Ireland: Macro-Financial Review

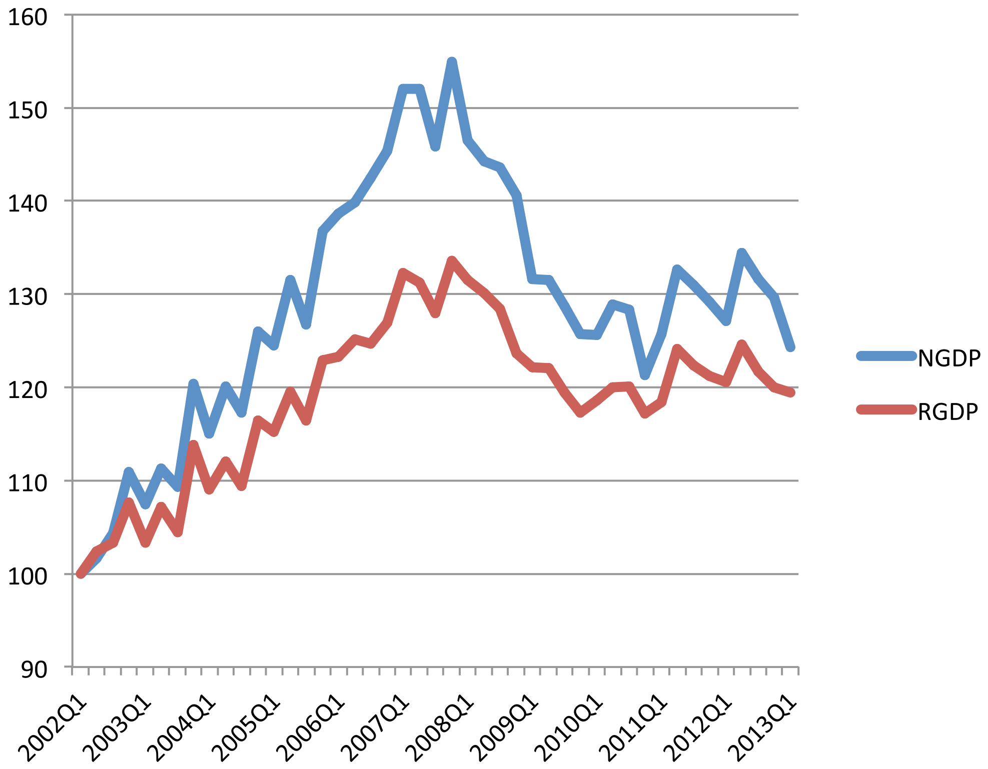
Philip R. Lane, Trinity College Dublin and CEPR

