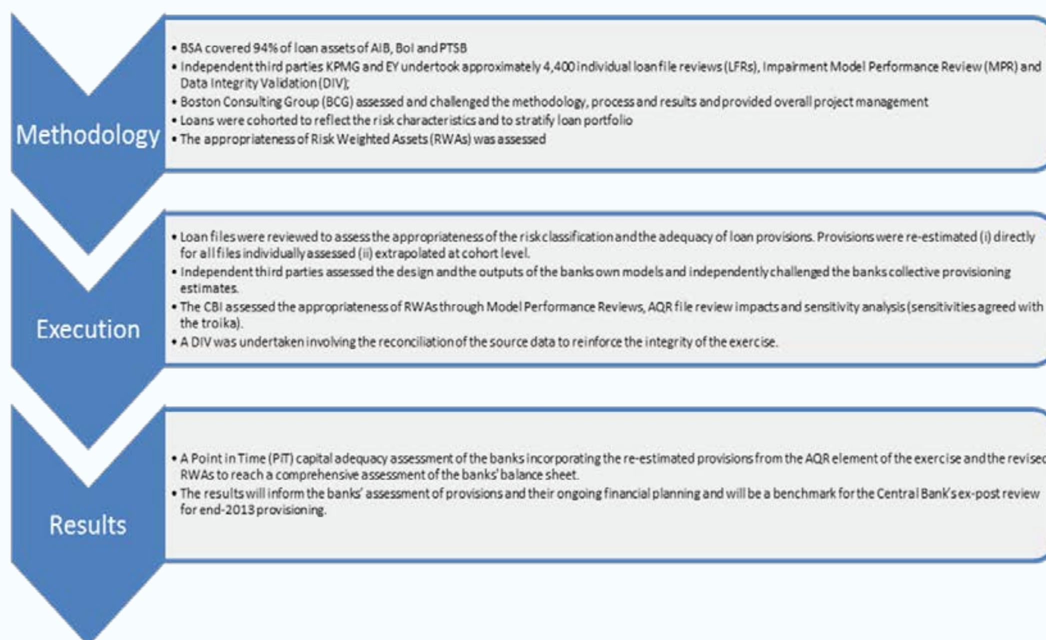
([15]) "Tracker" mortgages account for about a third of covered banks' total net loans carrying an average margin of about 130 basis points over ECB policy rates and, unlike similar products in other countries, in Ireland these contracts do not provide for the possibility of changing the interest-rate setting mechanism.

([16]) The first portfolio of loans brought to market ("Evergreen", a EUR 2.5 billion gross corporate/SME book) received 62 bids across 14 tranches of loans.

Box 3.1: **Irish Balance Sheet Assessment (BSA) Methodology**

The Troika and the authorities agreed that a Balance Sheet Assessment (BSA) of the banks was necessary before the completion of the financial assistance programme. This was decided in light of the evolving timeframe for the European wide stress tests which were delayed to beyond the programme horizon. The BSA was undertaken by the authorities and validated by an independent assessor. The exercise involved: (i) a quantitative assessment of impairment provisions and review of risk classifications i.e. an asset quality review on an incurred loss basis; and (ii) a review of the appropriateness of risk weighted assets (RWAs) calculations under alternative assumptions. The outputs from these two work streams were used by the CBI to assess the capital adequacy of the banks at end-June 2013.

The exercise assessed the application of the revised provisioning guidelines, developed in consultation with the Troika and published by the CBI in May 2013. The guidelines require a more stringent treatment of forborne loans in arrears and establish clearer triggers for identifying non-performing loans. These guidelines are broadly in line with the European Banking Authority's (EBA) proposed harmonised definitions for forbearance and non-performing exposures, which will be one of the key inputs for the upcoming SSM exercise ([1]).



([1]) Further details available here:
http://www.ecb.europa.eu/pub/pdf/other/notecomprehensiveassessment201310en.pdf?785ba099d0e5340a0dc4090f89972f21

exercise should be considered in finalising their end-2013 financial statements and will be used as a benchmark for the CBI's ex-post review of end-2013 provisioning. The BSA found that additional provisions are appropriate for some cohorts of loans and identified adjustments to the banks' stocks of risk weighted assets. However, the cumulative results estimated for each institution do not entail additional capital requirements as current capital buffers are sufficient for their core tier 1 ratios to remain above the current regulatory threshold of 10.5% and the 8% common equity tier 1 threshold used in the BSA The findings from the loan file reviews, the data integrity validation exercise and the review of risk weighted assets will inform the CBIs' supervision process and risk mitigation plans issued to banks. Given that the SSM exercise will be based on the banks' end-year balance sheets, every effort should be made to reflect the BSA's findings in the banks' annual accounts.

A return to profitability is essential for the banks to meet future capital thresholds under the Capital Requirements Regulation and Directive (CRR/CRD IV). Given the current composition of capital held by AIB and BOI, additional measures are likely to be required for the banks to meet the 7% common equity capital threshold (including the capital conservation buffer) from 2019. This is due to the gradual deduction of deferred tax assets (DTAs) and the treatment of the preference shares ([17]). Improvements in profitability will be key to allow banks to use these DTAs and conserve profits to rebuild their capital ratios and the changes to the treatment of DTAs for NAMA banks announced in Budget 2014 will assist ([18]). Other legislative solutions transforming some DTAs into tax credits may also be useful, but consideration needs to be given to their possible impact on government debt. Alternatively, the transformation of existing preferential shares into common equity tier 1 instruments would also result in capital ratios above the fully phased in Basel III/CRR capital requirements in both banks.

The two main banks, AIB and BOI, continue to meet their SME restructuring targets though the sustainability of the arrangements put in place to date have yet to be audited. The authorities have postponed their on-site assessments of the banks' restructuring proposals until the first quarter of 2014 but will use the finding of the individual loan file reviews undertaken in the context of the BSA to target their audits. Separately, the Irish Banking Federation (IBF) has announced the roll out of a protocol for SMEs that have multiple creditor debt in January 2014, similar to the pilot currently underway for mortgage holders ([19]). The protocol will be non-binding on each lender but will allow an SME in financial difficulty, with multi-banked debt, to communicate with the relevant banks and for those banks to collectively consider a proposed solution. Given the potential implication of this protocol for Revenue, and possibly also for NAMA, there is a need for close involvement of the state in any potential scheme. Any initiative that assists with the timely resolution of debt for the troubled SME sector is welcome and should be promptly implemented.

Policy initiatives designed to enhance access to finance for SMEs are supporting credit to and employment in the sector. The authorities' efforts have focused on enhancing SMEs' access to credit through lending volume targets for the covered banks, direct government funding via Microfinance Ireland, private debt and equity financing with state participation via the National Pension Reserve Fund (NPRF), the SME Loan Guarantee Scheme and credit mediation via the Credit Review Office (Table 3.4). These policy initiatives are witnessing some modest initial successes in generating extra credit volume and helping create and protect jobs in the sector. Nonetheless, repairing the bank credit channel through enhancing profitability and further normalisation of bank funding conditions will be important in delivering a more significant improvement in SME access to finance. Additional funding to the sector by the European Investment Bank (EIB) ([20]) and plans for low-cost lending by German development bank KfW will also play an important role in enhancing the availability of credit to Irish SMEs.

([17]) CRR/CRD IV involves a phasing out of the counting of DTAs towards core tier 1 capital by 10% annually from 2015 until end 2023 and the preference shares subscribed by the government will no longer count as regulatory own funds from 1 January 2018.

([18]) The government announced the removal of the 50% restriction on DTAs for participating banks in NAMA.

([19]) See page 26: http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp162_en.pdf

([20]) In 2012 Ireland received around EUR 505 million in long-term low cost funds from the EIB, supporting a number of projects including investment in universities, renewable energy, the water sector, and investments in SMEs in cooperation with domestic banks. Overall over the last five years, the EIB has provided more than EUR 3 billion for infrastructure investment and SMEs.

Table 3.4: SME credit policy initiatives

Policy measure	Date	Additional credit volume	Jobs protected/created
Credit Review Office (CRO), set up to mediate on disputes between lenders and prospective SME borrowers who have been refused credit.	Dec 2009	€18.5mn overturned as of end-Oct 2013	1,521
SME lending targets for AIB and BOI of €3bn, €3.5bn and €4bn each for 2011, 2012 and 2013, respectively.	2011	N/A* *targets in terms of new loan sanctions observed though in net terms banks' SME loan books still contracting	N/A
Microfinance Ireland extending loans between €2,000 and €25,000 to firms with less than 10 employees	Q3 2012	€90mn (over 10 year horizon); €1.81mn to date	263
Temporary Loan Guarantee Scheme for firms with specific characteristics that are unable to access bank financing.	Q4 2012	€150mn in guarantees available per year over 3 years; about €5mn to date	about 500
Provision of finance via NPRF to SMEs through partnership with private sector investors, comprising one credit fund (Bluebay Mid Market Fund - €200mn NPRF commitment; €450mn total fund size) and two equity funds (Carlyle SME Restructuring and Growth Fund - €125mn from NPRF, €350mn total; and Better Capital SME Turnaround Fund - €50mn from NPRF, €100mn total).	Q1 2013	€450mn credit and €450mn equity; strong transaction pipeline, 1 deal signed to date	N/A

Source: Capita Asset Services Ltd., CRO, Department of Finance, NPRF

Restructuring of the credit union sector has commenced with the loans and deposits of Newbridge Credit Union transferring to PTSB. The High Court recently approved an application from the Central Bank for the transfer of the loans and deposits of Newbridge Credit Union to PTSB. Credit Unions play an important role in the Irish financial sector ([21]) particularly for the financially excluded or the less well-off members of the community. The CBI is currently reviewing a portfolio of approximately 100 credit unions on a case by case basis to assess various supervisory concerns including the levels of arrears and the adequacy of provisions. At the end of September 2013, some 20 credit unions had reported regulatory reserves below the minimum requirement of 10% of assets. This implied a capital shortfall of approximately EUR 11 million for those 20 credit unions. While any capital shortfalls should be covered by the sector in the first instance, the authorities have put in place two funds totalling EUR 500 million to deal with the costs of restructuring ([22]).

The Insolvency Service has begun accepting applications but the capacity of the system remains largely untested, as only three applications have progressed to court so far. Some 78 individuals are registered as personal insolvency practitioners (PIPs), with more expected shortly. A pipeline of cases is being developed but only a small number of those are expected to advance to court before the end of 2013. The authorities are due to enact ([23]) changes to the bankruptcy law before year end which will see the automatic discharge period for bankruptcy fall from twelve to three years. These changes are likely to result in an increase in the number of bankruptcy cases in Ireland which could add additional pressure on courts capacity.

After significant delays, the legislation establishing a central credit register is expected to be enacted before the end of 2013. The introduction of the register will enhance transparency, a prerequisite for prudent lending. However, the authorities have indicated that the section providing for the use of the personal public service number (PPSN) to be used as a unique identifier may not be

([21]) The credit union sector consists of 393 credit unions with about 2.8 million members, and total loans of approximately EUR 4.5 billion.
([22]) In line with EU/IMF Programme commitments, the Irish authorities have established the Resolution Fund with EUR 250 million committed to the sector and a further EUR 250 million has been allocated to the Credit Union Fund to assist with restructuring vulnerable credit unions during the next three years.
([23]) The Personal Insolvency Act 2012 provides the legislative basis for the changes to the bankruptcy law but the relevant sections have yet to be commenced.

commenced immediately. A strong unique identifier is a key aspect of credit registers across Europe. The authorities should ensure this is a feature of the Irish register from the outset so that it contains all the relevant information. Once the legislation is passed, every effort should be made to have the register fully operational at the earliest possible date.

3.3. STRUCTURAL REFORMS

Labour activation mechanisms are in place and the critical issue is now to fully implement them and deliver services universally, including to the long-term unemployed. The course for further education and training reforms is firmly set, but more work is still required to improve delivery and the relevance of programmes, address the needs of the (long-term) unemployed and tackle skills mismatches. Water sector reforms are firmly on track but particular care will be needed to ensure that efficiency gains and improvement in services are delivered. Assets sales are imminent but proceeds will materialise only in 2014. Legal services reform is still delayed. Health care sector reform has started, but more remains to be done, including the reduction of pharmaceutical costs.

3.3.1. Labour market activation and further education and training

The capacity to deliver activation services and re-skilling opportunities should be improved. Ireland has put in place activation mechanisms over the past couple of years and recently restructured its further education and training (FET) system. While the new framework is broadly in place, significant work remains to be done in order to build on the recent positive developments in the labour market as most long-term unemployed remain outside the scope of the core activation services and as skills mismatches are sizeable. Further, the fact that 40% of the people who have been on the Live Register for more than a year are below 35 (and 64% below 45) make access to re/up-skilling opportunities all the more important.

The roll-out of *Intreo* (unemployment) offices has been slow but progress is expected by end-2013. A total of 43 offices, covering about 70% of the unemployed, should be opened by end-2013. Although the authorities insist that this target can still be met, only 16 offices were operational by end-September, with a mere six opened so far this year. Given that the one-stop-shop function of *Intreo* offices is important for service delivery, adhering to the roll-out programme should be a priority. In turn, the Department of Social Protection (DSP) is making progress with the redeployment of officers towards case management functions. Of the 300 redeployments planned before end-2013, 160 are on-going with officers being trained before assuming their new functions while another 140 officers have been identified and notified of their forthcoming redeployment. On the basis of these redeployments, the DSP plans to engage with an additional 10,000 long-term unemployed per quarter through one-to-one sessions, however, there were 230,000 people on the Live Register of unemployment for more than one year as of September 2013 ([24]).

