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The Economic Adjustment Programme for Ireland

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The Economic Adjustment Programme for Ireland

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EXECUTIVE SUMMARY

Ireland experienced strong growth from the early 1990s, after decades of poor economic performance. Initial success was attributable to sensible fiscal policies, an export-oriented industrial policy and the benefits of closer European economic integration and broader globalisation in a context of strong productivity enhancements. However, domestic demand increasingly took over from exports as growth driver. The strong economic expansion in the years immediately before the current crisis masked an over-reliance on construction as the engine of activity.

Boom-related windfall fiscal revenues were largely spent, contributing to overheating and loss of competitiveness. Amid intense competition for profits in the booming economy and property market, the pace of credit expansion accelerated sharply. Light-touch macro-prudential regulation and supervision did little to stem the swelling banking sector imbalances.

From late 2007, investor confidence in Ireland's property sector evaporated amid concerns about oversupply and a price bubble. This left Ireland facing the twin problems of a sharp decline in cyclical construction-related revenues and the sudden appearance of very large losses in the domestic banking system. The global financial crisis and the severe worldwide recession which it caused exacerbated the problems. From 2008, policies to address budgetary and financial stability concerns included fiscal consolidation as well as a range of banking support measures such as guarantees, capital injections and regulatory reforms. However, by 2010 GDP had fallen from peak by an estimated 17% in nominal terms and the underlying government deficit had increased to over 11%. Unemployment ratcheted upwards.

By the autumn of 2010 the loss of investor confidence in Ireland triggered a vicious cycle. Deposit outflows from the banking sector accelerated and the cost of government borrowing reached unsustainable highs. As financing costs increased and renewed banking losses were revealed, investors were increasingly concerned about the capacity of the government to deal with the dual challenge of a large fiscal deficit and the state's commitment to finance the growing cost of supporting a severely damaged banking sector. The credibility and thus the effectiveness of the government guarantees in the banking sector faded. More outflows and increasing borrowing costs further damaged confidence.

These challenges led the Irish authorities to request external help on 21 November 2010. A programme of €85bn financial assistance was agreed at staff level with the European Commission and the IMF, in liaison with the ECB; and approved by the ECOFIN Council and the IMF Board in December 2010. The programme provides for up to €50bn in fiscal needs and up to €35bn in banking support measures between 2011 and the end of 2013.

Funding from the programme partners is conditional on speedy action to clean up Ireland's financial sector, to put the public finances on a sustainable path and to implement a structural reform package. The banking sector will become smaller to suit Ireland's needs and credit institutions will have to increase capital adequacy standards as well as improve funding profiles to lower market perceptions of risk. Rigorous stress testing of the system is necessary, unviable institutions will need to be wound down and financial regulatory reform must be advanced. Fiscal consolidation of €15bn (9% of GDP) by 2014 – frontloaded and weighted towards expenditure reduction – is required to put the debt-to-GDP ratio on a firm downward trajectory after peaking in 2013. This will also put Ireland on track towards meeting its 2015 Excessive Deficit Procedure deficit target of 3% of GDP. In turn, reform to the budgetary process will help to ensure adequate safeguarding of the public finances. Although price competitiveness has improved, a sustainable economic growth path from 2011 onwards requires further relative price and wage adjustment and shifts of production capacity across sectors. Structural reform measures to boost competition and avoid unemployment traps are an important part of this strategy.

The following report provides background to the programme and builds on the documents agreed with the Irish authorities.

I. Looking back - Building imbalances

1. **Ireland's economic performance in the run-up to economic and monetary union in 1999 and in the early years of euro-area membership was impressive.** For decades one of the underperforming economies of Western Europe, Ireland's per capita GNI caught up from 83 per cent of the EU-15 average in 1996 to 113 per cent by 2006 (GNI per capita vs EU 15 @ PPS).[1] This was based on a large flow of foreign direct investment helped by Ireland's EMU accession and a favourable investment climate. Export growth averaged an impressive 17.8% between 1996 and 2000 and large productivity improvements spilled over from the traded sector to the non-traded sector. Employment grew by 54% in the decade to 2006, boosted by improved participation rates and a sharp decline in unemployment as net inward migration turned strongly positive. However, from about 2004 onwards the export contribution to Ireland's strong growth began to wane while the contribution of domestic demand (particularly the construction sector) made up the difference (see Figure 1). Export growth only averaged 4.6% in the five years to 2006.[2]

2. **Ireland's strong pre-crisis growth performance was increasingly based on unsustainable drivers**. The experience since the mid 1990s of persistently high growth in the context of the country's successful catching-up process contributed to an underestimation of risk. This fed into an over-extension of credit, over-investment in physical capital and excessive increases in asset prices, as well as overly buoyant consumer expenditures. In this context, low real interest rates and easy access to credit contributed to inflating private sector balance sheets (see Figure 2) and property prices. Both household and non-financial corporate indebtedness rose sharply prior to the crisis to levels that were among the highest in the EU27.[3]

3. **Construction, notably housing, was at the heart of a domestic credit boom** (see Figure 3 to Figure 5). House-price inflation was the highest among EU countries between the mid-1990s and 2006[4]. Favourable demographic developments, high employment and wage growth contributed to the strength of the housing boom. It spurred the construction sector's share in employment that peaked at double the euro-area average in 2007. While also driven by fundamental factors, the housing boom was facilitated by tax incentives for housing investment (such as deductibility of mortgage interest payments) and, even more importantly, rapid credit expansion through the banking sector.

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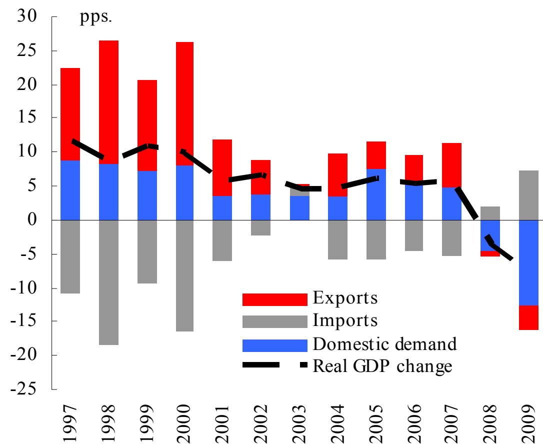
[1] As the relative price level increased as well, Ireland's per capita GNI increased even stronger when not corrected for purchasing power: from 78 per cent of the EU-15 average in 1996 to 130 per cent by 2006.

[2] With a DSGE model, Langedijk and Roeger (2007) identify shocks explaining different economic developments of member states in the early years of the euro area. Productivity shocks in the tradeable and non tradeable sector were important in Ireland. Productivity growth in the tradeable sector amounted to 15.8 % annually on average between 1999 and 2003 against 2.8% for the euro area as a whole. This figure is inflated by transfer pricing practices of multinational companies (See also footnote 4). In the non-tradeable sector, productivity growth in Ireland over the same period amounted to 3.2% versus 0.9% for the euro area as a whole. In addition, related to the creation of EMU, changes in the exchange risk premia were an important factor. These supply shocks exacerbated the effects on the demand side of financial market liberalisation as banks introduced new lending instruments which effectively increased credit ceilings for housing investment of private households.

[3] Deroose et al. (2004) illustrate with a simple macro-model how the lack of financial adjustment mechanisms and tailored monetary policy in individual euro-area Member States increases the risk of financial boom-bust cycles in EMU. They point to the need for close monitoring and supervision of the financial sector and emphasise that pro-cyclical fiscal policy, for instance by using growth dividends to reduce taxes or increase expenditures, can be detrimental in this context.

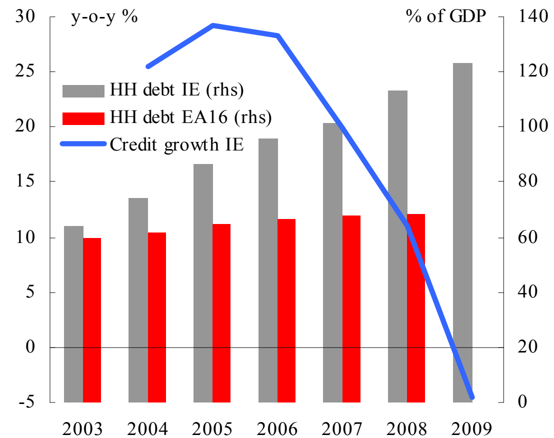
[4] See Rae and van den Noord (2006) and Malzubris (2008).

Figure 1: Contributions to real GDP growth (in pps.)



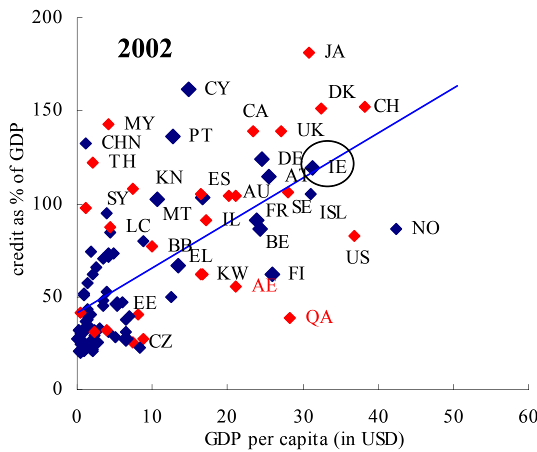
Source: AMECO

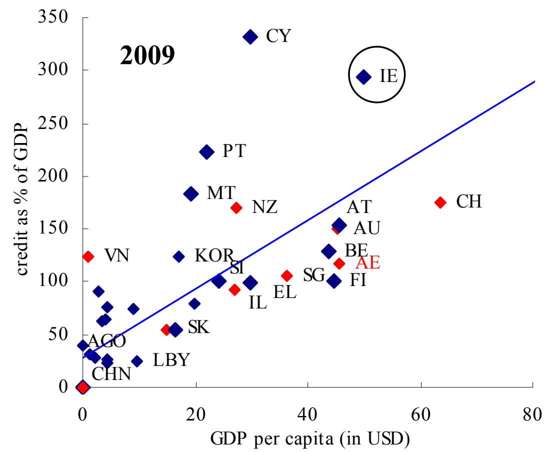
Figure 2: Private Sector Credit growth (y-o-y %) and household debt (% of GDP)



Source: Irish Central Bank, Eurostat

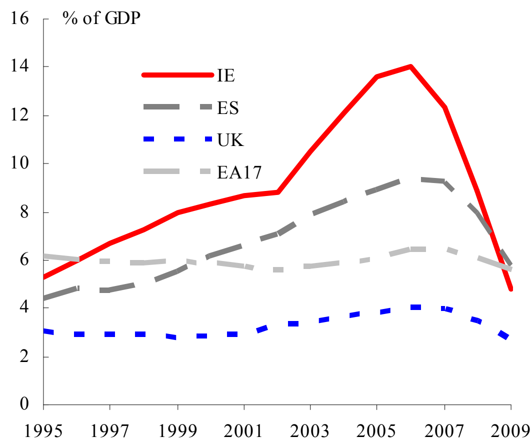
Figure 3: GDP per capita vs. credit to the private sector (2002 and 2009)





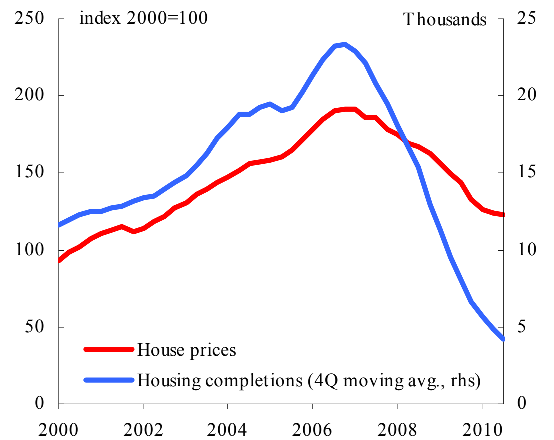
Source: AMECO, World Bank

Figure 4: Investment in dwellings (% of GDP)



Source: AMECO

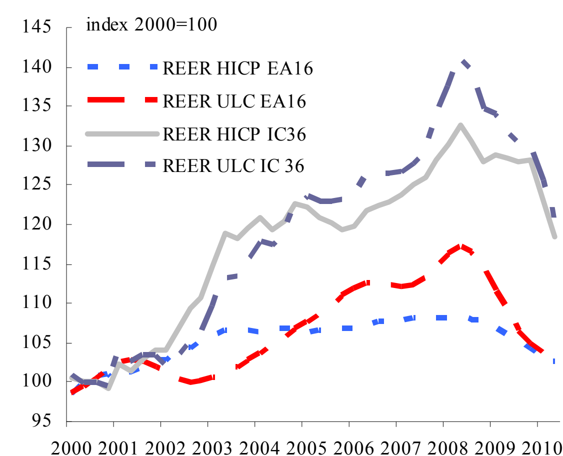
Figure 5: House prices (index, 2000=100) and housing completions (4Q moving average)



Source: Department of the Environment, Heritage and Local Government

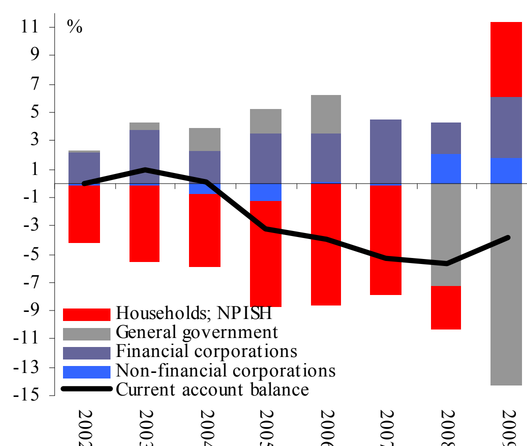
4. **External competitiveness deteriorated markedly during the domestic boom.** Vis-à-vis the euro area, Ireland's real effective exchange rate based on unit labour cost appreciated by some 16% between 2003 and 2008 as wage growth remained high while productivity gains declined to rates more comparable with those in the euro area[5] (see Figure 6). Vis-à-vis a larger group of trading partners (IC 36) the loss in competitiveness was compounded by exchange rate developments. This is of particular relevance for Ireland given its relatively high trade exposure to countries outside the euro area (notably the US and the UK). The loss of competitiveness was associated with declining export market shares in 2002-2008, after persistent increases since the 1990s. Moreover, the current account balance turned into deficit from 2005 onwards (see Figure 7), reflecting the strong increase in especially housing-related investment resulting in total investment exceeding domestic savings.[6]

Figure 6: Real effective exchange rates vis-à-vis the EA16 and IC36



Source: AMECO

Figure 7: Current account balance and sectoral net lending



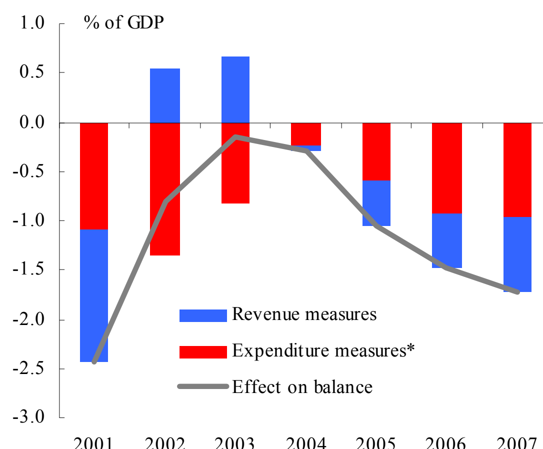
Source: AMECO

[5] Two important factors should be noted when interpreting many of the usual macroeconomic data series for Ireland, including those on productivity developments. First, while economic growth is usually measured in terms of GDP, GNI is probably a more appropriate measure for the Irish economy. The difference between GDP and GNI is net factor income, which is significantly negative in Ireland because of profit repatriations by multinationals. Irish GNI, which is about 20% smaller than GDP, is seen as a more suitable indicator of Irish living standards (among EU countries, Luxembourg is the only other country where the difference between the two measures is more than 10% of GDP). Second, some sectors with a marked presence of multinational companies are likely to be characterised by transfer pricing, attracted by Ireland's low tax rate on corporate profits. This has a considerable impact on standard measures of profits, output, productivity etc. (see Honohan and Walsh (2002).

[6] For a stylised analysis of competitiveness dynamics and risks of credit cycles for small open economies in the euro-area, see Deroose et al. (2004).

5. **Budgetary policy did not sufficiently lean against the wind.** While the period 2000-2007 saw the general government position in surplus in all but one year, boom-related windfall revenues were largely spent, contributing to overheating and loss of competitiveness (see Figure 8). The European institutions have repeatedly warned the Irish authorities of fiscal and macroeconomic risks related to the overheating in the economy and have recommended restraining public consumption growth.[7]

Figure 8: Fiscal policy stance - discretionary measures in the budgets for 2001-2007



*a negative sign signals an expenditure increase
Source: Commission Services' calculations using information from annual budgets - ex-ante estimates of full-year effect of new budgetary measures (non cumulative, cash).

6. **Significant imbalances built up in the domestic banking sector.**[8] Amid intense competition for profits in an overheating economy and property market, the pace of credit expansion accelerated sharply. Light-touch macro-prudential regulation and supervision did little to stem the swelling banking sector imbalances. The annual growth rate of loans to Irish households was close to 30 % in 2004-2006 (Figure 2 above). As a result of the credit boom and of the accompanying loosening of lending standards, Irish banks accumulated a high concentration of exposures in property-related lending. The rapid expansion of domestic banks' total assets, which reached around 320% of GDP in 2006 (Figure 9 and Table 1), is at the origin of the two main challenges that Irish banks currently face, namely the deterioration of the quality of their assets after the bursting of the housing market bubble, and the vulnerability of their funding structure.

Table 1: Structure of the Irish Banking Sector

	2003	2004	2005	2006	2007	2008	2009	2010 (Oct)
Total assets, EUR billion	575	723	942	1 178	1 337	1 412	1 324	1 247
Share of 5 largest institution, %	*44.4*	*43.9*	*47.8*	*49*	*50.4*	*55.3*	*58.8*	*N.A*
Share of domestic institutions, %	*45.6*	*47.9*	*49.8*	*51.4*	*52.2*	*56.8*	*60.3*	*61.1*
Loans to the Irish private sector, EUR billion	153	192	251	307	364	358	329	280
o.w. by domestic institutions	*138*	*178*	*233*	*291*	*342*	*342*	*313*	*264*
Deposits by the Irish private sector, EUR billion	110	124	146	170	180	176	184	177
o.w. at domestic institutions	*98*	*112*	*136*	*157*	*166*	*167*	*176*	*167*
Loan-to-deposit ratio	1.4	1.6	1.7	1.8	2.0	2.0	1.8	1.6
Loan-to-deposit ratio, domestic banks	1.4	1.6	1.7	1.9	2.1	2.1	1.9	1.6

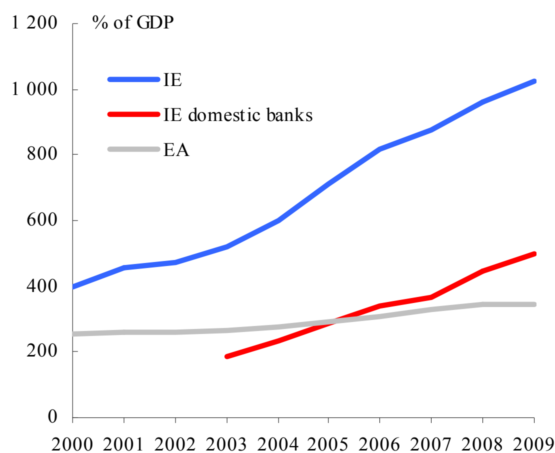
Source: Central Bank of Ireland

[7] OJ L 210, 21.8.2000, p. 28; OJ C 70, 27.3.2007, p. 3.

[8] The six main domestic credit institutions are Bank of Ireland (BoI), Allied Irish Banks (AIB), Anglo Irish Bank (Anglo), Irish Life and Permanent (ILP), Irish Nationwide Building Society (INBS) and the Educational Building Society (EBS). Domestic banks hold more than 55% of total banks' assets and provide about 95% of total loans to domestic households and corporations. In addition to domestic banks, the Irish banking system has a second distinct segment, comprised of non-domestic banks. This broad segmentation of the system reflects the existence of a relatively large offshore financial centre (the International Financial Services Centre, IFSC), which was established in the late 1980s and expanded steadily in the subsequent years. Non-domestic banks are specialising in providing credit to non-Irish residents through direct loans and purchases of securities.

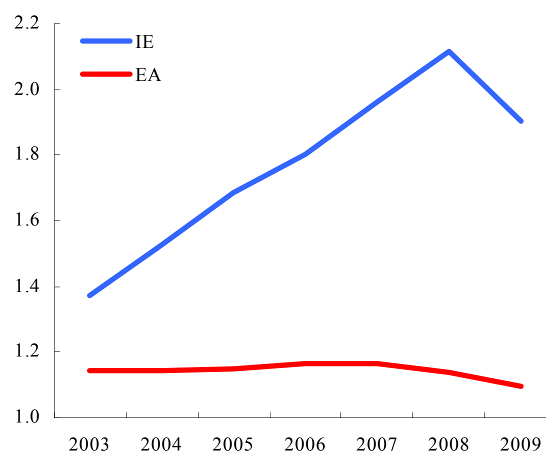
7. **The strong credit expansion resulted in an imbalanced funding structure of Irish banks.** Credit expanded substantially faster than deposits, resulting in substantial market funding needs. The loan-to-deposit ratio of Irish domestic banks, with respect to resident clients only, grew steadily from 133% in January 2003 to 215% in May 2008 (see Figure 10). This funding gap was closed by borrowing from international capital markets.

Figure 9: Banking sector assets (% of GDP)



Source: Irish Central Bank

Figure 10: Loan-to-deposit ratio, loans to residents



Note: For Ireland, domestic banking system only
Source: Irish Central Bank, ECB

II. The bubble bursts

8. **Several events coincided to bring about a fall in both construction's share of GDP and property prices by early 2007**. The construction of new housing units peaked in 2006, resulting from over-supply as evidenced by the large number of vacant units revealed in the census of that year. Uncertainty over the future tax treatment of property triggered a reduction in property market transactions. Mortgage financing in Ireland has traditionally been at variable rates and rising interest rates from late 2005 to early 2007 reduced affordability.

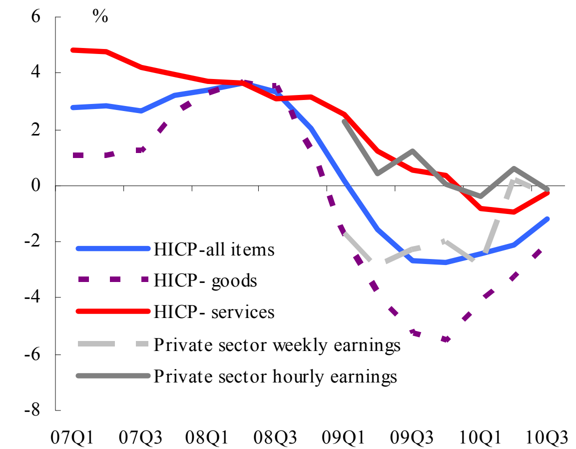
9. **The sharp adjustment from the 2006 peak in the Irish housing market spread rapidly to the wider economy.** By the end of 2010, house prices had declined by 38% from their peak at the end of 2006 as housing transactions stalled. The sharp change in market sentiment had its most drastic impact on land which had been purchased for development purposes.[9] Many of these transactions in the years before 2007 had been undertaken on a highly leveraged basis. Both empty sites and existing buildings intended for demolition saw a collapse in value in the face of a steep fall in demand for new construction. The broader economic impact of the correction in the housing market was amplified by the decline in global demand and especially by the recession in Ireland's main trading partners (euro area, US and UK). GDP is estimated to have declined by 11% in real terms and by 17% in nominal terms in 2008-10 and employment has fallen by close to 14% from its peak in Q3 2007. Despite a return to net outward migration and declining labour market participation, the unemployment rate rose to 13½% in 2010, up from 4½%

[9] While reliable data are scarce, a recent report suggests that land values might even have seen a 75% fall from peak (see http://www.daft.ie/report/patrick-koucheravy).

in 2007. The construction sector accounts for half of the decline in employment, requiring rebalancing of economic activity towards other sectors.

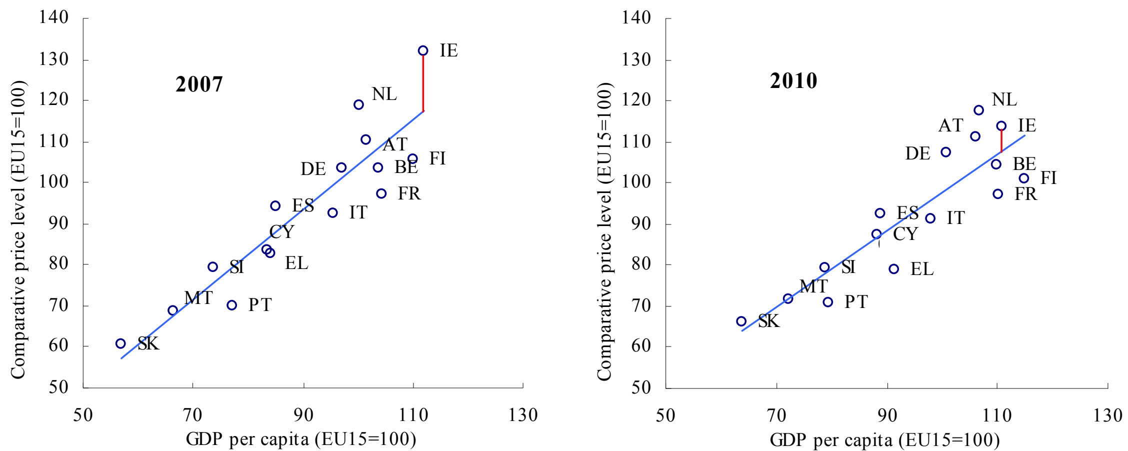
10. **Prices and wages reacted rapidly to the fall in demand**. After years of competitiveness losses, consumer price inflation turned negative. Consumer prices declined by around 3¼% cumulatively in 2009-10, mainly driven by a fall in goods prices (Figure 11). As Figure 12 shows, in a cross-country comparison, the price level in Ireland prior to the crisis had been very high, even after taking into account the country's per capita income. However, the adjustment in the context of the crisis has reduced this gap substantially. Led by cuts in public sector earnings which started in 2009, private sector nominal wages per employee also adjusted, including by declining hourly wages. By promoting cost competitiveness through an 'internal devaluation', these developments enhance medium-term growth prospects. However, disinflation also increases the real value of debt, which is of particular importance in a highly leveraged economy. As a result of the demand contraction and competitiveness improvement, the current account deficit narrowed (see Figure 13).