September 2013

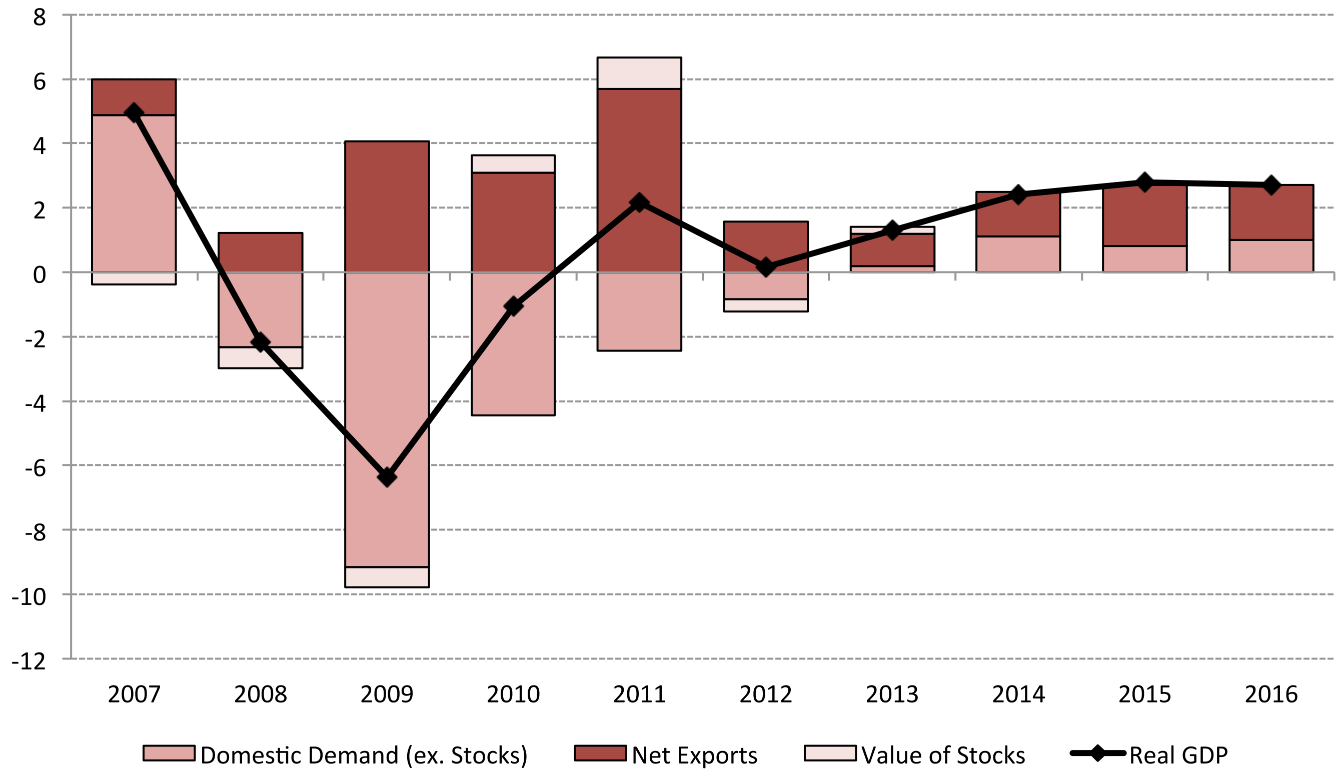
Outline

- Macroeconomics
- Fiscal Adjustment
- Banking Sector
- Future Prospects

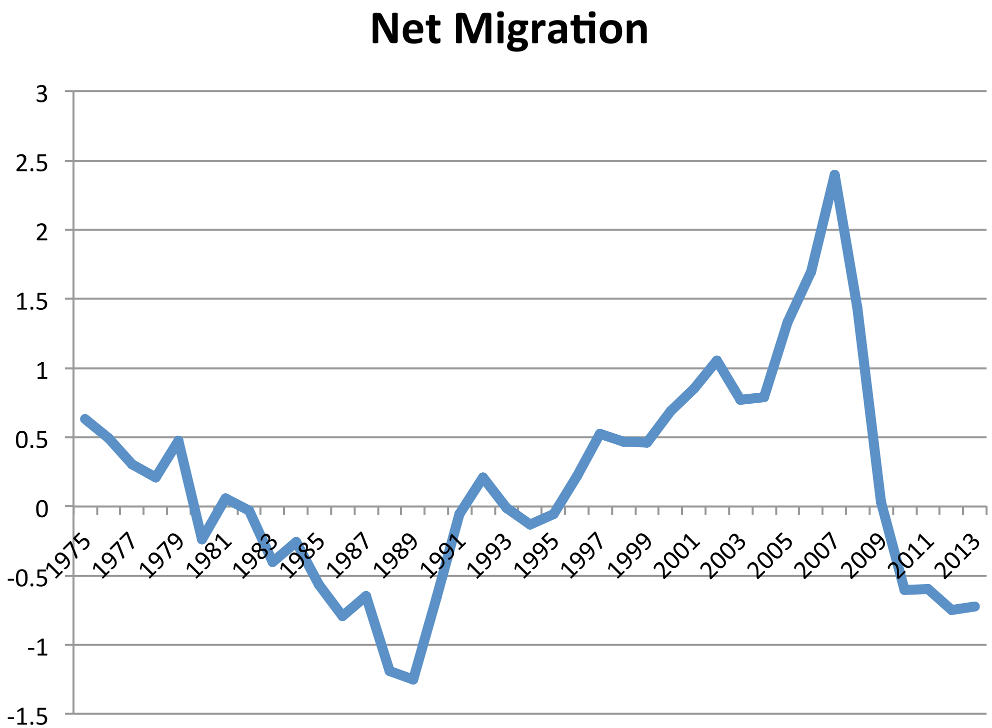
Ireland: Nominal and Real GDP



Composition of Irish Output Growth, 2007-2016 (NTMA)



Ireland: Net Migration



Growth Strategy

- Return to FDI-orientated pro-business focus
- Maintain low corporate tax rate; limit tax increases on mobile labour
- Improvement in cost base: cheaper commercial property (buy/rent); reduction in living costs; decline in hiring wages
- (But wages of existing workers quite rigid)
- Good fortune: social media cluster; offshore finance; agriculture
- Exports of services
- To come: resumption of domestic consumption/investment, tapering of fiscal austerity
- Confidence effects; accelerator effects; balance sheet repair; credit normalisation