The partial contracting out of activation services is shaping up. A large number of specialised international and domestic providers expressed interest following the issuance of a prior information notice in July and the authorities are currently finalising the drafting of the terms and conditions prior to the issuance of the request for tenders (RFT). It is urgent to enhance the capacity to deliver activation services to the long-term unemployed, and the planned issuance of the RFT by mid-December is welcome.

([24]) Economic Adjustment Programme for Ireland Summer 2013 Review.

Box 3.2: **Irish Water funding model**

The CER consultation paper on the economic regulatory framework recommends that the revenue cap (RPI-x) model be adopted. This option is superior to others due to its objectives of stability, sustainability and cost efficiency. The model would operate as follows:

- The CER would set the maximum revenue that Irish Water can recover from its customers on the basis of six-year regulatory cycles. An interim regulatory cycle of two years would be put in place initially.
- Under the RPI-x principle, the allowed revenue level would increase annually with inflation and a correction factor "x" representing anticipated efficiency gains to be passed on to customers. Efficiency gains above the "x" factor would be passed on to customers under the subsequent regulatory cycle.
- Revenues would be set at a level sufficient to finance Irish Water as an efficiently-run utility and provide an adequate return on capital, taking into account any direct support by the Exchequer. The determination of the level of revenue is a complex task for the regulator. The CER proposes that:

– Operational expenditure would be determined on an efficient-cost basis underpinned by benchmarking, economy-wide productivity trends and assessments by industry experts;

– Capital expenditure would be determined by a long-term investment strategy and multi-annual plans, with individual projects subject to regulatory approval;

– The rate of return on the regulatory asset base (RAB) would be determined by a target gearing ratio, an assumed cost of debt and a return on equity based on capital asset pricing modelling;

– The RAB is determined by an opening value following the transfer of assets and liabilities from local authorities to Irish Water and adapted for capital investments. The CER proposes that extra capital be valued at indexed historic cost and depreciated on a straight-line basis through the lifetime of the asset.

- Irish Water could adjust tariff schedules or amounts within the regulatory cycle, subject to regulatory approval and staying within the revenue cap. Performance-based incentives could also be put in place.

Driving efficiency gains in the water sector and establishing a well-run, high-quality and self-financed utility is the core objective of the reform. Achieving these objectives and implementing the revenue cap (RPI-x) framework will require significant supervisory work, with decisions by the CER significantly impacting the water sector, including the level of charges, quality of service, investment levels and efficiency gains. These decisions will need to be closely monitored, particularly regarding their impact on the efficiency of Irish Water. Forthcoming decisions on the level of the "x" factor, the RAB and the return on capital will be critical as they will determine how much the CER will pressure Irish Water to deliver efficiency gains.

The CER has expressed concerns that the long-term nature of SLAs between local authorities and Irish Water could compromise the achievement of efficiency gains. If long-term SLAs are put in place, the CER will need to use all its powers to drive efficiency gains. The establishment of SLAs with 34 local authorities should enable performance benchmarking, and the review of SLAs after year two and year seven (as currently envisaged under the Water Services (No 2) Bill) should be used to deliver efficiency. In addition, the CER could consider additional incentive mechanisms to drive efficiency gains at Irish Water. The incentive structure provided under the revenue cap (RPI-x) model (i.e. financial incentives for shareholders) may not work well for Irish Water since it will be 100% state-owned. Thus, other incentives could be designed.

Contracting out will boost service delivery capacity, but with a delay. In the best of cases, it is likely to take just under a year before contracted agents start delivering activation services. Payments will be

partly performance-based and exclusive contracts will be awarded in four geographic areas. Performance will be assessed based on well-defined outcomes (sustained return to employment) and adjusting for the macro-economic environment as well as for a measure of *ex-ante* difficulty to place a person into employment. In addition, minimum service levels will be set, without imposing a ratio of case officers to jobseekers. A total of 80,000 to 90,000 jobseekers, exclusively long-term unemployed, will be assigned to private contractors.

Contracting out should provide an opportunity to benchmark *Intreo* offices. Although contractors will handle a limited set of the pool of jobseekers and will face activation tasks that differ in some aspects from those of *Intreo* offices, the contracting out should enable the DSP to assess the efficiency of its own activation services, which will remain the backbone of Ireland's activation system, not only in terms of its ability to return jobseekers into employment, but also in terms of intermediate targets such as the conduct of one-to-one interviews and "customer" (jobseekers and employers) satisfaction.

Sanctions against non-participation in activation have been strengthened. A review of sanctions indicates that the application of penalty rates on welfare payments has risen steadily since their introduction in May 2011 and with the launch of activation services (which entails obligations on behalf of jobseekers). A high but relatively steady rate of about 5.5-6% of jobseekers fails to attend group engagement sessions after having received two invitations to do so, which indicates that sanctions have not been applied widely so far. Sanctions for refusal or failure to engage with activation measures have nevertheless been reinforced recently under the Social Welfare and Pensions (Miscellaneous Provisions) Act 2013. The penalty rate ([25]) can now be stepped up to a full suspension of payments, which is nevertheless capped at a maximum of nine weeks, after which the penalty rate applies again.

Uncertainty continues to affect collective bargaining arrangements. The authorities indicated that they will reduce the number of Joint Labour Committees to seven from thirteen following the recommendations of the review by the Labour Court. A new set of Employment Regulation Orders (EROs) will still have to be negotiated, however, as those concluded prior to the Industrial Relations (Amendment) Act 2012 were ruled anti-constitutional by a High Court ruling. Registered Employment Agreements (REAs), in turn, were ruled anti-constitutional by a Supreme Court ruling in 2013 and will need further legislation in order to be reinstated as collective bargaining instruments. No progress has been achieved since the previous review in this respect and there is no indication as to when draft legislation could be prepared.

Work progresses on reforming the delivery of FET. The authorities completed the strategic review of FET provision by the end of the third quarter as expected. The review offers a number of concrete recommendations that should inform the drafting of the strategy for SOLAS (Further Education and Training Authority), which must be finalised by end-March 2014 and will guide Ireland's future FET strategy. The review stresses the need to align FET with local and regional skills demand, make proper use of labour market intelligence, closely involve the business sector in the delivery of programmes, put in place seamless linkages between *Intreo* offices and Education and Training Boards (ETBs), direct funding where effective through SOLAS and prioritise the long-term unemployed. In addition to ensuring that FET programmes are relevant for re-skilling and up-skilling the unemployed, Ireland will also need to improve the vocational training offered to its youth that do not pursue tertiary education in order to equip them with proper qualifications and facilitate employment.

3.3.2. Water sector

The comprehensive legal framework for the reformed water sector was published at the beginning of December. The publication of the Water Services (No 2) Bill marks another major milestone in

([25]) Penalty rates vary according to circumstances and for Jobseeker Allowances or Jobseeker Benefits, but typically imply a 25% reduction in welfare payment.

reforming the sector and brings Ireland one step closer to transferring water assets from local authorities to the national utility, Irish Water. In spite of the two-month publication delay with respect to the MOU, the authorities are adamant that they can meet their objective of having the Bill enacted by the end of the year. The Bill will be considered first in the Seanad, commencing on 4 December, to proceed to the Dail soon thereafter. In addition, the authorities are working to prepare Ministerial orders and have finalised the template service level agreements (SLAs) between local authorities and Irish Water to ensure that the Bill becomes effective as soon as it is enacted.

Operational work continues apace ahead of the transfer of functions. The installation of water meters started in August in the Midlands and has recently been phased in across all regions. Pre-installation surveys are virtually complete and close to 20,000 meters had been installed by end-October. Irish Water expects to reach its target of installing 27,000 meters per month quickly. Other key operational work is advancing, in particular the establishment of processes and systems at Irish Water, recruitment of staff, due diligence on the asset transfer plan (from local governments to Irish Water), the negotiation of the terms of SLAs and their associated annual service plans, and a public information drive.

Public consultations on the economic regulatory framework for Irish Water have been launched. The Commission for Energy Regulation (CER) will be granted regulatory powers over the water sector under the Water Services (No 2) Bill. It will supervise Irish Water's operations and the implementation of its capital programme, authorise tariff levels and structure, protect customers and ensure that efficiency gains and high-quality services are delivered. Consultations will be held before the introduction of water charges for domestic users in the fourth quarter of 2014 ([26]). The first round concerns the economic framework, which will define how the CER supervises the business operations of Irish Water. A second round of public consultations on the tariff structure will be launched in January 2014, with other rounds to follow on Irish Water's tariff-based revenue during an interim period, customer protection and other issues.

While clarity is emerging on the funding model for Irish Water, the level of Exchequer support remains to be determined. The economic regulatory framework put forward details the bases upon which the CER proposes Irish Water to operate and finance its activities. While the proposal provides a sound overall framework (Box 3.2), it remains subject to changes as a result of the consultation process and still needs to be approved by the government. In addition, the authorities still have not clarified the extent to which Irish Water will continue to benefit from Exchequer support once charges are collected on a full-year basis (i.e. from 2015 onwards) and how quickly such support will be phased down. They remain committed to making Irish Water self-funded in the medium-term, however, and want to ensure that it meets Eurostat's market corporation test from the start ([27]). In addition, their target is for Irish Water to finance its capital expenditure entirely on the capital markets (without government guarantee) by 2019. The authorities have also recently engaged with European Commission to ensure that Exchequer support to Irish Water is compatible with state-aid rules.

A determined drive to reap efficiency gains and improve service delivery will be critical to the long-term success of the reform. The authorities and the CER will need to ensure that Irish Water does deliver the expected efficiency gains and an improved level of service ([28]). The long-term sustainability of – and support for – the reform hinges upon this, and recurrent supply problems being economically costly

([26]) Commission for Energy Regulation: The CER and Water Regulation in Ireland, 30 October 2013.
([27]) Eurostat has not issued a decision on this so far, but to qualify for the market corporation test, sales must cover more than 50% of production costs. A related decision from Eurostat will determine whether equity investment in Irish Water (including a budgeted capital funding programme of EUR 240 million in 2014) will be considered as capital transfer (deficit increasing) or acquisition of equity.
([28]) The independent assessment conducted by PWC at the start of the reform process identified a capital investment need of about EUR 600 million per annum. The authorities estimate that this could be reduced to around EUR 440 million per annum as a result of efficiency gains and water metering. Such sizeable efficiencies will not materialise automatically and easily, however, and will need to be accompanied with efficiency gains on the operational side.

and an embarrassment. In this respect, further consideration should be given to forcing Irish Water to operate through service level agreements with local authorities for as long as 12 years as is proposed.

3.3.3. Asset disposals

The sale of Bord Gaís Energy was unexpectedly cancelled at the end of November. While final bids had been received from a broad range of international players in the energy market, the authorities determined that none of them were at an acceptable value and therefore decided not to proceed with the transaction that had been expected to be the largest sale of a state asset under the privatisation programme. Nevertheless, they indicated that they would complete the separation of Bord Gaís Networks and Bord Gaís Energy, and review options for the latter. The sale of the 50% stakes held by the Electricity Supply Board (ESB) in two overseas power plants is progressing. The first of these transactions has been completed and ESB is currently finalising the sale of the second plant, which is expected to complete in early 2014 ([29]). In addition, the ESB is planning to sell two domestic peat-fired power plants by mid-2014. Budget 2014 only pencilled in revenue from assets sales of EUR 110 million. Also, while no privatisation proceeds will be collected in 2013, the authorities are committed under the programme to use at least half of the proceeds for debt reduction, a requirement that is echoed in the EDP recommendation of 2010, which stipulates that unplanned revenue should be allocated to deficit and debt reduction.

3.3.4. Legal services

Legal services reform continues to experience delays. The Legal Services Regulation Bill, initiated in October 2011, has yet to complete committee stage. This ambitious reform – if completed - would create a new regulatory framework for the legal professions, in which the current self-regulatory bodies of the legal professions will be accountable to an independent Legal Services Authority empowered to drive further competition-enhancing reforms. Renewed momentum could be achieved if the authorities use the interim period to prepare the ground for the establishment of the new authority, so it could occur in parallel to the completion of the legislative process, which is expected early in 2014. Key elements of competition reform include easing restrictions on advertising for barristers, facilitating the establishment of alternative business models, and making the provision of legal training more flexible and inclusive.

3.3.5. Healthcare sector

Necessary reform of financial management systems in the Health Services Executive (HSE) has begun. Financial management systems have remained fragmented, causing substantial delays in the processing of information and monitoring of budgetary pressures as they might emerge. Recognising the importance of timely and reliable financial information in identifying and eliminating waste, the authorities have now put in place a new financial reform initiative. Furthermore, by allowing for a break-down of costs by clinical activity, the new accounting system is a key enabler of the government's commitment to deliver a Money Follows the Patient funding model ([30]). A key first step, due to be commenced by the end of 2013, is the design of a common chart of accounts and data standards for use by budget holders throughout the HSE. In parallel, systems requirements will be defined with a view towards implementing a new single system for accounts management, by end-2015.