Figure 11: Annual changes in consumer prices and private sector wages



Source: Eurostat, CSO

Figure 12: Comparative price level and GDP per capita, euro-area countries 2007 and 2010 (excluding Luxembourg)

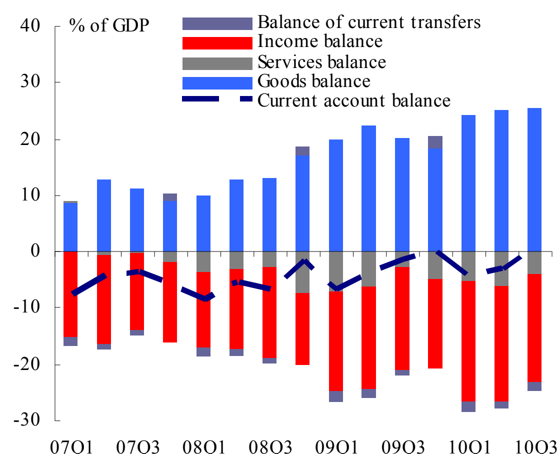


Source: Eurostat, Commission services' calculations for 2010

11. **The correction in property prices exposed very severe vulnerabilities in the Irish banking sector, with Anglo and INBS standing out.** While the quality of banks' loan portfolios differs, all Irish banks have been heavily loaded with bad assets. Anglo Irish Bank (Anglo) and the Irish Nationwide Building Society (INBS) are particularly exposed to commercial real estate development loans, many of which were highly speculative and have collapsed in value. The Educational Building Society (EBS), although principally active in the mortgage and deposit markets, entered the commercial real estate market just before the crisis and suffered serious losses in this area. The structure of assets held by Allied Irish Banks (AIB) and Bank of Ireland (BoI) is somewhat more diversified, albeit still heavily skewed towards residential mortgages and commercial non-property loans.

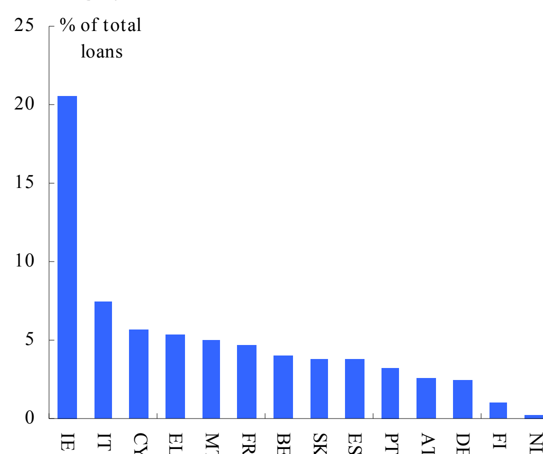
Irish Life and Permanent (ILP) is specialised in residential mortgages only. High expected, and by now confirmed, losses for 2009 and 2010 raised strong concerns among investors about banks' solvency already in late 2008. By 2010, the share of non-performing loans in the banking system had risen to the highest value in the euro area (see Figure 14). However, transfers of land and development loans with a nominal value of over €70bn to NAMA (see below) have since reduced the extent of banks' non-performing loans by a significant amount.

Figure 13: Quarterly current account developments (non-seasonally adjusted)



Source: Eurostat

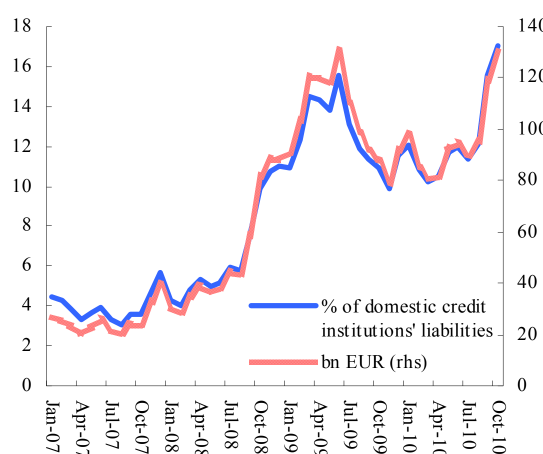
Figure 14: Non-performing loans, domestic banking system, H1 2010



Source: ECB

12. **The banking sector increasingly relied on the Eurosystem for funding**. Investors' growing doubts about the Irish banks' solvency resulted in a reluctance to renew maturing claims, causing serious liquidity problems. There were massive liquidity outflows in late 2008 and early 2009, which reappeared in May 2010. The lost funding was replaced by increasing reliance on the Eurosystem (see Figure 15). Given the limited amount of eligible collateral for repo transactions, banks have also increasingly had to take recourse to emergency liquidity assistance from the Central Bank of Ireland.

Figure 15: Eurosystem lending to banks in Ireland



Source: ECB and Central Bank of Ireland

III. Early policy actions

13. **Government offered a complete two-year guarantee on banks' liabilities in September 2008**. The objective was to alleviate banks' funding challenges. The so-called Credit Institutions Financial Support Scheme (CIFS) covered essentially all liabilities of the covered banks apart from undated subordinated debt. A new scheme, the Eligible Liabilities Guarantee Scheme (ELG) commenced in December 2009 and is intended to facilitate and permit credit institutions in Ireland to issue debt securities as well as take

deposits with a maturity of post-September 2010[10]. While the guarantees have provided some relief to banks, they have not allowed them to restore their access to term market funding. The ELG Scheme has been prolonged to 31 December 2011 for all liabilities under the Scheme, subject to continuing EU Commission state aid approval at six-monthly intervals.

14. **The government also took action to strengthen banks' capital.** Given banks' difficulties to find a private solution to their capital needs, the government provided additional capital in cash or through promissory notes[11] to five domestic institutions, Irish Life and Permanent being the exception. A second measure the government took with a view to providing impaired assets relief to banks was the establishment of the National Asset Management Agency (NAMA, see Box 1). In total, some €46 billion (29% of GDP) has been injected in domestic banks over the period 2009-2010 (see Table 2). This amount does not include additional recapitalisations which will be identified under the EU/ECB/IMF Programme and injected over its course.

Table 2: Capital injections into Irish banks during the crisis (as of 28 January 2011)

Anglo Irish Bank ***(Nationalised in January 2009)***	**Total**: **€29.3bn** (18 1/3 % of GDP), including o €4 bn (June 2009) o €8.3 bn in form of a promissory note (March 2010), increased to 10.3 bn (May 2010). o €8.6 bn through a promissory note (notified June 2010, approved by the Commission on 10 August). o €6.4bn (of which €1.5bn already approved in August 2010) through a promissory note (December 2010),
Allied Irish Bank (AIB)	**Total: €7.2bn** (4½% of GDP), including o €3.5 bn (2¼% of GDP) in preference shares, via the National Pension Reserve Fund (NPRF) (February 2009) (*As part of the capital injection approved by the Commission in December 2010, all preference shares were converted into ordinary shares to increase the equity in the bank*) o €3.7bn cash investment by the NPRF in equity (December 2010)
Bank of Ireland (BoI)	**Total: €3.5 bn** (2¼% of GDP) in preference shares, via the NPRF (February 2009) of which €1.7 billion were converted into equity as part of BoI's capital raise in April 2010
Irish Nationwide Building Society	**Total: €5.4bn** (3½% of GDP), including o €0.1bn through special investment shares (March 2010) o €2.6bn in form of a promissory note (March 2010) o €2.7bn in form of a promissory note (December 2010)
EBS Building Society	**Total: €0.9bn** (½% of GDP) o €0.1bn through special investment shares (March 2010) o €0.25bn in form of a promissory note (June 2010) o €0.525bn in form of special investment shares (December 2010)
TOTAL	**€46.3bn (29% of GDP)**

Note: In addition, covered institutions benefit from the *bank guarantees* granted by the Irish authorities and have *transferred impaired property-related assets* to the bad bank "NAMA".
Source: Commission services

[10] The liabilities covered include: all deposits (to the extent not covered by deposit guarantee schemes in the State (other than the Credit Institutions Financial Support Scheme) or any other jurisdiction); senior unsecured certificates of deposit; senior unsecured commercial paper; other senior unsecured bonds and notes. In addition, a blanket guarantee will apply to all relevant deposits incurred or rolled-over by a participating institution from the time such participating institution avails of a guarantee under the ELG Scheme for the first time, regardless of type, nature or the identity of the depositor.

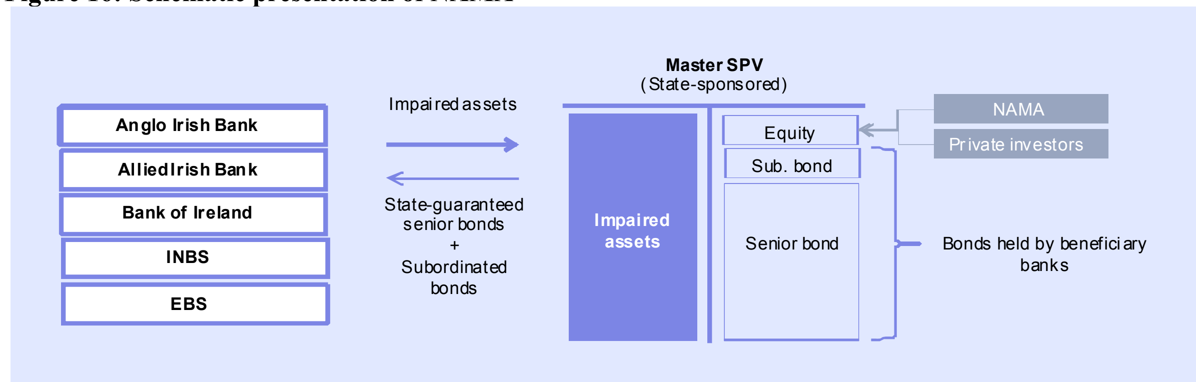
[11] Debt securities issued by the Irish State which qualify as core Tier 1 capital for the purpose of the calculation of Irish banks' regulatory capital adequacy ratio. The nominal amount of these securities is not disbursed immediately but over a 14 year period. The holder of these securities is also entitled to receive a coupon from the Irish State.

Box 1: The National Asset Management Agency (NAMA)

In December 2009, the Irish authorities established the National Asset Management Agency (NAMA), in order to arrange and supervise the purchase (as initially estimated) of approximately €82.5 billion worth of land, development property and associated commercial loans (together with associated derivatives). There are five financial institutions participating in the scheme: Anglo Irish Bank, Allied Irish Bank, Bank of Ireland, Irish National Building Society, and Educational Building Society. The minimum threshold for assets to be transferred to NAMA was initially set to €5 million for AIB, Anglo Irish Bank and Bank of Ireland. This threshold was raised to €20 million for AIB and Bank of Ireland in September 2010.. However, the minimum threshold will be removed for BoI and AIB as envisaged by the EU/ECB/IMF financial assistance programme.

NAMA is not directly involved in acquiring impaired assets and issuing bonds (see Figure 16) In order to achieve its objectives, NAMA established a special purpose vehicle (SPV), which is responsible for the purchase, management and disposal of loan assets from participating institutions and financing such purchases through the issuance of debt securities. The SPV is owned jointly by private investors (51%) and NAMA (49%). The purchase price of assets is paid through the issuance by the SPV of State-guaranteed senior debt securities (essentially IOUs) for 95% of the purchase price and the issuance of (non State-guaranteed) subordinated debt securities for 5%. The issued securities are held by the participating credit institutions pro rata their share in the assets transferred to NAMA. Table 3 presents a breakdown of assets transfers to NAMA by institution. The State-guaranteed debt securities could then be used by the participating credit institutions as collateral to receive financing from the European Central Bank, helping to improve the liquidity position of these banks.

Figure 16: Schematic presentation of NAMA



Source: Commission services

This institutional set-up implies that while NAMA is classified as part of the government, the SPV (as a company in which NAMA holds only a minority stake) is not.

The first two tranches of assets were respectively transferred in May and in August 2010, representing a total amount of respectively € 15.4 and € 11.9 billion. The assets were transferred to NAMA with an average haircut of respectively 50.2% and 55.7%. In September 2010, the Irish authorities announced that the remaining (NAMA eligible) assets (amounting to €46 billion) would be transferred in a single tranche to NAMA by the end of 2010 / early 2011. As of mid-January 2011, €71.3 billion had been transferred with an average discount of 58%. The transfer of the remaining €3.7 billion was expected to be completed by Q1 2011.

Table 3: Estimated NAMA Transfers (as at 20 January 2010)

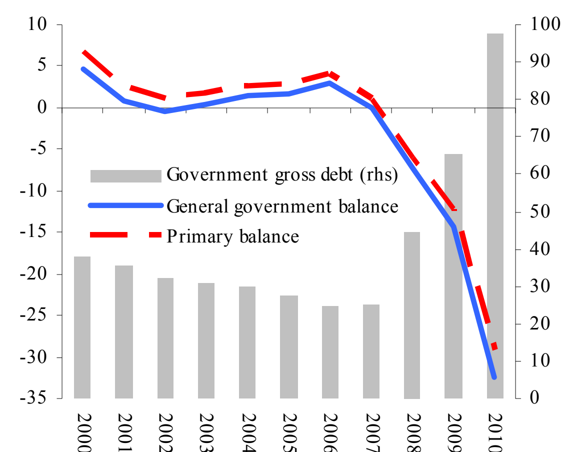
	AIB	BoI	Anglo	INBS	EBS	Total
Loans > Eur 20 mn						
Loan Nominal (Eur bn)	18.5	9.4	34.0	8.5	0.8	71.3
Consideration (Eur bn)	8.5	5.5	13.0	3.0	0.3	30.3
Discount	54%	42%	62%	64%	60%	58%
Loss	10.0	3.9	21.0	5.5	0.5	41.0
Loans < Eur 20 mn (Expected) *						
Loan Nominal (Eur bn)	4.40	2.10				6.50
Consideration (Eur bn)	1.94	1.26	Not applicable			3.20
Discount	56%	40%				51%
Loss	2.46	0.84				3.30

(* Initial information as of September 2010)

Source: Commission services

15. **The solvency of the Irish sovereign and the banking system have become inextricably linked**. Even without taking into account support measures to the banking sector, the public finance position has deteriorated markedly (see Figure 17) despite the implementation since mid-2008 of five consolidation packages with a total net-deficit reducing impact of 9% of GDP in 2008-2010. The crisis has exposed important weaknesses in the public finances which had been masked by strong growth in the boom years. These include a narrow tax base and strong reliance on cyclical tax revenue – in particular related to property transactions - used to finance structural increases in expenditure (Box 2 and Box 3). However, the impact of support measures for the financial sector on the public finance position was even bigger than the deterioration on account of these factors[12]. Including such one-off support measures amounting to almost 20% of GDP, the general government deficit is estimated to have reached 32.0% in 2010, while gross public debt has soared to an estimated 95.0% of GDP in 2010 from its low pre-crisis level of 25.0% in 2007. The total impact of support measures to the financial sector on the general government deficit amounted to 22.7% of GDP in 2009-10.

Figure 17: General Government balance and gross debt (% of GDP)



Source: AMECO

Box 2: Revenue structure

After a decade of gradual decline, the revenue-to-GDP ratio reached its lowest level of 33% in 2002 following a series of tax-cutting budgets. Then it gradually increased until its 2006 peak of 37½% of GDP, largely due to the tax-rich composition of growth and high cyclical tax revenue in particular. Some limited tax-increasing measures with an estimated effect of 0.6% of GDP on average were taken in 2002 and 2003 (Figure 8), somewhat offsetting previous tax cuts. However, from 2005 to 2007 further tax-decreasing measures were introduced with an estimated effect of 0.5% of GDP annually[13].

Before the crisis, Ireland's revenue structure (see Figure 18) was not very different from that for the euro area on average, except for social contributions. Very low social contributions in Ireland could be partly explained by lower welfare and pension payments due to the relatively young population and the fact that part of social protection is financed from general taxation. Going forward, a difficult choice will have to be made between maintaining the existing social safety net and keeping social contributions at their low level. This becomes even more challenging in the view of the projected increase in ageing-related expenditure.

The economic downturn and decline in the property market revealed a structural weakness of the Irish tax system. Much of the increase in both indirect and direct taxes between 2002 and 2006 can be attributed to revenues directly related to the property market, in particular: stamp duties (part of indirect taxes), taxes on holding gains (part of income taxes) as well as the value-added tax on new houses. Figure 19 shows that the share of property-related revenue in total tax revenue increased from 8.4% in 2002 to 18% in 2006, but is estimated to have decreased to 2.6% in 2010[14]. In addition, the housing boom stimulated higher economic activity in other sectors so that overall economic growth and tax revenue were higher than would have been the case in a "sustainable growth" scenario. Part of the decline in property-related tax revenue is likely to be permanent because the record levels of housing output seen during the boom are unlikely to be repeated. This

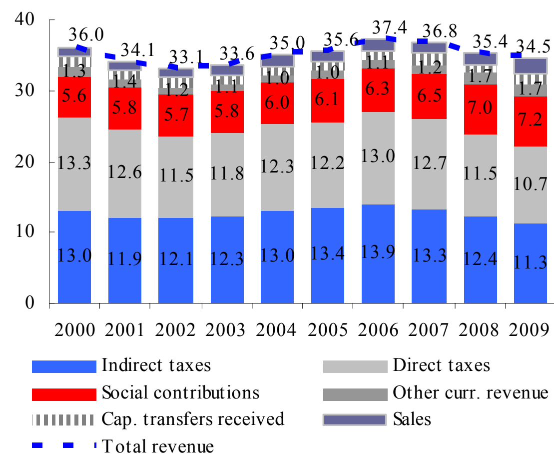
[12] It should be kept in mind, though, that the financial support measures have had a one-off effect on the public finance position, whereas the factors discussed before are of a structural nature.

[13] The estimated effects are taken from the successive budgets and are expressed in cash terms. They do not account for any impact of the budget measures on the economy, such as changes in consumption and investment patterns leading to additional tax buoyancy.

[14] The analysis is based on central government cash data, for which detailed information on 2010 is available.

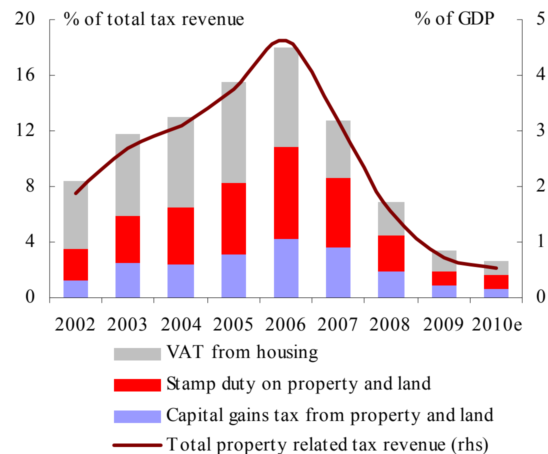
implies the need for a very significant structural adjustment to bring expenditure back in line with sustainable revenues.

Figure 18: General government revenue (% of GDP)



Source: Eurostat

Figure 19: Property-related tax revenue (% of GDP)

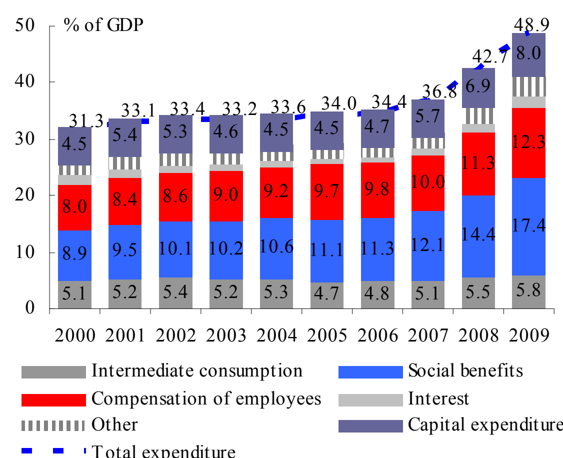


Source: Commission services' estimate

Box 3: Expenditure structure

Total expenditure increased by almost 11% annually on average in 2000-2007. Despite high nominal GDP growth, the expenditure-to-GDP ratio increased from 31% in 2000 to 37% in 2007 (see Figure 20). In 2008 and 2009, the substantial tax revenue shortfall resulting from the sharp downturn in economic activity was not matched by sufficiently fast adjustment on the expenditure side. High spending growth trends continued and expenditure-reducing efforts were taken from elevated starting positions based on the previous policy commitments. In 2008 total expenditure increased by 10.4%, while nominal GDP declined by 5%. Figure 21 illustrates this divergence between the growth paths of expenditure and GDP. It was more pronounced for current expenditure as capital expenditure was cut sooner and more sharply. In 2009 expenditure growth was curbed by several consolidation packages including the effect of measures taken since mid-2008. Total expenditure decreased by 3.7% excluding a one-off capital injection into Anglo Irish Bank of 2.5% of GDP (part of capital expenditure in Figure 20), but nominal GDP declined by 11.3%. The general government expenditure ratio peaked at 49%, some 17½ percentage points higher than its value in 2000.

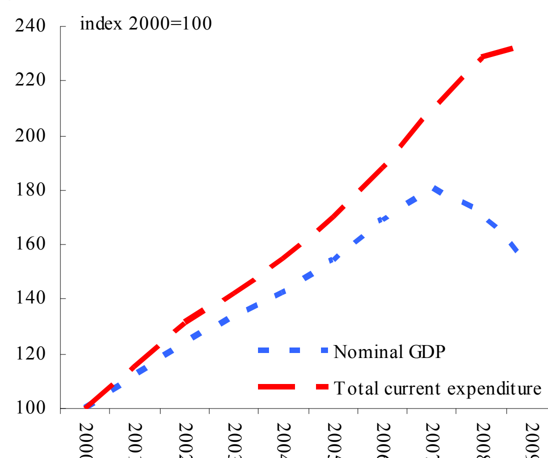
Figure 20: General Government expenditure



Note: Capital expenditure includes gross fixed capital formation and capital transfers. In 2009, capital expenditure amounted to 5.5% of GDP excluding a capital injection into Anglo Irish bank (2.5% of GDP). A figure for 2008 includes a non-recurrent expenditure on the purchase of the Westlink toll bridge, the purchase of oil stock by NORA and the Farm Waste Management scheme together accounting for 0.8% of GDP

Source: Eurostat

Figure 21: Nominal GDP and nominal general government expenditures (Index, 2000=100)



Source: Eurostat

As the bulk of expenditures is on social benefits, compensation of employees and capital expenditures, any sizeable expenditure reductions inevitably will need to include cuts in these items. Social transfers, the public sector wage bill and public investment showed particularly strong growth rates in 2000-2007. In this period compensation of employees increased by 12½% annually on average reflecting both high public sector wage increases and an expansion of public employment. Moreover, public sector employees earned on average 9.7% more than their private sector counterparts in 2003 and this gap had risen to 21.6% by 2006.[15] Public sector wages increased by some 4½% in 2007 and 2008, but have since then been reduced by some 7% in 2009 and 6.2% in 2010. The government has committed to no further pay reductions until 2014 but savings are due to arise from reductions in public service numbers and other administrative efficiencies.

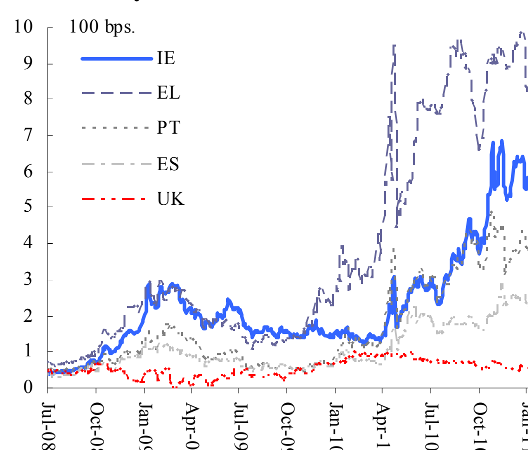
Social expenditure doubled between 2000 and 2007 and increased its share in total expenditure from 25% to 28%. Old age pension expenditure accounted for one third of social expenditure and its amount doubled in this period due to the generous pension increases. Family and children benefits rates doubled between 2000 and 2002 and saw further generous increases until 2008. While unemployment benefits accounted for only 13% of social spending in 2000-2007 due to the low unemployment level, benefit rates doubled in this period with adverse consequences when unemployment increased during the crisis. In 2009 and 2010 real increases were seen across a range of social benefits as falling consumer prices boosted their purchasing power.

Expenditure on gross fixed capital formation averaged close to 4% of GDP in 2000-2007, well above the EU average of 2.4%. However, this difference is projected to diminish by 2014 following the already implemented and planned expenditure reprioritisations and cuts.