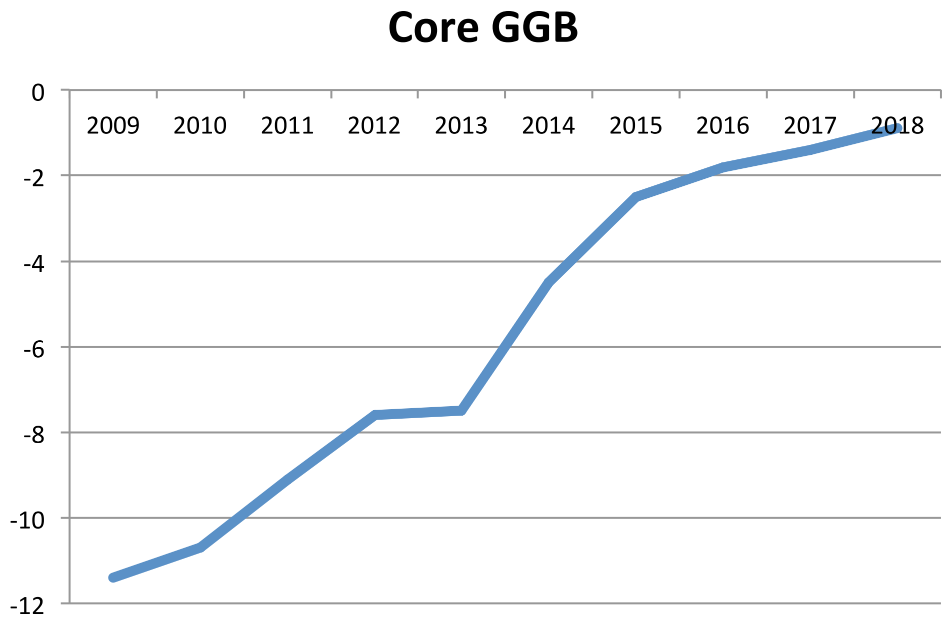
Longer-Term Growth Issues

- US tax reform?
- Reversals in globalisation of finance and production?
- Growth pessimism
- Scars from unemployment and emigration
- Debt overhangs

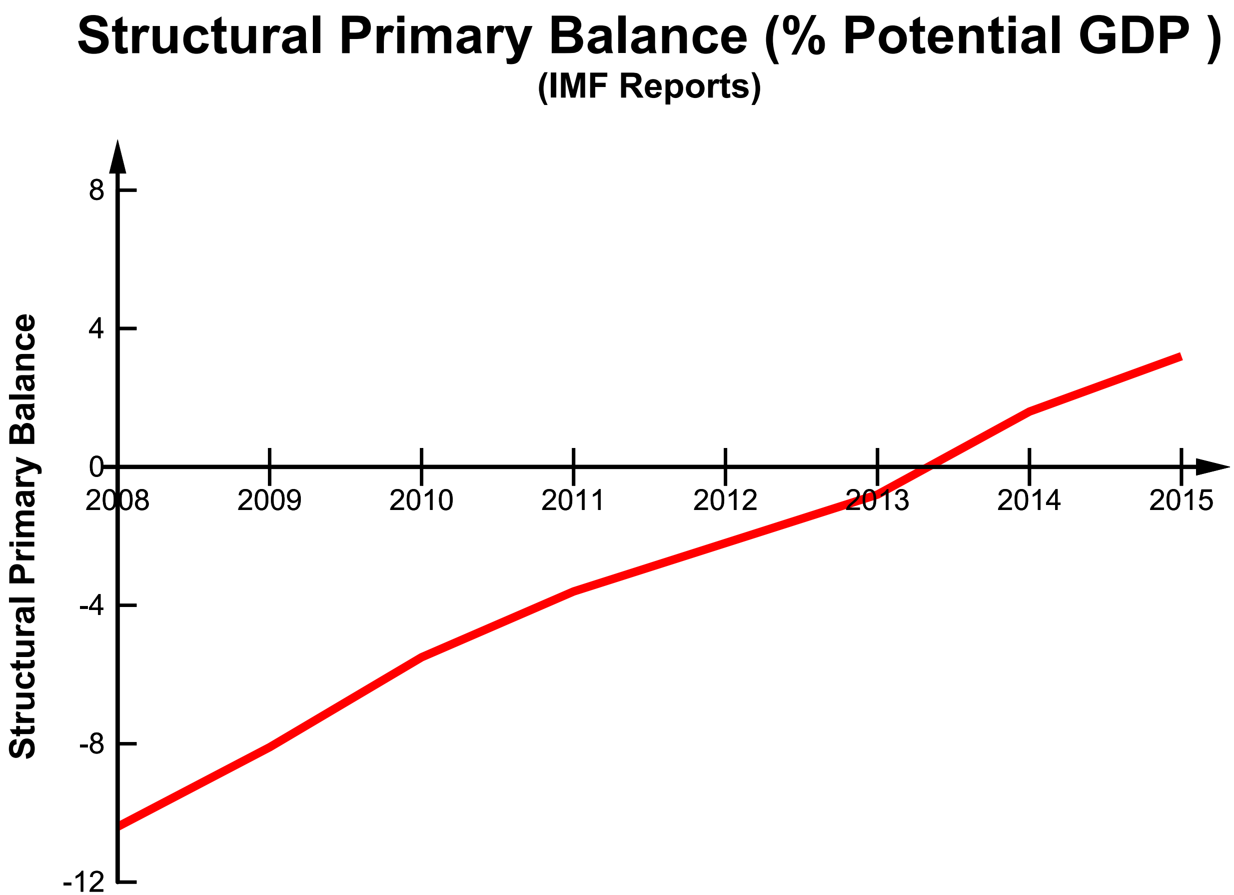
Fiscal Actions in Ireland (NTMA)