A new eHealth strategy has been developed, with emphasis on the establishment of health identifiers for patients and professionals. In developing a new eHealth strategy, to be published before the end of the year, the authorities have taken an important first step in catching up with Ireland's EU

([29]) The ESB announced on 21st November that it has completed the sale of its 50% shareholding in Marchwood Power Limited (MPL) in the UK to Munich Re, a major European insurance company. It announced on October 22 that the sale process for its stake in Bizkaia Energia would continue into 2014.

([30]) The Money Follows the Patient model would allocate funding to hospitals or hospital groups on the basis of treatments delivered, as opposed to the current model of block funding.

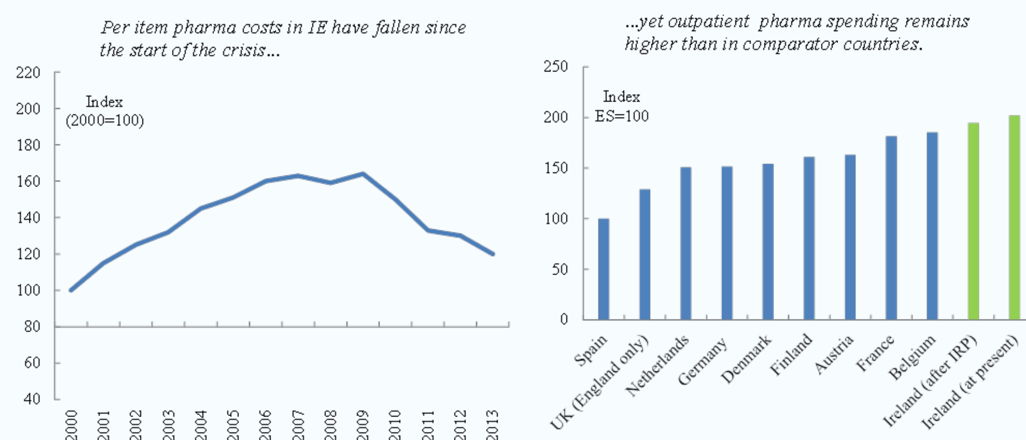
neighbours in the area of eHealth. A foundation element is the development of unique health identifiers for patients, with a secure link to the infrastructure of the Public Service Card. Identifiers are crucial to creating a system of ePrescription, which can enhance patient safety as well as enable substantial cost savings in pharmaceuticals over a medium-term horizon. Identifiers also enable a Money Follows the Patient funding model. While the introduction to parliament of the new legislation – the Health Identifiers Bill – has already been delayed, its publication before the end of the year would still be in line with targets under the eHealth strategy.

Further cost savings in pharmaceuticals are still possible. While this will require concerted policy effort, given the influential role of the industry, additional cost savings for outpatient medicines are possible in two of the three market segments: patented drugs and generics (Box 3.3). Patented drugs, which account for 75% of the outpatient market in value terms, continue to be purchased by the state at above-average prices. By harnessing the powers of the new Health (Pricing and Supply of Medical Goods) Act 2013, the authorities can use the mid-term review of the current agreement with industry – scheduled for June 2014 – as an opportunity to adjust reimbursement prices downward in line. While off-patent medicines represent a smaller market share, this is set to grow, as a number of high-cost drugs are due to come off patent. The establishment of groups of interchangeable medicines, more price transparency for pharmacists and stricter requirements for prescribers to use non-proprietary names when writing prescriptions, have the potential to deliver cost savings in this segment. Once these measures are in place, reforms should aim at reducing inpatient pharmaceutical costs.

Box 3.3: The potential for further savings in public pharmaceutical spending

Public spending on pharmaceuticals has come down, but from a very high level. Cost inflation in healthcare during the boom years resulted in per capita drugs spending in Ireland at the start of the crisis being among the highest in the developed world. Two important measures have been taken to reduce costs. First, the 2012 agreements with industry and the authorities reduced reimbursement prices. Second, in line with similar systems in the EU, Ireland is adopting "reference pricing" (IRP), by which groups of interchangeable off-patent drugs are defined, and the state sets a reference price for the group, based *inter alia*, on price comparisons with other member states. However, it is not clear that these measures will be enough to contain costs. Even after the price cuts of the 2012 agreements, spending on outpatient medicines, when taking into account Ireland's younger population, remains higher than for any of the countries in its 'reference basket' ([1]). Even if projected savings on off-patent medicines are included, demographically-adjusted spending remains nearly twice as high as the lowest country in the basket, i.e. Spain.

Graph 1: **Outpatient pharmaceutical spending in Ireland; Right: per item costs; Left: annual public spending in 2012/2013 (per capita, weighted for demographic effects; Spain=100)**



Source: LHS: Department of Health; RHS: Commission staff calculations based on national data, demographic data from Eurostat; all data are for 2012 except IE and ES: 2013 estimates; BE: 2013 budgetary envelope.

Further savings will require price reductions on patented medicines. Because such a large amount of pharmaceutical spending is on patented medicines (about 75% of 2013 outpatient spending), progress on reducing per item costs depends on the state's ability to obtain better prices on patented medicines. By ensuring sufficient expertise is in place and by fully applying its powers under the Health (Pricing and Supply of Medical Goods) Act 2013, the authorities would be well equipped to engage with industry early in 2014. New measures to make prescription by International Non-proprietary Name (INN) compulsory will also support rapid market entry for new generics, as more of these medicines come off patent.

Enhancing price transparency and improving prescribing practices are also needed. Further measures to increase price transparency would encourage competition in the retail pharmacy market, reducing co-payment costs for patients on medical cards. Finally the fact that per item cost reductions have not translated in an appreciable reduction in overall spending suggests that this can also be reduced by tackling volumes issues. Measures to ensure better prescribing practices and better targeting of medical cards can help, while Ireland's eHealth strategy, including ePrescribing, will enable more accurate control and targeting of prescriptions to reduce waste and to guard against counterproductive interaction effects between multiple medicines taken by the same patient.

([1]) The 'reference basket' is the nine countries used for the external reference pricing exercises, as set out in the 2012 agreement between the authorities and the Irish Pharmaceutical Healthcare Association.

4. FINANCING ISSUES AND POST-PROGRAMME MONITORING

By the end of 2013, the cash buffer will reach an estimated EUR 20 billion, sufficient to cover more than the entire 2014 financing need. The buffer is however EUR 2.8 billion less than previously estimated during the last review mission. This reduction is due to the authorities' decision not to issue any more government bonds in 2013 and the deferral of the final EFSM disbursement to early 2014. In 2014, the funding needs of the sovereign are determined by the exchequer deficit of EUR 9.6 billion and a maturing bond of EUR 6.9 billion. The end-2013 cash buffer is at historically high levels for the Irish sovereign and represents a significant backstop against internal or external risks.

Table 4.1: Financing table

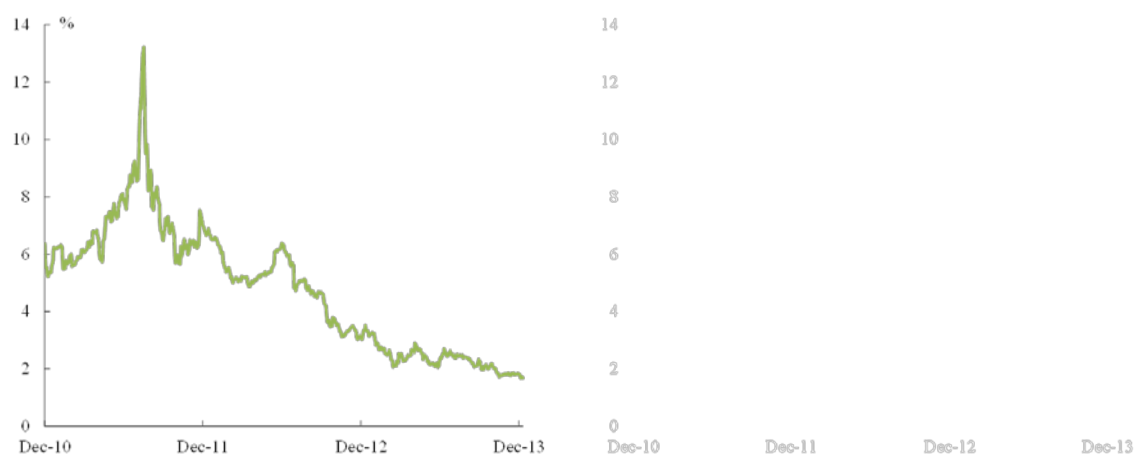
	2010	2011	2012					2013					2010-2013
EUR billion	Dec	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Total
A. Exchequer cash deficit 1/	**5.4**	**18.4**	**4.3**	**6.9**	**1.7**	**3.5**	**16.4**	**3.7**	**2.9**	**0.5**	**4.2**	**11.3**	**51.5**
B. Debt redemption 2/	**2.5**	**9.7**	**6.3**	**-0.6**	**-0.7**	**4.4**	**9.4**	**1.7**	**6.9**	**3.6**	**3.8**	**16.0**	**37.5**
of which: long term bonds	0.0	4.8	5.6	0.0	-0.3	0.7	6.0	0.4	4.6	0.7	0.0	5.7	16.6
C. Bank recapitalisation	**0.0**	**16.6**	**0.0**	**1.3**	**0.0**	**0.3**	**1.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**18.1**
D. Other Financing needs 3/	**0.0**	**0.7**	**0.2**	**-0.9**	**0.0**	**0.5**	**-0.2**	**0.0**	**0.0**	**0.5**	**0.5**	**1.0**	**1.5**
E. EU-IMF loan disbursement	**0.0**	**34.5**	**10.5**	**4.4**	**3.7**	**2.6**	**21.2**	**1.5**	**4.1**	**2.2**	**3.0**	**11.0**	**66.7**
EFSM/EFSF 4/	0.0	21.5	6.2	2.8	2.3	1.0	12.3	0.0	2.4	1.0	2.2	5.6	39.3
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	4.9
IMF	0.0	12.6	3.2	1.5	0.9	0.9	6.4	1.1	1.0	0.8	0.6	3.5	22.5
F. Market Funding	**0.5**	**1.4**	**0.4**	**3.4**	**6.5**	**1.9**	**12.3**	**12.2**	**3.7**	**1.6**	**0.6**	**18.1**	**32.3**
of which: long term bonds	0.0	0.0	0.0	3.1	5.1	0.0	8.1	7.8	0.0	0.1	0.0	7.9	16.0
Memorandum item:													
Cash balances, eop	22.3	13.0	13.2	14.3	23.5	19.3	19.3	27.6	25.5	24.8	20.0	20.0	

1/ Includes promissory note payments
2/ Includes long-term bonds, T-bills, commercial paper and others
3/ Include contingencies
4/ EFSM will disburse EUR 0.8 bn in Q1 2014
5/ UK, Sweden and Denmark.
Source: CSO

The low level of sovereign bond yields and spreads indicates a successful comeback to market funding during the programme. The ten-year government bond currently has a yield of around 3.5%, which is not only lower than the yield during the immediate pre-programme period, but also below the average yield in the pre-crisis years from 2003 to 2008. Similarly, the ten-year spread over German bonds is at its lowest level since the start of the programme at about 180 basis points (Graph 4.1). In an environment of uncertainty due to speculation over the end of quantitative easing by the Federal Reserve in the US, the yield on Irish sovereign bonds fell continuously in September and October, and the spread remained stable. Low yields together with the high cash reserves of the treasury prepare the ground for an effective return to a full reliance on market funding after the conclusion of the programme at the end of 2013. For the post-programme period, the Irish authorities plan to keep a prudent level of cash buffers as a first line of defence against any possible volatile market sentiment, but to gradually reduce them in accordance with market conditions. With global interest rates at record lows, the authorities must also prepare themselves for an eventual rise in interest rates.

On 14 November, the Irish authorities decided to conclude the EU-IMF Programme without seeking a precautionary credit line. They described the decision to not have a precautionary follow-up programme as 'finely balanced', and it was facilitated by the high amount of cash balances and low yields on Irish bonds.

Graph 4.1: Irish 10y sovereign bond spreads



Source: iBoxx

The successful completion of the economic adjustment programme implies that Ireland will return to the regular cycle of EU economic surveillance. As a result, it will be fully subject to the procedures that had been suspended under the programme (as per Articles 11 to 13, in Regulation (EU) 472/2013). Fiscal surveillance under the excessive deficit procedure, which was embedded in the economic adjustment programme, will continue as Ireland is expected to correct its excessive deficit by 2015. In addition, and in line with the two-pack provisions (i.e. Regulation (EU) 473/2013), Ireland will have to submit draft budgetary plans to the European Commission starting with Budget 2015.