IV. Run-up to the international financial assistance programme

16. **Since late summer 2010, financial markets have questioned the solvency of the Irish sovereign**. Spreads of Irish sovereign bonds vis-à-vis their German counterparts widened to record levels. The government attempted to calm markets by providing an estimate of the total cost of the support measures to the banking sector on 30 September and outlining a four-year consolidation plan on 24 November (see Box 4 for a timeline of events). These measures failed to impede further worsening of market conditions, with sovereign bond spreads skyrocketing in late November (Figure 22). Liquidity outflows from the banking sector accelerated, particularly before the expiry of the Credit Institutions Financial Support Scheme.

Figure 22: 10-year sovereign bond spreads vis-à-vis Germany



Source: ECOWIN

17. **The authorities requested financial assistance from the EU and the IMF on 21 November 2010.** They published a National Recovery Plan 2011-2014 on 24 November 2010 after months of preparation, which served as a basis for the policy conditionality of the financial assistance programme. A joint European Commission-ECB-IMF mission team negotiated the conditions of the programme and agreement at technical level was reached on 28 November 2010 on a comprehensive policy package for the period 2010-13 supported by financing for a total amount of €85 billion. On that same day, the Eurogroup issued a statement supporting the policy programme and the loan package associated with it. On 7 December, the ECOFIN Council adopted the formal Decision allowing for financial assistance to Ireland and a Recommendation extending the

[15] ESRI (2009).

deadline for compliance under the excessive deficit procedure by one year to 2015. The Irish Parliament approved the programme on 15 December. On 16 December, the IMF Board approved a loan arrangement on the basis of an Extended Fund Facility (EFF)[16].

Box 4: Timeline of events in 2010

- 7 May: Irish ten-year bond yields peak at 311 basis points over German bunds, a euro-era record, as the fear of contagion grows due to the Greek rescue. Spreads fall immediately but rise again through May and June as market concerns return.
- 23 July: Allied Irish Banks and Bank of Ireland, Ireland's two largest banks, pass EU-wide stress tests.
- August 2010: Concerns grow about losses in the banking sector and the imminent ending of the two-year government bank guarantee cause spreads to rise, reaching 366 points by the end of the month.
- 8 September: Bond spreads reach 386 points. Government announces plan to split Anglo Irish Bank into a funding bank and an asset recovery bank, and to provide an estimate of the final cost of restructuring and resolution of the bank.
- September 2010: Minister for Finance signals that the fiscal correction required in 2011 would be of the order of €3 billion.
- 23 September: Second quarter national account for 2010 are published. They show worse-than-expected fall of 1.2% in GDP quarter-on-quarter. Spreads reach 425 points.
- 30 September: A final cost to the state of the banking sector of €46bn with a worst case scenario of €51bn is estimated. Government announces that this cost will necessitate fiscal consolidation requirement. Spreads fall in early October.
- Starting in October, concerns in markets about possible private sector involvement affect the spreads of all vulnerable Member states.
- 26 October: Government announces that €15bn of consolidation is required over the period 2011-2014, up from the €7.5bn under existing plans. Spreads rise again to 401 points.
- 4 November: Government announces that €6bn consolidation is to be frontloaded in 2011. Despite this, spreads go above 682 points by 11 November, a new high.
- 21 November: Irish authorities make request to European Partners, IMF for assistance in assembling a financial stability package.
- 24 November: National Recovery Plan, detailing fiscal consolidation and structural measures from 2011 to 2014, is published by government.
- 28 November: Staff level agreement on financial stability support and macroeconomic adjustment programme for the period to 2013 is reached.
- 7 December: Eurogroup and ECOFIN Council formally agree on a financial assistance package for Ireland and on an extension of the excessive deficit target to 2015 from 2014.
- 15 December: Irish parliament votes on the Memorandum of Understanding on Specific Economic Policy Conditionality, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding.
- 16 December: The programme is agreed by the IMF board. Irish spreads remain elevated at 531 points.

18. **An important financing contribution (€17½ billion) comes from available Irish funds.** In addition, the programme will be financed through contributions from the IMF (one third of the remaining amount) on the basis of an Extended Fund Facility (EFF) and from Ireland's European partners (two thirds) through the EFSM, the EFSF as well as bilateral loans from the UK, Sweden and Denmark (for details see section VI).

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[16] Useful background analysis can also be found in the corresponding staff report, IMF (2010a).

V. Programme design and objectives

19. **The key objective of the programme is to restore financial market confidence in the Irish economy's banking sector and the sovereign.** Breaking the pernicious feedback loops between the fiscal and financial crises should enable the economy to return to sustainable growth.

20. **To achieve this objective, the programme consists of four key elements.**

    i. **A financial sector strategy comprising fundamental downsizing and reorganization of the banking sector**. Addressing market perceptions of weak capitalization, overhauling the banks' funding structure, as well as gradual downsizing and deleveraging the banking system will be required. These steps will be backed by the availability of programme funds both for recapitalization and deleveraging.

    ii. **A strategy to restore fiscal sustainability.** Building on the authorities' National Recovery Plan, the consolidation strategy will rely to a large extent on broad-based expenditure restraint. International experience shows that this is a typical characteristic of successful and sustainable fiscal consolidation episodes. At the same time, the tax system will undergo profound change. The formerly narrow tax base will be broadened, raising revenue stability and, together with increases in specified tax rates, contributing to the generation of additional revenue. Specific measures will be chosen also with a view to limiting the inevitable knock-on effect of consolidation on domestic demand, thereby contributing to the economy's return to balanced and sustainable growth.

    iii. **A structural reform package to underpin growth**. The programme includes measures to remove potential structural impediments to competitiveness and employment creation. Specifically, labour market related measures such as adjustments in the minimum wage and an intensification of activation measures will boost the growth potential of the economy. Product market reforms will include the opening up of sheltered service sectors.

    iv. **The external financial assistance will support the achievement of these policy objectives**. It provides the government with ample time to implement a comprehensive consolidation strategy that will underpin a sustainable path for gross government debt, by narrowing and eventually closing annual budget deficits and assuring a return to economic growth.

21. **To limit risks to achieving its main objectives, the programme is based on cautious assumptions, including the macroeconomic scenario.**

V.1. Macroeconomic outlook: export-led recovery

22. **Driven by exports, Ireland is projected to return to positive growth in 2011** (see Table 4). After a cumulative decline by an estimated 11% in real GDP and 17% in nominal GDP in 2008-2010, Ireland is projected to see an export-led recovery in 2011, with an increase in real GDP of around 0.9%. While growth is expected to accelerate from 2012 onwards, the projected pace of expansion is relatively modest by historical standards (which are inflated by Ireland's successful catching up process and the unsustainable real estate boom).

Table 4: Macroeconomic framework

	2009	2010	2011	2012	2013	2014	2015
			% change on previous year				
Real GDP growth	-7.6	-0.2	0.9	1.9	2.5	3.0	3.0
Domestic demand contribution	-11.3	-4.4	-3.1	-0.6	0.3	1.0	1.0
Net trade contribution	3.8	3.4	3.7	2.5	2.2	1.9	2.0
Unemployment rate (level)	11.8	13.6	13.4	12.7	11.6	10.7	10.0
HICP inflation	-1.7	-1.5	0.4	0.6	1.6	1.8	1.9

Source: Commission services

Figure 23: Consumer price developments (HICP)

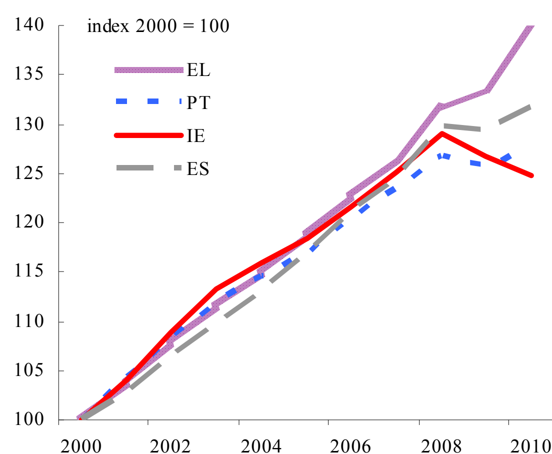


Figure 24: Nominal compensation per employee

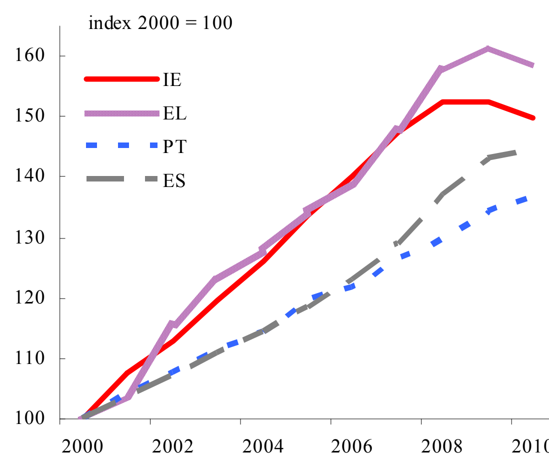


Figure 25: Nominal house prices

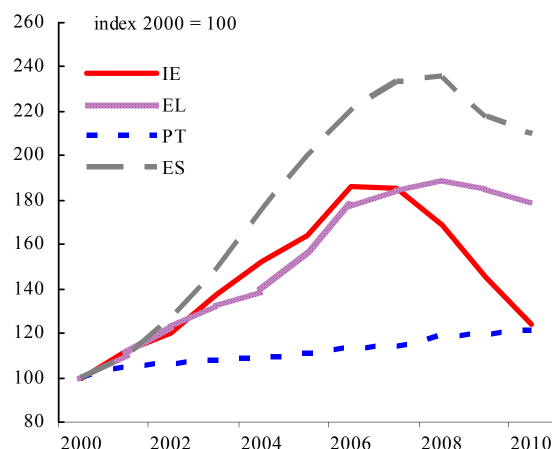
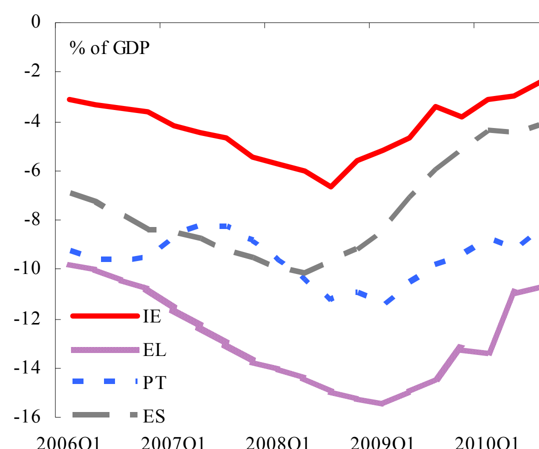


Figure 26: Current account balance



Source: Eurostat

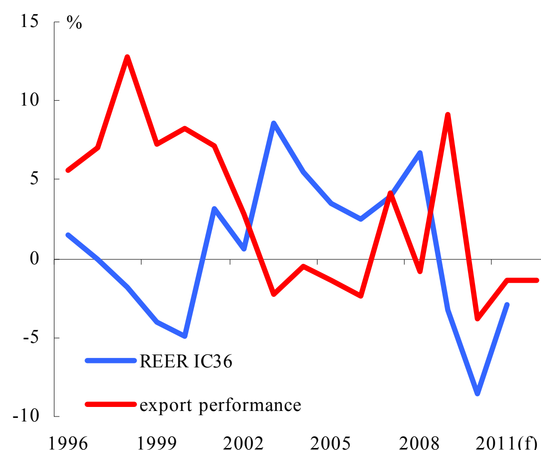
23. **Progress made in the correction of past nominal and external imbalances supports the starting position for the economy's export performance.** As illustrated by Figure 23 to Figure 26, rebalancing started earlier and is more advanced than in other peripheral euro area countries, reflecting the flexibility of the economy and the early outbreak of the crisis in Ireland. Since the end of the credit-fuelled construction boom in 2007 there has been a sharp fall in house prices, two consecutive years of falling consumer prices and nominal wage adjustment. A continued improvement in competitiveness, as assumed in the projections, should support Irish export growth over the programme period.

24. **Export growth should continue to lead the recovery**. Mainly due to composition effects (a large share in goods exports of a-cyclical chemicals, notably pharmaceuticals), Ireland's

export performance during the crisis was remarkably resilient. While some deceleration is expected relative to the strong expansion in 2010, export growth should remain relatively buoyant over the programme period: competitiveness has been strengthened; Ireland's export markets are expected to continue growing; and the country's strong multinational export base is largely independent of domestic financing conditions. Together with contained import growth reflecting contracting domestic demand, the continued expansion in exports should facilitate a further improvement in the current account. Despite the income outflows associated with the activity of multinational firms and with the interest payments on the increasing gross public debt, this should lead to a current account surplus by the end of the programme period.

25. **Export growth projections are based on prudent assumptions**. Demand from Ireland's trading partners is set to see healthy growth and the economy's current gains in competitiveness are important and should continue over the programme period, given the projected modest developments in prices and wages (see Figure 30). As Figure 27 illustrates, there was an inverse relation in the past between the Irish export performance and the country's real effective exchange rate vis-à-vis 36 trading partners deflated by unit labour costs (REER IC36). Going forward, a small deterioration in the relative export performance is cautiously assumed despite the projected gains in competitiveness. In view of this and also of the volatility of the Irish export performance, upside surprises regarding the projections for exports are not excluded.

Figure 27: Competitiveness developments and export performance (yoy change in %)



Note: Export performance is an index of exports divided by an index of export market growth
Source: AMECO

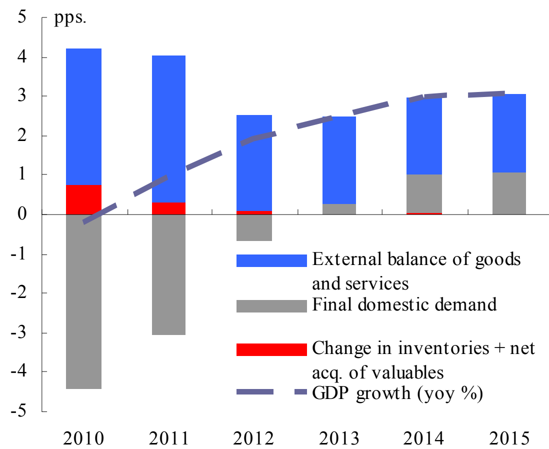
26. **The expected modest GDP growth rates reflect the drawn-out domestic adjustment process**. High household indebtedness due to the past housing boom is expected to limit the decrease in the saving rate, while the very gradual decrease in unemployment is also expected to restrain private consumption growth. At the same time, deleveraging in the financial sector is likely to continue holding back investment. Full implementation of the necessary fiscal consolidation will inevitably dampen activity. The negative effects should be progressively mitigated by positive confidence effects (Box 7 provides information on simulations made with a model calibrated to Ireland to quantify the impact of the planned consolidation package). Due to these factors, domestic demand is expected to continue acting as a drag on growth in the first two years of the programme.

27. **The slack in the economy should also keep inflation in check**. Consumer price inflation is expected to return to positive territory in 2011 after the decreases in 2009-10, but accelerating only gradually. Likewise, very moderate increases in private sector wages are projected while assumptions on public service wage developments reflect the nominal freeze to 2014 agreed between the government and public service unions in early 2010. As discussed above, these developments should help Ireland to further regain competitiveness, which should in turn support further dynamic export growth.

28. **The labour market is projected to see a gradual improvement**. Despite the Irish labour market's flexibility, as also reflected in recent wage adjustments, the pick-up in employment growth and reduction in the unemployment rate are projected to be very

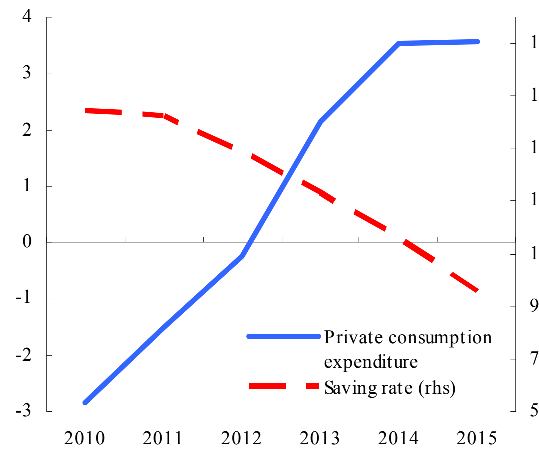
gradual. This reflects the export-led nature of the recovery and the capital-intensity of production in key export sectors. At the same time, the sectoral rebalancing process is projected to be drawn-out, and skills mismatches could arise in the labour market, where many of the newly-unemployed are low-skilled former construction workers[17]. Consistent with the gradual improvement, further sizeable net outward migration flows are assumed in the first years of the programme, while the government's activation measures should have a positive impact on participation rates.

Figure 28: Projected real GDP growth and contributions



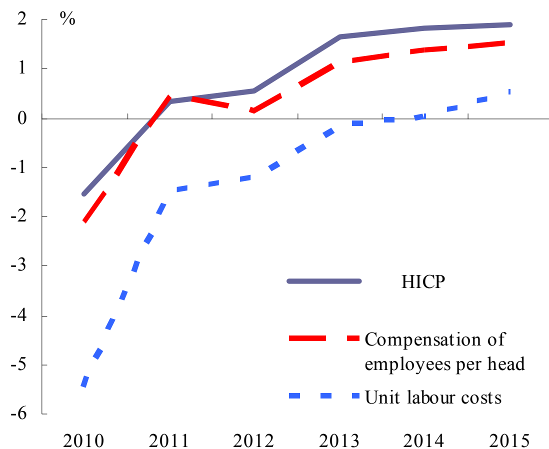
Source: Commission Services

Figure 29: Projected household saving rate and private consumption growth (%)



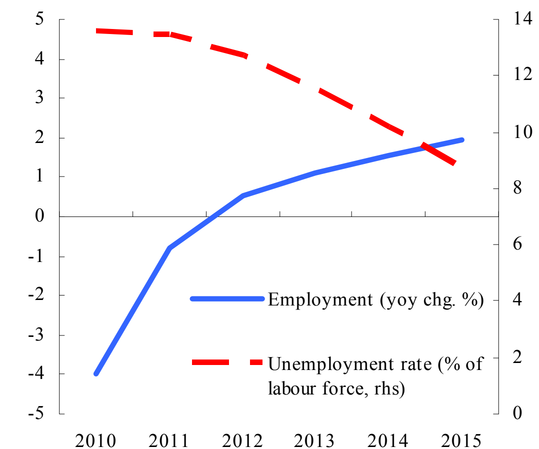
Source: Commission Services

Figure 30: Projected price and wage inflation, unit labour cost (y-o-y chg.)



Source: Commission Services

Figure 31: Projected employment growth and unemployment rate (%)



Source: Commission Services

[17] According to National Accounts data, the construction sector accounted for 54% of the employment decline by close to 300000 persons between Q3 2007 and Q3 2010. According to data from the Quarterly National Household Survey, the increase in unemployment over the same period was concentrated among persons with higher secondary education or lower educational attainment (54% of the increase).

V.2. Restoring financial stability

29. **The programme's financial sector strategy aims at restoring financial stability and thereby, investor confidence.** The lack of investor confidence in the banking sector reflects doubts about banks' solvency and the sovereign's capacity to rescue them. In devising a strategy for the banking sector, care was taken to provide the necessary public support to the banks while at the same time safeguarding the sustainability of public finances.

30. **The programme provides access to a dedicated funding source and a credible external involvement in designing and implementing a reform strategy**. Under the programme, €35 billion is available to finance measures to decisively overhaul the banking sector, with the objective of quickly delivering smaller and robust banks that will be viable in the long term without state support. These measures will have two main components – an immediate and credible recapitalization of banks coupled with reorganization and downsizing of the sector. The Commission, the ECB and the IMF will be actively engaged in each component of the strategy.

31. **Adequate capitalization of the banks is essential to underpin investor confidence in the solvency of the banks**. The first set of recapitalization measures (€10 billion) are being implemented starting in January 2011:

    i. **The minimum core Tier-1 capital requirement ratio is planned to be permanently increased from the current 8% to 10.5%.** This will be accompanied by an immediate extra capitalization of the banks to 12% of core Tier-I to cover any losses that might arise in the coming months. This increase in capital ratios will imply a capital injection of approximately €8 billion including additional capital to complete the transfer of commercial property development loans to NAMA. Not all comes from the programme financing. AIB and BOI have launched liability management exercises (LME) which will in all likelihood reduce the amount of total capital initially required to reach the new capital ratios. The programme funds that are saved through conducting LMEs will be available for banks for early deleveraging.

    ii. **At least €2 billion is set aside by the programme for early deleveraging of the banking system.** However, as mentioned above the amount available could increase as a result of the LME carried out by BOI and AIB.

32. **The capital will be provided in the form of cash, and not in preference shares and/or promissory notes**. Allowing for normal procedural constraints, capital will begin to flow into the banks from early in the first quarter of 2011. This recapitalization will be additional to that announced by the government statement of 30 September 2010.

Reorganization and downsizing – a radical overhaul

33. **Reviews of capital and liquidity needs will allow moving towards the objective of a lean and strong banking sector**. The key component of the reforms will be an overhaul of the banking sector with the objective of substantial downsizing, isolating the viable parts of the system and returning the sector to healthy functioning. Implementation of this strategy will require a set of policy tools, which will be put in place by end-Q1 2011. These policy tools will be:

    i. **An enhanced Prudential Capital Assessment Review (PCAR) for 2011, based on a thorough assessment of banks' asset quality and more rigorous stress testing** (see Box 5). The design and implementation of the PCAR 2011 will be the

responsibility of the Central Bank, in co-operation with the Commission, the ECB and the IMF. External expertise will be used for conducting the forensic analysis and the stress tests will be based on macroeconomic scenarios that are sufficiently severe. The PCAR will establish the true health of bank balance sheets on a credible basis and will be repeated annually.

ii. **A new Prudential Liquidity Assessment Review (PLAR) for 2011.** The PLAR will outline measures to be implemented with a view to steadily deleveraging the banking system and reducing banks' reliance on short term market funding by the end of the programme period (see Box 6). To this end, the PLAR will establish target funding ratios for 2013 for each bank. In order to reach the targeted LTD ratios, banks have to increase their deposit base and/or to decrease their loan portfolios. The PLAR will identify non-core assets and set an adjustment path to the agreed targets.

Box 5: Prudential Capital Assessment Review (PCAR)

The Irish authorities have committed to ensure that the banking system will maintain a high level of capital throughout the duration of the programme. For this purpose, the Central Bank of Ireland will continue to carry out a series of Prudential Capital Assessment Reviews (PCAR), the first of which was conducted in early-2010. The PCAR exercises will determine whether Irish banks need additional capital—beyond what has already been announced—to cover for newly expected losses, over a three year horizon. Recapitalisation to the target requirements specified in the PCAR will provide market participants with the confidence that the institutions have a strong capital base after realising expected losses and that a prudent capital buffer is in place to withstand additional losses in adverse stress conditions. The exercise will be carried out once a year at least until 2013.

The methodology applied in the 2010 PCAR will be significantly strengthened in order to dispel any possible doubts on the soundness of the forthcoming exercises. The 2011 PCAR exercise will be tailored to ensure consistency and comparability with the upcoming EU-wide exercise latter. In a second stage, deleveraging targets will be applied on top of the initial PCAR result to determine whether this process will generate higher capital needs. This calculation will be presented separately.

In the 2010 PCAR, most loss estimates were based on careful reviews of a variety of data such as asset quality, provisions, and expected losses, coupled with income and funding cost estimates. However, the exercise was conducted without a direct link to macroeconomic variables; partly due to difficulties in modelling strong macroeconomic shocks in Ireland. In contrast, the forthcoming PCAR exercises will be based on macroeconomic scenarios, supplemented by data validation and asset quality review exercises to verify that the inputs used in the calculation of capital needs are correct. External assessors will provide the necessary backup to carry out these tasks including the modelling of possible losses linked to the macroeconomic shocks. In addition, external authorities (Banca d'Italia and the French Commission Bancaire) will be invited to carry out a peer review of the PCAR in order to strengthen the external credibility of the exercise.

According to the MoU timeline, the results of the 2011 PCAR will be published by 31 March 2011.

34. **Ambitious target loan-to-deposit ratios will be established for each bank.** These targets will be designed to ensure convergence to Basel III standards. Compliance with the PLAR benchmarks will be monitored and enforced by the Central Bank taking account of prevailing market conditions. The PLAR will be updated on an annual basis.

Box 6: Prudential Liquidity Assessment Review (PLAR)

The liquidity profile of the Irish domestic banks reflects the fast credit expansion during the boom years, financed largely by wholesale funding. The loan-to-deposit (LTD) ratios are significantly above the international average, hovering well above 150% for most banks. In order to move towards a sounder and more sustainable funding structure and determine the liquidity needs of the Irish banking sector, the Central Bank of Ireland will conduct a Prudential Liquidity Assessment Review (PLAR) in 2011.

As an initial step, a target LTD ratio will be established for each bank for the duration of the programme, in consultation with international partners. The PLAR, commencing in early 2011, will then focus on designing and implementing new, more comprehensive liquidity risk metrics, guided by the ongoing discussion of the new Basel III liquidity guidelines and embracing additional liquidity concepts such as the Net Stable Funding Ratio and Liquidity Coverage Ratio, in addition to the conventional LTD ratios. After agreeing on the reference metrics, the CBI will conduct a quantitative impact study and bilateral industry discussions in order to issue individual Liquidity Guidelines to banks by 1 March 2011. Initial PLAR results, including an implementation timeline, will be published jointly with the PCAR results by 31 March 2011.