	2008	2009	2010	2011	2012	2013	2014f	2015f
Revenue	0.0	5.6	0.0	1.4	1.6	1.4	1.1	0.7
Expenditure	1.0	3.9	4.3	3.9	2.2	1.9	2.0	1.3
Total	1.0	9.4	4.3	5.3	3.8	3.5	3.1	2.0
Total (% of GDP)	0.6%	5.9%	2.7%	3.4%	2.4%	2.1%	1.8%	1.1%
% Progress	3.1%	32.1%	45.4%	61.7%	73.5%	84.3%	93.8%	100.0%
€bn Progress	1.0	10.4	14.7	20.0	23.8	27.3	30.4	32.4
% of GDP Progress	0.6%	6.5%	9.2%	12.6%	15.0%	17.1%	18.9%	20.0%

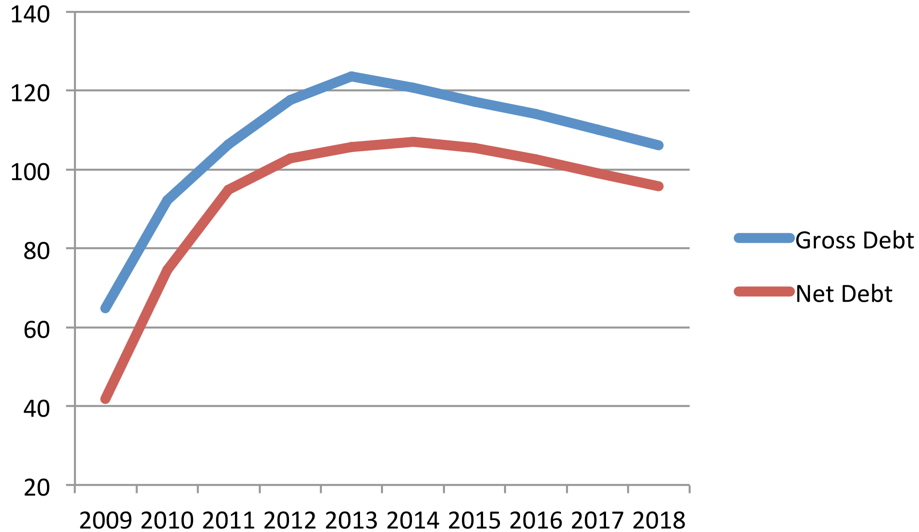
Ireland: Fiscal Balance



Ireland's Fiscal Adjustment Path



Public Debt (Gross/Net)



Impact of Revisions to EU Funding

- Summer 2011: Margin cut of 292.5bp on EFSM funding and increase in average EFSM maturity from 7.5 years to 12.5 years; Extension of EFSF maturities to 15-30 years and 200bp reduction in EFSF funding
- April 2013: further 7 year average maturity extension on EFSM/EFSF loans
- PV gain (at 6 percent discount rate): 19 percent (€35.8 billion to €29.0 billion)
- Much smoother rollover profile
- Maturity profile further boosted by February 2013 resolution of Anglo-Irish Bank (short-term promissory notes replaced by long-term government bonds)