Aside from these requirements common to all euro-area Member States, Ireland will be subject to the additional post-programme surveillance (PPS) mechanism, adopted under Regulation (EU) No 472/2013. PPS will apply until at least 75% of the financial assistance received under the programme has been repaid ([31]) so as to ensure that Ireland maintains its capacity to service its debt to the EFSM, EFSF and bilateral lenders. Under PPS, the Commission will be requested, in liaison with the ECB, to (i) conduct regular review missions in the Member State to assess its economic, fiscal and financial situation; and (ii) prepare semi-annual assessments of Ireland's economic, fiscal and financial situation and determine whether corrective measures are needed. The assessment is to be communicated to the competent committee of the European parliament, to the Economic and Financial Committee and to the Irish parliament. Acting upon proposal from the Commission, the Council could recommend Ireland to adopt such corrective measures ([32]). In parallel and in close coordination with the Commission, the EFSF will put in place procedures to administer its loans until the last payment is due (in 2042), including an early warning system.

([31]) Under the current repayment schedule, this means PPS will last until 2031 at the earliest.
([32]) Further details on post-programme surveillance are to be found in Article 14 of Regulation (EU) 472/2013.

5. RISKS

As highlighted in previous reviews and discussed earlier, Ireland continues to face substantial internal and external challenges and risks in the medium term, which require on-going policy action as it graduates from the economic adjustment programme:

- **Vulnerabilities remain in the financial sector.** The high level of non-performing loans needs to be addressed as it creates uncertainty over the health of the banks' balance sheet. The relatively slow pace of completing sustainable mortgage and SME loan restructurings also weighs on banks' capacity to lend and support the economic recovery. Some banks have been over reliant on the legal route to resolve mortgage arrears, and if continued, this could put additional strain on the legal system and lead to negative social outcomes. In this regard, the removal of obstacles to repossessions should help aid loan restructurings. In line with other euro-area countries the outcome of the upcoming SSM exercise and the potential impact on the Irish banks and the sovereign remains unclear.

- **Market risk will gain more prominence.** As the programme ends and Ireland returns to normal market issuance, risks emanate from international capital markets and investor sentiment which can be volatile. In particular, markets may fluctuate over speculation on the Federal Reserve's unwinding of unconventionally loose monetary policy, and low global interest rates will likely rise in the medium term. Nonetheless, high cash buffers and the maturity profile of the Irish debt will insulate Ireland from market swings and rising interest rates to an extent.

- **Risks related to low growth and fiscal sustainability need to be tackled.** The fiscal adjustment path is predicated on pickup in economic growth. If growth remains sluggish, higher fiscal effort will be necessary to reduce the excessive government deficit and to put public debt on stable downward trajectory. There are also fiscal implementation risks, particularly in the health care sector which has seen persistent overspending. It will be important to continue with structural reforms to boost growth and with labour market activation policies to reduce high unemployment and raise domestic demand.

LIST OF ABBREVIATIONS

AIB	Allied Irish Bank
BOI	Bank of Ireland
BGE	Bord Gáis Energy
BSA	Balance Sheet Assessment
BTL	Buy-to-Let
CBI	Central Bank of Ireland
CRR	Capital requirement regulation
CER	Commission for Energy Regulation
COM	European Commission
CPI	Consumer price index
CSO	Central Statistics Office
DoF	Department of Finance
Dpd	days past due
DSP	Department of Social Protection
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EFSF	European Financial Stability Fund
EFSM	European Financial Stabilisation Mechanism
EIB	European Investment Bank
ERO	Employment Regulation Order
ESB	Electricity Supply Board
ETB	Education and Training Board
DTA	Deferred tax asset
FET	Further Education and Training
GDP	Gross Domestic Product

GNP	Gross National Product
HH	Household
HICP	Harmonised Indices of Consumer Prices
HSE	Health Service Executive
IBF	Irish Banking Federation
IBRC	Irish Bank Resolution Corporation
IFAC	Irish Fiscal Advisory Board
IMF	International Monetary Fund
IO	interest-only
MIP	Macro-economic Imbalance Procedure
MOU	Memorandum of Understanding
NAMA	National Asset Management Agency
NBFI	Non-bank financial intermediary
NFC	Non-financial corporation
NIM	Net interest margin
NPRF	National Pension Reserve Fund
NTMA	National Treasury Management Agency
PDH	Primary dwelling house
PCAR	Prudential Capital Assessment Review
PCRS	Primary Care Reinbursement Scheme
PiP	Personal insolvency practioner
PiT	Point in time
PMI	Purchasing managers' index
PPS	Post-programme surveillance
PSRI	Pay Related Social Insurance
PTSB	Permanent TSB (bank)
qoq	Quarter-on-quarter

RWA	Risk weighted asset
REA	Registered Employment Agreement
RFT	Request for tender
sa	Seasonally adjusted
SDR	Special Drawing Rights
SOLAS	An tSeirbhís Oideachas Leanúnaigh Agus Scileana (Further Education and Training Authority)
SME	Small and medium enterprise
SSM	Single Supervisory Mechanism
SLA	Service level agreement
SREP	supervision, evaluation and assessment process
yoy	Year-on-year

ANNEX 1
Programme implementation

Permanent conditions	Status and COM assessment
PC.1 i. Rigorously implement fiscal policy consistent with the requirements of the excessive deficit procedure. In particular, the Department of Finance and the Department of Public Expenditure and Reform will continue to ensure effective tax collection and tight supervision of expenditure commitments by the line departments to ensure that the primary deficit target in cash (see Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the general Government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved. ii. Any additional unplanned revenues must be allocated to debt reduction. iii. Moreover, the nominal value of Social Welfare pensions will not be increased.	**i. Observed.** **EDP deficit ceilings were met with ample margin in 2011 and 2012** (in particular, based on the October 2013 EDP notification, the 2012 deficit outturn was 8.2% of GDP, against a programme ceiling of 8.6% of GDP). **Our current 2013 deficit forecast** (7.4% of GDP) is just below the 2013 EDP and programme ceiling. **ii. Observed.** **Revenue overperformance has been saved** (i.e., the deficit has undershoot the programme ceiling by an amount equal to or greater than the revenue overperformance), although some expenditure have been allowed to exceed programmed amounts (for example, on unemployment benefits and health). Overall expenditure has been in line with original programme projections because of the windfall savings on the interest bill including resulting from EU policy decisions. It needs to be kept in mind that it has been agreed that some proceeds from identified asset sales will be spendable on growth-enhancing projects (see PC.3 below). **iii. Observed.**
PC.2 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.	**Broadly observed** (in some cases the consultation period before announcement has been very short).

PC.3 Use at least half of the proceeds from state asset sales for eventual debt reduction while also reinvesting the remainder of 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.	**Not applicable.** There have been no privatisation proceeds so far.
PC.4 Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.	**Observed.**
PC.5 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).	**Observed, though pace/ambition of reforms could be stepped up.** Reforms of activation policies are on-going and in line with programme requirements, though progress has at times been slow. A key challenge is to ensure the proper mobilisation of resources for engagement with and re-skilling of the long-term unemployed.
PC.6 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.	**Observed.**
PC.7 Ensure that NAMA: (i) maintains the highest standards of governance with appropriate accountability and transparency arrangements;	**Observed.** (i) Detailed set of annual accounts, an Annual Statement and quarterly reports on NAMA activities were submitted to Minister for Finance and laid before both Houses of the Oireachtas.

(ii) reduces the costs of its operations; and	(ii) Administrative expenses fell slightly in 2012 to EUR 119 mn (2011: EUR 128 mn).
(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 bn worth of senior bonds by end 2013.	(iii) NAMA has introduced various initiatives that have played a role in the recovery of the Irish property market, including (a) vendor finance (EUR 375m advanced to date) (b) joint ventures and (c) capital investment programmes (EUR 2bn commitment of which EUR 500m has been spent). Disposal receipts have totalled EUR 9.7 bn out of a total of EUR 14.5bn of cash inflows since inception. NAMA has redeemed EUR 7 bn in NAMA senior bonds (93% of end 2013 target) and has reaffirmed the commitment to redeem EUR 7.5 bn by end 2013.
PC.8 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. (i) The restructuring will be completed in as short a timeframe as possible under a clear plan identifying credit unions appropriate for restructuring, subject to Central Bank approval. (ii) 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. (iii) In parallel, the Central Bank will continue its inspections to determine the financial condition of the weakest credit unions, and may engage its resolution powers drawing on Resolution Fund resources.	**Observed.**
PC.9	

Ensure continued compliance with the minimum capital ratio of 10.5 percent for all PCAR banks (AIB, BOI, and PTSB).	**Observed.**
PC.10 Continue to strengthen the fiscal framework and reporting in line with that of the EU.	**Partly observed.** Implementation challenges remain. Many elements of the budgetary framework have been strengthened. However, the expenditure framework falls short of the letter and spirit of the EU requirements and recommendations (formulated under the Fiscal Frameworks Directive and the EPC policy advice). In particular, the expenditure ceilings are not immune from discretionary changes and cover a different aggregate than the EU expenditure benchmark. **The Irish Fiscal Advisory Council has been tasked with independently endorsing the macroeconomic forecasts underlying the budgetary plans.** The Memorandum of Understanding setting out practical arrangements between the IFAC and the DoF was published on 9 August 2013. To comply with the 'two-pack' requirement. the Department of Finance will set out its forecasting methodology in a periodically updated working paper which will be published
PC.11 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.	**Observed.**

PC.12 In preparation for the timely introduction of the Single Supervisory Mechanism (SSM) the Irish authorities, in consultation with staff of the EC, ECB and IMF will conduct a stress test in accordance with the new EU methodology, ahead of and in close proximity to the upcoming SSM exercise. In addition, the authorities will consult with the staff of the EC, ECB, and IMF, and taking into account progress in developing the relevant SSM methodology, advance preparatory work on a number of fronts including the preparations of the loan loss forecasting models underpinning the forthcoming stress test. The models will be subject to external validation.	**Not yet applicable.**
Q3: financial sector reform	
Taking into account progress in developing the relevant SSM methodology, the authorities will agree with staff of the European Commission, the IMF, and the ECB, as part of the asset quality review on an incurred loss basis (as per paragraph 24),test parameters for benchmarking provisioning. Sampling and loan file reviews will follow best practice to ensure a high level of coverage and representativeness.	**Observed.**
With regards to the assessment of balance sheets (as per paragraph 24), the authorities will agree with the staff of the European Commission, the IMF and the ECB by end July: • the engagement of independent third parties to, respectively: (i) contribute to the implementation of the exercise including through on-site loan file reviews, and (ii) validate the exercise. • a detailed roadmap for the completion of the exercise specifying regular engagement, with the staff of the European Commission, ECB, and IMF, on an ongoing basis on progress, methodology, inputs, outputs, and findings.	**Observed.**
The authorities, in consultation with the staff of the European Commission, the IMF, and the	**Observed.**

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.	
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.	**Observed.**
The authorities will conduct a forward looking analysis of the operating profit for each of the PCAR banks, including sensitivity analysis to funding costs, to end 2015. The authorities will advise the banks of the outcome of this exercise in order to inform banks' business and financial planning going forward. In addition the authorities will report on the exploration of options to lower the funding cost of banks' tracker mortgage portfolios.	**Observed.**
The authorities will keep under review the effectiveness of statutory repossession arrangements in Ireland based on on-going experience with repossession actions. The authorities will agree with staff of the EC, ECB and IMF by mid-August the terms of reference for an expert group that will examine issues such as length, predictability and cost of proceedings, including relative to peer jurisdictions, as well as systems for dealing with non-cooperative borrowers and the merits of expedited proceedings for non-principal private residences, and propose, where necessary, appropriate measures to be brought forward quickly to deal with any problems arising.	**Observed.**
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	**Observed.**

resolving problem loans, and also against bank specific targets for reviewing new and existing individual arrears cases.	
The authorities will publish banks' reported data on mortgage loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.	**Observed**.
Following consultation with the staff of the European Commission, the ECB and the IMF, the authorities will publish a target for the conclusion by end-2013 of sustainable solutions of no less than 15% of mortgage loans in arrears for more than 90 days, consistent with largely completing sustainable solutions for all mortgage loans in arrears for more than 90 days by end-2014. The authorities will announce Q1 2014 targets for proposed solutions of 70% and concluded solutions of no less than 25% of mortgage loans in arrears for more than 90 days.	**Observed.**
The authorities will issue new supervisory guidance to credit unions on new requirements contained in the Credit Union and Co-operation with Overseas Regulators Act 2012 which include governance, internal audit, operational risk, outsourcing and strategic planning.	**Observed.**
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.	**Observed.**
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.	**Observed.**
The authorities will agree with the staff of the EC, ECB and IMF on the format and timeliness of regular reports on case load and processing times for repossession cases on a sufficiently granular basis, such as time lapse between civil bill filing and first court	**Observed.**

appearance.	
Q3: structural reforms	
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.	**Observed.** The Water Services Bill (N° 2) was published on December 2, with a delay of two months that does not compromise the reform process. In addition, the authorities are confident that they can achieve their objective of having Bill enacted by the end of 2013 so as to enable Irish Water to assume ownership and responsibility for managing water assets.
The authorities will communicate the funding model for Irish Water, including an outline of the expected levels of State support until such time as it is substantially self-funded.	**Mostly observed.** The Commission for Energy Regulation (CER) released public consultation papers on its future role in regulating the sector and on the forthcoming economic regulatory framework for Irish Water. The consultation papers detail the bases upon which the CER proposes Irish Water to operate and finance its activities. The authorities, however, have not communicated an outline of the expected levels of State support until such time as Irish Water is substantially self-funded. Under the calendar outline in the consultation paper, tariff level and structure will be determined through additional consultations in early- and mid-2014.
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.	**Observed.**
The authorities will develop an eHealth Strategy in conjunction with the HSE by end September. This will serve as a time-bound action plan for the implementation of eHealth	**Observed.** The authorities submitted their eHealth Strategy with a short delay of 10 days on 10 October.