The progressive return to lower LTD ratios by the end of 2013, already targeted in the banks' viability plans submitted to the Commission, is meant to achieve a more balanced assets-liabilities structure. In order to reach the targeted LTD ratios, banks have to increase their deposit base and/or to decrease their loan portfolios. It is the goal of the PLAR to objectively quantify the effort required from each bank and to oversee the implementation process.

35. **Legislation on improved procedures for early intervention in distressed banks and a special bank resolution regime (SRR) has been introduced.** The Credit Institutions (Stabilisation) Act 2010 which was enacted last December provides the legislative basis for the reorganisation and restructuring of the banking system agreed in the Programme. It is designed to deal with the urgent and pressing issues facing the domestic financial sector and as such provides broad but time limited-powers to the Minister for Finance to act on financial stability grounds to effect restructuring actions and recapitalisation measures envisaged in the Programme. Complementing this, the separate legislation introducing SRR which is due to be published by end-February will include a robust set of powers and tools to ensure the competent authorities can promptly and effectively resolve distressed banks e.g. when they pose a risk to financial stability. The legislation will be consistent with both the EU Treaty rules and similar initiatives ongoing at EU level.

36. **An in-depth review of the personal debt regime will be submitted to the Irish Parliament considering measures to limit the distress of mortgage holders and over-indebted consumers at the same time best serving the national and creditors' interests.** Building on the recommendations of the final report by the Mortgage Arrears and Personal Debt Expert Group and the final report on Personal Debt Management and Debt Enforcement of the Law Reform Commission, the government will prepare legislative changes.

37. **Using the above policy tools, the viable banks will be further streamlined.** In order to enhance market trust and facilitate the access of Irish banks to international capital markets, the banks that will be found viable will be required, inter alia, to (a) increase provisioning for non-performing assets as needed; (b) identify their non-core assets; and (c) dispose of non-core assets, using the most appropriate instruments (such as securitization with credit enhancement or sales of assets). The possibility of asset segregation (e.g. good and bad banks) will be considered. To the extent that these actions require additional capital, the government will provide the necessary capital if it cannot be met by private sources. The strategy will be set up without prejudging the approval of the specific restructuring plans for the viable institutions concerned, which will be submitted to the European Commission in accordance with EU competition rules; these plans will also be made available to the IMF and the ECB. Within the context of this comprehensive reorganization and downsizing of the banking sector, the strategy will also identify the

way forward that ensures that ultimately, the banking system will not rely on state support.

38. **For non-viable banks, notably Anglo and INBS, a resolution plan will be established and submitted to the European Commission in accordance with EU competition rules.** There are currently two banks (Anglo-Irish and INBS) in the process of being resolved. Any related legal procedures will be set in motion under a precise timetable; these plans will be made available to the IMF and the ECB. They will seek to minimize capital losses arising from the working out of such non-viable banks. Such losses would be met by cash payments from the government. These payments would come on top of the €34.7 billion capital already injected in Anglo and INBS. The size of cash payments will depend on the needs of Anglo and INBS over the programme period, and they will take place when needs occur. Anglo and INBS deposits are planned to be transferred via an open process to other institutions and legislation will be adopted to facilitate these transfers.

39. **A question inevitably arises about ownership and burden sharing with creditors.** The recapitalization strategy implied above may imply a majority state ownership of the system. Bank shareholders are likely to be diluted very heavily in the reorganization process. Based on current market prices the subordinated debt holders are expected to suffer large haircuts as in the case of Anglo. The above-mentioned new legal regime has reinforced the 'going concern' features of these instruments which implies that they can be subject to losses even without the resolution of the entity. For legal reasons, but also to avoid contagion to other parts of the financial system both in Ireland and elsewhere in the euro area, the measures agreed with the Irish authorities do not include steps that would affect senior debt holders.

V.3. Fiscal policy and reform

Fiscal Policy

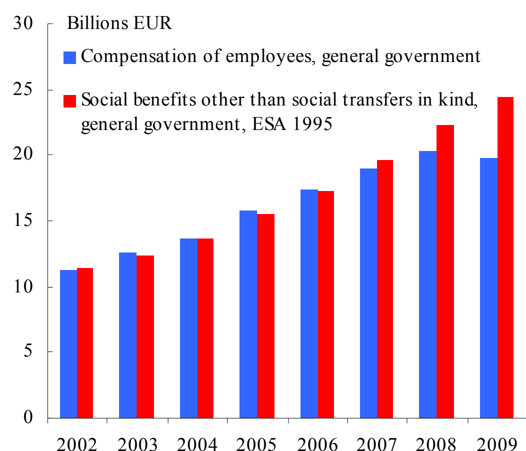
40. **Restoring fiscal sustainability will be key to bringing back investor confidence**. To this end, a broad-based, front-loaded and ambitious but realistic fiscal consolidation strategy has been devised with a view to putting gross public debt on a downward path. Measures had to be chosen carefully so as to limit their impact on the weakened financial sector and the fragile economic recovery, especially in 2011.

41. **The fiscal consolidation programme provides for a €15bn consolidation effort between 2011 to 2014, with a €6bn frontloading in 2011.** Phasing and composition of the fiscal measures is based on the Irish "National Recovery Plan" released by the authorities on 24 November 2010. It contains consolidation targets for the next four years and many of the measures underpinning them.

42. **Plans regarding the overall adjustment of €15 bn in 2011-2014 are well-specified**:
    - **€7bn current expenditure reduction**. The authorities plan an expenditure-heavy consolidation. It includes a further reduction in the public sector paybill, departmental expenditure reductions, cuts in public service pensions and reductions in welfare spending which showed very strong growth in the years to 2010 (see Figure 32).
    - **€3bn capital expenditure reduction**: This will see a strong reprioritisation of capital projects and a near-halving of 2010 spending. Public capital investment was twice the euro area average in recent years as Ireland attempted to close a large infrastructural gap (see Figure 33).

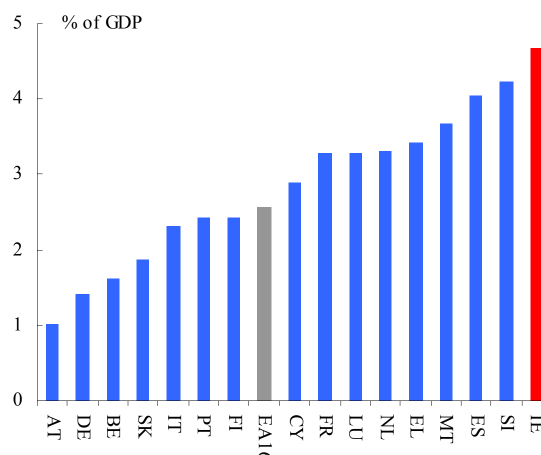
- **€5bn in revenue increases**. This will include a large increase in personal income tax revenue in 2011, mainly through broadening of the tax base. Later years will see well-signalled VAT, carbon tax, and property tax increases, as well as increases in capital gains tax. The authorities plan to leave the 12.5% corporation tax rate unchanged.

Figure 32: Social benefits in Ireland 2000-2009 (€bn)



Source: Eurostat

Figure 33: Share of public expenditure on gross fixed capital formation in 2007 (% GDP)



Source: Eurostat

43. **The programme's fiscal consolidation strategy is carefully designed based on past lessons of large fiscal consolidations**. International experience shows that reliance on expenditure restraint is a typical characteristic of successful and sustainable fiscal consolidation episodes[18]. The front-loading will help support the programme's objective of restoring confidence. At the same time, specific measures are chosen also with a view to limiting the inevitable knock-on effect of consolidation on domestic demand (see also Box 7), thereby contributing to the economy's return to balanced and sustainable growth.

44. **The budget for 2011 includes the envisaged €6bn adjustment**. Frontloading a 3.8% of GDP adjustment package in 2011 should help strengthen the consolidation strategy's credibility. The adjustment falls primarily on the expenditure side, with cuts in current expenditure summing to €2.1 bn. Reductions in social welfare payments account for around €0.9 bn. Savings in intermediate consumption should yield €0.9 bn. While payroll savings should amount to €0.3 bn, public sector pensions will be cut by an average 4% (pensioners had so far not shared the adjustment burden). Capital spending will be reduced by €1.9 bn. Measures on the revenue side amount to €1.4 bn. Together with an increase in social contributions for high income earners (€0.3 bn), personal income tax measures (€1 bn) account for the bulk of the adjustment, notably including a lowering of bands and credits by 10% to reduce the share of income earners not in the income tax net to 38% from 44%. To stimulate activity in the ailing property market, stamp duty rates on house purchases were lowered significantly. In addition to these adjustments with a permanent impact, measures with a one-off impact in 2011 are expected to yield around €0.7 bn, notably from asset sales and spectrum auction.

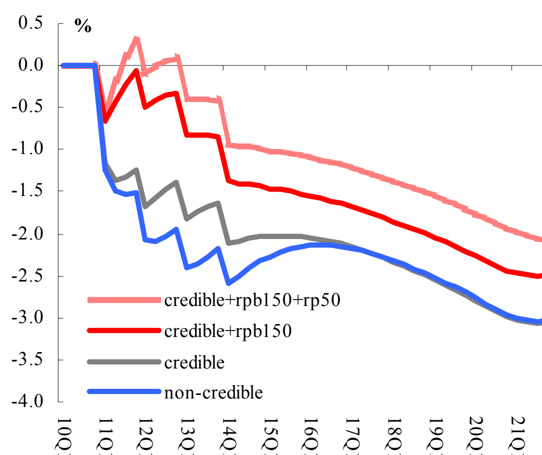
[18] See http://ec.europa.eu/economy_finance/publications/european_economy/2010/ee4_en.htm

Box 7: Model-based assessment of macroeconomic impact of fiscal consolidation

The programme's fiscal measures amount to a large fiscal consolidation which will have an impact on output and employment. Simulations of EU-wide consolidations with the Commission's QUEST model suggest a negative impact on GDP in the short run, but that they can raise output in the medium and long run as agents anticipate a lower future tax burden when government debt declines.[19] However, the macro-economic effects of consolidations may differ across countries depending on specific factors. One factor that determines the size of the fiscal multiplier is the degree of openness. Small open economies typically have smaller multipliers as the demand contraction has a larger effect on imports. Specific factors of the Irish situation are the extremely precarious budgetary position, which requires a much larger consolidation than in other member states, and which is phased in over a five year period. Anticipation effects and credibility can play an important role.

Figure 34 shows the impact on GDP of the envisaged fiscal consolidation in model simulations using a 3-region version of the QUEST model consisting of Ireland, the rest of the euro area, and the rest of the world. In the non-credible scenario, new measures introduced in each year are not anticipated but come as a surprise. In the first year, GDP falls on impact by around 1.5%, implying a multiplier of around 0.25. This is in the low end of the range reported for EU-wide consolidations, suggesting the high degree of openness of the Irish economy plays a significant cushioning role. In the second year, when further consolidation measures are introduced, output falls further and this sequence of negative fiscal shocks is repeated till 2014, when the final measures are introduced. The decline in output is persistent as the programme includes a large reduction in government investment, which is assumed to be productive spending in the model. If the programme is credible and consolidation measures are fully anticipated from the onset, the negative impact on GDP is smaller. Agents will expect larger reductions in government debt and anticipate already at an earlier stage future tax reductions (or smaller increases than under a no-policy-change scenario). Such anticipation effects can reduce the negative impact on the level of GDP by around 0.5%.

Figure 34: Impact on GDP of the envisaged fiscal consolidation



Source: Commission Services

Any assessment of the macro-economic impact of the Irish programme depends crucially on what is considered as counterfactual in case of no-policy-action. Ireland has been facing punitive sovereign bond spreads in recent months, which, if persistent, would have led to an escalation of interest payments and budget deficits which would ultimately have become unsustainable. The third scenario in Figure 34 shows the GDP impact if the credible consolidation is accompanied by an instantaneous reduction in sovereign spreads of 150 bps. The Figure shows lower risk premia have a significant cushioning impact, by reducing the government's interest burden, and avoiding the anticipation of higher future taxation to finance the servicing costs of debt.

A crucial question is how private sector borrowing rates would be affected in a no-policy-change-case. Spillovers of sovereign spreads to corporate bonds have been limited so far, but the weakness of the banking system and exposure of banks to Irish government bonds implies that the possibility of such an effect on borrowing rates could not be ruled out if no action was taken. The fourth scenario incorporates a reduction in private sector borrowing costs of 50 bps, assuming a one-third spillover of sovereign risks to private sector risk premia. This can reduce the negative GDP impact further.

These scenarios indicate the importance of designing fully credible consolidation measures that can affect economic agents' expectations of future fiscal positions and so help to reduce risk premia. By providing a strong multiannual framework for the planned consolidation efforts, the programme for Ireland can make a contribution to enhancing their credibility and thereby reducing their inevitable impact on real activity. Enacting legislation or changes in legislation that will take effect even several years down the road at an early stage could be crucial to reduce the costs from these painful reforms.

[19] See Chapter 2 "The impact of fiscal consolidation on Europe's economic outlook" in: European Commission (2010b), "European Economic Forecast - Autumn 2010", European Economy 7|2010.

45. **Beyond the programme and the National Recovery Plan 2011-2014 horizon, further adjustment is needed to reduce the deficit to below 3% of GDP.**

- Table 5 shows the deficit path for 2011-2014 resulting from the implementation of the fiscal consolidation strategy under the programme's cautious economic scenario. Implementing the foreseen €15bn consolidation package in 2011-14 should reduce the general government deficit to slightly over 5 % of GDP in 2014.
- The target date of 2014 set by the Council in the latest Recommendation it issued to Ireland on 2 December 2009 under the Excessive Deficit Procedure would therefore very likely not have been met on the basis of the National Recovery Plan.
- The need for further consolidation partly results from the fact that the programme measures deemed necessary to restore confidence in the banking sector imply an increase in interest payments due to higher debt levels. Given that the extent to which the contingent capital fund will need to be drawn down remains yet to be known, the corresponding interest payments were of course not yet reflected in the government's National Recovery Plan, implying a need for additional consolidation measures.
- Further, growth might well turn out to be lower than assumed in the government's projections, especially during the first programme year when the recovery is still fragile.

Table 5 Fiscal projections

	2009	2010	2011	2012	2013	2014	2015
			level as % of GDP				
General government balance	-14.4	-32.0	-10.6	-8.6	-7.5	-5.1	-2.9
Primary government balance	-12.2	-29.0	-6.8	-4.1	-1.5	1.2	3.2
Interest expenditure	-2.2	-3.0	-3.8	-4.6	-6.0	-6.2	-6.1
General government debt	65.5	95.0	112.4	118.7	120.5	119.1	115.5

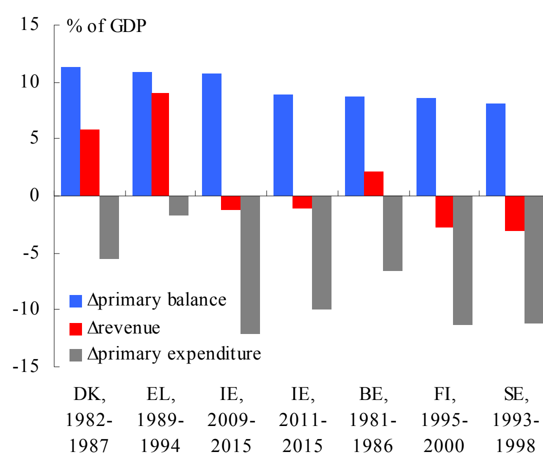
Note: If the full €35 bn available for support of the financial sector would be drawn, debt would peak in 2013 at 124% GDP. See Box 8.
Source: Commission services

46. **The deadline for the correction of the excessive deficit was extended to 2015.**

- If the consolidation to reduce the deficit to 3% of GDP needed to be achieved by 2014, this would risk choking the recovery and further weakening the banking sector, possibly resulting in additional budgetary costs. The necessary additional budgetary effort in 2011-14 would amount to around €4 ½ to €5 bn, according to the Commission services forecast. If additional efforts are made in 2015, by when growth is expected to have recovered, measures amounting to only €3bn would be needed. Under this trajectory debt is predicted to stabilise at below the peak of 121% of GDP which is projected to be reached in 2013. It therefore seemed adequate to extend the deadline for the correction of the excessive deficit by one year to 2015.

- The rules of the Stability and Growth Pact allowed for the extension given that unexpected adverse economic events with major unfavourable consequences for government finances can be considered to have occurred in Ireland, which make the achievement of the originally foreseen deficit reduction path unfeasible. This reflects three main factors. First, a considerable worsening in the economic outlook over the last months, inter alia due to a more pronounced than anticipated impact of the crisis on banks and resulting negative confidence effects. Real GDP growth is now projected at 0.9% in 2011, compared to 2.6% in the Commission services Autumn 2009 forecasts underlying the Council's Recommendation to Ireland which set the deadline of 2014. Second, as discussed above, the stronger-than-expected impact of the crisis on banks necessitated further support measures with a budgetary impact. Finally, concerns in financial markets and the resulting sharp rise in risk premia on government debt compound the difficulties in controlling the path of government deficit and debt.
- By historical standards, the necessary adjustment between 2011 and 2015 is very large, but not without precedents. Figure 35 shows that several EU Member States have in the past successfully implemented packages of comparable size, often with an emphasis on expenditure reduction.

Figure 35: Successful large fiscal consolidation episodes, cyclically adjusted budgetary correction



Note: One-off measures are excluded for Ireland.
Source: AMECO, Commission services' calculations

47. **Full implementation of the fiscal consolidation strategy will help preserve the sustainability of gross public debt developments**. Technically, a debt path can be considered as sustainable if the debt-to-GDP ratio decreases over time. The formula below shows that public debt dynamics are influenced by a number of factors, notably including the primary deficit, the interest rate paid on the debt and nominal GDP growth:

$$\Delta d_t = pd_t + \left(d_{t-1} \frac{i_t - y_t}{1 + y_t} \right) + sf_t$$

where t is a time subscript; and d, pd and sf are the shares in GDP of the stock of debt, the primary deficit and the stock-flow adjustment[20], respectively. The implicit interest rate is represented by i, while y is the nominal GDP growth rate. By reducing the primary deficit, fiscal consolidation thus contributes to the sustainability of the debt path. However, the relative size of nominal GDP growth and the interest rate also plays an important role, which is reflected in the term in brackets, the "snowball effect". In a situation where the interest rate paid on the existing stock of debt is lower than the nominal GDP growth rate, the economy's expansion, which reduces the debt burden in relative terms, is strong enough to more than offset the debt increase resulting from interest payments on the existing stock of debt. This underlines the importance of

[20] The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

supporting the Irish economy's return to steady economic growth, also from a debt sustainability perspective. Asset sales or other stock-flow adjustments resulting in a one-off downward level shift can also support the debt reduction process. Improving market confidence contributes to debt sustainability by reducing the risk premium and thus the average interest rate on debt, i.

48. **The Irish public debt-to-GDP ratio is projected to peak at just above 120% GDP in 2013 before declining.** In particular, the combination of large primary deficits, rising interest expenditure, the impact of banking sector support measures and, until 2010, falling nominal GDP, leads to a rise in the debt ratio from 65.5% in 2009 to a peak of 120.5% in 2013. The debt projections assume partial use of the contingency element of the programme – €25 bn in 2011, of which half is covered by an Irish contribution trough the Treasury cash buffer and investments of the NPRF. This implies a one-off increase in the debt level by almost 8% of GDP. Cash interest payments, which increase the debt level, will be higher than the accrued interest expenditure in Table 5 in 2011-2012, but lower thereafter. This is largely explained by the front-loaded interest payments of the borrowings from EFSF and an effect of accrued interest payments on the promissory notes. The latter is accounted in the government deficit after the grace period in 2011-2012[21], but will be included in the gross debt only when paid in 2021-2024. Up to 2013, the nominal GDP growth rate is lower than the average cash interest rate, which together with the existence of primary deficits implies an increase in the debt ratio. However, these developments are projected to be reversed starting in 2014. Increasing primary surpluses and a positive difference between nominal growth and the average cash interest rate will put debt on a downward path beyond that year. Until 2015, assumptions for the long-term debt sustainability analysis are based on the macro-fiscal projections underlying the programme. After that, an average nominal GDP growth rate of 4.8%[22] and an average interest rate on debt of 5% are assumed in 2016-2030 (see Box 8**).**

49. **Debt would peak at 124% of GDP if the full €35bn available for the financial sector would be used.** Under the programme's assumptions regarding economic growth and interest rates, and conservatively assuming that the contingent capital fund is used in its entirety for banking sector recapitalizations, the debt ratio would peak at just below 124% of GDP in 2013 and decline thereafter. This assumes that half of the capital for the financial sector comes from the Irish existing resources. Sensitivity analysis is presented in Box 8.

[21] In line with the preliminary view of Eurostat on the matter available at http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/methodology/advice_member_states

[22] The European Commission's 2009 Ageing Report assumes *real* GDP growth of 2.8% on average in 2015-2030, see European Commission (2009b).

Box 8: Debt sustainability analysis

In the programme's scenario government debt stabilizes at 120.5% of GDP in 2013 and begins to decline thereafter. A number of adverse economic scenarios are considered including the effect of weak nominal growth, higher-than-expected capital injections, slow consolidation and higher interest rates. In all scenarios debt stabilizes in 2013 or 2014, albeit at higher levels than in the central scenario, and declines afterwards.

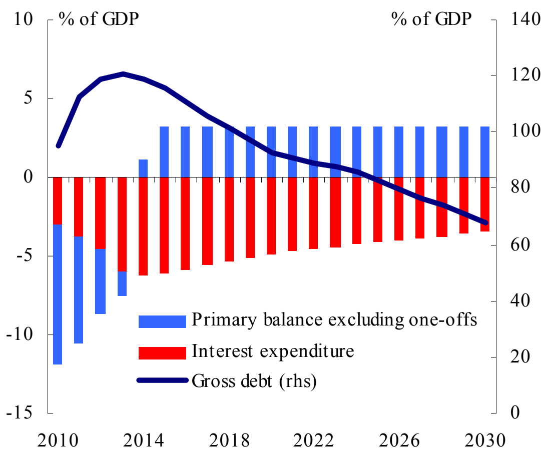
A number of conclusions can be drawn from these results. The effect of low growth on debt sustainability is large so a strong focus on structural reforms to boost potential output must be maintained during the programme period and beyond. The permanently lower growth has an effect on the primary balance and a lower denominator effect.

Results also show that higher marginal interest rates, slower consolidation, or a combination of both would result in lower pace of debt reduction. This underlines the importance of avoiding deviations from the agreed consolidation path as well as of taking steps to ensure that revenue windfalls are allocated to debt reduction. A sustainable debt level by 2013 is essential to help return Ireland to the markets at a moderate interest rate. The higher marginal interest rate scenario excludes any possible effect of a higher risk premium on economic activity (see Figure 36). This and the underlying assumption on primary surpluses (fixed at the 2015 level for 2016-2030) explain markedly different debt developments between the scenarios with lower growth and with a higher interest rate, respectively.

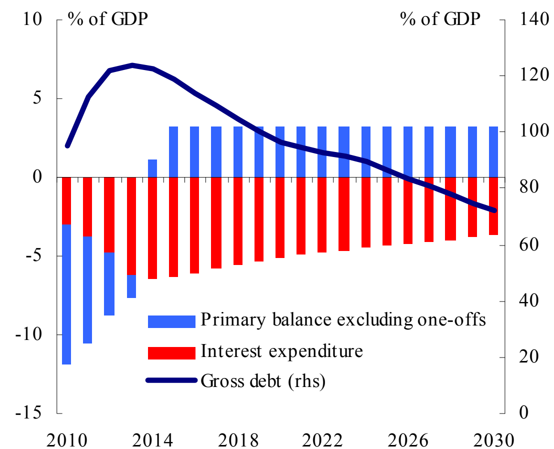
Higher-than-expected capital injections into banks would also result in a higher debt level before it is reduced. More generally, Ireland's high debt level will have to be addressed by high primary surpluses over the medium to long term, while reforms to address Ireland's high cost of ageing will also be necessary. While possible revenues from privatisations of state owned enterprises have not been taken into account in the sensitivity analysis, they could contribute to lowering the debt level.

Figure 36: Scenarios for the public debt path

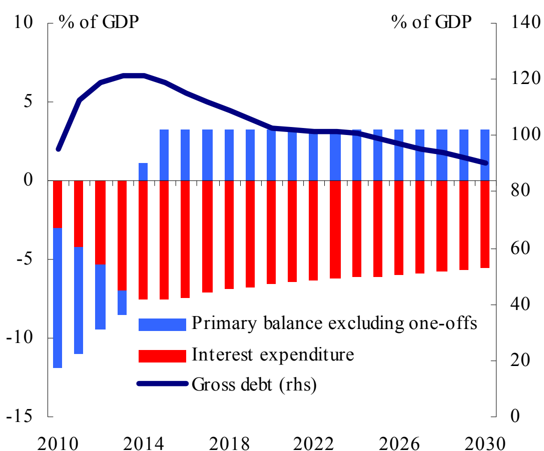
Programme's central scenario



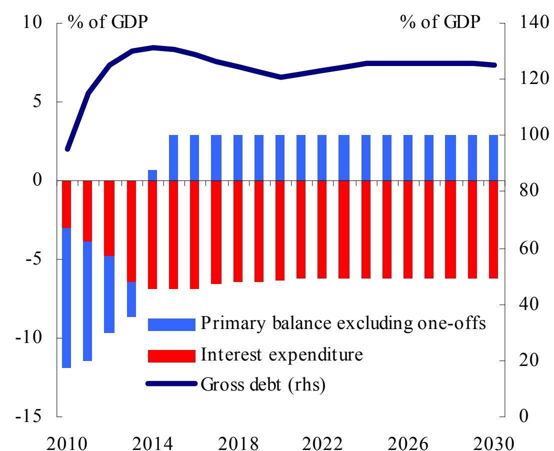
One-off capital injection of €10 bn in 2012 half of which is covered by the NPRF



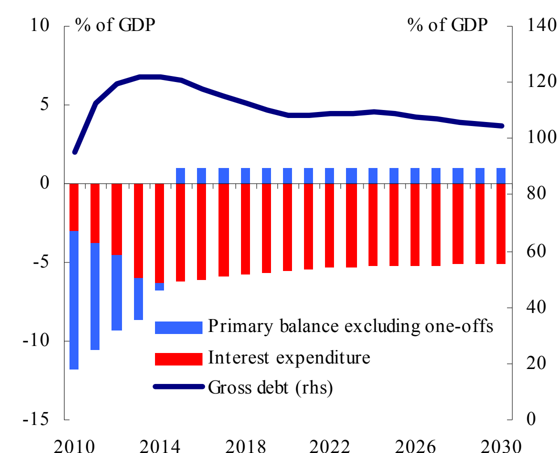
Marginal interest rate permanently increased by 2 pps.