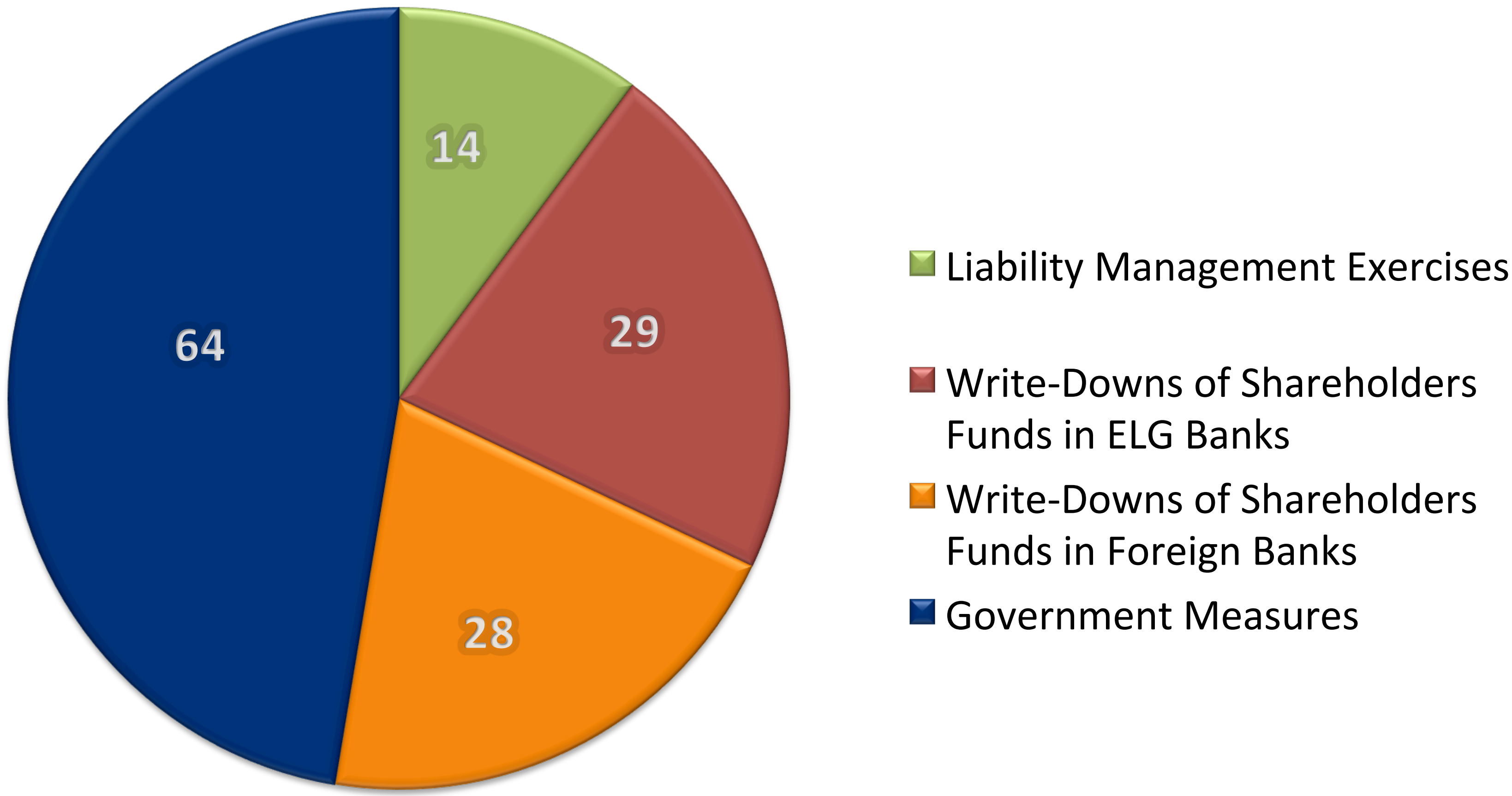
International Austerity Debate

- Speed of adjustment for low-risk countries with plentiful fiscal space (US, UK, Germany, …)
- Scale of adjustment in 2012 in Greece, Italy, Portugal and Spain (much larger than in Ireland)
- Ireland’s strategy: gradual-but-sustained adjustment process (since 2008)

Sovereign-Bank Loop

- Allocation of bank losses
- Fiscal interventions – capital transfers; equity stakes; contingent liabilities
- