EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS
Economics of the Member States III

# First Post-Programme Surveillance Review for Ireland

**PolicyBrief**

**EU LIMITED**
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## ACKNOWLEDGEMENTS

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## Executive Summary

**Jointly with the ECB and the IMF, an EC mission will visit Dublin during April 29-May 2 to conduct the first post-programme surveillance (PPS) review for Ireland.** The IMF will be conducting its first post-programme monitoring (PPM) mission. The European Stability Mechanism (ESM) will participate in the meetings on aspects related to its own Early Warning System. The main objective of PPS is to assess the country's capacity to repay the loans granted under the expired EU/IMF programme and, if necessary, to recommend corrective actions. The capacity to repay reflects fiscal, structural and financial developments and how they affect the growth prospects of the Irish economy.

**The economic and financial situation remains positive in Ireland since the completion of the EU/IMF supported programme at the end of 2013, though challenges lie ahead.** Demand for Irish assets from national and international investors is high as the authorities resume normal market borrowing. At -0.3% real GDP growth was below expectations in 2013, and in conflict with other economic indicators especially employment. High-frequency indicators continue to point to a solid recovery in 2014. In first few months of the year, unemployment remained on a downward path and the property market is picking up, though the highly leveraged private and public sectors inhibit a faster recovery, especially of private consumption. This highlights the importance of continued fiscal consolidation and, in particular, of financial repair so as to revive domestic credit growth and underpin growth prospects.

**Key objectives of the review and proposed mission positions:**

i. **Fiscal policy.** The 2014 general government deficit is projected to decline further to 4.8% of GDP, below the EDP deficit ceiling of 5.1% of GDP. Implementation risks relate particularly to the health sector, which will be discussed with the authorities. The mission will seek clarification on the 2015 fiscal plans as although the authorities remain committed to reducing the fiscal deficit below 3% of GDP, this commitment is not yet supported by specific adjustment plans. The mission will reiterate aligning better the domestic fiscal framework with the EU requirements.

ii. **Financial sector.** The financial implications of the Irish Balance Sheet Assessment (BSA) completed at the end of 2013 have been partly reflected in banks' 2013 financial statements, both in terms of provision increases and risk-weighted-asset (RWA) adjustments. The mission will investigate progress and preparations for the ECB's upcoming Comprehensive Assessment (CA), which includes not only a point-in-time asset quality review, but also forward-looking bank stress tests and a supervisory risk assessment, covering also liquidity and funding risks. The mission will also search for an acceleration in the pace of completing sustainable solutions for the still significant number of mortgages in arrears. The progress and impact of the new insolvency framework will also be assessed, and the follow up to the recent working group report on repossessions will be discussed. The mission will continue to urge for more action to address the high level of NPLs in other sectors, particularly SMEs. Efforts at improving the profitability outlook for banks will be examined, and in the context of the CA, the status of PTSB's restructuring and options will be discussed. The recent successful sale of IBRC's loan book will be examined, along with progress towards the eventual (earlier-than-planned) wind down of NAMA. The mission will continue to urge the speedy implementation of the central credit registry.

iii. **Structural reforms.** The mission will follow up on the continuation of important structural reforms from the EU/IMF programme. With regards to the new labour activation system, the mission will urge the authorities to put in place measures in providing services to the unemployed and to complete reforms to further education and training. Additional clarity will be sought on the funding model for Irish Water and plans to phase down state support for the sector. The use of the proceeds of state assets will be examined. Measures to revive credit to SMEs will be discussed, including plans to set up a new bank. The mission will press for faster progress towards the enactment of the Legal Services Bill as this is important to increase Ireland's competitiveness. The mission will follow up on measures aimed at generating savings in the healthcare sector, in particular boosting the usage of generics.

**Media relations.** The mission will issue a concluding joint press statement with the ECB (subject to hierarchy's review at HQ). Ideally, the press statement should be co-signed by the IMF. However, so far the Fund expressed a preference for a separate press statement, although it will be necessary to align the main messages. There will be no final press conference on the EC/ECB side.

**Roadmap for completion of the PPS review.** The review would be considered by EFC/EWG in their 12-13 June meetings. It would be sent to the ECON committee of the European Parliament and to the national parliament thereafter. The first PPS review report will be published on the ECFIN website as an occasional paper in late June.

# 1 Introduction

**An EC mission will visit Dublin during April 29-May 2 to conduct, jointly with the ECB and the IMF's post-programme monitoring (PPM) mission, the first post-programme surveillance (PPS) review.** Under Regulation (EU) No 472/2013, PPS will apply until at least 75% of the financial assistance received under the programme has been repaid [1] so as to ensure that Ireland maintains its capacity to service its debt to the EFSM, EFSF and bilateral lenders. Under PPS, the Commission is requested, in liaison with the ECB, to (i) conduct regular review missions in the Member State to assess its economic, fiscal and financial situation; and (ii) prepare semi-annual assessments of Ireland's economic, fiscal and financial situation and determine whether corrective measures are needed. The assessment is to be communicated to the competent committee of the European parliament, to the Economic and Financial Committee and to the Irish parliament. Acting upon proposal from the Commission, the Council could recommend Ireland to adopt such corrective measures[2].

**The mission will discuss recent economic and financial developments, along with the outlook, the principal policy challenges, and government funding.** The discussion will mainly focus on (i) the implementation of the 2014 budget, the details of the 2015 budget and medium-term fiscal strategy; (ii) the ongoing reforms of the financial sector with regards to arrears resolution, the preparation for the ECB's Comprehensive Assessment (CA) this year, and the restructuring plans of the domestically-owned banks; and (iii) the leftovers from the financial assistance programme in the area of structural reforms, including in particular the labour market.

# 2 Recent economic developments and outlook

**GDP growth in 2013 disappointed on the downside and contradicts positive indications from high-frequency indicators, as inflation remained low.** Real GDP shrank by 0.3% year-on-year (yoy) in 2013 (+0.3% in the Commission services 2014 Winter forecast), with a disappointing contribution to growth from the final quarter

1 Under the current repayment schedule, this means PPS will last until 2031 at the earliest.

2 Further details on post-programme surveillance are to be found in Article 14 of Regulation (EU) 472/2013.

related to a surge in imports and sluggish private consumption. For 2013, real private consumption shrank by 1.1% yoy. While this may in part reflect ongoing deleveraging, statistical anomalies in the construction of the private consumption price deflator may have also impacted[3]. Investment grew at 3.6% in real terms in 2013, albeit from very low levels. The more robust performance of GNI in 2013, at 3.4% yoy, coupled with positive signal from soft and high-frequency indicators, reflects the relative health of the economy, which has benefited from a relative stabilisation of domestic demand[4]. The positive difference between GDP and GNI narrowed in 2013 due to unusually high imports of royalties, which are used as a tool for profit shifting out of Ireland by multinational companies. GDP growth has been also weighed down by the effect of expiring patents in foreign firms (see next paragraph). Confidence in the economic recovery was evidenced by a surge in machinery investment at the end of 2013, and a steady increase in construction though from very low levels. Inflation has remained muted, with HICP inflation at 0.5% yoy in 2013, well below the euro-area average of 1.3%. This was due to lower energy prices, low imported inflation and the lack of wage pressures in the domestic economy.

**The 'patent cliff' continues to weigh on goods exports, while services exports and the current account balance strengthened.** The dampening effect of patent expirations for some pharmaceutical products hides steady improvements in other categories of goods exports, for which the three-month annual moving average was 5.9% to January 2014. Real services exports grew by 3.9% yoy in 2013, bolstered by competitiveness gains and a favourable business climate for the mostly foreign-owned companies operating in the information and communication technology (ICT) and financial services sectors. Overall the current account position further improved in 2013 to 6.6% of GDP, aided by a large drop in factor income outflows, which fell by 9.2% yoy. Ireland maintained a large positive trade balance in 2013 of 23.3% of GDP.

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[3] In addition to HICP consumption items, the National Statistics Office (CSO) includes imputed rents in the basket used to calculate the private consumption deflator. Thus, an increase in actual rents paid by tenants (which rose 8.5% yoy in December 2013), impacts the private consumption price deflator more than five times as much as it affects HICP inflation, given roughly 85% of homes are owner-occupied.