systems, including a comprehensive system of ePrescription which uses a unique patient identifier, such as the Personal Public Service Number (PPSN) – to support and enable the delivery of integrated patient care under the reform agenda.	Publication of the Strategy is expected by end 2013.
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-October 2013, where appropriate – required for the achievement of these targets will be put in place and kept under further review.	**Observed and on-going.** The commitment of setting annual targets for generics was observed with some delay. The authorities indicated that the objective is reaching a target of 60% in 2014, 65% in 2015 70% in 2016 in generic penetration of the off-patent market by volume (the current share is 55%). In terms of enabling measures such as compulsory e-prescription by international non-property name (INN), the authorities stated that the relevant regulations will be amended and become effective from end Q1 2014 in order to provide the mandatory inclusion of the INN on prescriptions. The inclusion of brand names will not be prohibited.
Following the enactment of the Ministers and Secretaries (Amendment) Act 2013 on 23 July 2013, the authorities will publish, by the end of August 2013, a circular specifying the operational details of the ceilings—including on the circumstances under which they can be revised and on the correction mechanisms.	**Partially observed.** The circular was issued and published at the following link: http://per.gov.ie/pay-and-other-circulars/ and http://circulars.gov.ie/pdf/circular/per/2013/15.pdf. The administrative circular clarifies operational details of the expenditure framework, including over-arching conditions of the national and EU budgetary rules, including EU expenditure benchmark, and circumstances for revisions of the expenditure ceilings. While the circular provides limited circumstances for changing the Government Expenditure Ceiling (GEC), it does not restrict the government's discretion beyond the existing European and National Fiscal rules . Also, the GEC covers somewhat different aggregate that the EU expenditure benchmark, which may impede consistency with the SGP rules. The circular provides a correction mechanism ensuring compliance with the Ministerial Expenditure Ceilings (MEC), but the consequences for non-compliance with the MEC and the GEC are thus far not well defined, especially multi-annual correction.
Q4: financial sector reform	

Taking into account progress in developing the relevant SSM methodology and in consultation with staff of the European Commission, ECB and IMF the authorities will complete a preliminary assessment of balance sheets of PCAR banks by end-October incorporating the results of (i) an assessment of quantitative impairment provisions and a review of risk classification i.e., an asset quality review on an incurred loss basis and (ii) a review of the appropriateness of risk weighted assets calculations under alternative assumptions. The asset quality review will be based on the Central Bank of Ireland's Impairment Provisioning and Disclosure Guidelines updated at end May 2013. Outputs will include a sensitivity analysis for critical parameters. The assessment of balance sheets will be finalized by end-November 2013 and the results will be communicated to the PCAR Banks to help inform their assessment of impairment provisions and financial plans going forward.	**Observed.**
The authorities will analyze current eligible regulatory capital under Basel III/CRD IV by end October.	**Observed.**
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.	**Observed.**
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 liquidity and funding requirements using the advanced monitoring framework, and will produce a final report on progress towards compliance with Basel III liquidity and funding requirements by the relevant dates.	**Observed.**
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.	**Observed.**

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.	
The authorities will monitor the principal mortgage banks' progress on resolving mortgage arrears including through audits of performance against the resolution targets as set out in the MART framework, and assessing the sustainability of offered and concluded solutions. The authorities will provide an update to staff of the EC, ECB, and IMF by early-November on the number and nature of solutions proposed in Q3 2013 with a preliminary assessment of sustainability issues. Furthermore, by mid-November, the authorities will report on the outcome of the audit of banks' Q2 2013 proposed solutions for mortgage loans in arrears, which will include an assessment of the sustainability of banks' solutions. The authorities will devise a system for lenders to report on legal proceedings with a view to ensuring progress towards achieving sustainable solutions. The authorities will also require lenders to have in place a strategy to address any potential shortfall from the repossession of the property.	**Observed.**
The authorities will publish banks' reported data on mortgage loan modifications, including re-defaults of modified loans, to permit analysis of the effectiveness of alternative resolution approaches in improving debt service performance.	**Observed.**
Building on the expedited proceedings in the Commercial Court, the authorities will examine the possibility of introducing tight deadlines on plenary repossession proceedings for non-principal private residences by end-October.	**Observed.**
The authorities will announce Q2 2014 targets for the principal mortgage banks to propose and conclude restructuring solutions for mortgage loans in arrears for more than 90 days.	**Due to be announced in December 2013.**

The authorities will examine by end-October the merits of assigning additional functions to the Specialist Judges appointed to deal with personal insolvency cases which will enable them to deal with repossession cases as needed.	**Observed**.
The authorities will discuss with staff of the EC, ECB and IMF the results and the policy implications of the review of the effectiveness of statutory repossession arrangements as per paragraph 10.	**Due by end-December 2013.**
The authorities will seek to accelerate the adoption of relevant provisions of the Companies Bill 2012 that give optional jurisdiction to Circuit Courts for SME examinership.	**Observed.** **Progress to be monitored during Q4.** The authorities announced on October 11 that they will fast track the Companies (Miscellaneous Provisions) Bill, principally to allow SMEs to apply to Circuit Courts for examinership. The Bill will be drafted on a priority basis and is targeted for enactment before end-2013. It will allow faster enactment of key provisions of the wider Companies Bill as required under the MoU. Direct application for examinership to Circuit Courts will be possible for companies satisfying two of three conditions: (1) balance sheet below EUR 4.4 million; (2) turnover below EUR 8.8 million; and (3) at most 50 employees. Other smaller provisions of the Companies Bill will be included to speed up their implementation.
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.	**Due by end-December 2013.**
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.	**Observed.**

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.	**Observed.**
The authorities will promptly commence the Credit Reporting Bill 2012 upon its enactment—which is expected by November. Through utilisation of an array of personal identifiers including the Personal Public Service Number (PPSN), this centralised credit register will enable a more accurate borrower-by-borrower determination of credit exposures and payment histories. To ensure the earliest operation of the register the Central Bank of Ireland will tender for the design and implementation of the register shortly after the commencement of the Act. Furthermore, the authorities will prepare a final comprehensive report on the remaining steps towards the full and timely implementation of the Central Credit Register, which will be discussed with the staff of European Commission, the IMF, and the ECB.	**The Credit Reporting Bill 2012 has passed Committee Stage and is expected to be enacted by the end of the year.** **A final comprehensive report was delivered at end-November.**
The authorities will assess banks' fee income relative to peers in selected other jurisdictions. Based on this assessment they will complete an external review of the regulation of bank fees.	**Due by end-December 2013.**
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.	**Not applicable.** The proposal for a bank resolution and recovery Directive has yet to be adopted and come into force.
Q4: structural reforms	
The authorities will report on compliance with the action plan to double the number and ensure adequate training of Intreo case managers. They will seek ways to increase redeployments beyond existing targets by redeploying staff from outside of the Department of Social Protection (DSP).	**Observed and on-going.** The DSP is in the process of redeploying and training 300 officers as case managers.
The authorities will determine the scope and structure of a contracting model of activation services to private providers and issue a request for tender by end-November.	**Observed.** The authorities have finalised the scope and structure of the contracting model. A request for

	tender will be issued before mid-December 2013.
The authorities will announce a definitive time-plan for the introduction of domestic water charges in the fourth quarter of 2014. Consultations will be carried out to determine the framework for water charges.	**Due to be announced in December.**
The authorities will finalise and communicate a template service level agreement between Irish Water and local authorities, with the view to ensuring that such agreements are in place with all local authorities by the end of 2013.	**Observed.**
In line with the eHealth Strategy, the authorities will publish by end-October legislation in conformity with data protection law to enable the introduction of universal and unique health identifiers for patients and service providers as well as to facilitate the introduction of full ePrescription.	**In progress.** The heads of the Health Information Bill have been agreed and the text has been drafted, The publication is expected by the end of December 2013.
The authorities will adopt a framework by end-October to streamline and consolidate multiple and fragmented financial management and accounting systems and processes.	**Observed and on-going.** The authorities presented the new finance model for health in Ireland. The Finance board has been established. The new Finance Operating Model will support financial management across the entire health system in an integrated way. This is a three process (from 2013 to 2016) which will build on different steps, i.e. (i) regional structure maintained and operations excellence and finance specialists established, (ii) business partnering introduced, new system and processes designed and implemented, skills and capabilities developed. The authorities detailed the actions required in the next 12 weeks, including the approach to support shadow tariffs in 2014, which is another end-October commitment. Implementation needs to be monitored in the context of a successor programme, if any, or European Semester.
The authorities are committed to the introduction of a prospective case-based payment system for public hospitals, in line with a principle of case based cost recovery for use of public hospitals by public and private patients. This will be implemented on a phased basis beginning with a shadow phase by end-	**Observed and on-going.** The initial phase for the case base funding has already started in 8 core group of hospitals (academic centres, children's hospital) and will be developed for statutory and voluntary hospitals.

October 2013.	
Consistent with the new powers afforded by the recently enacted "Health (Pricing and Supply of Medical Goods) Act 2013" and the recommendations of the June 2013 ESRI report titled "Ireland: Pharmaceutical Prices, Prescribing Practices and Usage of Generics in a Comparative Context", the authorities will provide, by end-October 2013, an update on the exercise of these powers, including a plan for the mid-term review of the Oct 2012 agreement with IPHA, under which they will carry out a comprehensive pricing re-alignment exercise, including in the hospital sector.	**Observed and on-going.** The authorities provided a plan indicating the milestones for the renegotiation of the IPHA Agreement.
Given the significant discrepancy in generic pricing identified in various reports, and consistent with the new powers afforded by the recently enacted "Health (Pricing and Supply of Medical Goods) Act 2013", the authorities will complete by end October 2013, a comprehensive exercise to realign downwards the prices of off-patent listed items.	**Not observed.** Discussions are on-going on the interpretation of the MOU commitment. The authorities claim that the MOU conditionality has already been met by implementing Section 24 of the Health (Pricing and Supply of Medical Goods) Act 2013. Staff consider that the Autumn comprehensive external reference pricing review for the off-patent segment has not been carried out (so far IRP has only been applied for Atorvastatin).
Once the relevant legislation has been enacted, the authorities will take the appropriate measures to establish the Legal Services Regulatory Authority in an expedited fashion.	**Observed and on-going.** While the formal commitment to introduce the legislation has been met, the Authorities need to place renewed higher priority on ensuring the necessary steps are taken to swiftly advance the Bill through parliament.

ANNEX 2
Debt sustainability analysis

Commission services' assessment of the sustainability of Ireland's public debt remains broadly unchanged. Assuming the authorities achieve the planned consolidation and the economy reaps its growth potential in the medium to long term, debt would peak in 2013 and then steadily decline. The slight downward revision of the economic growth outlook in the baseline scenario as compared to the previous review implies a somewhat higher debt ratio trajectory (both as a result of a denominator effect, and because government primary surpluses would be somewhat lower, all else equal).

The baseline forecast for the debt ratio is broadly unchanged qualitatively, though lower projected growth results in somewhat higher debt levels over the projection period than previous estimates. Updating the programme's baseline scenario to incorporate the latest fiscal and macroeconomic projections until 2016 shows the gross debt ratio peaking at 124% of GDP in 2013 and declining to 103% of GDP by 2020 (see Graph A2.1b). The increase in the 2013 debt level reflects high precautionary cash balances (around 13% of GDP at the end of 2013, assumed to fall to about 6% of GDP in 2015 and kept unchanged thereafter). However, the downward revision of nominal GDP growth projections in 2013-16 increases the 2020 debt ratio by some 2 percentage-point relative to the forecast of the previous review ([33]). Weaker economic growth in the near term also increases the required debt-stabilising primary balance, which the projected primary balance is expected to exceed only in 2015 (see Graph A2.1a) ([34]). Reaching nominal GDP growth of 4.0% from 2016 onward would bring the growth-interest rate differential broadly in balance, so that primary balances could be fully used for debt reduction going forward.

Basic scenario analysis underscores the sensitivity of the debt path to both actual growth and the fiscal policy response:

- A stress scenario with a 1 percentage point lower nominal GDP growth and no additional consolidation measures would see the deficit exceed the programme nominal deficit targets with the 2015 deficit at 4.8% of GDP (against a programme target of below 3% of GDP). In the absence of consolidation measures for 2016, the deficit would then worsen to 4.9% of GDP, given the need to reach higher primary surpluses with lower growth to stop the debt ratio from increasing. Assuming a deficit reduction path similar to that of the stability programme would be resumed in 2017, the deficit would fall below 3% of GDP in 2019. In this scenario, the debt-to-GDP ratio would peak at 128% in 2018 and would decline to 125% of GDP by 2020 (rather than to 103% as in the baseline).

- Assuming that the same negative growth shock (1 percentage point lower nominal growth) is met with corrective fiscal measures to ensure that the programme and EDP deficit path is respected, would result in a lower debt ratio (reaching 114% of GDP by 2020).