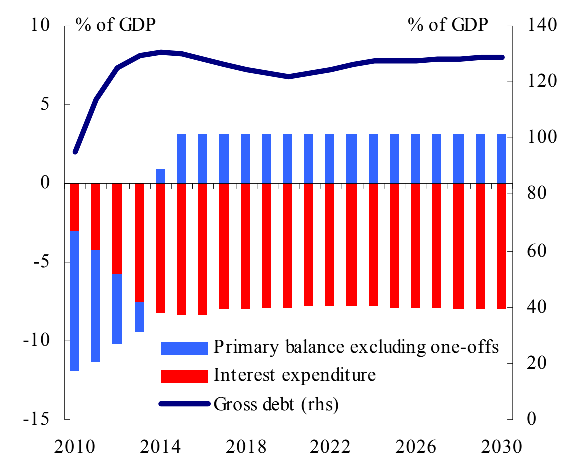
Nominal GDP growth permanently lower by 2 pps.



Lower consolidation effort in 2012-2015 by €4 bn (€1 bn each year)



Nominal GDP permanently lower by 1pp., marginal interest rate permanently increased by 2 pps., one-off capital injection of €10 bn in 2012



Note: For 2016-2030, nominal growth rate, implicit interest rate on debt excluding accrued interest on promissory notes and primary surplus in % of GDP are fixed at their 2015 levels; no assumption is made on further consolidation efforts after 2015. In 2021-2024, repayment of accumulated interest on promissory notes increases the debt level.

Source: Commission Services

Structural Fiscal Reforms

50. **Weaknesses in the medium-term budgetary framework had been masked by high economic growth during the boom years preceding the crisis**. Commission services' analysis[23] shows that Ireland scores well below the EU average regarding to the efficiency and quality of its domestic budgetary procedures encompassing the preparation, approval and execution of the budget. The existing rule-based framework is weak. Medium-term planning has been in place only for capital expenditure, while the current expenditure rules applied to the central government are in need of improvement due to their poor target definition.

51. **Significant reforms to the medium-term budgetary framework are to be introduced under the programme.** This will enhance the consolidation strategy's credibility and further strengthen the credibility of Ireland's fiscal stance over the medium to long term. A Fiscal Responsibility Bill will be introduced, including provisions for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area. The Bill will take into account any revised economic governance reforms at EU level. Further, the government will establish a budgetary advisory council to provide an independent assessment of the budgetary position and the underlying forecasts. The MoU also stipulates that any additional unplanned revenues must be allocated to debt reduction.

52. **Further measures to reform the pension system should help ensure the long-term sustainability of public finances**. In accordance with the National Pensions Framework published by the authorities in March 2010, the age at which people qualify for State Pension will be increased from currently 65 years to 66 years in 2014, 67 in 2021, and 68 in 2028. Pension entitlements for new entrants to the public service will also be reformed in 2011. Notably, pensions will be based on career average earnings, while the retirement age will be linked to the state pension retirement age.

[23] http://ec.europa.eu/economy_finance/publications/publication15390_en.pdf

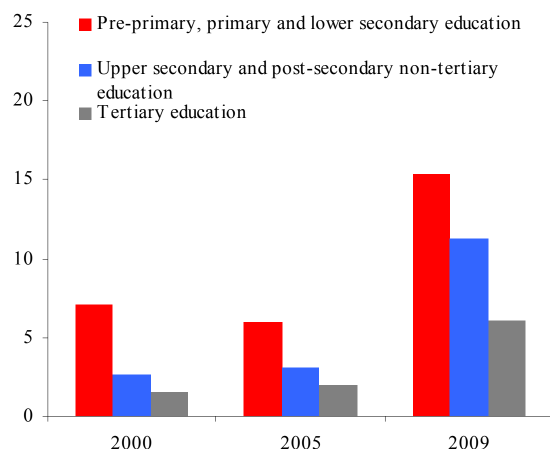
V.4. Structural reforms

53. **An ambitious structural reform agenda is required to accelerate the unwinding of imbalances**. It will further boost the growth capacity of the economy. Ireland has a good track record regarding the flexibility of its labour market and is recognised to provide an attractive business environment, but there is scope for further improvement in certain areas (Box 9).

54. **Well targeted reforms will enhance competitiveness and facilitate shifting production capacity from construction and financial services to other sectors.** In particular, the severe impact of the crisis on the labour market necessitates reforms supporting activation and employment. At the same time, pursuing efforts to enhance competition in specific product markets could help encourage export-led growth.

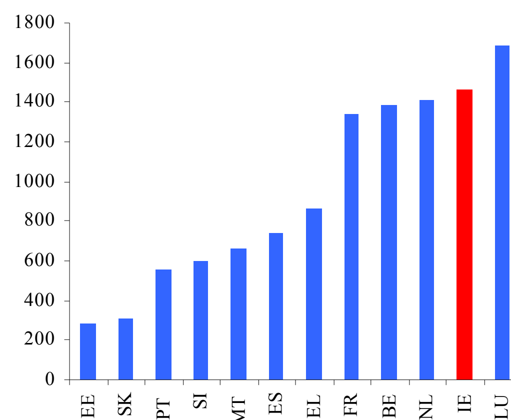
55. **Envisaged reforms will focus on the labour market**. The unemployment rate has risen to three times the pre-crisis level and the effect of the crisis over sectors has been uneven, posing a risk for potential skill mismatches once the recovery starts again. This could result in high levels of unemployment becoming structural, with an increase in the share of long-term unemployed. Activation should be a priority given that long-term unemployment is high and job loss has been concentrated in particular sectors, notably construction, where pay rates were high increasing reservation wages, all of which raises the risks of a rise in a structural unemployment. Furthermore, Guichard and Rusticelli (2010) estimate that the relative sensitivity of structural unemployment to cyclical unemployment in Ireland is high. If not tackled, the registered drop in the activity rate and the entrenchment of long-term unemployment would have very negative effects on potential growth prospects. To address these issues, it is important to ensure wage and price adjustments that restore and sustain competitiveness and to remove any obstacle to the full utilisation of the economy's labour potential.

Figure 37: Unemployment rate by level of education



Source: Eurostat

Figure 38: Monthly minimum wages in the euro area in January 2010



Note: Before the cut in the Irish minimum wage by €1 as of February 2011.
Source: Eurostat

56. **Envisaged labour market reforms cover the system of minimum wages, the unemployment benefit system and activation policies**.

    - **The planned downward adjustment of the minimum wage** by 12% will reflect the recent evolution of Ireland's price developments and worsening labour market conditions. As prices have declined, the real minimum wage increased in the

course of the crisis. At the same time employment has fallen by close to 14% and average nominal wages declined by 4.9%, while deflation has more than offset nominal wage cuts resulting in an increase in the average real wage. Unemployment is concentrated particularly amongst workers with relatively low productivity, for whom labour demand is most affected by the minimum wage (see Figure 37), which is the second highest in the EU (see Figure 38).[24]

- Sectoral wage agreements, which set higher minima for some sectors and are extended to parts that have not signed the agreements, need to be reviewed. It needs to be investigated whether they hamper inter-sectoral adjustment, a critical issue given that the crisis has hit different sectors so unevenly.
- Income protection for unemployed workers needs to be set so as to eliminate unemployment and poverty traps, increase incentives to accept job offers and reduce the risk of long-term unemployment. Given that in Ireland most benefits have the same flat rates, unemployment traps and inactivity traps are the same for all household types but two-earner couples. They are high in particular for low wage persons and persist at high levels over the unemployment spell. Given that unemployment benefits decline over the unemployment spell in most EU countries, Ireland has in relative terms a relatively low unemployment trap and a relatively high inactivity trap (see Table 6 and Table 7). In terms of the low-wage trap lone parent and one- earner couple households with two children are at relatively high risk.
- Enhanced labour market activation policies, together with more stringent job-search conditionality attached to unemployment benefits, will strengthen job search efforts and improve labour market matching at limited budgetary cost. Training should be targeted (Carcillo and Grubb, 2006) and careful programme evaluation will be required.

57. **Policy measures will be taken to bolster competition in product and energy markets and other network industries**. Despite Ireland's openness to global markets and generally competition-friendly business environment, there are still outstanding issues which have contributed to comparatively high price levels, which feed through to production costs. This will be tackled through the concerted implementation of still outstanding recommendations by the Irish Competition Authority in various areas: sheltered professional service sectors such as the legal and the medical profession, where prices are particularly high and impervious to the economic situation; the general competition environment, in particular adjusting incentives so as to discourage anti-competitive behaviour. To increase competition in network industries, particularly gas and electricity, privatisation or revised corporate governance frameworks to encourage performance will be contemplated in these sectors, as it could be for other state-owned assets.

58. **Labour market reforms boost employment and potential output.** A reduction in the minimum wage and a review of the framework for other regulated wages will exert downward pressure on wages both directly and through spill-over effects. Stylised simulations carried out for the Irish economy by D'Auria et al. (2009) using the QUEST

[24] Of all EU countries only Luxemburg (EUR 1683) had higher monthly minimum wages than Ireland (EUR 1461) in January 2010. As a percentage of the average and median wage the minimum wage is not particularly high, because Ireland is a high income country. However, for firms' costs it is the absolute value of the minimum wage that matters.

III[25] model show that, after 10 years, a decline in nominal wages of 0.6% leads to a 0.3% increase in employment and a 0.2% increase in GDP compared to a baseline scenario of no policy change. A decrease in the unemployment benefit replacement rate is also likely to have sizeable effects on employment and output. In a scenario where the unemployment benefit replacement rate is reduced by 5 percentage points, total employment increases by 1% and GDP by 0.7% after 10 years relative to the baseline. The measure is particularly beneficial for low-skilled workers, whose employment rate increases by 1.8%.

Table 6: Unemployment trap, 2009
(Marginal effective tax rate for an unemployed person (previous work= 67% of the average wage (AW) wage level) returning to work at a wage equivalent to X% of the AW)

Family Type	% of AW	IE	EU27
Single, no children	50%	85	89
	67%	74	76
	100%	61	62
	150%	58	55
1 earner couple, no children	50%	127	89
	67%	101	77
	100%	77	63
	150%	66	54
2 earners couple, no children	50%	59	87
	67%	55	74
	100%	46	61
	150%	46	53
Single parent, 2 children	50%	54	85
	67%	63	76
	100%	66	67
	150%	61	58
1 earner couple with 2 children	50%	106	84
	67%	96	79
	100%	81	68
	150%	69	58
2 earners couple with 2 children	50%	63	90
	67%	58	76
	100%	49	62
	150%	47	54

Source: Commission services

Table 7: Inactivity trap, 2009
(Marginal effective tax rate when moving from social assistance to work at a wage level equivalent to X% of the AW)

Family Type	% of AW	IE	EU27
Single, no children	33%	120	69
	50%	85	61
	67%	74	55
	100%	61	49
	150%	58	46
1 earner couple, no children	33%	186	80
	50%	127	70
	67%	101	64
	100%	77	54
	150%	66	49
2 earners couple, no children	33%	5	25
	50%	15	27
	67%	22	29
	100%	24	31
	150%	31	34
Single parent, 2 children	33%	39	68
	50%	54	63
	67%	63	60
	100%	66	56
	150%	61	51
1 earner couple with 2 children	33%	126	76
	50%	106	74
	67%	96	68
	100%	81	61
	150%	69	54
2 earners couple with 2 children	33%	34	35
	50%	34	35
	67%	36	35
	100%	34	36
	150%	37	37

Source: Commission services

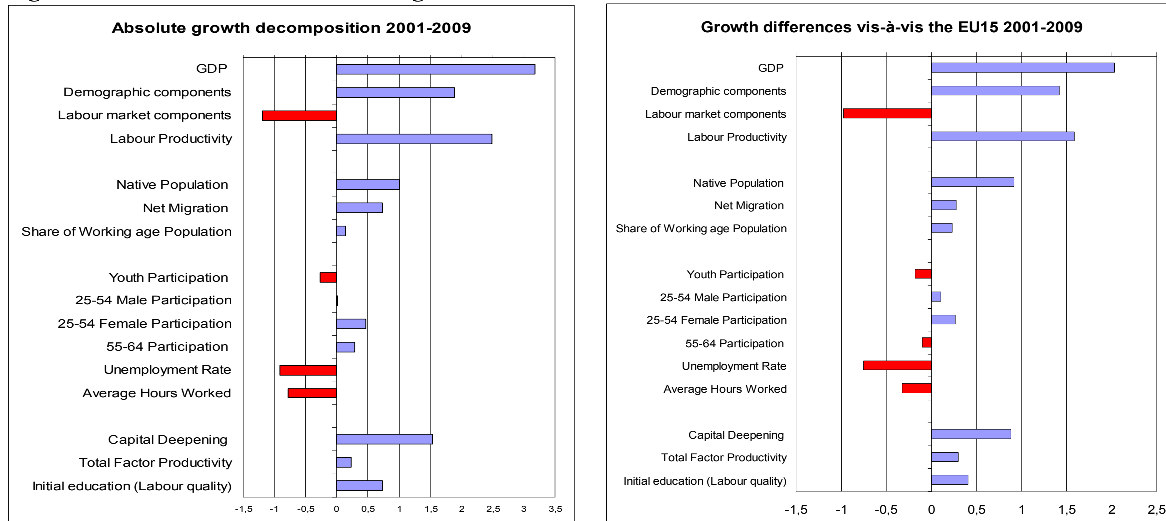
[25] QUEST III is a dynamic stochastic general equilibrium model developed in DG ECFIN and used for policy analysis. For a detailed description of the semi-endogenous growth version of the model, used in the simulations, see Roeger, Varga and in 't Veld (2008).

Box 9: Ireland's Performance on Structural Indicators

Even after the sharp fall in its real average GDP growth rate in 2008-2009, Ireland still had one of the EU27's highest levels of GDP per capita in 2009, thanks mainly to brisk productivity increases between 2001 and 2009. Nevertheless, closer analysis of the drivers of Ireland's growth performance identified problems with the labour market specific component (see Figure 39). In addition, Irish unit labour costs rose strongly after 2002, significantly undermining competitiveness. These underlying labour market problems were masked by Ireland's growth performance before the crisis, but are now becoming an obstacle to recovery. Ireland's unemployment rate has increased from 4.5% in 2007 to 13.6% in Q1 2010, with long term unemployment rising to 52% of the unemployed for men and 36% for women in that quarter. The drop in the activity rate by nearly 4% since the peak in Q3 2007 reflects a labour supply shock and the decreasing rate of prime-age workers may indicate further increases in long-term unemployment. The strong contraction of labour demand in labour intensive sectors, especially construction, poses a risk of possible skill mismatches during the recovery. Against the background of falling demand for labour downward nominal wage adjustment started in 2009. However, minimum wages could hamper further wage adjustment; as pointed out above, Ireland's minimum wage was second highest in the EU in 2010. To avoid the high level of unemployment becoming structural, a menu of measures is clearly needed and is included in the programme.

Figure 39 only hints at labour market problems, but further analysis suggests that there are problems with competition in product and energy markets and other network industries as well. While Ireland is well-known to be very open to global markets and to possess a generally competition-friendly business environment, Irish prices were 27% above the EU average in 2008, higher than pre-crisis GDP levels justified and making it the EU's second most expensive Member State. That is suggestive of a certain weakness in competition. Specific evidence certainly exists that points to competition problems in sheltered professional service sectors: prices are particularly high by EU standards, yet have been impervious to the economic situation. All these higher prices feed through to production costs harming overall competitiveness. In addition, competition law could be made more effective; sanctions do not exist for cases brought under civil law, while cases brought under criminal law require criminal law standards of proof. Recent progress in enhancing competition in gas and electricity needs to be continued and consolidated.

Figure 39: Overview of income and growth differentials



Note: The left panel of the figure presents the contributions from demographic, labour market and labour productivity components to real GDP growth over 2001-2009. The right panel provides the same decomposition of GDP but in relation to the EU-15. For further details about the methodology, go to http://ec.europa.eu/economy_finance/publications/publication_summary13273_en.htm

59. **Product market reforms increasing competition lead to lower prices and stronger demand for sectoral output.** Enhanced competition in the services sector modelled in the simulations as a one percentage point reduction in mark-ups translates into a 0.1% increase in employment and a 0.5% increase in GDP over a 10-year period. In addition, the Irish authorities undertake to introduce legislation to increase the state pension age. Simulations carried out for the EU economy as a whole[26] show that a gradual increase in

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[26] See European Commission (2010b), Box I.2.2.

the age of retirement by two years puts downward pressure on wages and raises employment by 2.1% and GDP by 2.2% after 10 years.

60. **A revised framework for management of state-owned assets has the potential to both aid consolidation and boost debt sustainability by end-period.** Ireland maintains a notable level of state ownership in the economy, including large stakes in the transport, energy, broadcasting and forestry sectors. A review of state assets and liabilities (with a view to divestment and better commercial practise) has been underway since mid-2010 and is due for publication shortly. Notwithstanding this, authorities' plans already include higher dividends and greater efficiencies from the state-owned sector as part of their multi-annual consolidation plan. The programme agreed with the EU and IMF also includes agreement that any additional unplanned revenues are allocated to debt reduction. In this regard privatisation also has the potential to reduce government debt, and lower the burden on taxpayers. These types of gains are not included in the government debt calculations and have the potential to improve debt sustainability by the end of the programme period.

VI. Programme financing

61. **A financing gap of €85 billion may have to be covered until end-2013[27].** Calculations by EC, ECB and IMF staffs suggest that notwithstanding the significant fiscal adjustment, the financing gap for the sovereign may sum up to €50 bn over the programme period. Further, to restore confidence in the Irish banking system on a sustainable basis, a banking support scheme is established totalling €35 bn of which €25 bn is a contingency provision.

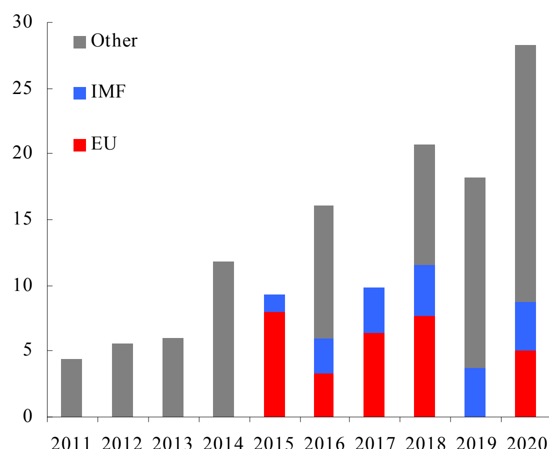
62. **The Irish government does not need to tap international bond markets until the second half of 2012, but will gradually return to the markets thereafter.** Available funds allow financing fiscal needs amounting to some €30 bn until end-2011, €17 bn in 2012 and €2 bn in 2013. Underlying this are assumptions of roll-over rates of maturing long-term debt of 0% until end-2011, 20% in 2012, and 80% in 2013. A further conservative estimate underlying the programme is that the rollover of short-term debt is significantly impaired in 2011 and access to private short-term debt funding will be restored only gradually.

63. **The rather long average maturity of the outstanding public debt implies limited financing needs up to 2020.** Figure 40 shows the maturity profile of long-term public debt over the medium term. Repayments of both the EU and IMF loans start in 2015. The timing profile of the repayment schedule implies that financing needs related to the roll-over of maturing bonds and loans will remain below or close to €20 bn for all years until 2020.

64. **Further financing needs arise in relation to the programme's financial sector strategy**. As discussed in section V.2.

Source: Commission Services

Figure 40: Maturing long-term public debt 2011-2020 (bn €)



[27] A table with details of the financing needs and sources is provided in the Annex.

Restoring financial stability, the maximum amount of up to €35 bn includes a contingency element for bank recapitalization to provide assurance that banks are able to meet current and future capital requirements. Actual funding needs may, however, be lower, in particular if market conditions improve and no severe unexpected banking losses materialize during the programme period.

65. **The programme will be financed through contributions from the EU (€45 bn), the IMF (€22.5 bn) and the use of Irish financial buffers (€17.5 bn).** An important contribution (€17½ billion) to the financing of the programme will come from Irish sources, notably through the Treasury cash buffer and investments of the National Pensions Reserve Fund. In addition, the programme will be financed through contributions from the IMF (€22.5 bn) on the basis of an Extended Fund Facility (EFF) and contributions from Ireland's European partners (€45 bn). The EU financing comes from the EFSM (€22.5 bn), together with €22.5 bn from the EFSF and bilateral loans from the UK, Sweden and Denmark (together €4.8 bn, EFSF €17.7 bn). Box 10 provides further details on financing through the EFSF and EFSM.

66. **The Irish contribution from Treasury cash reserves and the NPRF provide half of the contributions to banks' capital needs**. The use of Irish funds is justified from a cost perspective. The cost of holding cash reserves and other liquid assets has risen as the difference between sovereign funding costs and the return on the assets and cash reserve has increased. At the same time, the benefit of holding cash reserves has declined as the programme provides a large part of the financing needs up to 2013. The contribution does not lead to a complete running-down of available Irish buffers. Both the Treasury cash reserve and the discretionary portfolio of the NPRF remain significantly above €5 bn throughout the programme period, providing a considerable buffer against further unexpected needs arising from either the fiscal or the financial side during the programme period.

67. **Ireland will draw on European and IMF financing sources in parallel**. In particular, Ireland will draw on the EU and IMF financing broadly in a ratio of 2 to 1 in each disbursement throughout the programme period. Bilateral loans from the United Kingdom, Sweden and Denmark are only set for activation in late 2012 and 2013.

Box 10: EFSM and EFSF financing

The EU share of the programme in the amount of €45 bn is provided by different sources. Loans from Ireland's EU partner countries include contributions of €22.5 bn from the EFSM, €17.7 bn from the EFSF, and bilateral lending support from the United Kingdom (€3.8 bn), Sweden (€0.6 bn), and Denmark (€0.4 bn). As for the EFSM, the European Union borrows directly in its own name on the capital markets to fund any such aid. The EFSF is the intergovernmental mechanism for providing assistance to any euro area member. It is a separate legal entity and obtains funds for any aid it provides through borrowing on the capital markets on the strength of guarantees provided by Euro area members (excluding Ireland and Greece).

Both the EFSM and the EFSF contribute to the programme financing from the first quarter of 2011. The average maturity of the loans to Ireland will be 7.5 years for both EFSM and EFSF. Assistance under the EFSM and EFSF facilities will come through fixed rate bullet loans. This stands in contrast to IMF loans which come through floating rate loans with a gradual repayment of the principal. EFSM and EFSF loans will involve a combination of shorter and longer maturities in the range of 5 to more than 10 years, mainly in standard benchmark maturities of 5, 7 and 10 years. Issuances by the EU under the EFSM will be denominated only in euros. The EFSF will also most likely issue in euros, but it does not have any currency limitation for its funding activities and can adapt to market developments.

Due to the EFSF's structure of credit enhancements including a cash reserve and a loan specific cash buffer, its lending capacity does not correspond to the funding volume. To lend €17.7 billion to Ireland, the EFSF is expected to raise around €26.5 billion in total. The difference between the amounts raised on the markets and the amount disbursed to Ireland is due to the EFSF's credit enhancement using a cash reserve and loan-specific cash buffer to secure Triple A rating. The cash reserve comprises a margin rate and a one-off service fee. It is also explained by the EFSF's structure which requires both the principal and interest to be covered by guarantees. The final cost charged to Ireland and the exact loan amount will only be known once the cash reserve and the loan-specific cash buffer, which are retained at the EFSF, have been reinvested.

The EU (EFSM) and the EFSF are rated triple A by the three major rating agencies, Fitch, Moody's and Standard & Poor's. The ratings of the EFSF as a borrower reflect the strong shareholder support and credit enhancements such as an over-guarantee of the amount borrowed by 120% and the cash buffer which will be deducted from the cash amount remitted to a borrower from each loan. The rating outlook was qualified as stable. Issuances by the EU are executed by the European Commission's financial operations department located in Luxembourg. They will all be launched through a syndication format. Issuances by the EFSF are executed by the German Debt Management Office on behalf of the EFSF.

The average interest payment on EU funds is close to IMF lending rates. The average interest rate on the €45 bn available to be drawn from the EU share of the programme will depend on the prevailing market rates at the time of each drawdown. As of end-November 2010, loans by the EFSM had an effective interest rate of 5.7%. Loans by the EFSF had an average interest rate of 6.05%. Since then, interest rates have increased somewhat. This compared to an average interest rate of 5.7% for the IMF commitment to the financial assistance package (if expressed as the equivalent rate when the IMF SDR floating rates are fully swapped into fixed rates in euro with 7.5 years duration). An IMF quota reform, which is expected to be effective in the coming months, will decrease the IMF lending rate by 0.13 percentage points. In contrast to EU loans, IMF loans are subject to currency risk as they are provided in Special Drawing Rights (SDR) whose exchange rate to the euro can change.