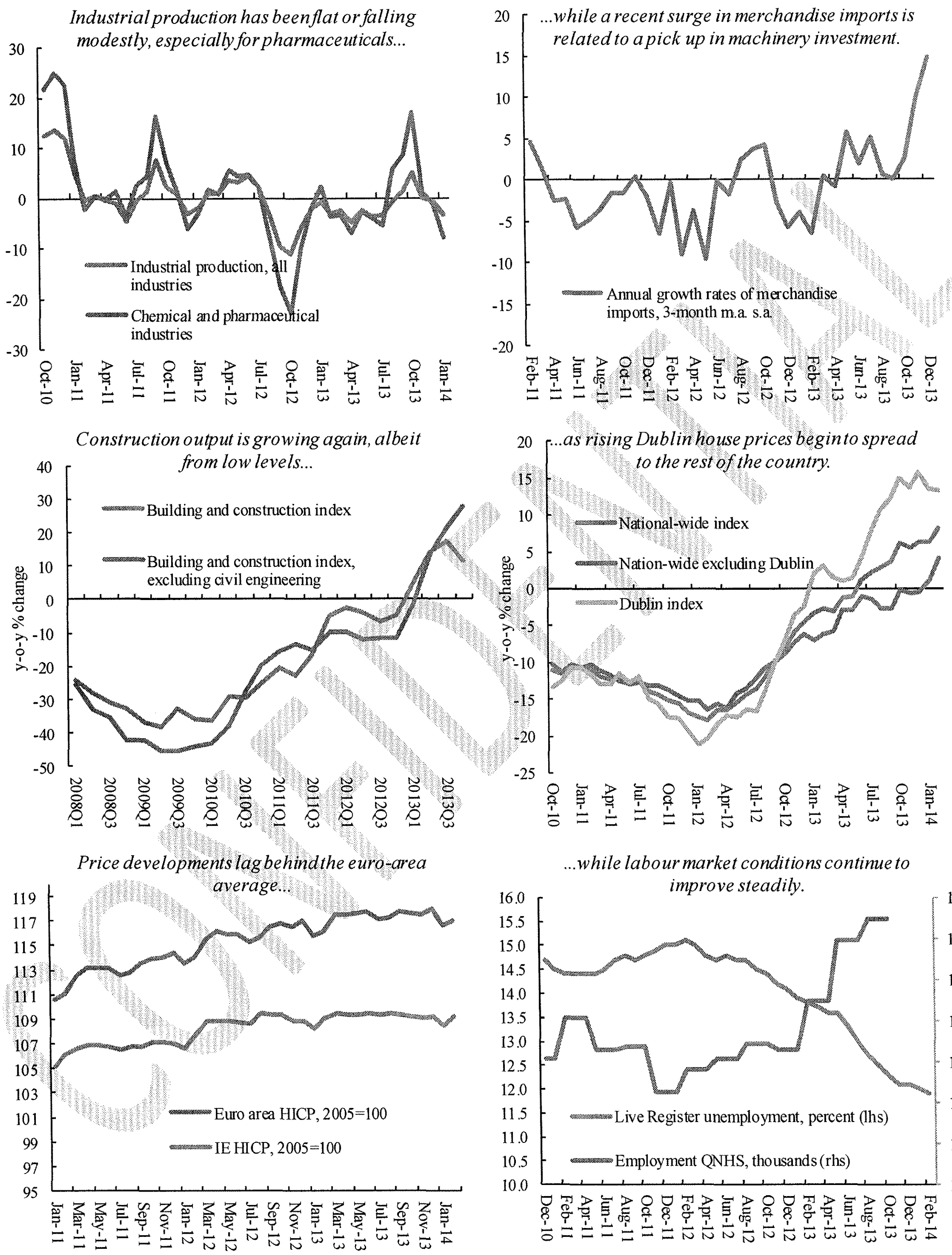
[4] The quarterly national accounts series is highly volatile in Ireland and subject to frequent, large revisions. For instance, the first two quarters of 2013 came out fairly negative in the first national accounts estimates and were revised upward significantly later on, closing the gap with respect to signals from high-frequency indicators.

**Improvements in the labour market continue to outpace growth**. In 2013, employment rose by 2.4% yoy. The standardised unemployment rate has dropped steadily since February 2012 to 11.8% seasonally adjusted (sa) in March 2014, compared to 11.9% for the euro-area average. Recent Eurostat data shows that though long-term unemployment remains high at 63.9% of the total unemployed in the third quarter of 2013, it has declined since the beginning of 2012. Similarly, youth unemployment fell to 24.2% in the third quarter of 2013, down from its high of 33.0% in the second quarter of 2012.

**The housing market has stabilised and prices have recovered.** Property prices began to rise in 2013 and were up 8.1% yoy in February 2014. The national figure continue to disguise divergent regional trends, as a supply shortage in Dublin continues to drive the price increases, whereas price growth in Cork and Galway has turned positive but remains flat elsewhere in the country. A 16.5% increase yoy in new home starts in January 2014, with a strong focus on Dublin activity, reveals the market is responding to rising prices. Still, the lag to completion implies continued low levels of supply for much of this year.

## Figure 1: Recent economic developments

**Figure 1. Recent economic developments**




Sources: CSO, Eurostat

**The general government deficit narrowed by 1 percentage point of GDP in 2013 to 7.2% of GDP, below the EDP ceiling of 7.5% of GDP.** The outturn is in line with the Winter 2014 forecast: a negative GDP denominator effect is offset by positive cash-accrual adjustments in the notified 2013 deficit estimate. Public finances in 2013 were broadly in line with expectations. Weaker VAT revenue was offset by somewhat stronger corporation and labour tax revenue. Overall expenditure developments were on track, while some overruns in the health sector (0.1% of GDP) were offset by savings in other areas. The government debt peaked at 123.7% of GDP at the end of 2013.

**Public finances were on track in the first quarter of 2014.** Tax returns were somewhat better than expected by the authorities (almost 0.2% of GDP), in particular excise revenue were boosted by a strong pick up in car sales and taxes on labour were above expectations. Overall spending was lower than planned (less than 0.1 % of GDP). Most of the government departments show small savings, except for the health sector. Annualised overruns in the health sector would amount to some 0.1% of GDP.

**Table 1: Main elements of the draft Spring 2014 forecast**

**Main elements of the draft Spring 2014 forecast**

| | | 2012 | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | bn EUR | Curr. prices | % GDP | 94-09 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| GDP | | 163.9 | 100.0 | 5.7 | -1.1 | 2.2 | 0.2 | **-0.3** | **1.7** | **2.9** |
| Private Consumption | | 78.3 | 47.8 | 4.9 | 0.4 | -1.4 | -0.3 | **-1.1** | **0.4** | **0.8** |
| Public Consumption | | 29.4 | 18.0 | 4.6 | -4.9 | -2.9 | -3.2 | **-0.6** | **-2.4** | **-0.5** |
| Gross fixed capital formation | | 17.5 | 10.7 | 5.4 | -22.7 | -9.1 | -0.6 | **3.6** | **12.0** | **6.5** |
| of which: equipment | | 6.8 | 4.2 | 6.6 | -11.2 | -1.6 | 2.3 | **-8.5** | **12.0** | **5.1** |
| Exports (goods and services) | | 176.7 | 107.8 | 9.7 | 6.4 | 5.4 | 1.6 | **0.2** | **2.8** | **3.7** |
| Imports (goods and services) | | 137.0 | 83.6 | 9.0 | 3.6 | -0.4 | 0.0 | **1.0** | **2.8** | **2.6** |
| GNI (GDP deflator) | | 133.9 | 81.7 | 5.1 | -0.2 | -1.4 | 0.8 | **3.4** | **0.4** | **3.5** |
| Contribution to GDP growth: | Domestic demand | | | 4.3 | -4.4 | -2.4 | -0.8 | **-0.3** | **1.1** | **1.1** |
| | Inventories | | | 0.1 | 0.6 | 0.9 | -0.5 | **0.2** | **-0.1** | **0.0** |
| | Net exports | | | 1.7 | 3.1 | 5.7 | 1.6 | **-0.7** | **0.7** | **1.8** |
| Employment | | | | 3.1 | -4.1 | -1.8 | -0.6 | **2.4** | **2.4** | **2.3** |
| Unemployment rate (a) | | | | 7.2 | 13.9 | 14.7 | 14.7 | **13.1** | **11.6** | **10.9** |
| Compensation of employees / head | | | | 4.7 | -3.8 | -0.1 | 0.8 | **-1.7** | **-0.8** | **0.5** |
| Unit labour costs whole economy | | | | 2.1 | -6.7 | -4.0 | 0.0 | **1.0** | **-0.1** | **-0.1** |
| Real unit labour cost | | | | -0.4 | -5.3 | -4.6 | -0.6 | **0.6** | **-1.4** | **-1.4** |
| Saving rate of households (b) | | | | - | 13.2 | 11.2 | 10.2 | **12.3** | **11.6** | **14.6** |
| GDP deflator | | | | 2.6 | -1.5 | 0.7 | 0.7 | **0.4** | **1.3** | **1.2** |
| Harmonised index of consumer prices | | | | - | -1.6 | 1.2 | 1.9 | **0.5** | **0.6** | **1.1** |
| Terms of trade goods | | | | 0.1 | -3.6 | -6.2 | -0.7 | **-0.2** | **0.4** | **0.1** |
| Trade balance (c) | | | | 19.9 | 22.6 | 22.6 | 22.2 | **19.6** | **18.2** | **17.8** |
| Current-account balance (c) | | | | -0.5 | 1.1 | 1.2 | 4.4 | **6.6** | **6.7** | **8.3** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | -0.1 | 0.7 | 1.1 | 3.2 | **6.6** | **7.1** | **8.1** |
| General government balance (c) | | | | -0.5 | -30.6 | -13.1 | -8.2 | **-7.2** | **-4.8** | **-4.2** |
| Cyclically-adjusted budget balance (c) | | | | -0.9 | -28.6 | -12.6 | -7.9 | **-6.1** | **-3.7** | **-3.7** |
| Structural budget balance (c) | | | | - | -9.3 | -8.4 | -7.9 | **-6.0** | **-3.9** | **-3.6** |
| General government gross debt (c) | | | | 47.0 | 91.2 | 104.1 | 117.4 | **123.7** | **120.9** | **119.9** |