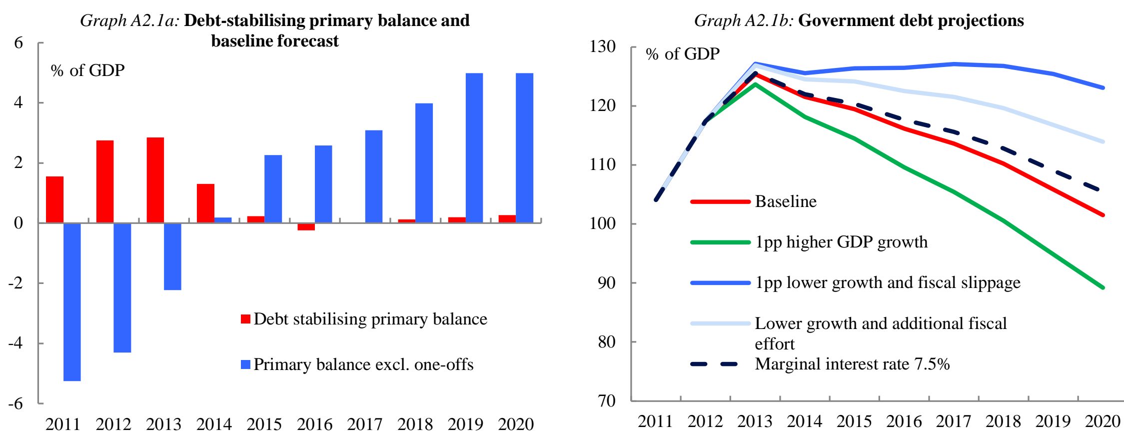
- In case of positive surprise of a 1 percentage point higher nominal GDP growth over the forecast period, the government deficit would be reduced to 1.6% of GDP by 2015 and close to balance by 2018, maintaining the baseline fiscal adjustment. The debt ratio would be brought down to 91% of GDP by 2020.

- A scenario with a substantially higher marginal interest rate (7.5% versus the baseline assumption of 5.5%) does not materially alter the debt trajectory due to relatively low refinancing needs and only gradually increasing average interest rate on debt.

([33]) The baseline scenario assumes, as per the Stability Programme, that the government balance would improve steadily from a deficit of 2.4% of in 2016 to a small surplus of 0.1% of GDP in 2019, at which point the fiscal adjustment is assumed to be completed.

([34]) The gross debt ratio nonetheless is projected to decline starting from 2014 as high cash balances are reduced.

Graph A2.1: **Debt and primary balance projections**



Baseline assumptions: Programme projections until 2016. Liquid assets (including Exchequer account, commercial deposits and non-Irish treasury bills) of EUR 20 bn at end-2013 and EUR 10 bn from end-2014. After 2016, general government deficit is reduced by the adjustment path presented in the stability programme (0.5pp of GDP in 2017, 0.9 pp in 2018 and 1.1 pps in 2019) until a surplus is reached; real GDP growth of 2.8% (4.0% nominal growth); marginal interest rate on new government bonds of 5.5%. Some 10% of the general government debt, including short-term debt, local government debt and other general government liabilities are 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 increase to 4.9% of GDP in 2016 from a deficit of 4.8% of GDP in 2015, in the absence of the corrective action in 2016, but applying the baseline correction for 2017-19 the deficit would decline to 2.4% of GDP in 2019 and to 1.4% of GDP in 2020 (assuming adjustment of 1pp of GDP). 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. The scenario assumes that the adjustment path of the stability programme is implemented for the period 2016-19 and reaching a balance in 2019.
Source: Commission services

ANNEX 3
Supplementary tables

Table A3.1: Use and supply of goods and services (volume)

Annual % change	2010	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	0.6	-1.6	-0.3	-0.6	0.5	1.0	1.3
2. Government consumption expenditure	-6.9	-2.8	-3.7	-1.0	-2.8	-2.5	0.3
3. Gross fixed capital formation	-22.6	-9.5	-0.8	2.9	4.4	5.4	5.2
4. Final domestic demand	**-5.6**	**-3.1**	**-1.2**	**-0.2**	**0.3**	**0.9**	**1.7**
5. Change in inventories							
6. Domestic demand	**-6.9**	**-0.5**	**-0.8**	**0.0**	**0.2**	**0.9**	**1.7**
7. Exports of goods and services	6.4	5.3	1.6	0.5	2.5	3.7	4.1
7a. - of which goods	5.2	3.8	-3.6	-2.8	1.1	2.0	3.2
7b. - of which services	7.7	7.0	6.9	3.6	3.7	5.2	4.8
8. Final demand	**-0.1**	**2.7**	**0.5**	**0.3**	**1.6**	**2.6**	**3.1**
9. Imports of goods and services	3.8	-0.4	0.0	0.2	1.4	2.7	3.5
9a. - of which goods	-1.1	-2.4	-2.9	0.1	2.2	4.8	6.0
9b. - of which services	6.7	0.8	1.7	0.3	1.0	1.4	2.1
10. Gross domestic product at market prices	**-1.1**	**2.2**	**0.2**	**0.3**	**1.7**	**2.5**	**2.8**
Contribution to change in GDP							
11. Final domestic demand	-0.7	-3.6	-1.5	-0.2	0.2	0.7	1.3
12. Change in inventories + net acq. of valuables	-1.1	2.1	0.3	0.2	0.0	0.0	0.0
13. External balance of goods and services	3.1	5.7	1.6	0.3	1.5	1.8	1.5

Source: Commission services

Table A3.2: Use and supply of goods and services (value)

Annual % change	2010	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-1.7	0.3	0.1	0.2	1.4	2.2	2.6
2. Government consumption expenditure	-8.6	-1.7	-1.5	-0.3	-1.8	-1.5	1.0
3. Gross fixed capital formation	-26.2	-10.1	1.4	4.3	5.9	7.3	7.2
4. Final domestic demand	**-8.0**	**-1.8**	**-0.1**	**0.6**	**1.3**	**2.1**	**3.0**
5. Change in inventories	-65.1	-289.1	-70.2	125.6	-11.0	0.0	0.0
6. Domestic demand	**-7.3**	**-0.6**	**-0.6**	**0.9**	**1.2**	**2.1**	**3.0**
7. Exports of goods and services	7.8	5.8	5.9	1.5	3.7	4.9	5.1
8. Final demand	**3.4**	**-2.9**	**6.1**	**1.3**	**2.7**	**3.8**	**4.3**
9. Imports of goods and services	6.6	2.7	3.9	1.5	2.9	3.9	4.6
10. Gross national income at market prices	-1.8	-1.0	0.1	-0.6	1.5	2.4	2.7
11. Gross value added at basic prices	-2.6	3.3	1.1	1.0	2.4	3.3	4.2
12. Gross domestic product at market prices	**-2.6**	**2.8**	**0.8**	**1.1**	**2.5**	**3.6**	**4.0**

Source: Commission services

Table A3.3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015	2016
1. Private consumption expenditure	-2.3	1.9	0.5	0.8	0.8	1.1	1.3
2. Government consumption expenditure	-1.8	1.1	2.3	0.7	1.0	1.0	0.7
3. Gross fixed capital formation	-4.6	-0.7	2.2	1.4	1.4	1.8	1.8
4. Domestic demand	**-0.4**	**-0.2**	**0.2**	**0.9**	**1.0**	**1.2**	**1.3**
5. Exports of goods and services	1.3	0.4	4.2	1.0	1.2	1.2	1.0
6. Final demand	**0.5**	**0.2**	**2.5**	**1.0**	**1.1**	**1.2**	**1.1**
7. Imports of goods and services	2.8	3.1	3.9	1.3	1.4	1.3	1.0
8. Gross domestic product at market prices	**-1.5**	**0.7**	**0.7**	**0.7**	**0.8**	**1.1**	**1.2**
HICP	**-1.6**	**1.2**	**1.9**	**0.8**	**0.9**	**1.2**	**1.4**

Source: Commission services

Table A3.4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015	2016
1. Labour productivity	3.1	4.0	0.7	-0.9	0.4	1.2	1.3
2. Compensation of employees per head	-4.3	-0.1	0.7	0.0	-0.6	-0.3	0.3
3. Unit labour costs	-7.9	0.2	-0.3	1.0	-0.9	-1.2	-1.1
4. Total population	0.3	2.3	0.4	0.8	0.9	1.0	1.2
5. Population of working age (15-64 years)	-0.8	2.1	-0.6	-0.1	0.0	0.1	0.4
6. Total employment	-4.0	-1.8	-0.6	1.2	1.3	1.3	1.5
7. Calculated unemployment rate - Eurostat definition (%)	13.9	14.9	14.7	13.3	12.3	11.7	11.3

Source: Commission services

Table A3.5: External balance

levels	2010	2011	2012	2013	2014	2015	2016
1. Exports of goods (fob)	82.6	85.0	85.9	84.3	86.3	89.0	92.8
2. Imports of goods (fob)	46.9	48.3	49.5	50.2	52.0	55.2	59.1
3. Trade balance (goods, fob/fob) (1-2)	**35.8**	**36.7**	**36.4**	**34.1**	**34.2**	**33.8**	**33.6**
3a. (3 as % of GDP)	*22.6*	*22.6*	*22.2*	*20.6*	*20.1*	*19.2*	*18.4*
4. Exports of services	75.2	82.0	90.9	95.2	99.9	106.3	112.5
5. Imports of services	81.5	83.5	87.5	88.9	91.0	93.5	96.4
6. Services balance (4-5)	**-6.3**	**-1.6**	**3.4**	**6.3**	**8.9**	**12.8**	**16.1**
6a. (6 as % of GDP)	*-4.0*	*-1.0*	*2.1*	*3.8*	*5.2*	*7.3*	*8.8*
7. External balance of goods & services (3+6)	**29.5**	**35.1**	**39.7**	**40.4**	**43.1**	**46.6**	**49.7**
7a. (7 as % of GDP)	*18.6*	*21.6*	*24.2*	*24.4*	*25.4*	*26.5*	*27.1*
8. Balance of primary incomes and current	-27.7	-33.2	-31.7	-33.6	-35.4	-38.0	-41.3
8a. - of which, balance of primary income	*-25.2*	*-31.0*	*-32.2*	*-34.8*	*-37.1*	*-40.1*	*-43.4*
8b. - of which, net current Transfers	*-2.5*	*-2.2*	*0.5*	*1.2*	*1.7*	*2.1*	*2.1*
8c. (8 as % of GDP)	*-17.5*	*-20.4*	*-19.3*	*-20.3*	*-20.8*	*-21.6*	*-22.5*
9. Current external balance (7+8)	**1.8**	**1.9**	**8.0**	**6.8**	**7.7**	**8.6**	**8.4**
9a. (9 as % of GDP)	1.1	1.2	4.9	4.1	4.6	4.9	4.6
10. Net capital transactions	-0.7	-0.2	-0.8	-1.9	-0.8	-0.3	-0.2
11. Net lending (+)/ net borrowing (-) (9+10)	**1.1**	**1.7**	**7.2**	**5.0**	**7.0**	**8.3**	**8.2**
11a. (11 as % of GDP)	*0.7*	*1.0*	*4.4*	*3.0*	*4.1*	*4.7*	*4.5*