The first issuances of EFSM and EFSF took place in January 2011 amid strong interest of investors. The first instalment of the EFSM loan has been disbursed to Ireland on 12 January. The resulting interest rate of the 5-year loan to Ireland is 5.51%. This is composed of the cost of borrowing for the EU at 2.59% plus a margin of 2.925% as decided by the Council on 7 December 2010. This margin goes back to the EU Budget and is distributed to the 27 EU Member States at the end of each financial year. The Commission does not charge any fees or keep any margin for its own use. The EFSF placed its inaugural bond for an amount of €5 bn on January 25. The issuance spreads was fixed at mid-swap plus 6 basis points which implies borrowing costs for the EFSF of 2.89%. Over the first quarter of 2011, the instalments by the EFSM and EFSF combined will amount to €11.7 bn.

More info on:
EFSF: http://www.efsf.europa.eu/about/index.htm
EU as an issuer (EFSM): http://ec.europa.eu/economy_finance/publications/publication14403_en.pdf

VII. The risks ahead

68. **The programme rests upon strong foundations**. The fiscal consolidation package is strongly frontloaded and fully specified. National support for fiscal adjustment is strong. The extraordinary amount of financing available and the broad support of the programme by Ireland's international partners further add to the programme's credibility.

69. **Key risks for the success of the programme were addressed in designing the programme**. In particular, the programme is of sufficient scale to provide capital to the banking sector. At the same time, even with the inclusion of a sizeable contingency element, gross public debt is put on a firm downward path towards the end of the programme period. The activation of this financial assistance programme primarily aims at restoring confidence regarding Ireland, notably in the banks by providing assurances about their solvency and longer-term viability as well as by enhancing the credibility of the sovereign guarantees. Considering the prudent assumptions under the programme and the sharp economic adjustment that has already occurred, disciplined implementation of the programme should ensure external and sovereign debt sustainability and go a long way towards restoring Ireland's credibility vis-à-vis foreign investors, and help the country to successfully recover access to international capital markets.

70. **The programme is built on conservative assumptions.** This regards the yield of fiscal consolidation measures as well as banking sector developments. The same holds for the macroeconomic outlook underlying the programme. In this context, it should be considered that Ireland entered the crisis early and has experienced important adjustment of its imbalances also compared to other euro-area economies. Downward adjustment of prices (including asset prices) and wages has been sizeable and restored much price competitiveness. Real economic activity has plummeted providing scope for some rebound.

71. **While prudent, the macroeconomic and banking sector projections underlying the programme are subject to considerable uncertainty**.

    - ***Economic growth* could be lower than currently projected, especially in the near term.** Domestic demand developments could be more unfavourable than projected if positive confidence effects only kick in very gradually or if lending activity remains subdued on account of slower-than-expected restructuring in the financial sector. Lower growth would inter alia lead to negative surprises regarding government revenue and expenditure. Moreover, in the highly leveraged Irish economy, further negative feedback loops between growth, the financial sector and the public finances cannot be excluded. With an export-led recovery being projected, growth prospects depend strongly on the outlook for Ireland's main trading partners, as well as on exchange rate developments, especially vis-à-vis USD and GBP. While a deterioration in the outlook for the main trading partners would reduce the growth prospects of the very open Irish economy, cautious assumptions in conjunction with the volatility resulting from Ireland's export structure imply that the external sector is also a possible source of upside risks.

    - **While lower-than-expected *inflation* would further support the economy's competitive adjustment, it would add to the real burden of debt.** This could have negative implications for households with high mortgage debt and other leveraged agents, as well as altering public debt dynamics.

    - **Additional *recapitalisation needs* could arise in the banking sector as result of loan losses**. Prudent assumptions have been made under the programme with an

immediate recapitalisation of €10 bn allowing large capital buffers in the banking sector, while a further €25 bn would be available under the programme in case further unforeseen losses were to be revealed. In particular, such losses could be driven by the deleveraging process, which is expected to begin after completion of the PLAR 2011. Also, were the macroeconomic situation to worsen significantly beyond the scenarios envisaged under the stress tests, further pressures on banks' asset quality and solvency could call for additional capital injections. However, LMEs (such as those launched recently by AIB and BOI) could be a strong mitigating factor reducing recapitalisation needs.[28] In addition, BOI is looking for external sources of capital to keep the bank majority private-owned.

- **The envisaged *financial sector deleveraging* may in turn be hampered by market conditions that could prevent sales of assets.**
- **If the programme were slow to restore market credibility, *elevated spreads* could persist for an extended period of time.** Market sentiment could also deteriorate were adverse developments in other euro area Member States to occur. Also, the new legislation on resolution and restructuring which has addressed the issue of burden sharing by subordinated shareholders could affect the price of new bond issuances. The fiscal programme is robust to a slow improvement in market sentiment as the Irish sovereign does not need to access the sovereign bond market before end-2012, but stabilisation of spreads at a high level would negatively impact the private sector risk premium and economic growth, with repercussions on the budgetary position.
- ***Implementation risks* also exist.** The planned reforms are substantial, will take a number of years, and engage a wide range of stakeholders both public and private. An election in Ireland is now imminent and a change of government is very likely. In this context it should be noted, however, that in the preparation phase the programme partners met the leaders of the main opposition parties. Many aspects of the programme have a legislative component, and these will need the approval of the Irish parliament.

VIII. Programme monitoring and implementation

72. **Progress in programme implementation will be monitored by European Commission, ECB and IMF teams through quarterly programme reviews**. Fiscal performance will be assessed through updated forecasts and quantitative performance criteria (in particular related to fiscal consolidation). Compliance with measures regarding the financial sector and other macroeconomic and structural policies will be assessed against the conditionality and timetable in the Memorandum of Understanding as also laid down in the Council Decision 17211/1/10 of 7 December 2010 on granting Union financial assistance to Ireland. The Commission will furthermore monitor compliance with the relevant Council Recommendation 17210/10 issued to Ireland on 7 December 2010 in accordance with Articles 126(7) TFEU under the excessive deficit procedure.

[28] For instance, the LME carried out by Anglo at the end of 2010 generated a profit of EUR 1.59 billion.

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Letter of Intent

Dublin, 3 December, 2010

Mr Jean-Claude Juncker
President
Eurogroup

Mr Didier Reynders
European Union Presidency

Mr Olli Rehn
Commissioner
European Commission

Mr Jean-Claude Trichet
President
European Central Bank

Dear Messrs. Juncker, Reynders, Rehn and Trichet,

1. Ireland faces an economic crisis without parallel in its recent history. The problems of low growth, doubts about fiscal sustainability, and a fragile banking sector are now feeding on each other, undermining confidence. To break this vicious circle, we are proposing a strong, wide-ranging, reform programme, backed by a substantial international financing package, to restore confidence and return the economy to a path of sustained growth and job creation.

2. At the root of the problem is a domestic banking system, which at its peak was five times the size of the economy, and now is under severe pressure. The Irish owned banks were much larger than the size of the economy. The fragility of the banking sector is undermining Ireland's hard-earned economic credibility and adding a severe burden to acute public finance challenges. Decisive actions to restore the strength of the financial sector and re-establish fiscal credibility are needed now.

3. The Irish authorities have already undertaken major steps to address these challenges. For the financial sector, these include measures to facilitate funding of banks, separate good assets from bad, asset disposals, and bank recapitalisation. On the fiscal side, we have

pursued a large consolidation programme since 2008 and have announced a National Recovery Plan that accelerates the process of putting public finances on a sound footing.

4. But we recognize that more needs to be done. A fundamental downsizing and reorganisation of our banking system is essential. We are immediately undertaking several bold measures to achieve a robust, smaller, and better capitalised banking system that will effectively serve the needs of the economy. Restoring the banks to viability will also help insulate public finances from further pressures. We are mindful that the transition to a healthy banking sector will need to be actively managed to avoid fire sales of assets and reduce market uncertainty. We are, therefore, expeditiously raising capital standards, stepping up efforts that will ensure that banks losses are promptly recognised, and creating a mechanism to inject needed capital into the banks.

5. In addition, we are also pressing ahead with our commitment to achieving a sustainable budget position. The National Recovery Plan lays out our strategy for staying the course of needed reform in a way that is socially fair and protects the most vulnerable. Recognising that Ireland already has put in place a business-friendly environment, our Plan also lays out a range of structural reforms that will be implemented to underpin economic stability, and enhance growth and job creation.

6. We turn to our European and international partners for support as we implement these far-reaching objectives. We therefore request support from the European Financial Stability Mechanism/European Financial Stability Facility which can be drawn down over a period of 36 months as well as bilateral loans from the United Kingdom, Sweden and Denmark; the overall total of this support will be €45 billion. We also send a parallel request for financial assistance to the IMF for a total amount of €22.5 billion. The judicious use of our own existing financial resources (€17.5 billion) will also help ensure financial stability as we restore market confidence and return to durable growth.

7. The attached Memorandum of Economic and Financial Policies outlines the economic and financial policies that the Irish Government and the Central Bank will implement during the remainder of 2010 and the period 2011–13 to strengthen Ireland's banking sector and fiscal position. An annexed Memorandum of Understanding (MoU) specifies detailed economic policy measures that will serve as benchmarks for assessing policy performance in the context of the quarterly reviews under the financial assistance programme. We are confident that the policies set forth in these memoranda are adequate to achieve the objectives under the programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change.

8. The implementation of our programme will be monitored through quantitative performance criteria and structural benchmarks as described in the attached MEFP, and through the detailed and specific economic policy criteria in the MoU. There will be quarterly reviews of the arrangement, in coordination with the IMF. The reviews will assess

progress in implementing the programme and reach understandings on any additional measures that may be needed to achieve its objectives.

9. The programme is designed such that it best reflects the interest of Ireland and the international community. We have explored options for the provision of collateral for support under the EFSF and found legal and economic constraints that would risk undermining the goals of the programme. The conditionality under the programme provides substantial comfort that the programme will be delivered and that the support will be repaid. We will ensure that the financial assistance in the context of the EFSM and EFSF and bilateral lenders to be provided to Ireland will be subject to the loan terms and conditions that will protect the EU's and the euro-area and EU Member States' financial and legal interests in a non discriminatory way as compared to the assistance provided by the EU to other Member States under its Balance of Payments facility and for the EFSF adapted to take into account its structure and credit enhancement mechanism.

10. The Irish authorities believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of our economic programme, but stand ready to take any further measures that may become necessary for this purpose. The authorities will stay in close contact and consult with the European Commission, the ECB and the IMF on the adoption of these measures and in advance of revisions to the policies contained in the MEFP and the MoU. All available information requested by the European Commission, the ECB and the IMF to assess implementation of the programme will be provided.

We are copying this letter to Mr. Strauss-Kahn, Managing Director of the IMF.

Sincerely,

/s/	/s/
___________________	___________________
Brian Lenihan	Patrick Honohan
Minister for Finance	Governor of the Central Bank of Ireland

Memorandum of Economic and Financial Policies

1. We have concluded that Ireland expeditiously requires a strong programme to restore domestic and external confidence and, thus, snap the pernicious feedback loops between the growth, fiscal, and financial crises.

2. We propose that such a programme comprise of four key elements:

- A fundamental downsizing and reorganisation of the banking sector—complemented by the availability of capital to underpin solvency—is required to restore confidence. Addressing market perceptions of weak bank capitalisation, overhauling the banks' funding structure, and immediately beginning a process of downsizing the banking system will be required.
- An ambitious fiscal consolidation building, on the progress already made.
- Renewing growth through a multi-pronged effort.
- A substantial external financial assistance will support the achievement of our policy objectives.

Recent Economic Developments and Outlook

3. After two years of sharp declines in output, the Irish economy is expected to broadly stabilise this year before expanding during 2011–14. As domestic imbalances from the boom years are being repaired, the recovery will, at least initially, be primarily export-driven. We project that GDP growth will increase over time as export performance filters through to investment and consumption, consumer confidence returns, and labour market conditions improve. We recognise that the risks in the short term are tilted to the downside, and, in particular, the headwinds from fiscal consolidation on domestic demand could be larger than anticipated. Over the longer haul also, continued private and public sector balance sheet adjustments, coupled with a weak banking sector, could delay the recovery.

4. Inflation is expected to remain low, reflecting the large output gap and modest external price pressures. Although the inflation rate will likely increase over time, it is expected to remain lower than in trading partner countries. This will have the benefit of improving competitiveness but the low rates of inflation would unavoidably keep real debt burdens high and dampen domestic demand.

5. The current account balance is projected to continue to improve gradually over the medium term, reflecting export expansion and the contraction in domestic demand. However, profit repatriation from multinationals and large interest payments to foreign holders of Irish debt are expected to limit the improvement over the programme period.

Restoring Financial Sector Viability

6. With its large size relative to the economy, its heavy reliance on wholesale funding, and its large exposures to the real estate sector, much of the domestic Irish banking system is in a stressed state. The Government has intervened heavily to safeguard financial stability. In late 2009, we established the National Asset Management Agency (NAMA) to take over certain vulnerable commercial and property development assets of banks. In addition, major efforts have been made to boost banks' capital.

7. Although the Government has made strong efforts to contain the fallout from the sector's vulnerabilities, a continued lack of market access and the loss of deposits have created significant funding pressures, alleviated largely by an increase in recourse to Eurosystem financing facilities and Emergency Liquidity Assistance by the Central Bank. Moreover, capital injections in the banks have placed a heavy burden on public finances.

8. Our proposed programme will take decisive steps to ensure the viability and health of the financial system. We intend to lay the foundations of this process very quickly, if we are to reassure the markets that banks will return to viability and will have the ability to operate without further state support in a reasonable period of time.

9. The key component of our efforts is an overhaul of the financial sector with the objective of substantial downsizing, isolating the non-viable parts of the system and returning the sector to healthy functionality. It will be important to support this process through capital injections into viable financial institutions. In addition, structural measures—a special resolution scheme for deposit-taking institutions and a further strengthening of the supervisory system—will impart greater stability to the system. It is our goal that the leaner and more robust system that emerges from these efforts will not be dependent on state support, will have a more stable funding base, and will provide the credit required to foster growth.

10. The plan to overhaul the banking system has several elements. First, banks will be required to run down non-core assets. Second, land and development property loans that have not yet been transferred to NAMA will also be transferred. Third, banks will be required to promptly and fully provide for all non-performing assets as needed. Fourth, the banks will be required to securitise and/or sell asset portfolios or divisions with credit enhancement if needed, once the market normalises. And finally, swift and decisive action will be taken to resolve the position of Anglo Irish Bank (Anglo) and Irish Nationwide Building Society (INBS) in a way that protects depositors and strengthens the banking system. To this end, by end-January 2011, we will submit to the European Commission a revised proposal developed in collaboration with IMF, to resolve Anglo and INBS. Each of these initiatives will require technical or legislative measures, most of which we believe can be expeditiously instituted.

11. To achieve the above goals, banks will be required to submit deleveraging plans to the national authorities by end-February 2011. The plans will be prepared on the basis of

clear periodic targets defined by the Central Bank, taking into consideration the Prudential Liquidity Assessment Review (PLAR) to be conducted in consultation with the EC, ECB and IMF. By end-March 2011, the Central Bank with assistance from an internationally recognised consulting firm, will complete the assessment of the banks' restructuring plans (structural benchmark). The deleveraging plans will be a component of the restructuring plans to be submitted to the European Commission for approval under EU competition rules.

12. This reorganisation and downsizing of the banks will be bolstered by raising capital standards. While we expect that, in a restructured system, banks will be able to raise capital in the market, we recognise that the higher standards may imply that, in the short run, public provision of capital will be needed for banks that are deemed to be viable. To support this process—and to render it credible—we will undertake a review of the capital needs of banks on the basis of a diagnostic of current asset valuations and stringent stress tests (PCAR 2011).

- As an immediate step, to enhance confidence in the solvency of the banking system, the Central Bank will direct Allied Irish Bank (AIB), Bank of Ireland (BoI) and EBS to achieve a capital ratio of 12 percent core tier 1 by end-February 2011 (structural benchmark) and Irish Life & Permanent (ILP) by end-May 2011 (structural benchmark). This would imply an injection of fresh equity capital of €7bn into these four banks and provide an additional buffer for a potential increase in expected losses. This action, along with early measures to support deleveraging and taking account of haircuts on the additional loans to be transferred to NAMA (see ¶10) would result in an injection of €10bn of fresh capital into the banking system, above and beyond the already committed capital injection of €6.6bn for AIB previously announced by the Irish authorities.

- By end-December 2010, in consultation with EC, ECB, and IMF staff, we will define the criteria to run stringent stress test scenarios (structural benchmark). We will also agree with EC, ECB, and IMF staff, by end-December 2010, on draft terms of reference for the due diligence of bank assets by internationally recognised consulting firms (structural benchmark). We intend to complete the diagnostic evaluation of banks' assets by end-March 2011 and the stress tests (PCAR 2011) by end-March 2011 (both structural benchmarks), and transparently communicate our findings.

- Based on these assessments, starting end-April 2011, banks will be required to maintain a core tier 1 capital ratio of 10.5 percent. Banks will report their capital adequacy ratios to the Central Bank on a quarterly basis. The Central Bank's assessment of banks' capital adequacy ratio will be made public at least semi-annually.

13. The question of whether burden should be imposed on bank sub debt is influenced by two factors: the quantum of capital the State has committed to support the institution and the

perceived viability of the bank in the absence of receiving such capital. Forced burden sharing through legislation is possible and legislation is currently being prepared in this regard. Alternatively, in certain cases, a very deeply discounted liquidity management exercise might also be an appropriate option.

14. In addition, we will finalise proposals to strengthen the legal framework for dealing with distressed deposit-taking institutions in line with recent EU developments (including EU competition rules) and international sound practices. Such a special resolution regime will broaden the available resolution tools with the aim of promoting financial stability and protecting depositors. In particular, the draft legislation will (i) provide for the appointment of a special manager where, in the opinion of the Central Bank, an institution's financial condition has severely deteriorated; (ii) grant powers to the Central Bank for the transfer of assets and liabilities to other institutions; and (iii) create a framework for the establishment of bridge banks. We seek to submit draft legislation including the above-mentioned elements to Dáil Éireann by end-February 2011 (structural benchmark).

15. Moreover, we will continue the efforts to strengthen banking supervision by ensuring higher staffing levels and budget allocations in line with OECD best practices. We will enhance the risk assessment framework and raise the corporate governance standards. By end-September 2011, a report by an independent assessor on our compliance with Basel core principles for effective banking supervision will be made public.

16. We will also reform the personal insolvency regime for financially responsible individuals (including sole traders), which will balance the interests of both creditors and debtors. The objectives will be to lower the cost and increase the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline. The new legal framework will include a non-judicial debt settlement and enforcement mechanism as an alternative to court-supervised proceedings.

17. We will continue to provide means-tested financial assistance to limit the economic and social fallout of the crisis. The existing mortgage interest supplement scheme is crucial for providing temporary assistance to distressed mortgage holders. The scheme's administration will be centralised to ensure a more consistent application focusing on households that are most in need, and further modification will be introduced in the 2011 Social Welfare Act.

18. Our strategy for the credit union sector is based on three components. First, we will complete a full assessment of their loan portfolios by end-April 2011 (structural benchmark). Second, by end-April 2011, we will have ready a comprehensive strategy to enhance the viability of the sector. And third, by end-December 2011 we will submit legislation to Dáil Éireann to assist the credit unions with a strengthened regulatory framework including effective governance and stabilisation requirements.

19. We will continue efforts to ensure the flow of credit to viable businesses, building on actions already taken under previous recapitalisations and NAMA legislation. Allied Irish

Bank and Bank of Ireland have agreed, in connection with recapitalisation last March, to make available not less than €3 billion each for targeted lending for new or increased credit facilities to small and medium-sized enterprises in both 2010 and 2011 as well as funds for seed and venture capital and for Environmental lending. The lending policies and decisions of both banks are subject to review by the Credit Review Office, which enables businesses who have had credit refused or withdrawn, to apply for an independent review of the bank's decision.

20. NAMA is subject to an extensive range of statutory Governance and Accountability arrangements and these will be fully adhered to. Members of the NAMA Board must have relevant experience and expertise, and the work of the Board is supported by audit and other sub-committees. NAMA operations are also subject to statutory codes of practice. NAMA is required to prepare various reports, including quarterly reports of its activities, and these are subject to scrutiny by Oireachtas committees. The Comptroller and Auditor General audit the annual accounts and prepare reports on NAMA for review by the Public Accounts committee.

Safeguarding Public Finances

21. To continue with the programme of fiscal consolidation, a comprehensive National Recovery Plan 2011-14 was approved by the Government and published on 24 November 2010. This Plan forms the basis for the 2011 budget consistent with fiscal consolidation measures amounting to €15 billion, a 9 percent of GDP budgetary correction over the period 2011–14. Having stabilised the deficit, albeit at a high level, the steps announced in the Plan will place the budget deficit-to-GDP ratio on a firm downward path. While the debt-to-GDP ratio will remain at high levels for the next few years, it is projected to decline thereafter, underpinning debt sustainability. We also propose to keep under review progress towards meeting the Stability and Growth Pact targets.

22. Budget 2011 which will include adjustment measures of €6 billion, will be submitted to Dáil Éireann for passage on 7 December (prior action). As set out in the National Recovery Plan, most of this adjustment will come from the expenditure side. The capital budget will be reduced, partly through greater value for money in our infrastructure procurements. On current expenditures, we are pursuing public service numbers reductions through natural attrition and voluntary schemes, adjustments in public service pensions, and further savings on social transfers (from reductions in working age payments, reductions in universal child benefit payments and other reforms). Protecting the socially vulnerable at a time of difficult economic adjustment remains a central policy goal. Current savings will also be realised from streamlining government programmes and through administrative efficiencies. Should these savings or the expected numbers reductions not materialise, we reserve the option to take further measures.

23. An income tax-led revenue package—sized at over €2 billion in a full year—will supplement the above expenditure measures in 2011. Over the past decade, the proportion of citizens exempt from income tax has risen to 45 percent and tax credits have doubled,

resulting in a comparatively low burden of tax on ordinary incomes. This is no longer sustainable. Accordingly, we are widening the tax base, by lowering income tax bands and credits by 10 percent, and by reducing various pension-related tax reliefs. We are also taking action on other tax expenditures, and distortions arising from the existence of multiple levies.

24. To secure our fiscal targets, a number of fiscal measures have been identified for 2012–14. We will continue to rely on expenditure savings (€6.1 billion), led by current spending (€4.9 billion), as outlined in the National Recovery Plan. We are targeting further reductions in public sector numbers, social benefits and programme spending, and have anchored the prospective savings by publishing multi-year expenditure ceilings by Vote Group through 2014. We are also planning to move towards full cost-recovery in the provision of water services and ensuring a greater student contribution towards tertiary education, while ensuring that lower-income groups remain supported. In addition, we will accelerate the process of placing the pension systems on a path consistent with long-term sustainability of public finances. On the tax side, we will build on the base-broadening measures outlined above and establish a sound basis for sub-national finances through a new residential-property based site value tax. The Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

25. We are preparing institutional reform of the budget system taking into account anticipated reforms of economic governance at the EU level. A reformed Budget Formation Process will be put in place. Furthermore, we will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by end-July 2011 (structural benchmark). A Budget Advisory Council, to provide an independent assessment of the Government's budgetary position and forecasts will also be introduced by end-June 2011 (structural benchmark). These important reforms will enhance fiscal credibility and anchor long-term debt sustainability.

Raising the Growth Potential

26. We recognise the need to restore strong sustainable growth. The structural changes to the financial and fiscal sectors, described above, are critical for improving the prospects of economic recovery and raise the medium-term growth potential. Although, as is widely recognised, Ireland is a global leader in providing a business-friendly environment, the National Recovery Plan includes a strategy to remove remaining structural impediments to competitiveness and employment creation. It also details appropriate sectoral policies to encourage exports and a recovery of domestic demand, which will also support growth and promote jobs.

27. Specifically, we will continue to press ahead with other structural reform as set out in the Memorandum of Understanding on specific economic policy conditionality:

- We will promote service sector growth through vigorous action to remove remaining restrictions on trade and competition, and will propose amendments to legislation to

enable the imposition of financial and other sanctions in civil law cases relating to competition.

- Building on the forthcoming report of the Review Group on State Assets & Liabilities the government will undertake an independent assessment of the electricity and gas sectors with a view to enhancing their efficiency. State authorities will consult with the Commission Services on the results of this assessment with a view to setting appropriate targets for the possible privatisation of state-owned assets.

- To reduce long-term unemployment and to facilitate re-adjustment in the labour market, we will reform the benefits system and legislate to reform the national minimum wage. Specifically, changes will be introduced to create greater incentives to take up employment.

Programme Financing

28. Ireland is facing large and medium-term balance of payments needs that arise from (i) substantial pressures on the capital account that need to be relieved, and (ii) the need to build up reserves to improve banks' ability to meet their large external debt rollover needs. The programme's success is dependent on substantive external financial assistance. This external financing will serve as a bridge during the implementation of the critical reforms to fundamentally restructure the banking system and restore fiscal sustainability. It is our view that, given Ireland's medium-term structural adjustment needs, an arrangement under the Extended Fund Facility (EFF) would be appropriate. Such an arrangement would also have the added benefit of a more realistic repayment schedule for Ireland.