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

**The Irish sovereign and banks continue to benefit from regained market confidence.** After a heavily subscribed issuance of EUR 3.75 billion at a yield of 3.54% in January, the National Treasury Management Agency (NTMA) sold EUR 1 billion worth of ten-year sovereign bonds at a record low yield of 2.97% in mid-March. The favourable outcome was in the context of a general drop of sovereign bond yields in the EU. Moreover, in January Moody's raised the long-term credit rating of the Irish government by one notch to investment grade (Baa3). The ten-year bond spread over German Bunds stood near record lows at [140] basis points in mid-April. Domestic banks have also benefitted through low-yield issuances: since September 2013, the three main domestic banks have issued a total of EUR 5.5 billion of new securities, reflecting lower cost of funding. This has contributed to a significant decrease in reliance on ECB funding, which has dropped from 42% of GDP in January 2013 to 22% of GDP in December of the same year. However, a better operating environment and important improvements in profitability prospects did not fully offset the persistent asset quality issues. NPLs as a share of total loans for the three covered Irish banks remain high at 27% in June 2013, while the large amount of loss-generating tracker mortgages on banks' balance sheets also limits profitability. This was reflected in Moody's decision in March to keep the banking sector outlook negative in spite of the recent sovereign upgrade.

**Table 2: Financial sector indicators**

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| **Total assets (% GDP)** | 960.6 | 1006.9 | 965.9 | 807.8 | 713.7 | 613.9 |
| **Share of assets of the five largest banks (%)** | 55.3 | 58.8 | 56.8 | 53.2 | 56.9 | - |
| **Non-performing loans ratio (%)** | 1.9 | 9.8 | 12.5 | 16.1 | 24.6 | 24.6 |
| **Capital adequacy ratio (%)** | 12.1 | 12.8 | 14.5 | 18.9 | 19.2 | 21.1 |
| **Return on Equity ratio (%)** | 1.3 | -35.8 | -41 | -10.8 | -7.8 | -3.1 |
| **Credit growth (% y-o-y)** | 1.4 | -5.6 | -12.3 | -4.7 | -2.6 | -6.8 |
| **Lending for house purchase (% y-o-y)** | -6.9 | -4.1 | -2.5 | -0.9 | 6.6 | -1.7 |
| **Loan to deposit ratio (%)** | 179 | 162 | 141.7 | 133.4 | 128.7 | 113.3 |
| **Central Bank liquidity (% liab.)** | 5.6 | 6 | 8.7 | 9.1 | 10.9 | 4.5 |

Source: ECB, IMF

**Mortgage arrears remain high but have begun to decline.** Mortgage arrears of over three months duration (which corresponds to the EBA definition of a non-performing loan) were 19.6% of total mortgage loans in final quarter of 2013 and fell by 1141 cases from the previous quarter, or by 1.1% quarter-on-quarter (qoq). This was the first decline in over 90-days past due mortgage arrears since September 2009 when the data series was created. The only category of arrears that continued to increase, by 4.5% qoq in the fourth quarter of 2013, was the longest-term category (over 720 days past due), in line with prevailing trends in previous quarters.

**In order to meet their Mortgage Arrears Restructuring Targets (MART)[5], monitored by the CBI, banks have increasingly been coming up with "sustainable solution products".** In addition to offering split mortgages[6], banks are involving mediators, cutting interest rates and even proposing substantial debt write-offs in certain cases. There was a notable increase of 3.4% qoq in the number of restructured mortgage accounts in the fourth quarter of 2013, driven mostly by principal dwelling home (PDH)-mortgage restructuring arrangements. However, increasing longest-term arrears signal that banks are still struggling with finding loan restructuring solutions for the toughest arrear cases.

**Net lending to the private sector continued to fall.** Loans for house purchases, which account for 78 per cent of total household loans, declined by 3% yoy in February 2014. Lending to Irish resident non-financial corporations (NFCs) declined by 5.6% yoy in February 2014, following an annual decrease of 5.8 per cent in January. The outstanding amount of credit advanced to Irish SMEs was EUR 67.6 billion at the end of the fourth quarter of 2013, which represented a decrease of 5.5% in annual terms. Despite improving macro-economic conditions, demand for credit remains subdued as the private sector is highly leveraged. Though gradually declining, private sector debt stood at 316% of GDP at the end of September 2013.

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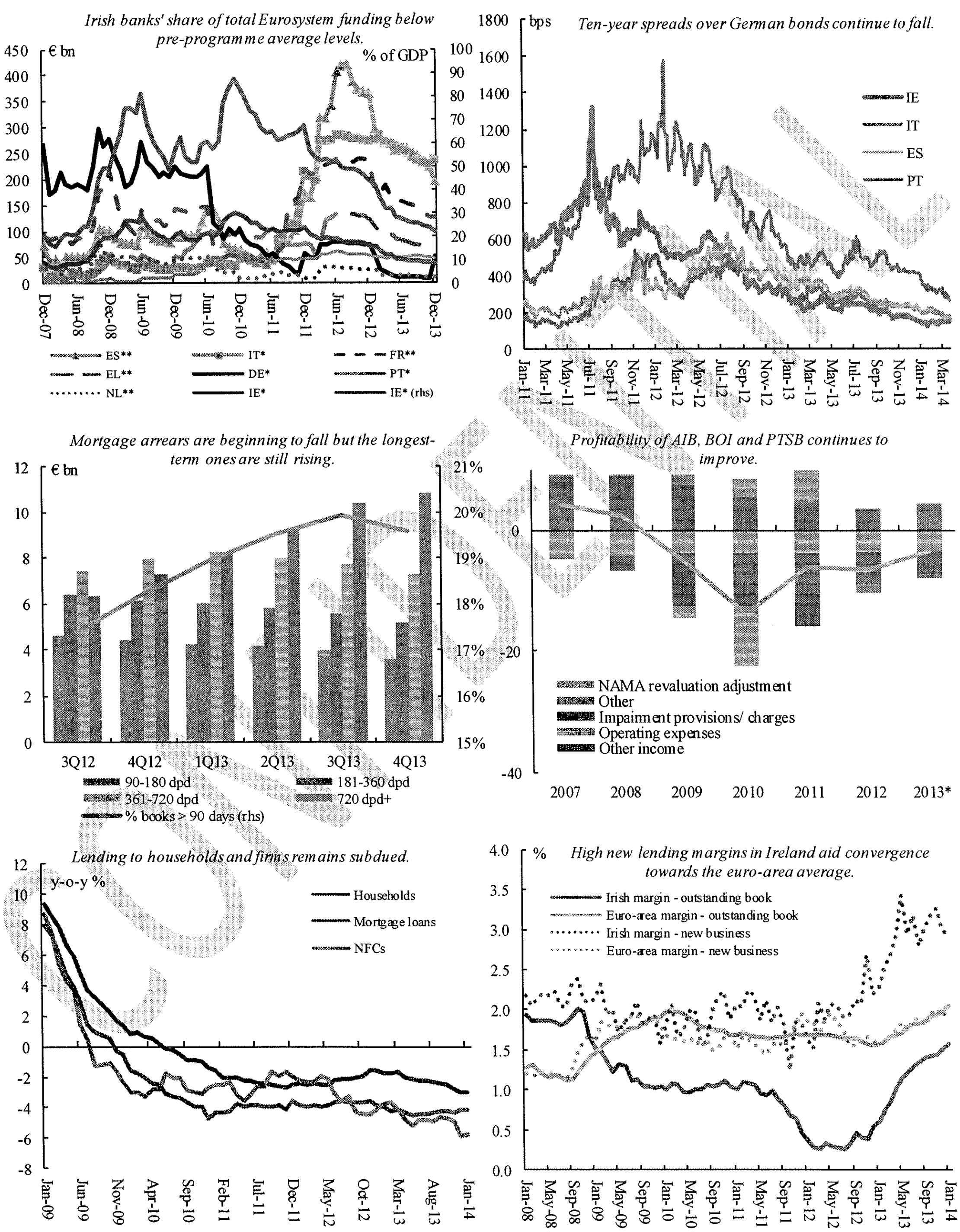
5 CBI's Mortgage Arrears Resolution Targets (MART)

https://www.mortgageholders.ie/media/130313-approach-to-mortgage-arrears-resolution.pdf

6 Split mortgages involve the set-up of two accounts: one which is serviced and the other portion is placed in a "warehouse account" with little or no repayments. In this way, the amount of total monthly repayments is reduced.