Source: Commission services

Table A3.6: **Fiscal accounts**

	2008	2009	2010	2011	2012	2013	2014	2015	2016
				% of GDP					
Indirect taxes	12.3	11.2	11.4	10.8	11.0	10.9	11.0	11.0	10.8
Direct taxes	11.5	10.7	10.5	11.9	12.6	12.9	13.3	13.5	13.5
Social contributions	6.8	7.4	7.3	6.2	5.9	6.0	6.0	5.8	5.6
Sales	2.3	2.8	3.3	3.1	3.0	2.7	2.5	2.4	2.3
Other current revenue	1.3	1.3	1.4	1.3	1.4	1.7	1.4	1.5	1.4
Total current revenue	**34.2**	**33.4**	**33.9**	**33.4**	**33.9**	**34.2**	**34.3**	**34.2**	**33.6**
Capital transfers received	1.2	1.0	1.0	0.7	0.6	0.6	0.7	0.4	0.4
Total revenue	**35.4**	**34.5**	**34.9**	**34.0**	**34.5**	**34.9**	**35.1**	**34.7**	**34.1**
Compensation of employees	11.8	12.8	12.2	11.8	11.5	11.2	10.5	9.8	9.5
Intermediate consumption	5.7	6.3	5.9	5.4	5.1	4.9	4.7	4.4	4.3
Social transfers in kind via market producers	2.3	2.4	2.7	2.6	2.6	2.6	2.5	2.4	2.4
Social transfers other than in kind	12.3	15.1	15.3	15.2	15.0	14.2	13.7	13.0	12.8
Interest paid	1.3	2.0	3.1	3.3	3.7	4.6	4.8	5.0	4.7
Subsidies	1.0	1.0	1.0	0.8	0.9	0.8	0.8	0.4	0.4
Other current expenditure	1.3	1.3	1.2	1.1	1.1	1.2	0.9	0.7	0.7
Total current expenditure	**35.7**	**41.0**	**41.3**	**40.2**	**40.0**	**39.5**	**37.9**	**35.7**	**34.7**
Gross fixed capital formation	5.3	3.7	3.4	2.4	1.9	1.8	1.7	1.7	1.6
Other capital expenditure	1.8	3.4	20.7	4.6	0.8	1.0	0.5	0.3	0.2
Total expenditure	**42.8**	**48.1**	**65.5**	**47.2**	**42.7**	**42.3**	**40.1**	**37.6**	**36.5**
General Government balance	**-7.4**	**-13.7**	**-30.6**	**-13.1**	**-8.2**	**-7.4**	**-5.0**	**-3.0**	**-2.4**
Underlying Government balance (EDP)	**-7.4**	**-11.2**	**-10.6**	**-8.9**	**-8.2**	**-7.4**	**-5.0**	**-2.9**	**-2.4**
				EUR billion					
Indirect taxes	22.1	18.2	18.0	17.6	18.0	18.1	18.7	19.3	19.8
Direct taxes	20.7	17.4	16.6	19.3	20.7	21.4	22.7	23.8	24.7
Social contributions	12.3	12.0	11.5	10.1	9.7	9.9	10.2	10.2	10.2
Sales	4.2	4.5	5.2	5.1	4.9	4.5	4.3	4.2	4.3
Other current revenue	2.3	2.1	2.3	2.1	2.3	2.8	2.5	2.7	2.5
Total current revenue	**61.6**	**54.3**	**53.6**	**54.2**	**55.6**	**56.7**	**58.3**	**60.2**	**61.6**
Capital transfers received	2.2	1.7	1.6	1.1	1.0	1.1	1.2	0.8	0.8
Total revenue	**63.8**	**56.0**	**55.1**	**55.3**	**56.5**	**57.7**	**59.5**	**61.0**	**62.4**
Compensation of employees	21.2	20.7	19.3	19.1	18.8	18.5	17.8	17.3	17.3
Intermediate consumption	10.3	10.2	9.3	8.8	8.4	8.1	7.9	7.7	7.8
Social transfers in kind via market producers	4.1	4.0	4.2	4.2	4.3	4.3	4.3	4.3	4.3
Social transfers other than in kind	22.2	24.5	24.2	24.8	24.6	23.6	23.3	22.8	23.5
Interest paid	2.4	3.3	5.0	5.3	6.1	7.6	8.2	8.8	8.6
Subsidies	1.8	1.7	1.6	1.3	1.5	1.3	1.3	0.8	0.8
Other current expenditure	2.3	2.1	1.9	1.8	1.8	1.9	1.5	1.2	1.2
Total current expenditure	**64.3**	**66.5**	**65.4**	**65.3**	**65.6**	**65.4**	**64.3**	**62.9**	**63.5**
Gross fixed capital formation	9.5	6.1	5.4	3.9	3.1	3.0	2.9	2.9	2.9
Other capital expenditure	3.3	5.6	32.8	7.5	1.3	1.7	0.9	0.5	0.4
Total expenditure	**77.1**	**78.1**	**103.5**	**76.7**	**70.0**	**70.0**	**68.1**	**66.2**	**66.8**
General Government balance	**-13.3**	**-22.2**	**-48.4**	**-21.4**	**-13.5**	**-12.3**	**-8.6**	**-5.2**	**-4.4**
Deficit-increasing financial sector measures		4.0	31.6	6.8	0.0	0.0	0.1	0.1	0.1
Underlying Government balance (EDP)	**-13.3**	**-18.2**	**-16.8**	**-14.5**	**-13.5**	**-12.3**	**-8.5**	**-5.1**	**-4.4**

Source: Commission services

Table A3.7: **Debt developments**

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Government deficit (% of GDP)	**-7.4**	**-13.7**	**-30.6**	**-13.1**	**-8.2**	**-7.4**	**-5.0**	**-3.0**	**-2.4**
Government gross debt (% of GDP)	44.2	64.4	91.2	104.1	117.4	124.4	120.8	119.1	115.9
					levels, EUR billion				
Government deficit	**-13.3**	**-22.2**	**-48.4**	**-21.4**	**-13.5**	**-12.3**	**-8.6**	**-5.2**	**-4.4**
Gross debt	79.6	104.5	144.2	169.2	192.5	206.1	205.2	209.7	212.2
Change in gross debt	32.3	24.9	39.6	25.1	23.2	13.6	-0.9	4.6	2.4
Nominal GDP	180.2	162.3	158.1	162.6	163.9	165.7	169.9	176.1	183.1
Real GDP	171.8	160.9	159.1	162.6	162.9	163.4	166.1	170.3	175.1
Real GDP growth (% change)	**-2.2**	**-6.4**	**-1.1**	**2.2**	**0.2**	**0.3**	**1.7**	**2.5**	**2.8**
Change in gross debt (% of GDP)	17.9	15.4	25.1	15.4	14.2	8.2	-0.5	2.6	1.3
Stock-flow adjustments (% of GDP)	10.5	1.7	-5.5	2.3	5.9	0.8	-5.6	-0.4	-1.1
					% of GDP				
Gross debt ratio	**44.2**	**64.4**	**91.2**	**104.1**	**117.4**	**124.4**	**120.8**	**119.1**	**115.9**
Change in gross debt ratio	19.2	20.3	26.8	12.9	13.3	7.0	-3.6	-1.7	-3.2
					Contribution to change in gross debt				
Primary balance	6.1	11.6	27.5	9.9	4.5	2.8	0.2	-2.0	-2.3
"Snow-ball" effect	2.7	7.0	4.9	0.8	2.9	3.4	1.8	0.8	0.1
of which									
Interest expenditure	*1.3*	*2.0*	*3.1*	*3.3*	*3.7*	*4.6*	*4.8*	*5.0*	*4.7*
Real growth effect	*0.6*	*3.1*	*0.7*	*-1.9*	*-0.2*	*-0.4*	*-2.1*	*-2.9*	*-3.2*
Inflation effect	*0.8*	*1.9*	*1.0*	*-0.6*	*-0.7*	*-0.9*	*-1.0*	*-1.3*	*-1.3*
Stock-flow adjustments	**10.5**	**1.7**	**-5.5**	**2.3**	**5.9**	**0.8**	**-5.6**	**-0.4**	**-1.1**
Implicit interest rate	*5.1*	*4.1*	*4.8*	*3.7*	*3.6*	*4.0*	*4.0*	*4.3*	*4.1*

The projections assume no borrowing for precautionary contingencies foreseen in the programme's financing plan. Stock-flow adjustments include a reduction in cash balances from around 13% of GDP at end-2013 to around 6% by end-2014 and other financial transactions.
Source: Commission services

Table A3.8: **Fiscal outturn to end-October and estimates for 2013**

EUR million	2013 Jan-Oct			2013 Jan-Dec		
	Profile	Outturn	Outturn vs profile	Profile	Updated EC forecast	EC forecast vs profile
Revenue	**41042**	**41447**	**405**	**52864**	**52748**	**-117**
Tax revenue	**35118**	**35427**	**309**	**45370**	**45240**	**-130**
Personal income tax	12252	12131	-121	15860	15730	-130
VAT	8804	8622	-182	10560	10360	-200
Corporation tax	2532	2767	235	4135	4355	220
Excise duties	3905	3853	-52	4920	4720	-200
Social contributions (PRSI & NTF)	5914	6185	271	7420	7420	0
Other taxes	1711	1870	159	2475	2655	180
Appropriations-in-Aid	**2920**	**2806**	**-114**	**3764**	**3764**	**0**
Health current receipts	1129	1027	-102	1457	1457	0
Education current receipts	574	431	-143	650	650	0
Other current receipts and balances	1038	1169	131	1323	1323	0
Capital A-in-As	179	179	0	335	335	0
Non-tax Revenue	**2152**	**2397**	**245**	**2360**	**2558**	**198**
Central Bank Surplus Income	1040	1148	108	1040	1148	108
Bank Guarantee Fees	435	576	141	433	577	144
National Lottery Surplus	175	175	0	220	220	0
Dividends	131	146	15	260	250	-10
Interest on contingent capital notes	300	247	-53	300	247	-53
Other	71	106	35	107	117	10
Capital receipts (1)	**852**	**817**	**-35**	**1370**	**1185**	**-185**
Below-the-line financial receipts		**2388**	**2388**		**2310**	**2310**
Sale of CoCos in the Bank of Ireland		1010	1010		1010	1010
Sale of Irish Life Limited		1300	1300		1300	1300
Repayment of loan to Risk Equalisation Fund		78	78			
Expenditure	**53786**	**53563**	**-223**	**65000**	**65723**	**723**
Current voted (gross)	**42614**	**42274**	**-340**	**51146**	**51146**	**0**
Social Protection	16841	16821	-20	20233	20233	0
Health	11497	11542	45	13624	13624	0
Education	7014	6892	-122	8456	8456	0
Other	7262	7019	-243	8833	8833	0
Current non-voted (1)	**8603**	**9137**	**534**	**9579**	**10384**	**805**
Interest	6521	6479	-42	7225	7160	-65
Debt management expenses	136	111	-25	163	123	-40
Promissory Notes interest	506	13	-493	506	13	-493
EU Budget Contribution	1248	1353	105	1444	1730	286
ELG claim cost (IBRC liquidation)		1009	1009		1115	1115
Other non-voted (ex-SF)	192	172	-20	241	243	2
Capital expenditure	**2569**	**2152**	**-417**	**4275**	**4193**	**-82**
Exchequer capital funding (gross)	2376	2027	-349	3431	3431	0
FEOGA	150	95	-55	800	730	-70
Other	43	30	-13	44	32	-12
Below-the-line financial transfers	**3361**	**797**	**-2563**	**3361**	**726**	**-2635**
Promissory Notes principal	2579	12	-2567	2579	12	-2567
Loans to Insurance Compensation Fund	272	198	-74	272	204	-68
Loan to Risk Equalisation Fund	0	78	78			
ESM capital payment	510	510	0	510	510	0
Exchequer balance	**-16105**	**-10525**	**5579**	**-15496**	**-11391**	**4105**
Below-the-line financial transfers				3361	726	-2635
Below-the-line financial receipts					-2310	-2310
Local government sector				0	0	0
Promissory Notes interest accrual adjustment				-1382	-215	1167
Accrual adjustments and other below-the-line operations				872	949	77
General government balance (2)				**-12645**	**-12241**	**404**
% of GDP				-7.6	-7.4	

((1) Excludes Sinking Fund transfer from current to capital account and loan/repayment to/from the Social Insurance Fund which are the Exchequer deficit neutral.
(2) The government balance excludes one-off deficit-increasing financial sector measures. Revised GDP forecast since the budget affects deficit ratio.
Source: Exchequer returns, Commission services estimates

ANNEX 4
Updated programme documents

Dublin, 29 November 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. Rimantas Šadžius
Minister of Finance
Lukiškių 2,
01512 Vilnius,
Lithuania

Dear Messrs. Draghi, Dijsselbloem, Rehn and Šadžius,

1. **Our economic programme has achieved its main objectives and has underpinned Ireland's emergence from the crisis.** The key objectives of our programme were to address financial sector weaknesses, to put Ireland's economy on a path of sustainable growth, to strengthen our public finances, to boost job creation, and to fully regain international capital market access. Now, as we approach the conclusion of our programme we are beginning to reap the rewards of our sustained efforts. Economic growth has returned, albeit at a slower pace than was anticipated at the start of the programme. The public finances have been put on a sustainable footing and unemployment is declining slowly but steadily. Importantly, we have also successfully returned to financial market funding. The financial sector has undergone significant restructuring since the beginning of the crisis and we will continue to progress this agenda. All of this has been achieved by steadfast implementation and delivery of our commitments under the programme and complemented by European decisions that led to a reduction of the interest rates and an extension of the maturities of the EFSF and EFSM loans. This effort has encompassed the completion of over 260 actions to date. Looking ahead we intend to maintain our momentum and press on with our reform agenda. We are preparing a Medium-Term Economic Strategy (MTES), which will articulate the key principles that will underpin economic policy for the period to 2020. It will address the key policy areas such as education and training, labour market activation, industrial innovation, access to credit, competition and fiscal policy. Through this strategic, medium-term perspective, the MTES will not

duplicate – but will complement – the necessarily more short-term focus of other related policy efforts such as the *Action Plan for Jobs*. Although the Programme of Financial Support is ending we will keep our close dialogue with our European colleagues and will consult with them semi-annually under Post-Programme Surveillance arrangements.

I. MACROECONOMIC OUTLOOK

2. **Economic growth has resumed and has supported programme objectives.** Real GDP is forecast to grow by a modest 0.2 per cent this year. The impact of the patent cliff is weighing on pharma-chem activity, given its large weight in Irish output and exports. Developments in the domestic economy have been considerably more favourable though. So far this year the employment growth over the first three quarters is averaging 2.0 per cent, and unemployment, while still high, is continuing to fall. High-frequency indicators for the third and fourth quarters are also positive. Purchasing managers' indices have recorded some multi-annual highs, tourism numbers are up substantially and house prices have shown consistent growth since early in the year. 2014 GDP is forecast to grow by about 2 per cent. Net exports are expected to make a positive contribution to growth again, as the fast-growing service export sector offsets some drag from pharma-chem activity. Expectations for trading partner growth are also supportive as are continuing strong inflows of foreign direct investment. Domestic demand is expected to expand modestly, as increased employment and incomes spill over into real activity and construction output continues to rise from very low levels. The recovery is expected to strengthen with GDP growth set to average 2.5 per cent over 2015 and 2016.