29. Notwithstanding the large fiscal adjustment, we estimate the financing need to be up to €85 billion until the end of 2013. This includes a contingency element for bank recapitalisation. An amount of €17.5 billion will be covered by an Irish contribution through the Treasury cash buffer and investments of the National Pension Reserve Fund. We expect commitments from the IMF under the Extended Arrangement to amount to €22.5 billion and EU financial support from the European Financial Stability Mechanism/European Financial Stability Facility and bilateral arrangements to amount to €45 billion. Ireland will draw on these resources in parallel throughout the programme period. While the envelope of resources to be provided to Ireland is a source of reassurance to the authorities and to financial markets, we plan to draw pari passu on IMF and EU financial support on an as needed basis. Moreover, if market access is restored on a sustainable basis, we would anticipate paying down the drawings made on an advanced schedule.

30. We are confident that the implementation of the fiscal and banking sector reforms will help the economy recover.

Programme Monitoring

31. Progress in the implementation of the policies under the programme will be monitored through quarterly and continuous performance criteria, indicative targets,

structural benchmarks, and quarterly programme reviews and compliance with requirements under the Excessive Deficit Procedure (EDP). The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer balance (central government cash balance) excluding interest payments will be monitored through quarterly performance criteria and net central government debt will be an indicative target (Table 1). As is standard in IMF arrangements, there will be a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms will be monitored through structural benchmarks (Table 2). A joint EC-ECB Memorandum of Understanding specifies, notably, the structural policies recommended in the MEFP, and sets a precise time frame for their implementation,

32. As is standard in all Fund arrangements, a safeguards assessment of the Central Bank of Ireland will be completed by the first review of the arrangement. In this regard, the Central Bank will receive a safeguards mission from the Fund and provide the information required to complete the assessment by the first review. As a related matter, and given that financing from the IMF will be used to provide direct budget support, a framework agreement will be established between the government and the Central Bank of Ireland on their respective responsibilities for servicing financial obligations to the IMF. As part of these arrangements, Fund disbursements will be deposited into the government's account at the Central Bank.

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

Table 1. Ireland: Quantitative Performance Criteria and Indicative Targets under the Economic Programme for 2010–11

	December 31, 2010	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
	(In billions of Euros)				
	Performance Criterion	Performance Criterion	Indicative Target	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 1/	-15.3	-7.8	-11	-14.3	-14.6
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 2/	0	0	0	0	0
	Indicative Target	Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	83.1	91.6	96.5	100	102.2

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

2/ Applies on a continuous basis.

Table 2. Prior Action and Structural Benchmarks Under the Economic Programme for 2010–11

Measure		
Submit the 2011 Budget to Dáil Éireann (MEFP, ¶22).	7 December 2010	Prior Action
Define the criteria to run stringent stress tests scenarios (MEFP ¶12).	End-December 2010	Structural Benchmark
Agree on terms of reference for the due diligence of bank assets by internationally recognised consulting firms (MEFP, ¶12).	End-December 2010	Structural Benchmark
The Central Bank will direct the recapitalisation of the principal banks (AIB, BOI and EBS) to achieve a capital ratio of 12 percent core tier 1 (MEFP, ¶12).	End-February 2011	Structural Benchmark
Submit to Dáil Éireann the draft legislation on a special resolution regime (MEFP, ¶14).	End-February 2011	Structural Benchmark
The Central Bank to complete the assessment of the banks' restructuring plans (MEFP, ¶11).	End-March 2011	Structural Benchmark
Complete the diagnostic evaluation of banks' assets (MEFP, ¶12).	End-March 2011	Structural Benchmark
Complete stress tests (PCAR 2011) (MEFP, ¶12).	End-March 2011	Structural Benchmark
Complete a full assessment of credit unions' loan portfolios (MEFP, ¶18).	End-April 2011	Structural Benchmark
The Central Bank will direct the recapitalisation of ILP to achieve a capital ratio of 12 percent core tier 1 (MEFP, ¶12).	End-May 2011	Structural Benchmark
Establish a Budget Advisory Council (MEFP, ¶25).	End-June 2011	Structural Benchmark
Introduce a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area (MEFP, ¶25).	End-July 2011	Structural Benchmark

Ireland

Memorandum of Understanding on Specific Economic Policy Conditionality

8 December, 2010

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism, and in particular Article 3(5) thereof, this Memorandum of Understanding details the general economic policy conditions as embedded in Council Decision 17211/1/10 of 7 December 2010 on granting Union financial assistance to Ireland.

The quarterly disbursement of financial assistance from the European Financial Stabilisation Mechanism (EFSM)[29] will be subject to quarterly reviews of conditionality for the duration of the programme. Release of the instalments will be based on observance of quantitative performance criteria, respect for EU Council Decisions and Recommendations in the context of the excessive deficit procedure, and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and in this Memorandum of Understanding on specific economic policy conditionality (MoU), which specifies the detailed criteria that will be assessed for the successive reviews up to the end of 2013. If targets are (expected to be) missed, additional action will be taken.

The authorities commit to consult with the European Commission, the ECB and the IMF on the adoption of policies that are not consistent with this Memorandum. They will also provide the European Commission, the ECB and the IMF with all information requested that is available to monitor progress during programme implementation and to track the economic and financial situation. Prior to the release of the instalments, the authorities shall provide a compliance report on the fulfilment of the conditionality.

The release of the first instalments will be conditional on the successful adoption of Budget 2011 as described in the MEFP and this MoU.

[29] On 28 November 2010 Eurogroup and ECOFIN Ministers issued a statement clarifying that euro-area and EU financial support will be provided on the basis of the programme which has been negotiated with the Irish authorities by the Commission and the IMF, in liaison with the ECB. Further to the Union support from the EFSM, loans from the EU and its Member States will include contributions from the European Financial Stability Facility (EFSF) and bilateral lending support from the United Kingdom, Sweden, and Denmark. The Loan Facility Agreements on these financing contributions will specify that the disbursements thereunder are subject to the compliance with the conditions of this Memorandum.

1. Actions for the first review (actions to be completed by end Q1-2011)

i. Fiscal consolidation

Government submits the draft budget for 2011 for Dáil approval. The budget provides information and prudent projections on the entire general government sector and targets a further reduction of the general government deficit in line with the MEFP. It includes a detailed presentation of fiscal consolidation adjustments for 2011 of €6 billion.

The budget includes the following measures (in exceptional circumstances, measures yielding comparable savings could be considered in close consultation with European Commission, IMF and ECB staffs);

- Revenue measures to raise at least €1,400m in 2011 and an extra €620m in a full year will be introduced to the Houses of the Oireachtas, including:
    - A lowering of personal income tax bands and credits or equivalent measures to yield €945m in 2011 and an extra €300m in a full year.
    - A reduction in pension tax relief and pension related deductions to yield €155m in 2011, and an extra €105m in a full year.
    - A reduction in general tax expenditures to yield €220m in 2011, and an extra €185m in a full year.
    - Excise and miscellaneous tax measures to raise €80m in 2011 and a further €30m in a full year will be introduced.
    - The government will outline methods to raise at least €700m in one-off and other measures in 2011.
- A reduction of current expenditure in 2011 of at least €2,090m will be implemented including;
    - Social Protection expenditure reductions.
    - Reduction of public service employment numbers in 2011.
    - A reduction of existing public service pensions on a progressive basis averaging over 4% will be introduced.
    - Other expenditure savings of €1,030m including savings on goods and services.
- A reduction of at least €1,800m in public capital expenditure against existing plans for 2011 will be introduced.

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

Recapitalisation measures

- The measures proposed for the recapitalisation of Irish banks in the government statement of 30 September 2010 will be implemented, taking into account any changes in strategy for the future of the banking sector agreed under the programme.
- Further deleveraging of the banks will be achieved by the extension of the NAMA programme to include approximately €16bn of land and development loans in AIB and Bank of Ireland, which had previously been excluded as they were below a value threshold of €20m. NAMA will categorise sub-€20m AIB and BOI land and development and associated loans (roughly estimated to number 10,000) by reference to asset type and region. NAMA will then apply different discounts to each category based on NAMA's loan valuation experience up to the point of valuation. On this basis it is expected that all loans will be transferred by end-March 2011. NAMA will issue bonds in return for the assets transferred. NAMA would build on the existing outsourcing arrangements with the banks for the management of these smaller loans and performance will be incentivised as appropriate. The NAMA legislation will be amended to underpin the valuation and acquisition of these assets on a portfolio basis. The additional capital requirement will be met by the programme and is included in the figure below. These measures will be notified to the European Commission in accordance with EU competition rules.
- Prudential Capital Assessment Review (PCAR) minimum capital requirement for the Irish banks (AIB, BOI, EBS and ILP) will be set at 10.5% core tier 1;
- In addition the Irish authorities will ensure that AIB, BOI and EBS are initially recapitalised to a level of 12% core tier 1 capital, which will take account of haircuts on the additional loans to be transferred to NAMA and will fund early deleveraging by making available EUR 10 billion in the system; the recapitalisation will take the form of equity shares (or equivalent instruments for EBS);
- The PCAR exercise will be enhanced to provide a comprehensive evaluation of the underlying assets of the banks, taking into account future expected losses.
- The PCAR for 2011 will be completed based on comprehensive Terms of Reference for its design and implementation, which will have been previously agreed between the Central Bank, the European Commission, IMF and ECB staff. The methodology used will be published in detail. The Commission, IMF and ECB shall be involved in the validation of the PCAR process. In particular, key data and information that relates to the PCAR exercise will be available to the Commission, IMF and ECB upon request.

Deleveraging measures

- The Central Bank will complete a Prudential Liquidity Assessment Plan (PLAR) for 2011, outlining measures to be implemented with a view to steadily deleveraging the banking system and reducing the banks' reliance on short term funding by the end of the programme period. Ambitious target loan to deposit ratios, to be achieved by end 2013, will be established for each bank by the Irish authorities in consultation with the ECB, EC and the IMF by end Dec 2010. These targets will be designed to ensure that convergence to Basel III standards can be readily met by the relevant dates. To this end, the PLAR will establish target funding ratios for 2013 for each of the banks, identify non core assets and set an adjustment path to these targets based on specified non public annual benchmarks. Banks will be informed of necessary actions to be taken so as to comply with the

respective funding targets and adjustment paths. The design and implementation of the PLAR will be agreed with the European Commission, the ECB and the IMF. Compliance with the PLAR benchmarks will be monitored and enforced by the Central Bank taking account of prevailing market conditions. The PLAR will be updated on an annual basis.

Reorganisation of banking sector

- The strategy for the future structure, functioning and viability of Irish credit institutions will be developed in detail and agreed with the European Commission, the ECB and the IMF. Within the context of a comprehensive reorganisation and downsizing of the banking sector the strategy will identify the appropriate path to ensure that the banking system will operate without the need of further State support. The Irish authorities are committed to divest the participations in the banks acquired during the crisis within the shortest timeframe possible which is compatible with financial stability and public finance considerations. Building on restructuring undertaken to date, further restructuring and viability plans for the institutions concerned will be submitted in accordance with EU competition rules; these plans will also be made available to the IMF and ECB. Commitments undertaken by the Irish authorities in the context of EU competition decisions will be maintained.
- In the context of the above strategy, a specific plan for the resolution of Anglo Irish Bank and Irish Nationwide Building Society will be established and submitted to the European Commission in accordance with EU competition rules. Any related legal procedures will be set in motion under a precise timetable. This plan will seek to minimise capital losses arising from the working out of these non-viable credit institutions. The Government will ensure that these credit institutions adhere to the requisite capital ratios.
- Legislation on improved procedures for early intervention in distressed banks and special bank resolution regime (SRR) will be introduced. The SRR should include a robust set of powers and tools to ensure the competent authorities can promptly and effectively resolve distressed banks e.g. when they pose a risk to financial stability. The legislation will be consistent with the EU Treaty rules and will be consistent with similar initiatives ongoing at EU level.
- Central Bank staffing in relation to the PCAR and PLAR exercises will be reviewed and augmented as necessary to guarantee that both exercises can be conducted on a timely and efficient basis.

Burden sharing by holders of subordinated debt

- Consistent with EU State aid rules, burden sharing will be achieved with holders of subordinated debt in relevant credit institutions over the period of the programme. This will be based on the quantum of capital and other financial assistance the State commits to support specific credit institutions and the financial viability of those institutions in the absence of such support. Resolution and restructuring legislation which will address the issue of burden sharing by subordinated bondholders will be submitted to the Oireachtas by end-2010. Where it is appropriate in line with the above criteria, the process of implementing liability management exercises similar to that which is currently being undertaken in relation to holders of subordinated debt in Anglo Irish Bank will be commenced by end-Q1 2011.

iii. Structural reforms

To facilitate adjustment in the labour market

The government will introduce legislation to reform the minimum wage in such a way as to foster job creation notably for categories at higher risk of unemployment and prevent distortions of wage conditions across sectors associated with the presence of sectoral minimum wages in addition to the national minimum wage. Measures will be as follows:

- Reduce by €1.00 per hour the nominal level of the current national minimum wage.
- Enlarge the scope of the "inability to pay clause" permitting firms to invoke this clause more than once;

These measures should come into effect by May 2011.

An independent review of the Framework REA and ERO arrangements will be initiated by the end of Q1 2011. Terms of Reference and follow up actions will be agreed with European Commission Services.

To reduce the risk of long-term unemployment

The government will reform the unemployment benefit system in such a way as to provide incentives for an early exit from unemployment. This reform of unemployment and social assistance benefits will be part of overall reforms in the welfare system designed to reach budgetary savings of €750m in 2011.

Legislative measures will be *introduced* with a view to:

Taking steps to tackle unemployment and poverty traps including through reducing replacement rates for individuals receiving more than one type of benefit (including housing allowance).

The government reforming the system of activation policies in such a way as to adapt it to the reform in benefits and make it more effective. Legislative and other measures will be introduced with a view to:

- improving the efficiency of the administration of unemployment benefits, social assistance and active labour market policies, by exploiting synergies and reducing the overlapping of competencies across different departments;
- enhancing conditionality on work and training availability;
- strengthening activation measures via:
    - i. the introduction of instruments to better identify of job seekers' needs ("profiling") and increased engagement;
    - ii. a more effective monitoring of jobseekers' activities with regular evidence-based reports;
    - iii. the application of sanction mechanisms for beneficiaries not complying with job-search conditionality and recommendations for participation in labour market programmes set in such a way as to imply an effective loss of income without being perceived as excessively penalising so that it could credibly be used whenever lack of compliance is ascertained.

At each subsequent review of the programme, the government will submit reports containing an assessment (including by means of quantitative indicators) of the management of

activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.

Legislative measures should come into effect by May 2011.

An in-depth review of the personal debt regime will be published shortly. Work will commence on reform of legislation which will balance the interests of both creditors and debtors.

2. Actions for the second review (actions to be completed by end Q2-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress will be assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

The government will submit a timetable for implementing the recommendations of the Memorandum. Upon consideration by the European Commission, IMF and ECB staffs the measures in this timetable shall become the performance benchmarks for future reviews.

ii. Financial sector reforms

- The results of the PCAR for 2011 will be assessed by the authorities, together with the European Commission, the ECB and the IMF. The results will be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2011, the Government will ensure that the banks are recapitalised in the form of equity, if needed, so as to ensure that the minimum capital requirement of 10.5% will be maintained.
- Introduce legislation for the enhancement of financial regulation, expanding the supervisory and enforcement powers of the Central Bank.
- The Irish authorities will ensure that ILP is recapitalised to a level of 12% core tier 1 capital.
- Progress in implementation of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural reforms

To enhance long-term fiscal sustainability

- The Authorities undertake to introduce legislation to increase the state pension age. Under the Government's National Pension Framework the age at which people will qualify for the State Pension will be increased to 66 years in 2014, 67 in 2021 and 68 in 2028.

iv. Structural fiscal reforms

To reinforce a credible budgetary strategy

- The government will continue to ensure the reliability and the regular availability of budgetary data for both the whole of the general government sector and its breakdown into government layers. Specifically, reporting will comply with the provisions included in annex 1 of the MoU.
- Under the period of this financial assistance programme, any additional unplanned revenues must be allocated to debt reduction.
- In accordance with the proposal set out in the National Recovery Plan 2011-2014, the government will establish a budgetary advisory council to provide an independent assessment of the Government's budgetary position and forecasts.
- Government extends the voluntary 15 day rule relating to prompt payments to the health service executive, local authorities and state agencies.

3. Actions for the third review (actions to be completed by end Q3-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU).

Government will consider an appropriate adjustment, including to the overall public service wage bill, to compensate for potential shortfalls in the projected savings arising from administrative efficiencies and public service numbers reductions.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.

- Progress in implementing the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements.

iii. Structural reforms

To increase growth in the domestic services sector

Government will introduce legislative changes to remove restrictions to trade and competition in sheltered sectors including:

- - the legal profession, establishing an independent regulator for the profession and implementing the recommendations of the Legal Costs Working Group and outstanding Competition Authority recommendations to reduce legal costs.
- - medical services, eliminating restrictions on the number of GPs qualifying and removing restrictions on GPs wishing to treat public patients as well as restrictions on advertising.
- - the pharmacy profession, ensuring that the recent elimination of the 50% mark-up paid for medicines under the State's Drugs Payments Scheme is enforced.

To enhance competition in open markets

- Government should introduce reforms to legislation to (1) empower judges to impose fines and other sanctions in competition cases in order to generate more credible deterrence and (2) require the competition authorities to list restrictions in competition law which exclude certain sectors from its scope and to identify processes to address those exclusions.

To encourage growth in the retail sector

- The government will conduct a study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers and discuss implementation of its policy implications with the Commission services.

iv. Structural fiscal reforms

To put the public service pension system on a more sustainable basis

- Pension entitlements for new entrants to the public service will be reformed with effect from 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New public service entrants will also see a 10% pay reduction. New entrants' retirement age will also be linked to the state pension retirement age.

To ensure a more credible fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

To facilitate better government at a local level

- Government will ensure that effective measures are in place to cap the contribution of the local government sector to general government borrowing at an acceptable level. The mechanisms in place to underpin this position will be kept under close review, in consultation with the Commission services. The review will also consider how to provide data on the financial position including assets and liabilities of the sector on a timelier basis.

4. Actions for the fourth review (actions to be completed by end Q4-2011)

i. Fiscal consolidation

Government will rigorously implement the budget for 2011 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU).

The government will provide a draft budget for 2012 aiming to further reduce the general government deficit in line with the National Recovery Plan and the programme and including the detailed presentation of consolidation measures amounting to at least €3.6bn.

- Revenue measures to yield €1,500m[30] in a full year will be introduced, including:
    - A lowering of personal income tax bands and credits.
    - A reduction in private pension tax reliefs.
    - A reduction in general tax expenditures.
    - A property tax.
    - A reform of capital gains tax and acquisitions tax.
    - An increase in the carbon tax.
- The budget will provide for a reduction of expenditure in 2012 of €2,100m including:
    - Social expenditure reductions.
    - Reduction of public service numbers. and public service pension adjustments.
    - Other programme expenditure, and reductions in capital expenditure.

The Authorities will introduce measures to ensure that the deficit reduction targets as set out in the National Recovery Plan are achieved.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) and the general government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved.

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[30] Inclusive of 2011 carryover

ii. Financial sector reforms

- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural reforms

To assist in financing need and to increase competition

- Building on the forthcoming report of the Review Group on State Assets & Liabilities the government will undertake an independent assessment of the electricity and gas sectors. State authorities will consult with the Commission Services on the results of this assessment with a view to setting appropriate targets.

In advance of the introduction of water charges

- The government will have undertaken an independent assessment of transfer of responsibility for water services provision from local authorities to a water utility, and prepare proposals for implementation, as appropriate with a view to start charging in 2012/2013.

iv. Structural fiscal reforms

To reinforce the credibility of the budgetary process

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.
- The Government will introduce a Fiscal Responsibility Law which will include provision for a medium-term expenditure framework with binding multi-annual ceilings on expenditure in each area by Q4 2011. This will take into account any revised economic governance reforms at EU level and will build on reforms already in place.

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

i. Fiscal consolidation

Government will rigorously implement the budget for 2012 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU). Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- PCAR for 2012 will be completed. The methodology used will be published in detail. The Government will ensure that the banks adhere to the requisite capital ratios.
- PLAR 2012 will be completed and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF
- Legislation to reform the personal debt regime to be presented to the Houses of the Oireachtas.

iii. Structural reforms

To boost the integrity of the fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

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

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1of MEFP) 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. Financial sector reforms

- The results of the PCAR for 2012 will be assessed, together with European Commission, the ECB and the IMF. The results will then be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2012, the Government will ensure that the minimum capital requirement of 10.5% will be maintained.
- Progress in implementation of the strategy for the restructuring of the Irish credit institutions banking system will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural fiscal reforms

To further enhance the credibility of the fiscal framework

- Assessment of work in progress related to the fiscal governance requirements considered in the previous quarters.

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

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for restructuring of the Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements.

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

i. Fiscal consolidation

The government will provide a draft budget for 2013 aiming at a further reduction of the general government deficit in line with the 4-year plan and the programme and including the detailed presentation of consolidation measures amounting to at least €3,100m.

- Revenue measures to raise at least €1,100m[31] in the full year will be introduced, including:
    - A lowering of personal income tax bands and credits.
    - A reduction in private pension tax relief.
    - A reduction in general tax expenditures.
    - An increase in property tax.
- The budget will provide for a reduction in expenditure in 2013 of no less than €2,000m, including:
    - Social expenditure reductions.
    - Reduction of public service numbers and public service pension adjustments.
    - Other programme expenditure, and reductions in capital expenditure.

[31] Inclusive of carryover from 2012

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- Progress in implementation of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Implementing of the plan for restructuring and strengthening the balance sheets of the credit union sector will be completed.

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

i. Fiscal consolidation

Government will rigorously implement the budget for 2013 and the fiscal consolidation measures announced afterwards, consistent with the requirements of the excessive deficit procedure. Progress is assessed against the (cumulative) quarterly primary deficit ceilings in the Memorandum of Economic and Financial Polices (MEFP) including the Technical Memorandum of Understanding (TMU).

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- PCAR for 2013 will be completed. The methodology used will be published in detail.
- PLAR 2012 will be completed and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

iii. Structural fiscal reforms

- Assessment of work in progress related to the fiscal reforms considered in the previous quarters.
- The nominal value of the State pension should not rise over the period of the programme.

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

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- The results of the PCAR for 2013 will be assessed, together the European Commission, the ECB and the IMF. The results will then be published in detail and on a bank-by-bank basis.
- Depending on the results of the PCAR 2013, the Government will ensure that the minimum capital requirement of 10.5% will be maintained.
- The PLAR for 2013 will be completed.
- Progress in implementation of the strategy for the restructuring the banking system will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

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

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1of MEFP) 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. Financial sector reforms

- Interim review of progress under PLAR 2011 and any related actions will be assessed, together with the European Commission, the ECB and the IMF.
- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.
- Review progress against PCAR requirements

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

i. Fiscal Consolidation

The Department of Finance will continue to ensure tight supervision of expenditure commitments by the line departments, and effective tax collection, to make certain that the primary deficit target in cash (see Table 1 of MEFP) 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. Financial sector reforms

- Progress in implementing of the strategy for the reorganisation of Irish credit institutions will be assessed by the authorities, together with the European Commission, the ECB and the IMF.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF staffs by the authorities on a regular basis.

To be provided by the Department of Finance	
Monthly data on adherence to budget targets (Exchequer statement, details on Exchequer revenues and expenditure with information on Social Insurance Fund to follow as soon as practicable).	Monthly, 10 days after the end of each month
Updated monthly report on the central government's budget execution and prospects for the remainder of the year.	Monthly, 30 days after the end of each month
Quarterly data on main revenue and expenditure items of local government.	Quarterly, 90 days after the end of each quarter
Updated annual plans for the general government balance showing transition from the Exchequer balance to the general government balance (using presentation in Table 1 and Table 2A of the EDP notification).	Monthly, 30 days after the end of each month
Quarterly data on the public service wage bill, number of employees and average wage (using the presentation of the Pay and Pension Bill with further details on pay and pension costs of local authorities).	Quarterly, 30 days after the end of each quarter
Information on the main Government spending and receipt items	Weekly on Friday, reporting on the previous Thursday
Quarterly data on general government accounts, and general government debt as per the relevant EU regulations on statistics.	Quarterly accrual data, 90 days after the end of each quarter
Updated annual plans of the general government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general government budgetary prospects.	Together with EDP notification
To be provided by the NTMA	
Weekly information on the Government's cash position with indication of sources as well of number of days covered	Weekly on Friday, reporting on the previous Thursday
Data on below-the-line financing for the general government.	Monthly, no later than 15 days after the end of each month
Data on public debt, new guarantees and other instruments issued by the general government to public enterprises, banks and the private sector.	Monthly, 30 days after the end of each month
Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months for the general government (interest and amortisation) and for central government and local authorities	Monthly, 30 days after the end of each month

Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months for State-guaranteed enterprises (interest and amortisation) (or Dept of Finance)	Quarterly, 30 days after the end of each quarter
Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and government sectors in the next 12 months	Monthly, 30 days after the end of each month
To be provided by the Central Bank	
Assets and liabilities of the Central Bank	Weekly, next working day
Assets and liabilities of the Irish banking system - aggregate monetary balance sheet of credit institutions	Monthly, 30 days after the end of each month
Short-, medium- and long-term debt falling due (by type of instrument) over the next 36 months for domestic banks of systemic importance (interest and amortisation).	Monthly, 30 days after the end of each month
Weekly individual operational balance sheets of commercial banks (of systemic importance), including detailed information on deposits (by maturity and type of depositor) and loans provided to the public and the private sector (households and corporates)	Weekly, next working day
Public debt and new guarantees issued by the general government to banks.	Monthly, 30 days after the end of each month
Financial stability indicators (IMF core set: deposits, non-performing loans, capital adequacy ratios)) for systemic domestic banks	Monthly, 30 days after the end of each month
Estimates of domestic banks' capital needs in the next 12 months	Monthly, 30 days after the end of each month
Estimates of funding sources for the banking sector for the next 12 months	Monthly, 30 days after the end of each month

Fiscal measures included in the programme

2011

in million EUR		% of GDP
Revenue measures	1400	0.9
One-off and other revenue measures	700	0.4
Current expenditure measures	2090	1.3
Capital expenditure measures	1800	1.1
TOTAL IMPACT in 2011	**5990**	**3.8**

2012

in million EUR		**% of GDP**
New revenue measures	880	0.5
Revenue carryover from previous year	620	0.4
Current and capital expenditure measures	2100	1.3
TOTAL ANNUAL IMPACT	**3600**	**2.2**

2013

in million EUR		**% of GDP**
New revenue measures	850	0.5
Revenue carryover from previous year	250	0.1
Current and capital expenditure measures	2000	1.2
TOTAL ANNUAL IMPACT	**3100**	**1.8**

Technical Memorandum of Understanding (TMU)

3 December, 2010

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

2. For programme purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "programme exchange rates", with the exception of the items affecting the government fiscal balances, which will be measured at current exchange rates. The programme exchange rates are those that prevailed on November 24, as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 SDR.