# Figure 2: Recent financial developments

**Figure 2. Recent financial developments**




*Related to MPOs **Total to domestic MFIs/not further specified

Sources: Central Bank of Ireland, European Central Bank, iBoxx, annual financial reports of BOI, AIB and PTSB

**Growth in 2014 and 2015 is projected to be driven by a pick up in domestic demand and net exports.** In the Commission services' 2014 Spring forecast, GDP is projected to grow by 1.7% in 2014 and accelerating to 2.9% in 2015, although under the no-policy change assumption this does not account for the effects of further fiscal consolidation required to meet EDP targets. Investment growth will be strong, albeit from low levels; the gradual recovery in private consumption will results in a positive contribution to growth for the first time since 2009. The recovery in key trading partners such as the United Kingdom will further boost net exports in 2014, a trend set to continue into 2015. Improvements in the labour market are expected to continue, with unemployment forecast at 11.4% for 2014, and falling to 10.7% in 2015. Robust employment growth is set to continue and broaden into more sectors.

**Fiscal consolidation is expected to continue in 2014.** The 2014 general government deficit is projected to decline to 4.8% of GDP, below the EDP deficit ceiling of 5.1% of GDP, on the back of a rigorous implementation of the budget and helped by the favourable growth outlook. The forecast includes discretionary measures of 1.5% of GDP, and other deficit improving elements, some of which are temporary. Discretionary measures include tax increases on alcohol and tobacco, on bank deposits, on pension fund assets and on financial institutions. Expenditure measures include further public sector wage savings, and tighter eligibility for social benefits and medical services. The improved employment outlook benefits the fiscal balance as it leads to lower unemployment benefits and higher income and consumption tax receipts. However, savings in unemployment-related benefits may lead to a relaxation of expenditure control in other areas. For example, some of the expected savings have already been reallocated to cover shortfalls in the health sector. In 2015, assuming that no further measures are taken, the general government deficit is projected at around 4.2% of GDP. Government debt is projected to decline further to just under 120% of GDP in 2015.

# Table 3: General government operations

| General government operations | | | |
|---|---|---|---|
| % of GDP | 2013e | 2014f | 2015f |
| Indirect taxes | 11.2 | 11.3 | 11.1 |
| Direct taxes | 13.3 | 13.5 | 13.7 |
| Social contributions | 6.0 | 6.0 | 5.9 |
| Sales | 2.7 | 2.5 | 2.4 |
| Other current revenue | 1.7 | 1.4 | 1.4 |
| Total current revenue | 35.0 | 34.7 | 34.6 |
| Capital transfers received | 0.6 | 0.7 | 0.4 |
| **Total revenue** | **35.6** | **35.5** | **35.0** |
| | | | |
| Compensation of employees | 11.3 | 10.5 | 10.1 |
| Intermediate consumption | 4.8 | 4.6 | 4.4 |
| Social transfers in kind via market producer | 2.6 | 2.6 | 2.5 |
| Social transfers other than in kind | 14.5 | 13.9 | 13.4 |
| Interest paid | 4.7 | 4.7 | 4.9 |
| Subsidies | 0.8 | 0.8 | 0.7 |
| Other current expenditure | 1.2 | 0.9 | 0.9 |
| Total current expenditure | 40.0 | 38.0 | 36.9 |
| Gross fixed capital formation | 1.8 | 1.7 | 1.7 |
| Other capital expenditure | 1.0 | 0.6 | 0.6 |
| **Total expenditure** | **42.8** | **40.3** | **39.2** |
| | | | |
| **General Government balance** | **-7.2** | **-4.8** | **-4.2** |

Source: Commission services

# 3 Policy Issues

## 3.1 Public finances

**Though the 2014 budget is broadly on track, discussions will focus on implementation risks and how to address them.** The 2014 budget was presented to the parliament in October 2013 and most of the legislative and procedural steps were completed by end-2013, some two to three month earlier than in the past. The main risks to the 2014 budgetary plans include overruns in the health sector. More than half of the 2014 expenditure adjustment is expected to impact the health sector, including measures delayed in 2013. Implementation risks stem from a poor past track record in that particular area of the budget. Ambitious budgetary plans were devised for the health sector in 2014 but some savings were revised down in December 2013. For example, savings from increased control of medical cards have been revised down from EUR 113 million to EUR 25 million. The resulting shortfall was compensated from lower unemployment expenditure, due to the improved labour market, and some other savings in health. Major health saving are expected from the implementation of the Haddington Road Agreement, including savings from longer and more flexible working hours and from transferring some tasks from doctors to nurses. Achieving these savings presupposes an effective management and acceptance by staff, which is difficult to predict and garner.

**The mission will seek to clarify fiscal plans for 2015 which remain uncertain.** The authorities remain committed to reducing the fiscal deficit below 3% of GDP in 2015, but this commitment is not supported by specific adjustment plans yet. The draft Stability Programme provided no details on the revenue and expenditure measures for 2015; neither did the additional EDP reporting under Regulation (EU) 473/2013.Details will only be announced in the draft budget in October. Political statements on possible tax cuts have been repeatedly made in the recent past. The mission will underscore that cuts must not jeopardize the timely correction of the excessive deficit. According to the latest Commission services' and the IMF's forecasts, around 1.5% of GDP in consolidation measures are necessary to reduce the deficit to below 3% of GDP by 2015. The mission will discuss areas of adjustment which are supportive of growth and most sustainable (Box 1).

**Box 1: The quality of expenditure adjustment**

**During the boom years between 2000 and 2007, primary government spending increased by 5.7 percentage points of GDP.** According to the functional classification of expenditure[7], the largest increase was recorded in social protection, followed by health, housing and community, and education (graphs 1 and 2). Examining the economic classification of expenditure, the biggest increase between 2000 and 2007 was in social transfers, followed by wages, and capital (graph 3).

**With the sharp economic downturn, primary expenditure continued to increase by 8.0 percentage points of GDP between 2007 and 2009, led by social transfers.** This was largely due to due to shrinking GDP and less so, to automatic stabilizers. Together with a permanent loss of property-related revenue, this resulted in a rapid deterioration of the general government balance from a small surplus of 0.2% of GDP in 2007 to a peak in the underlying deficit of 11.2% of GDP in 2009. The increase in primary expenditure during this period was led by a rise in social protection, largely due to rising unemployment benefits, and in health and education. Nonetheless, expenditures were reduced in housing and community services, transport[8] and environmental protection, as capital spending cuts were the first response to the acute fiscal crisis.

**The large adjustment to primary expenditure started in 2010 with reductions across virtually all functional categories and in capital spending.** Between 2009 and 2012, primary expenditure declined by 4.7 percentage points of GDP with the main reductions in health, economic affairs (including transport), housing and community, education, and social protection (graph 4). The decline in health spending mostly reflected lower purchases of goods and services and gross wage savings. The reduction of social protection expenditure reflected reduced family, children, and sickness and disability benefits, partly offset by an increase in pensions. Education spending cuts were limited as reductions for primary and secondary education were partly offset by increased benefits for tertiary education incentivizing further education of the unemployed. A breakdown by economic category reveals that almost half of the adjustment in 2009 and 2012 was in capital expenditure with the rest coming from wages and purchases of goods and services.

**The expenditure adjustment could have been implemented in a more growth friendly and durable manner.** A reduction of government transfers is generally considered to be less damaging to economic growth than a decrease in capital spending[9]. Looking at Ireland's experience, the sizable reduction in capital expenditure could have a negative effect on the economy's growth potential, although some cut backs to boost efficiency of spending can be justified after a prolonged period of significant investment. There is also evidence that curtailing current spending, particularly in transfers

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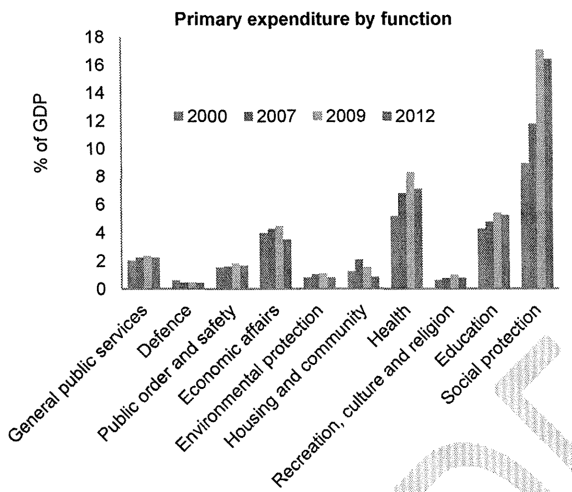
[7] COFOG (classification of the functions of government) data is available until 2012 only.