II. FISCAL POLICY

3. **In each year of the programme we have met or exceeded the fiscal headline targets.** The level of adjustment has been significant with measures designed to yield €16.4 billion (9.6 per cent of 2013 GDP) announced for Budget 2011 to Budget 2014. This quantum of adjustment has ensured that fiscal targets were met or bettered against a background of much lower growth than was projected when the programme started. On the basis of present forecasts, the majority of the required adjustment has been delivered, with Budget 2015 expected to be the last of the consolidation Budgets. We have also introduced important structural changes to the management of our public finances with the enactment of the Fiscal Responsibility Act 2012, the establishment of the Irish Fiscal Advisory Council on a statutory basis, the introduction of regular wide-scale reviews of public spending (the next Comprehensive Review of Expenditure is to take place in advance of Budget 2015), and the implementation of multi-annual expenditure budgeting and Ministerial expenditure ceilings. The improved fiscal frameworks that have been put in place over recent years will assist in ensuring that the mistakes of the past will not be repeated.

4. **The 2013 Budget position remains on track and we will ensure the 2013 fiscal deficit target of 7.5 per cent of GDP is met.** Building on the actions taken since mid-2008, which were designed to yield savings around €28 billion, *Budget 2014* introduced a set of adjustment measures aimed at reducing the deficit next year to 4.8 per cent of GDP, below the 5.1 per cent of GDP ceiling under the Excessive Deficit Procedure (EDP). The measures are also intended to achieve a primary balance or a small surplus

next year. Broadening the revenue base, reforming the health sector, and targeting social supports towards the most vulnerable will help achieve the further fiscal consolidation needed in a durable and growth-friendly manner.

5. **A clear focus on reducing the deficit below 3 per cent of GDP in 2015 has been the cornerstone on which budgetary planning over recent years has been anchored.** The Government remains steadfast in its commitment to meet this deficit target and will do whatever is necessary to achieve this. Beyond 2015, Ireland will be subject to all the conditions of the preventive arm of the Stability and Growth Pact which necessitates continued fiscal prudence and structural improvement over the medium term.

III. FINANCIAL SECTOR

6. **Confidence in the Irish banks is beginning to return and has helped reduce their reliance on Eurosystem funding, which is now a fraction of what it was at the beginning of the programme.** As part of the 2011 Financial Measures Programme Irish banks were recapitalised to meet a capital requirement identified at €24 billion which was sourced from the private market, burden sharing with subordinated bondholders and from the State. The banking system has been restructured including deleveraging undertaken as part of the Financial Measures Programme and the merger of Allied Irish Banks with EBS. Exceptional Liquidity Assistance (ELA) has been removed from the system following the liquidation of IBRC. NAMA has maintained a strong financial position, generating considerable cash, leaving it on track to redeem €7.5 billion of bonds by the end of this year. Private capital has been introduced to the banking system including the sale of equity (in 2011) and contingent capital notes in Bank of Ireland in 2013 and the sale of Irish Life (in 2013).

7. **We will press ahead with further restructuring of the banking sector.** We have prepared a preliminary assessment of the balance sheets of the PCAR banks. A rigorous review is being performed incorporating an assessment of impairment provisions and a review of the appropriateness of risk weights for regulatory capital purposes. The review has the benefit of extensive sampling of loan files by independent third parties and engagement with staff of the EC, ECB and IMF on an ongoing basis on progress, methodology, inputs, outputs and findings. The review will inform the continuing supervisory dialogue with each of the banks on the adequate level of provisioning at year end, in line with the Central Bank's guidelines. We will agree restructuring plans for AIB and PTSB with the European Commission and these plans will be implemented along with the already agreed restructuring plan for Bank of Ireland. Returning the banks to profitability will continue to be a key focus. The legacy banking assets now housed in NAMA will be run down over time together with assets that will be transferred to it from the liquidated IBRC. We will continue our policy of exiting our banking investments in a manner that maximises the proceeds to be returned to taxpayers. The main Irish banks will undergo a comprehensive risk assessment, including a stress test in 2014, in the context of the upcoming euro area-wide exercise prior to the establishment of the SSM.

8. **Building on the recommendations of the 2011 Inter-Departmental Mortgage Arrears Working Group, we have put in place a broad suite of measures to address the problem of**

mortgage arrears in a way that seeks to maintain credit discipline while providing appropriate relief to borrowers who are experiencing genuine repayment difficulty. We have significantly reformed and updated our personal insolvency law and practice and also made changes to vindicate the legitimate rights of creditors. The Personal Insolvency Act 2012 introduced new insolvency resolution frameworks and also modernised the judicial bankruptcy system. The Land and Conveyancing Law Reform Act 2013 removed an uncertainty regarding the rights of some secured creditors. We have also put in place a process to require mortgage lenders to resolve, on a sustainable basis, cases of mortgage arrears. In particular, performance targets have been set for six credit institutions requiring them to propose and conclude sustainable mortgage solutions for their mortgages which are more than 90 days in arrears.

9. **Financial sector repair will continue with a view to ensuring that significant progress is made in the resolution of mortgage and SME difficulties in 2014.** The ongoing work on durable resolution of mortgages in arrears will reduce uncertainties that weigh on economic recovery. The Mortgage Arrears Resolution Targets process will be implemented in a resolute manner with a view to addressing most mortgages in arrears by the end of next year. The Insolvency Service of Ireland is now fully operational and will process insolvency applications from insolvent debtors in a fair and efficient way. In addition, we are continuing to address the SME distressed portfolios (which include considerable property-related exposures) through targets which require the banks to implement sustainable long-term debt resolution strategies for all distressed SME loans. Overall, we will continue to monitor and assign a high priority to the resolution of the arrears problem. Ensuring an adequate flow of credit for SMEs remains a priority and active consideration is being given to alternative provision of non-bank financing for the enterprise sector.

IV. STRUCTURAL REFORM

10. **Structural reform focusing on improved competitiveness has also been progressed.** This included the enactment of the Competition (Amendment) Act (2012) (to support the Competition Authority in the investigation and prosecution of anti-competitive practices) and the implementation of Sectoral Wage Reforms. As a result, over the last three years, we have won back much of the competitiveness we lost during the boom. Having seen significant erosion in competitiveness during the boom years, the European Commission is now estimating a 22 per cent improvement in unit labour costs in Ireland vis-à-vis the euro area over the period 2008-2014. The economic path for the years ahead will be directed by the Medium Term Economic Strategy 2014-2020 which we are preparing (see paragraph 1 also).

11. **There has been significant reform in the Health Sector, with substantial reduction in the cost of drugs to the State.** The implementation of generic substitution and reference pricing has been prioritised by the Department, the Health Service Executive and the Irish Medicines Board. Reference pricing is expected to deliver at least €50 million savings in 2014. The Health (Pricing and Supply of Medical Goods) Act 2013 also includes a process for the review of existing prices outside of reference pricing. Each medicinal product, which was on the Reimbursement List when the legislation was commenced, must be reviewed by the HSE within three years to determine whether it should remain on the List and, if so, the price that should apply.

12. **Structural reform in other areas including labour market activation is well underway and will be continued.** The labour activation effort will prioritise the reduction and prevention of long-term unemployment, combatting youth unemployment and helping to reduce the number of jobless households; this will involve greater engagement on job seeking activity and appropriate referral to activation or further education and training programmes. We also intend to deliver a Strategic Implementation Plan for Further Education and Training that will draw on the analysis and recommendations of the FET Strategic Review carried out under the Programme this year. Legal services reform is also being advanced. The Legal Services Regulation Bill has completed Second Stage and commenced Committee Stage in July 2013. The resumption of Committee Stage is expected early 2014 with a view to the Bill's earliest enactment and the expedited establishment of the new Legal Services Regulatory Authority. Water sector reforms are also continuing at pace and the definitive time-plan for the introduction of domestic charges will be announced by the end of the year. The Water Services (No. 2) Bill has been approved by Government and is expected to be published shortly.

V. FUNDING

13. **Strong policy implementation of the programme has improved funding conditions even as domestic challenges and external uncertainties remain.** Ireland remains on course to end the year with a cash buffer sufficient to cover more than 12 months of Exchequer financing needs. Developments during 2013, most notably the 7 year extension in EFSM/EFSF maximum average maturities, have continued to strengthen Ireland’s ability to access long-term market funding on sustainable terms. The NTMA is guiding for €6 billion to €10 billion of market issuance in 2014 by way of pre-funding for 2015. In the context of euro area sovereign issuance requirements this is relatively modest. The NTMA looks forward to normalised engagement with the debt markets, following exit from the EU-IMF programme, through 2014 and beyond using the standard issuance mechanisms, such as bond auctions and syndications.

14. In light of our performance under the programme we request the completion of the twelfth review and the release of the final disbursement of EUR 0.8 billion from the EFSM.

15. This letter is being copied to Mme Lagarde.

Sincerely,

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

Dublin, 29 November 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

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2. **Economic growth has resumed and has supported programme objectives.** Real GDP is forecast to grow by a modest 0.2 per cent this year. The impact of the patent cliff is weighing on pharma-chem activity, given its large weight in Irish output and exports. Developments in the domestic economy have been considerably more favourable though. So far this year the employment growth over the first three quarters is averaging 2.0 per cent, and unemployment, while still high, is continuing to fall. High-frequency indicators for the third and fourth quarters are also positive. Purchasing managers' indices have recorded some multi-annual highs, tourism numbers are up substantially and house prices have shown consistent growth since early in the year. 2014 GDP is forecast to grow by about 2 per cent. Net exports are expected to make a positive contribution to growth again, as the fast-growing service export sector offsets some drag from pharma-chem activity. Expectations for trading partner growth are also supportive as are continuing strong inflows of foreign direct investment. Domestic demand is expected to expand

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V. FUNDING

13. **Strong policy implementation of the programme has improved funding conditions even as domestic challenges and external uncertainties remain.** Ireland remains on course to end the year with a cash buffer sufficient to cover more than 12 months of Exchequer financing needs. The 7-year extension in EFSM/EFSF maximum average maturities and the February IBRC Promissory Note transaction significantly reduce funding needs in the coming years. These positive developments strengthen Ireland's ability to access long-term market funding on sustainable terms. The NTMA is guiding for €6 billion to €10 billion of market issuance in 2014 by way of pre-funding for 2015. In the context of euro area sovereign issuance requirements this is relatively modest. The NTMA looks forward to normalised engagement with the debt markets, following exit from the EU-IMF programme, through 2014 and beyond using the standard issuance mechanisms, such as bond auctions and syndications.

14. **In light of our strong performance and the policies outlined in this letter, we** request the completion of the twelfth review under the Extended Arrangement. We request the drawdown of the remaining programme funding in an amount equivalent to SDR 579 million at the time of the completion of the review. This would complete the disbursements of IMF assistance under the programme.

15. **We authorise the IMF to publish this Letter of Intent and the related staff report.**

This letter is being copied to Messrs. Draghi, Dijsselbloem, Rehn, and Šadžius.

Sincerely,

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

OCCASIONAL PAPERS

The following papers have been issued. Copies may be obtained by applying to the address:

European Commission
Directorate-General for Economic and Financial Affairs
Unit Communication
N105
B - 1049 Brussels, Belgium
E-mail: Ecfin-Info@ec.europa.eu

Occasional Papers can be accessed and downloaded free of charge at the following address:

http://ec.europa.eu/economy_finance/publications/

No. 1 The Western Balkans in transition (January 2003)

No. 2 Economic Review of EU Mediterranean Partners (January 2003)

No. 3 Annual Report on structural reforms 2003, by Economic Policy Committee (EPC) (April 2003)

No. 4 Key structural challenges in the acceding countries: the integration of the acceding countries into the Community's economic policy co-ordination processes; by EPC (July 2003)

No. 5 The Western Balkans in transition (January 2004)

No. 6 Economic Review of EU Mediterranean Partners (March 2004)

No. 7 Annual report on structural reforms 2004 "reinforcing implementation", by Economic Policy Committee (EPC) (March 2004)

No. 8 The Portuguese economy after the boom (April 2004)

No. 9 Country Study: Denmark – Making work pay, getting more people into work (October 2004)

No. 10 Rapid loan growth in Russia: A lending boom or a permanent financial deepening? (November 2004)

No. 11 The structural challenges facing the candidate countries (Bulgaria, Romania, Turkey) – A comparative perspective (EPC) (December 2004)

No. 12 Annual report on structural reforms 2005 "Increasing growth and employment" (EPC) (January 2005)

No. 13 Towards economic and monetary union (EMU) – A chronology of major decisions, recommendations or declarations in this field (February 2005)

No. 14 Country Study: Spain in EMU: a virtuous long-lasting cycle? (February 2005)

No. 15 Improving the Stability and Growth Pact: the Commission's three pillar approach (March 2005)

No. 16 The economic costs of non-Lisbon. A survey of the literature on the economic impact of Lisbon-type reforms (March 2005)

No. 17 Economic Review of EU Mediterranean Partners: 10 years of Barcelona Process: taking stock of economic progress (April 2005)

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