I. Quantitative Performance Criteria And Indicative Targets

A. Floor on the Exchequer Primary Balance

3. The exchequer balance is the traditional domestic budgetary aggregate which measures the net surplus or net deficit position of the Exchequer Account. The Exchequer Account is the single bank account of the Central Fund and is held at the Central Bank of Ireland. The annual audited accounts of the Exchequer Account produced by the Department of Finance are known as the Finance Accounts. An unaudited summary known as the Exchequer Statement is produced at the end of each month. Under the Irish Constitution, all Government receipts are paid in to the Central Fund and all Government expenditure is funded from it, unless provided otherwise by law.[32] The Exchequer balance is the difference between total receipts into, and total expenditure out of, the Exchequer Account. It measures the sum of the current and capital balances. The current balance is defined as current receipts (tax and non-tax revenue) minus current expenditure (voted expenditure and non-voted expenditure charged directly on the Central Fund, including the Sinking Fund). The capital

[32] Receipts of the Central Fund comprise Exchequer tax revenues, non-tax revenues, receipts from the European Union and other capital receipts. Charges on the Central Fund include the expenditure of Government departments and offices, payments related to the servicing of the national debt, payments to the European Union Budget, the salaries, pensions and allowances of the President, judiciary, and Comptroller & Auditor General and the running costs of the Houses of the Oireachtas (Parliament). Extra-budgetary funds (including the National Pensions Reserve Fund), the Social Insurance Fund, semi-state bodies and local governments are not part of the Exchequer system.

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

4. The performance criteria are set on the exchequer primary balance (the exchequer balance excluding net debt interest payments in the service of the National Debt)[33].

5. For the purposes of the programme, the floor on the exchequer primary balance (quantitative performance criterion) will be adjusted downward by payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. Such payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation), unrequited recapitalisation, and purchases of troubled assets, which are carried out in line with programme objectives. Any other financial operation by Government to support banks, including the issuance of guarantees or provision of liquidity, will be reported to IMF staff.

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

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2010:	
End-December 2010 (performance criterion)	-15.3
From January 1, 2011:	
End-March 2011 (performance criterion)	-7.8
End-June 2011 (indicative target)	-11.0
End-September 2011 (indicative target)	-14.3
End-December 2011 (indicative target)	-14.6

7. The performance criterion on the exchequer primary balance (floor) for end-March 2011 and thereafter, will be adjusted upward (downward) for the full amount of any over-performance (under-performance) in Exchequer tax revenues, pay-related social insurance contributions (PRSI), health levy and national training fund contributions against the current projection which is listed below[34]:

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
End-March 2011 (projection)	9.7
End-June 2011 (projection)	19.4
End-September 2011 (projection)	29.7
End-December 2011 (projection)	41.9

[33] Net debt interest payments are as per the end-month Exchequer Statements.
[34] Exchequer tax receipts are comprised of income tax, value added tax (VAT), corporation tax, excise duties, stamp duties, capital gains tax, capital acquisitions tax and customs duties.

8. Any policy changes, including in tax administration and enforcement, which impact the above revenue projection will lead to a reassessment of the adjustor in the context of program reviews.

B. Ceiling on the Stock of Central Government Net Debt

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

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

11. The ceiling on the outstanding stock of central government net debt will be adjusted upward (downward) by the amount of any final upward (downward) revision to the stock of end-October 2010 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-October 2010 (provisional)	78.6
End-December 2010 (indicative target)	83.1
End-March 2011 (indicative target)	91.6
End-June 2011 (indicative target)	96.5
End-September 2011 (indicative target)	100.0
End-December 2011 (indicative target)	102.2

C. Non-accumulation of External Payments Arrears by Central Government

12. The central government will accumulate no external payment arrears during the programme period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the central government on its contracted or guaranteed

external debt that has not been made within five business days after falling due. The performance criterion will apply on a continuous basis.

13. The stock of external payments arrears of the central government will be calculated based on the schedule of external payments obligations reported by the National Treasury Management Agency. This performance criterion does not cover arrears with regard to trade credits.

II. REPORTING REQUIREMENTS

14. Performance criteria under the programme will be monitored using data supplied to the IMF. The Irish authorities will transmit promptly any data revisions in a timely manner.

- The Department of Finance will report the Exchequer balance to the IMF staff, with a lag of no more than seven days after the test date.

- The National Treasury Management Agency will provide provisional figures on the outstanding stock of net government debt with a lag of no more than seven days after the test date. The revised figures will be provided within three months of the test date.

- The National Treasury Management Agency will provide the final stock of the central government system external payments arrears to the IMF staff, with a lag of not more than seven days after the arrears arise in accordance with the definition of external payments arrears as set forth in paragraph 12 of this memorandum.

Commission services' macroeconomic projections

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

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-1.8	-7.2	-1.4	-1.9	-1.0	0.5	1.6	1.6
2. Government consumption expenditure	2.8	-4.1	-2.2	-5.7	-1.8	-2.4	-3.7	-2.0
3. Gross fixed capital formation	-14.3	-31.1	-21.1	-8.9	1.8	4.3	7.5	5.1
4. Final domestic demand	**-4.6**	**-12.4**	**-5.1**	**-3.8**	**-0.8**	**0.4**	**1.3**	**1.4**
5. Change in inventories								
6. Domestic demand	**-5.0**	**-13.9**	**-4.3**	**-3.4**	**-0.7**	**0.4**	**1.4**	**1.5**
7. Exports of goods and services	-0.8	-4.1	5.7	4.5	4.5	4.6	4.7	4.9
7a. - of which goods	-0.2	-5.2	4.5	5.0	4.8	4.6	4.7	4.9
7b. - of which services	-1.4	-2.9	7.1	4.0	4.2	4.6	4.7	4.9
8. Final demand	**-3.0**	**-9.2**	**0.9**	**0.9**	**2.3**	**2.8**	**3.4**	**3.5**
9. Imports of goods and services	-2.9	-9.7	2.3	0.9	2.7	3.3	3.9	4.2
9a. - of which goods	-13.3	-18.4	0.6	0.7	3.0	3.3	3.9	4.2
9b. - of which services	6.5	-3.3	3.4	1.1	2.5	3.3	3.9	4.2
10. Gross domestic product at market prices	**-3.5**	**-7.6**	**-0.2**	**0.9**	**1.9**	**2.5**	**3.0**	**3.0**
Contribution to change in GDP								
11. Final domestic demand	-4.2	-11.3	-4.4	-3.1	-0.6	0.3	1.0	1.0
12. Change in inventories + net acq. of valuables	-0.4	-1.4	0.7	0.3	0.1	0.0	0.0	0.0
13. External balance of goods and services	1.4	3.8	3.4	3.7	2.5	2.2	1.9	2.0

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

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	1.2	-11.3	-2.8	-1.5	-0.2	2.1	3.5	3.6
2. Government consumption expenditure	9.1	-5.9	-5.0	-4.8	-2.3	-2.0	-3.3	-1.5
3. Gross fixed capital formation	-20.5	-38.0	-25.6	-10.2	2.1	7.0	11.8	10.2
4. Final domestic demand	**-3.8**	**-16.6**	**-7.4**	**-3.5**	**-0.4**	**1.9**	**3.2**	**3.6**
5. Change in inventories	-82.6	-898.7	-52.5	-43.5	-23.9	3.0	-11.0	0.0
6. Domestic demand	**-4.8**	**-18.0**	**-6.5**	**-3.2**	**-0.3**	**1.9**	**3.3**	**3.6**
7. Exports of goods and services	-1.4	-3.6	6.2	5.1	6.6	5.6	5.8	6.0
8. Final demand	**-3.3**	**-11.1**	**0.1**	**1.4**	**3.6**	**4.0**	**4.8**	**5.0**
9. Imports of goods and services	-1.1	-10.1	2.7	1.4	4.9	4.3	4.9	5.2
10. Gross national income at market prices	-5.1	-15.4	-4.7	-0.5	1.0	2.4	4.0	4.4
11. Gross value added at basic prices	-3.9	-9.3	-2.4	1.6	2.7	3.8	4.6	4.8
12. Gross domestic product at market prices	**-5.0**	**-11.3**	**-2.0**	**1.3**	**2.7**	**3.9**	**4.6**	**4.8**

Table 3: Implicit price deflators

% change in implicit price deflator	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	3.0	-4.4	-1.5	0.4	0.8	1.6	1.8	1.9
2. Government consumption expenditure	6.2	-1.8	-2.9	1.0	-0.5	0.4	0.4	0.5
3. Gross fixed capital formation	-7.3	-10.0	-5.6	-1.4	0.3	2.6	4.0	4.8
4. Domestic demand	**0.5**	**-4.9**	**-2.4**	**0.3**	**0.4**	**1.5**	**1.9**	**2.1**
5. Exports of goods and services	-0.7	0.6	0.5	0.5	2.0	1.0	1.0	1.0
6. Final demand	**0.0**	**-2.2**	**-0.9**	**0.4**	**1.4**	**1.2**	**1.3**	**1.4**
7. Imports of goods and services	1.9	-0.4	0.4	0.5	2.1	1.0	1.0	1.1
8. Gross domestic product at market prices	**-1.5**	**-4.0**	**-1.8**	**0.4**	**0.8**	**1.4**	**1.6**	**1.7**
HICP	**3.1**	**-1.7**	**-1.5**	**0.4**	**0.6**	**1.6**	**1.8**	**1.9**

Table 4: Labour market and cost

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Labour productivity	-2.4	0.6	3.9	1.7	1.3	1.3	1.4	1.1
2. Compensation of employees per head	3.4	0.0	-2.1	0.5	0.1	1.1	1.4	1.5
3. Unit labour costs	4.5	-3.5	-5.5	-1.5	-1.2	-0.2	0.0	0.5
4. Total population	1.6	0.6	0.1	0.0	0.1	0.4	0.5	0.5
5. Population of working age (15-64 years)	1.0	-0.1	-0.8	-0.9	-0.8	-0.3	-0.1	0.1
6. Total employment	-1.1	-8.1	-4.0	-0.8	0.5	1.1	1.5	2.0
7. Calculated unemployment rate - Eurostat definition (%)	6.3	11.8	13.6	13.4	12.7	11.6	10.7	10.0

Table 5: External balance

levels	2008	2009	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	81.0	77.0	81.1	85.8	91.4	96.4	102.0	108.1
2. Imports of goods (fob)	57.2	44.7	45.3	45.9	48.1	50.1	52.6	55.4
3. Trade balance (goods, fob/fob) (1-2)	**23.8**	**32.4**	**35.8**	**39.9**	**43.3**	**46.3**	**49.4**	**52.7**
3a. p.m. (3) as % of GDP	*13.2*	*20.3*	*22.9*	*25.1*	*26.6*	*27.4*	*27.9*	*28.4*
4. Exports of services	69.1	67.8	72.7	75.8	80.9	85.4	90.4	95.8
5. Imports of services	76.7	75.7	78.3	79.4	83.3	86.9	91.2	95.9
6. Services balance (4-5)	**-7.5**	**-8.0**	**-5.7**	**-3.6**	**-2.4**	**-1.4**	**-0.8**	**-0.1**
6a. p.m. 6 as % of GDP	*-4.2*	*-5.0*	*-3.6*	*-2.3*	*-1.5*	*-0.9*	*-0.4*	*-0.1*
7. External balance of goods & services (3+6)	**16.3**	**24.4**	**30.1**	**36.3**	**40.9**	**44.9**	**48.6**	**52.6**
7a. p.m. 7 as % of GDP	*9.1*	*15.3*	*19.3*	*22.9*	*25.1*	*26.5*	*27.5*	*28.4*
8. Balance of primary incomes and current	-25.2	-29.2	-31.5	-34.3	-37.2	-40.5	-43.1	-45.7
8a. - of which, balance of primary income	*-22.7*	*-27.0*	*-29.7*	*-32.4*	*-35.4*	*-38.6*	*-41.3*	*-43.8*
8b. - of which, net current Transfers	*-2.5*	*-2.2*	*-1.8*	*-1.9*	*-1.8*	*-1.8*	*-1.8*	*-1.9*
8c. p.m. 8 as % of GDP	*-14.0*	*-18.3*	*-20.1*	*-21.6*	*-22.9*	*-23.9*	*-24.4*	*-24.7*
9. Current external balance (7+8)	**-8.9**	**-4.8**	**-1.4**	**2.0**	**3.7**	**4.4**	**5.6**	**6.9**
9a. p.m. 9 as % of GDP	-5.0	-3.0	-0.9	1.2	2.2	2.6	3.1	3.7
10. Net capital transactions	0.0	-1.3	0.0	0.0	0.0	0.0	0.0	0.1
11. Net lending (+)/ net borrowing (-) (9+10)	**-8.9**	**-6.1**	**-1.3**	**2.0**	**3.6**	**4.4**	**5.5**	**7.0**
11a. p.m. 11 as % of GDP	*-4.9*	*-3.8*	*-0.9*	*1.2*	*2.2*	*2.6*	*3.1*	*3.8*

Table 6: Fiscal accounts

	2008	2009	2010	2011	2012	2013	2014	2015
			% of GDP					
Indirect taxes	12.4	11.3	11.3	11.1	11.1	11.1	11.1	11.2
Direct taxes	11.5	10.7	10.3	11.1	11.7	12.0	12.1	12.1
Social contributions	7.0	7.2	7.3	7.2	7.1	7.0	6.8	7.0
Sales	1.7	2.2	2.4	2.4	2.0	1.9	1.9	1.9
Other current revenue	1.7	1.7	1.8	1.9	1.7	1.6	1.6	1.5
Total current revenue	**34.3**	**33.2**	**33.1**	**33.6**	**33.6**	**33.5**	**33.5**	**33.6**
Capital transfers received	1.2	1.3	2.1	1.3	1.4	1.4	1.4	1.4
Total revenue	**35.4**	**34.5**	**35.2**	**34.9**	**35.0**	**34.9**	**34.8**	**35.0**
Compensation of employees	11.3	12.3	11.7	11.3	10.8	10.2	9.6	9.1
Intermediate consumption	5.5	5.8	5.9	5.2	4.8	4.4	3.9	3.5
Social transfers in kind via market producers	2.0	2.1	2.1	2.0	1.8	1.5	1.3	1.2
Social transfers other than in kind	12.4	15.3	16.1	15.6	14.7	13.7	12.8	12.2
Interest paid	1.4	2.2	3.0	3.8	4.6	6.0	6.2	6.1
Subsidies	0.5	0.5	0.8	0.7	0.7	0.7	0.7	0.6
Other current expenditure	2.5	2.7	2.2	2.1	2.1	2.0	1.9	1.8
Total current expenditure	**35.7**	**40.9**	**41.8**	**40.8**	**39.3**	**38.5**	**36.4**	**34.6**
Gross fixed capital formation	5.2	4.7	4.5	3.5	3.1	2.8	2.4	2.3
Other capital expenditure	1.9	3.2	21.0	1.3	1.1	1.1	1.1	1.0
Total expenditure	**42.7**	**48.9**	**67.2**	**45.5**	**43.6**	**42.4**	**39.9**	**37.9**
General Government balance (EDP)	**-7.3**	**-14.4**	**-32.0**	**-10.6**	**-8.6**	**-7.5**	**-5.1**	**-2.9**
			% change					
Indirect taxes	-11.6	-19.1	-1.9	-0.8	2.5	4.0	5.0	5.3
Direct taxes	-13.9	-17.3	-5.9	9.4	8.4	6.4	5.5	4.5
Social contributions	2.7	-8.8	-0.1	-0.5	0.7	2.1	2.7	7.2
Sales	0.3	17.8	3.6	1.4	-11.3	-5.5	4.6	4.8
Other current revenue	35.6	-9.6	0.5	4.6	-7.3	-0.6	1.7	3.8
Total current revenue	**-7.7**	**-14.1**	**-2.3**	**2.9**	**2.6**	**3.6**	**4.5**	**5.3**
Capital transfers received	-29.1	3.1	50.2	-33.6	6.9	3.1	3.7	4.2
Total revenue	**-8.6**	**-13.5**	**-0.2**	**0.7**	**2.7**	**3.6**	**4.5**	**5.3**
Compensation of employees	7.0	-3.1	-7.0	-2.3	-2.3	-1.6	-1.6	-0.5
Intermediate consumption	3.8	-6.4	-1.3	-9.9	-6.8	-3.8	-7.9	-5.3
Social transfers in kind via market producers	10.8	-5.7	-2.2	-5.3	-7.7	-10.4	-8.5	-6.6
Social transfers other than in kind	13.3	9.1	3.2	-1.6	-3.4	-3.0	-2.0	-0.1
Interest paid	25.1	38.7	38.3	26.7	23.6	36.3	8.5	2.5
Subsidies	7.9	-9.4	38.0	0.0	0.0	0.0	0.0	0.0
Other current expenditure	3.4	-5.8	-21.2	-1.0	0.0	0.0	0.0	0.0
Total current expenditure	**9.2**	**1.8**	**-0.1**	**-1.0**	**-1.0**	**1.8**	**-1.1**	**-0.6**
Gross fixed capital formation	4.9	-18.9	-7.2	-21.4	-7.3	-7.8	-8.5	0.0
Other capital expenditure	69.8	52.2	535.0	-93.9	-6.7	0.0	0.0	0.0
Total expenditure	**10.4**	**1.5**	**34.6**	**-31.4**	**-1.6**	**1.0**	**-1.5**	**-0.5**
Nominal GDP, EUR bn	180.0	159.6	156.4	158.5	162.7	169.0	176.8	185.4

Note:
The general government projections include the measures announced in the National Recovery Plan and the budget for 2011. In 2015, an additional consolidation effort of almost EUR 3 bn is assumed to bring the government deficit below 3% of GDP.

Table 7: Government debt dynamics

	2008	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-7.3**	**-14.4**	**-32.0**	**-10.6**	**-8.6**	**-7.5**	**-5.1**	**-2.9**
EDP gross debt (% of GDP)	44.3	65.5	95.0	112.4	118.7	120.5	119.1	115.5
				levels, EUR bn				
EDP deficit	**-13.1**	**-23.0**	**-50.1**	**-16.7**	**-14.1**	**-12.7**	**-9.0**	**-5.4**
Gross debt	79.8	104.6	148.5	178.1	193.2	203.7	210.7	214.1
Change in gross debt	32.5	24.8	43.9	29.6	15.0	10.6	6.9	3.5
Nominal GDP	180.0	159.6	156.4	158.5	162.7	169.0	176.8	185.4
Real GDP	146.9	135.8	135.5	136.8	139.4	142.8	147.0	151.5
Real GDP growth (% change)	**-3.5**	**-7.6**	**-0.2**	**0.9**	**1.9**	**2.5**	**3.0**	**3.0**
Change in gross debt (% of GDP)	18.0	15.5	28.1	18.7	9.2	6.2	3.9	1.9
Stock-flow adjustments (% of GDP)	10.7	1.1	-4.0	8.1	0.6	-1.3	-1.1	-1.0
				% of GDP				
Gross debt ratio	**44.3**	**65.5**	**95.0**	**112.4**	**118.7**	**120.5**	**119.1**	**115.5**
Change in gross debt ratio	19.3	21.2	29.4	17.4	6.3	1.8	-1.4	-3.6
				Contribution to change in gross debt				
Primary balance	5.9	12.2	29.0	6.8	4.1	1.5	-1.2	-3.2
"Snow-ball" effect	2.7	8.0	4.4	2.5	1.7	1.6	1.0	0.7
of which								
Interest expenditure	*1.4*	*2.2*	*3.0*	*3.8*	*4.6*	*6.0*	*6.2*	*6.1*
Real growth effect	*0.9*	*3.8*	*0.1*	*-0.9*	*-2.1*	*-2.8*	*-3.4*	*-3.5*
Inflation effect	*0.4*	*2.0*	*1.2*	*-0.4*	*-0.8*	*-1.6*	*-1.9*	*-2.0*
Stock-flow adjustments	**10.7**	**1.1**	**-4.0**	**8.1**	**0.6**	**-1.3**	**-1.1**	**-1.0**
Implicit interest rate	*5.2*	*4.3*	*4.6*	*4.1*	*4.2*	*5.3*	*5.4*	*5.4*

Notes:
Gross debt projections include injections of EUR 25 bn of fresh capital into the banking system in 2011, above and beyond the already announced capital injections. If additional capital injections of EUR 10 bn take place in 2012, using the programme's contingency element of EUR 35 bn in its entirety, the debt ratio would peak at just below 124%
Projections assume lower debt issuance / roll-over rates than it is assumed in the table on financing needs and sources, as well as some use of cash balances to reduce the grosss debt.

Financing needs and sources

from 15/12/2010 to end-2013, bn EUR

The drawdown schedule in this table is an indicative scenario estimated by the Commission, IMF and ECB staffs. The actual amounts to be drawn down will be determined on the basis of assessed requirements and will be kept under continuing review.

	Dec-2010 2011-Q1	2011 Q2	2011 Q3	2011 Q4	2010/11 Year	2012 Year	2013 Year	2010-2013 Total
A. Gross financing needs public sector	**16.1**	**10.3**	**4.9**	**8.9**	**40.2**	**29.5**	**29.2**	**98.9**
Exchequer cash deficit, incl. promissory notes 1/	7.0	8.6	4.5	3.1	23.2	18.7	17.4	59.4
Long-term debt securities, maturing	0.0	0.0	0.0	4.4	4.4	5.6	6.0	16.0
Short-term debt, maturing	7.0	1.4	0.1	1.2	9.6	3.4	3.7	16.7
Treasury Bill	4.7	1.2	0.0	0.1	6.0	2.0	2.0	10.0
Commercial paper	2.3	0.1	0.1	1.1	3.6	1.4	1.7	6.7
Retail debt	2.1	0.3	0.3	0.3	3.0	1.8	2.1	6.9
B. Debt issuance/ Roll-over	**5.4**	**1.5**	**1.0**	**2.0**	**9.8**	**12.3**	**26.8**	**48.9**
Exchequer cash deficit, financing	0.0	0.0	0.0	0.0	0.0	3.7	14.0	17.7
Long-term debt securities , issuance	0.0	0.0	0.0	0.0	0.0	1.1	4.8	5.9
Short-term debt, issuance	2.7	0.5	0.1	1.1	4.5	3.7	3.8	12.0
Treasury Bill	1.6	0.4	0.0	0.0	2.0	2.0	2.0	6.0
Commercial paper	1.2	0.1	0.1	1.1	2.5	1.7	1.8	6.1
Retail debt	2.7	0.9	0.9	0.9	5.4	3.8	4.2	13.3
C. Net financing needs public sector (A-B)	**10.7**	**8.8**	**3.9**	**7.0**	**30.4**	**17.2**	**2.5**	**50.0**
Budget deficit and promissory notes	7.0	8.6	4.5	3.1	23.2	15.0	3.5	41.7
Long-term debt	0.0	0.0	0.0	4.4	4.4	4.5	1.2	10.0
Short-term debt	4.3	0.8	0.0	0.1	5.1	-0.3	-0.2	4.6
Treasury Bill	3.2	0.8	0.0	0.1	4.0	0.0	0.0	4.0
Commercial paper	1.1	0.0	0.0	0.0	1.1	-0.3	-0.2	0.6
Retail debt	-0.6	-0.6	-0.6	-0.6	-2.4	-2.0	-2.1	-6.4
D. Bank recapitalization	**13.8**	**7.5**	**3.7**	**0.0**	**25.0**	**5.0**	**5.0**	**35.0**
Direct capital injection 2/	7.0	0.0	0.0	0.0	7.0	0.0	0.0	7.0
Further capital provisions	6.8	7.5	3.7	0.0	18.0	5.0	5.0	28.0
TOTAL - FINANCING NEEDS (C+D)	**24.5**	**16.3**	**7.6**	**7.0**	**55.4**	**22.2**	**7.5**	**85.0**
FINANCING and PHASING								
Use of Ireland's financial buffers 3/	**6.9**	**3.8**	**1.9**	**0.0**	**12.5**	**2.5**	**2.5**	**17.5**
EU-IMF loan disbursement	**17.6**	**12.6**	**5.8**	**7.0**	**42.9**	**19.7**	**5.0**	**67.5**
EU	11.7	8.4	3.9	4.6	28.6	13.1	3.3	45.0
IMF	5.9	4.2	1.9	2.3	14.3	6.6	1.6	22.5
TOTAL - FINANCING	**24.5**	**16.3**	**7.6**	**7.0**	**55.4**	**22.2**	**7.5**	**85.0**

Notes:

1/ Includes interest payments.

2/ Capital injections to domestic banks to meet higher Core Tier 1 ratios.

3/ Includes Treasury cash buffer and investments by the National Pension Reserve Fund.