[8] Cuts in transport are not reflected in graph 2 as it is included in economic affairs.

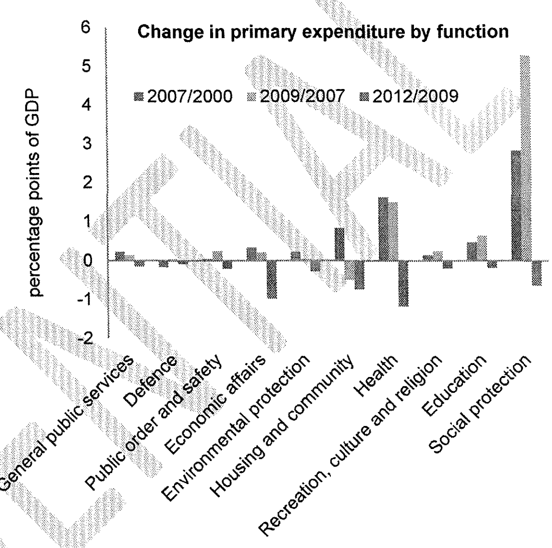
[9] For analysis of the impact of different revenue and expenditure items on economic activity, see chapter I.2 "The impact of fiscal consolidation on Europe's economic outlook" in European Commission, European Economic Forecast - Autumn 2010, European Economy 7/2010.

and subsidies and wages, supports more sustainable adjustments[10]. In Ireland, subsidies and social transfers, which rose significantly before the crisis, have seen limited adjustment though wages have decreased. This suggests there is room to reduce subsidies and social transfers through, for example, reducing or means testing certain general social benefits. Conversely, the protection of education spending is positive as it plays a role in the reskilling of the unemployed and in building human capital which is key to boosting economic growth.

Graph 1. Primary expenditure by functional categories – levels




Graph 2. Primary expenditure by functional categories - change



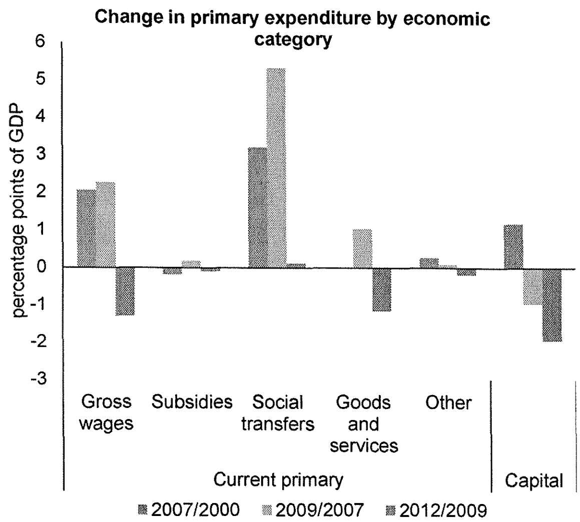

Note: One-off deficit-increasing capital injections into banks are excluded.

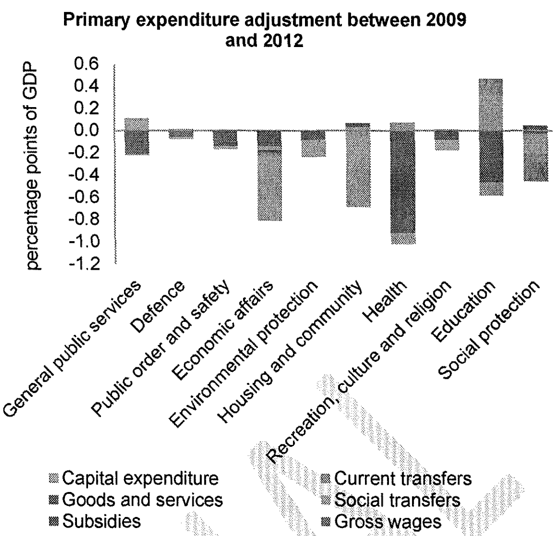


Graph 3. Primary expenditure by economic classification - change

Graph 4. Primary expenditure change in 2009-2012 by economic and functional classification

[10] See *Fiscal Adjustment for Stability and Growth*, Pamphlet Series No. 55, by Daniel, Davis, Fouad, and Van Rijckeghem, IMF 2006.




**Ireland remains compliant with the EDP recommendation.** Nominal deficits have been observed, except for 2015 which is based on the no-policy change forecast, as fiscal consolidation measures are yet to be fully specified. Structural fiscal effort is estimated to be met using the bottom-up estimates. Ireland is on track towards a timely correction of its excessive deficit, provided the 2015 budget is has a fiscal deficit below 3% of GDP.

**Further planned improvements in fiscal data reporting and transparency will be followed up.** The authorities have implemented the EU directive on the budgetary framework by the end-2013 deadline and have started publishing the required fiscal data reports. Reporting standards and compliance with other provisions of the directive are being reviewed by the Commission services for all Member States and some issue can be clarified during the mission. However, the expenditure ceiling framework continues to fall short of EU requirements and recommendations in terms of its binding nature and robustness (as per the EPC policy advice provided for the peer review of national fiscal frameworks in 2012). Expenditure ceilings have been subject to discretionary changes since their introduction in 2012, as rules allowing for the specific adjustment of ceilings are not legally binding.

## 3.2 Financial sector

**Following the completion of the Balance Sheet Assessment (BSA) at the end of 2013, the financial soundness of banks will continue to be a main focus.** The BSA assessed the adequacy of provisions and reviewed the appropriateness of Risk Weighted Assets (RWA). Factoring in these elements, it estimated a point-in-time capital assessment as of June 2013. The BSA results did not call for an increase in capital, as all banks were estimated to have a buffer over the central bank's 10.5% core tier 1 threshold (CET1). The BSA results were reflected in banks' 2013 financial statements as both loan-loss provisions and RWAs were increased, reducing their capital ratios. The banks' end-2013 financial accounts released in March (Box 2), incorporated an updated expected loss treatment, RWA adjustments and revised impairment charges. The main drivers behind this were adjustments in collateral valuations and the re-classification of some restructured loans as impaired, in line with the CBI's revised impairment provisioning guidelines published in May 2013.The mission will follow up any further implications or lessons from the BSA.

**Box 2. Domestic banks' public financial results for 2013**

**Bank of Ireland (BOI)**

**BOI is historically the most resilient of the three main domestic banks,** and showed a core tier 1 capital ratio (CT1) of 12.3% in 2013. The bank was also the first of the three domestically-owned institutions to return to profitability in early 2014, after a loss before taxes of EUR 525 million in 2013 (down 76% from end-2012). In the second half of 2013 net interest income increased by 27%, compared to the same period of 2012, driven by the substantial improvement in the net interest margin (NIM), which rose from 1.34% to 2.03%. Bond issuances in 2013 and 2014 have attracted investors at favourable terms. The bank also had the lowest level of reliance on ECB funding of all three banks, at about 8% of total funding in 2013. Total loan arrears formation stabilised during 2013. In nominal terms, as of December 2013, the value of defaulted loans (in arrears and/or impaired) decreased by EUR 1.2 billion or by 6% since June 2013. The bank's provisioning of NPLs (or coverage ratio) increased to 48% in 2013 from 43% in 2012. With regards to mortgage loans in arrears specifically, they increased to 14.2% in 2013 from 13.1% in the previous year. BOI also announced new lending plans for 2013-2017 of EUR 33 billion in total. BOI's loan-to-deposit (LTD) ratio fell to 114% at end-2013 from 123% the previous year, reflecting also a shrinking balance sheet (down by EUR 36 billion since December 2010).

**Allied Irish Bank (AIB)**

**AIB's financial position continued to improve.** Its annual report revealed that the bank had a CT1 ratio of 14.3% in 2013. It also has a solid liquidity position with its short-term focused liquidity coverage ratio (LCR)[11] at 95% and the medium-term focused net stable funding requirement (NSFR)[12] at 105% in 2013. The bank expects to return to profitability in 2014. Its revenue rose by 34% in 2013, due to a recovery in NIM, a 25% decrease in provisions and a reduction in operating expenses. In 2013, AIB's balance sheet contracted further as a result of deleveraging, lower provisioning, NAMA bond redemptions and weak credit demand. Loan reductions largely resulted in a decrease in risk weighted assets and, together with an increase in deposits of 3% in 2013, led to a significantly more stable LTD ratio of 100% in 2013. However, non-performing loans (NPLs) increased by 2% in 2013, to 35% of total loans. AIB had total provisions of EUR 17.1 billion in 2013, implying a coverage ratio of 55% of impaired loans.

**Permanent TSB (PTSB)**

**PTSB remains the least profitable of the three banks,** due the large proportion of tracker mortgages on its balance sheet. Nonetheless, its capital position remains relatively comfortable given its CT1 ratio of 13.1% in 2013. PTSB closed 2013 with approximately the same losses as in 2012. Including a one-off accounting adjustment for pension schemes and for deferred tax assets, it recorded an after-tax loss of EUR 261 million in 2013. Its funding profile improved with a decline in net loans and an increase in deposits. The LTD ratio fell significantly in 2013 but it is still high at 150%. It sold a EUR 0.5 billion secured residential mortgage backed securities (RMBS) issuance in late 2013 which was three times over-subscribed, due to the high quality of the portfolio selected. PTSB also decreased its reliance on ECB funding in 2013. Still, NPLs continued to increase to 26% of total loans in 2013, from 20% the previous year. Arrears (90 days past due) in primary dwelling homes (PDH) rose by 1.2% in 2013. A reduction was noted, however in the Irish buy-to-let (BTL) mortgage arrears, from 21% in 2012 to 16.9% in 2013. PTSB's total coverage ratio increased to 47% in 2013 from 45% in 2012.

**~~Table 1. Capital Ratios post BSA/~~AQR at end-2013**[13]

| | BOI | AIB | PTSB |
|---|---|---|---|
| **Core Tier 1 Capital Ratio**[11] | 12.3% | 14.3% | 13.1% |
| **CET1 Capital Ratio** | 9% | 10.5% | 10.5% |

[11] The LCR demands that the amount of highly liquid assets (such as cash or Treasury bonds) held by financial institutions in order to meet short-term obligations is equal to or greater than their net cash over a 30 day period (having at least 100% coverage).

[12] The NSFR requires a minimum amount of funding that is expected to be stable over one year based on liquidity risk factors assigned to assets and off-balance sheet liquidity exposures. It is defined as the ratio of the available amount of stable funding to the required amount of stable funding. This ratio must be greater than 100%.

**Preparation for the ECB's Comprehensive Assessment (CA) will be examined.** The CA results will be published in October 2014 ahead of the implementation of the Single Supervisory Mechanism (SSM) in November. The exercise includes an asset quality review (AQR) assessing banks' asset classifications and collateral valuations, as well as the adequacy of their loan-loss provisions, capital and leverage. The reference date for the AQR will be 31 December 2013 and the AQR will be complete by early July. The CA also comprises a stress test, in coordination with the European Banking Authority (EBA) assessing the resilience of banks' balance sheets under forward-looking (three-year) baseline and adverse scenarios. In addition, the ECB is carrying out in parallel a supervisory risk assessment to assess the risk profile of the banks under review (including liquidity and funding risks), which is based on both quantitative and qualitative indicators. The ECB published the methodology of the AQR in March but details of the stress testing methodology and macroeconomic assumptions are still under discussion. In addition to the domestically-owned banks, the CA will cover Ulster and Merrill Lynch. Further clarification will be sought on including the loan-loss estimates for banks and the treatment of forborne exposures relative to those used in the BSA[14]. The mission will assess how likely the forward-looking ECB CA may identify some weaknesses in the banks' capital positions or provisioning needs, particularly for PTSB. The new core tier 1 capital threshold under the CA is 8%.

**Developments on enhancing banks' profitability will be assessed.** Though bank prospects have improved somewhat, low-yielding tracker mortgages remain a drag on banks' profitability, especially for PTSB. Previously the authorities had indicated their preference for the ESM to be involved in a solution for the tracker mortgages, possibly through guarantees. Given the limited political appetite among Member States on enhancing the role of ESM in direct bank recapitalisation, the authorities should continue to explore domestic solutions to reduce the negative carry from trackers by, for example, lowering the marginal cost of funding, or offsetting the drag

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[13] The difference between the two ratios reflects mostly, in the case of Ireland the gradual phasing out of preference shares and deferred tax assets (DTAs) - except as tax credits -, from CET1.

[14] There have been some analyst comments recently suggesting that the ECB exercise may be more stringent on this item relative to the BSA as it may be using the EBA definition on forbearance, which includes a minimum two year adherence to renegotiated terms prior to reclassifying a loan as performing versus the CBI's guidelines requiring one year.

on profitability from trackers by other means. The mission will also seek an update on the outlook for banks in cost reduction and increasing non-interest income.

**The outlook for PTSB and its restructuring plans will be discussed, particularly in the context of its entry to the SSM.** While the improvement in profitability is welcome across the banks, PTSB's 2013 operating loss[15] was largely unchanged from the previous period and as a single legal entity it is not expected to return to profitability until 2017. There have been long delays in the approval of a restructuring plan for PTSB. The last restructuring plan was submitted to DG COMP in November 2013 and PTSB continues to consider restructuring options. In particular, the mission will investigate how PTSB with its large amount of tracker mortgages may be impacted by the ECB's CA ahead of the start of the SSM. PTSB announced it plans to sell its loss-making non-core commercial real estate book in Ireland and its Springboard Mortgage business, which is no longer writing loans and is being wound down. This is planned to take place later in 2014 or 2015 subject to market conditions, and the mission will assess potential implications in particular in terms of expected loss on disposal and attendant capital costs. There has also been press speculation that PTSB or part of it may merge with Ulster bank, but this has not been confirmed, and appears unlikely considering the acquisition ban contained in the Royal Bank of Scotland's (Ulster Bank's parent) state-aid decision.

**The mission will assess the banks' progress in finding sustainable solutions for mortgage arrears.** While the pace of formation of new mortgage arrears continues to fall, the long-term nature of arrears is a key concern. In December 2013, these banks met their mortgage arrears restructuring targets for proposed and concluded solutions and the audit of these results is due end-April. Previous audits have highlighted a number of issues that need to be addressed in order to ensure the solutions are sustainable in the long term for customers. Data from end-2013 suggest that arrears 90 days past due may have already peaked, though the longest-term arrears (of over two years past due) continued to grow. In December 2013, the CBI announced targets for proposed and concluded restructuring solutions for end-June 2014. These entail

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15 The number refers to loss before exceptional items, including a write-back of pension liabilities (EUR 329 million). In addition, there was a EUR 407 million credit from deferred tax assets.

banks to have proposed sustainable solutions to 75% of customers in arrears of over 90 days by the end of June, and to have concluded sustainable restructuring agreements in 35% of these cases. The CBI is considering phasing out proposed targets after June 2014 and extending the concluded targets to 40% for September and to 45% for December 2014. The goal still remains to largely complete the restructuring framework for mortgages in arrears greater than 90 days by end-2014. The mission will seek an update on any issues or concerns that are emerging regarding the restructures undertaken so far. It will also follow up on bank offers, particularly AIB's, to begin proposing, on an individual basis, partial write-offs of mortgage loans in arrears and offering loans with much lower interest rates. Further clarification is needed on the envisaged volume of these proposals and on what are the qualifying factors for customers.

**The mission will continue to call for decisive action to address the high levels of NPLs in other sectors, especially the SME sector.** The mission will seek an update on the progress being made by the banks in meeting their restructuring targets[16] and an update on the CBI's on-site reviews and assessment of the durability of the proposed arrangements. The authorities recently adopted legislation to facilitate SME examinership by the Circuit Court and the mission will seek an update on cases that have gone through this new process. It will also follow up on the Irish Banking Federation's new Protocol on multi-banked SME debt, and on possible plans for banks to implement debt-to-equity swaps. There are concerns over the large stock of NPLs reflecting in many cases property-related exposures loan book of SMEs with limited restructuring prospects. While the levels of provisions held by the banks' against these books are significant, given their size (the coverage ratio of the three PCAR banks ranges from 47% to 55%), the mission will seek an update on the banks' plans in addressing arrears in this sector.

**The mission will follow up on the recent IBRC loan book sale and on any plans for an accelerated NAMA wind down**. The sale and valuation of EUR 21.7 billion

[16] The authorities have set non- public restructuring targets for the two main banks involved in SME lending, consistent with ensuring a migration from short-term forbearance measures to a sustainable solution or recovery for roughly half of their total stock of SME loans in arrears by end-2013, and almost all by end-2014. In March 2014, BOI reported to have concluded deals with 90% of its non-performing SME customers. AIB stated that 60% of its non-performing SME customers have either been permanently restructured or are in the process of a permanent restructure.

of assets by the liquidators of IBRC was completed in the first quarter of 2014. As of April 1, EUR 19.8 billion of the portfolio had been sold to international investors with the liquidators continuing to work to dispose of the remaining assets. Thus, only a small amount will be transferred to NAMA. NAMA anticipates buying the unsold assets at the price set by the liquidators in a number of tranches during the second quarter of 2014. Afterwards, NAMA will manage these assets as it does its current portfolio. The sale of the majority of the IBRC portfolio at prices that are in-line with or above the independent valuations decreases the likelihood of a negative impact on public finances from the IBRC liquidation[17]. NAMA achieved its 2013 target of redeeming EUR 7.5 billion of senior bonds issued to buy bank loans in 2010 and 2011. This leaves EUR 22.7 billion of the original senior bonds outstanding for NAMA. It plans to redeem more bonds, EUR 7.5 billion, by 2016. Ultimately, NAMA will need to manage its balance sheet to zero by 2020.

**Finally the mission will evaluate with the authorities:**

- **The recent experience with the new personal insolvency regime**. The Insolvency Service of Ireland (ISI) began accepting cases in early September. The first results of the reformed system will be seen in 2014. So far, there has been little recourse to the system as it is still being set up. Data for the first quarter of 2014 reveals a low use of the new system, though there has been a rise in the amount of informal deals done outside the ISI remit, i.e. bilaterally between creditors and debtors. There have been complaints on the cost and complexity of the procedures. Two new protocols will be issued in 2014 to address these concerns. The mission will seek an update on the projected levels of activity based on experience to date and plans for improvements.
- **The progress made on restructuring credit unions.** The mission will seek a quantification of potential drawdowns from the restructuring fund in 2014. It will also follow up on plans for 90 credit unions to merge, which could reduce the number of credit unions by about 45, as well as an update on the restructuring of Newbridge Credit Union and any other planned restructurings.

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17 This is because the Department of Finance would have to compensate NAMA for any shortfall arising due to a difference between the sale price and the independent valuation of the assets.

- **The creation of a central credit registry.** The Credit Reporting Act 2013 was enacted in December 2013, and a procurement process was launched. The mission will seek an update on progress in implementing this important initiative.

- **Follow up to the report of the Expert Group on Repossessions and reforms to enhance the efficiency of the repossession system.** The report examined the possibility of introducing expedited proceedings, based on the experience of the Commercial Court,[18] for repossession cases relating to buy-to-let (BTL). Such a fast-track scheme would reduce the costs of BTL repossessions and allow the banks to focus more resources on working with co-operating home owners to find sustainable solutions. However, the report found that this was not necessary for now, though the existing system will remain under review and a fast-track scheme could remain an option for the future. The report did find that there were capacity constraints on the part of lenders in dealing with the large amount of repossession cases, and suggested better and more timely data on repossession be made available. The mission will discuss the report's recommendations and any follow-up actions by the authorities.



[18] The Commercial Court is a division of the High Court that was established in 2004 to provide efficient and effective dispute resolution in commercial cases. The court deals with disputes of a commercial nature between commercial bodies where the value of the claim is at least EUR 1 million. The Court uses a detailed case management system that is designed to streamline the preparation for trial, remove unnecessary costs and stalling tactics, and ensure full pre-trial disclosure.

### 3.3 Structural reforms

**It is important to monitor the continued implementation of structural reforms undertaken under the programme as they will have an impact on Ireland's return to balanced and sustainable growth.** Important structural reforms were advanced during the programme, with a particular focus on active labour market policies, further education and training (FET), the water sector, competition in sheltered sectors and healthcare. The long-term nature of these reforms, together with some delays in implementation, means that work continues on these issues, including on specific goals that were set out in the programme.

**The mission will follow up on the progress made with labour market reforms to lower unemployment.** Ireland adopted the third iteration of its annual *Action Plan for Jobs* at the end of February 2014. The action plan, which coordinates efforts aimed at fostering job creation and improving the investment climate, has generated good momentum for reforms. It has increasingly involved stakeholders in its design and in the monitoring of its implementation. Although the direct impact of measures is difficult to measure, job creation has gained significant momentum in Ireland. As far as active labour market policies are concerned, Ireland ended the programme with all the institutional elements established. Work continues, however, to reach the goal of having all one-stop-shop labour offices (*Intreo*) opened by the end of 2014 and to boost the capacity of *Intreo* offices to deliver support services to the unemployed. In order to reduce costs and boost capacity faster, the authorities have started the process of contracting out the provision of support services to about 100,000 long-term unemployed. This is expected to be complete by early fall and is critical in the fight against (long-term) unemployment.

**Further education and training (FET) reforms will be discussed as they are important to reduce significant skills mismatches.** Improving the skills of the unemployed is also critical to reduce unemployment. Reforms to improve the functioning of the FET system and better align the delivery of FET programmes with the needs of the economy (employers and jobseekers alike). The core elements of the new system were established by the end of the programme, including with the creation of Education and Training Boards (ETBs) and a new supervisory and funding authority for the sector, SOLAS. SOLAS had a deadline of end-March 2014 to submit a strategy for the FET sector to the Minister. The strategy will determine the implementation of FET reforms. The main aspects of the strategy and the next steps in reform implementation will be discussed during the PPS mission, including the critical referral process of jobseekers between *Intreo* offices and ETBs.

**The mission will follow the implementation of the health sector reforms started under the programme.** Key reforms include i) the implementation of reforms to the financial management systems, in particular to ensure more timely budget control; ii) the roll-out of the first phase of the eHealth strategy, including current plans to implement individual health identifiers (IHI); and iii) measures to tackle overspending in the pharmaceutical sector, in particular the completion of reference pricing, the review of the agreement with the patented drugs manufacturers and the implementation of new prescribing guidelines. Other reforms to be discussed include progress on the roll-out of diagnosis related groups in line with the move to Money Follows the Patient funding, the roll-out of free general practitioner care and the fixing of the basket of services under the new Universal Health Insurance (UHI) plan.

**As they reach an important stage, water sector reforms and their fiscal implications will be reviewed.** Water charges for domestic users were initially to be introduced by the end of 2013, but they would be postponed to the final quarter of 2014. All steps are being put in place to prepare for this deadline, which has been publicly announced. The legal framework has been established with the enactment of the Water Services (N 2) Act at the end of 2013. Irish Water, the new water utility company, has also been established and is taking over responsibility for running the sector from local authorities, even though the latter will remain involved. A number of essential issues will be determined soon, including the structure and level of tariffs, the treatment of metered and non-metered customers and the extent of free water allowances for vulnerable groups. Key papers will be released in April and decisions taken in August. These steps will have significant implications for public finances as the sector is almost entirely funded through direct Exchequer support, with total annual expenditure in excess of EUR 1 billion. The level of tariffs will determine not only the amount of spending that will be taken off the general government budget, but also whether Irish Water will be classified by Eurostat as being part of general government, which could impact the measure of the deficit and government debt.

**The Commission will check progress towards the enactment of the Legal Services Regulation Bill.** It will also urge making the future Legal Services Regulatory Authority operational as quickly as possible. The bill was published back in 2011 and was an important programme condition. It has finally moved close to enactment. The bill aims to increase competition in legal services and reduce high legal services costs, which have impeded Ireland's competitiveness and negatively affected the SME sector.

**Given its importance to growth, SME financing will be examined during the mission.** Despite improved trading conditions, SME's demand for credit is low as they remain highly leveraged, although there are also some supply constraints to credit. The SME market is becoming increasingly concentrated with the withdrawal of many foreign banks. This is not conducive to raising the low risk appetite of the remaining banks that endanger meeting the needs of the real economy. The mission will examine the effectiveness of dedicated SME funds put in place by the authorities as they have had limited use. There is a need to enhance SMEs' awareness of the range of SME state support and to boost the financial capacity of SMEs. In particular, the mission will discuss the authorities' plans to pass legislation around May to create a Strategic Investment Bank Project to fund SMEs using funds from KfW and the EIB. As this may involve public money or guarantees, and since there are already many SME funds in place, the mission will try to understand the motivation for this scheme. The authorities have already consulted with DG COMP on this. The mission will also investigate plans to support non-bank financing for SMEs. It will follow up on the work of the expanded Credit Review Office (CRO) which advises SMEs. The CRO recently reported that 55% of appeals it reviewed were found in favour of the borrowers, resulting in additional credit extended to SMEs.

**The use of proceeds from the sale of state assets will be investigated.** During the EU-IMF programme, there was a condition that at least half of the proceeds from asset sales should be used to accelerate debt reduction, but no proceeds were collected. The sale of Bord Gáis Energy has recently been concluded for EUR 1.1 billion. While proceeds will initially accrue to Bord Gáis Eireann, the parent company, they will be eventually transferred to the Exchequer through dividends. Government plans to receive special dividends over several years below the superdividend threshold (so counted as revenue) and then spend these receipts on capital projects. The flow of the funds will be monitored.

# 4 Capacity to repay and financing issues

**The financing outlook will be discussed.** The financing position remains relatively comfortable. The final IMF disbursement under the programme of EUR 0.6 billion EFSM was in December 2013; while the final EFSM disbursement of EUR 0.8 billion was drawn down in March 2014. The NTMA has announced plans to hold one or two auctions of bonds per quarter for the remainder of 2014. It will also issue treasury bills. As of early April, the NTMA had raised EUR 4.75 billion so far in 2014, out of an annual target of EUR 8 billion. Significant debt redemptions reduced the size of the cash buffer at the end of the first quarter of 2014 to EUR 14.7 billion, covering about 18 months financing needs. At the end of 2014, cash balances are projected to decline to EUR 8.8 billion. Given the expected pace of reduction in the borrowing requirement, this is broadly in line with the minister for finance's indication that Ireland is targeting cash buffers sufficient to meet financing needs for 15 to 16 months. The sale of EUR 25 billion in long-term government bonds held by the Central Bank of Ireland, which were issued in exchange for the promissory notes in 2013, is not projected to impact the market as only a minimum EUR 0.5 billion has been agreed to be sold per year initially[19]. [redacted]

[19] The bonds have maturities ranging from 27 years to 40 years with a weighted average maturity of 34.5 years. A minimum of bonds will be sold in accordance with the following schedule: 2014-2018, EUR 0.5 billion per year; 2019-2023, EUR 1billion per year; and 2024 and after, EUR 2 billion per year.

## Table 4: Financing plans

Financing plans

| | 2011 Year | 2012 Year | 2013 Year | 2014 Year | 2015 Year | 2013 - 2015 Total |
|---|---|---|---|---|---|---|
| **A. Exchequer cash deficit 1/** | **18.4** | **16.4** | **11.3** | **9.6** | **6.0** | 26.9 |
| **B. Debt redemption 2/** | **9.7** | **9.4** | **16.0** | **12.7** | **7.5** | 36.1 |
| of which: long term bonds | 4.8 | 6.0 | 5.7 | 7.6 | 3.0 | 16.3 |
| of which: IMF | 0.0 | 0.0 | 0.0 | 0.2 | 0.7 | 0.9 |
| **C. Bank recapitalisation** | **16.6** | **1.6** | **0.0** | **0.0** | **0.0** | 0.0 |
| **D. Other Financing needs 3/** | **0.7** | **-0.2** | **1.0** | **2.5** | **0.0** | 3.5 |
| **E. EU-IMF loan disbursement** | **34.5** | **21.2** | **11.0** | **0.8** | **0.0** | 11.8 |
| EFSM/EFSF | 21.5 | 12.3 | 5.6 | 0.8 | 0.0 | 6.4 |
| Bilaterals 4/ | 0.5 | 2.5 | 1.9 | 0.0 | 0.0 | 1.9 |
| IMF | 12.6 | 6.4 | 3.5 | 0.0 | 0.0 | 3.5 |
| **F. Market Funding** | **1.4** | **12.3** | **18.1** | **12.7** | **16.4** | 47.2 |
| of which: long term bonds | 0.0 | 8.1 | 7.9 | 8.8 | 10.0 | 26.6 |
| **Memorandum item:** | | | | | | |
| Cash balances, eop | 13.0 | 19.3 | 20.0 | 8.8 | 11.7 | |

Notes:

1/ Includes promissory note payments.

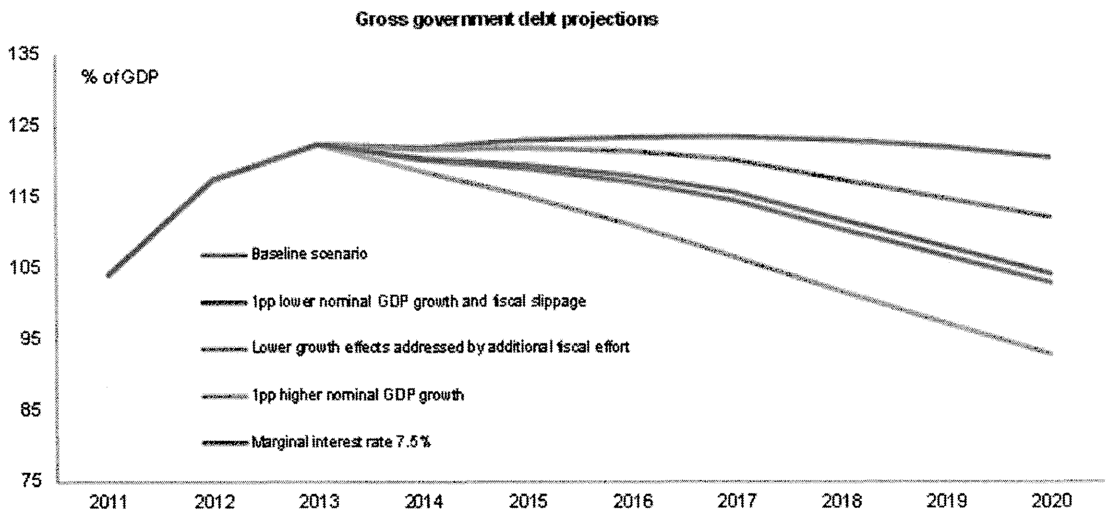
2/ Includes long-term bonds, T-bills, commercial paper and others.

3/ Include contingencies.

4/ Includes UK, Sweden and Denmark.

**Debt sustainability hinges on continued fiscal adjustment and pick-up in economic growth.** The authorities are committed to bring the fiscal deficit below 3% of GDP in 2015 and reach their MTO of structural balance in 2018. Real economic growth is expected at around [3%] of GDP in the medium term, consistent with the long-term potential growth. Achieving high primary surpluses and returning to sustainable growth path would put the government debt on steady downward path. The government debt is assumed to decline to [105%] of GDP in 2020 in the baseline scenario. Main risks to the debt sustainability are related to negative economic growth shocks and the deviation from fiscal adjustment path (see chart). Interest rate risks are estimated to be low due to low future refinancing needs. The PPS report will use the new standardised ECFIN debt sustainability analysis developed by unit C2.

**Figure 3: Gross government debt projections**




[Note, chart needs to be updated with latest forecast numbers.]

## 5 Other issues

### 5.1 Timeline and process

A proposed timeline of events leading to a conclusion of the first review PPS by the Commission (and consultation with the EFC) is presented in Annex 1. The review will be discussed at the EWG/EFC meetings on 12-13 June. A version of the Commission services' report will subsequently be published as an ECFIN Occasional Paper towards late June.

The authorities have tentatively agreed to share individual bank data on the three main domestic banks for PPS, though this is still subject to confirmation by the banks. The data will be shared with the Commission services until April next year, when the SSM is in place. At that time, they will then reconsider whether to continue or not. Given the vulnerabilities that still exist in the financial sector and its potential impact on public finances, this data is essential to monitor the ability of the sovereign to repay its debts.

During the 2014 in-depth review on macroeconomic imbalances procedure (MIP) for Ireland, it was concluded that remaining imbalances require decisive policy action and specific monitoring of the implementation of MIP-related country specific recommendations (CSRs). PPS in case of Ireland will also cover the specific monitoring of the adjustment of macroeconomic imbalances in the context of the MIP.[20] However, since a first full set of CSRs for Ireland will only be issued in June this year, specific monitoring will be launched with the second PPS mission.

## 5.2 Press plans

There will be a joint EC and ECB press release after the mission. The IMF has expressed a clear preference for a separate statement, which in terms of content would be aligned with the EC/ECB text. Commission services will not participate in any press conference at the end of the mission.



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20 See Communication from the Commission to the European Parliament, the Council and the Eurogroup: "Results of in-depth reviews under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances" http://ec.europa.eu/economy_finance/economic_governance/documents/2014-03-05_in-depth_reviews_communication_en.pdf

## List of Abbreviations

| | |
|---|---|
| AIB | Allied Irish Bank |
| BoI | Bank of Ireland |
| BTL | Buy-to-let |
| CBI | Central Bank of Ireland |
| CSO | Central Statistics Office Ireland |
| CSR | Country specific recommendation |
| CCR | Centralized Credit Registry |
| CRO | Credit Review Office |
| DoF | Department of Finance |
| EC | European Commission |
| ECB | European Central Bank |
| EBA | European Banking Authority |
| EDP | Excessive deficit procedure |
| EFC | Economic and Financial Committee |
| EFSF | European Financial Stability Facility |
| EFSM | European Financial Stabilisation Mechanism |
| ESM | European Stability Mechanism |
| ETB | Education and training boards |
| FET | Further education and training |
| HICP | Harmonised Index of Consumer Prices |
| IBRC | Irish Bank Resolution Corporation |
| IFRS | International Financial Reporting Standards |
| IMF | International Monetary Fund |
| LDR | Loan-to-deposit ratio |
| MART | Mortgage Arrears Restructuring Targets |
| MIP | Macroeconomic imbalance procedure |
| MTO | Medium-term Objective |
| NSFR | Net stable funding ratio |
| NAMA | National Asset Management Agency |
| NTMA | National Treasury Management Agency |
| PDH | Primary dwelling home |
| PPS | Post-programme surveillance |
| PPM | Post-programme monitoring |
| qoq | quarter-on-quarter |
| SME | Small and medium enterprises |
| SSM | Single Supervisory Mechanism |
| SRM | Single Resolution Mechanism |
| VAT | Value Added Tax |
| yoy | year-on-year |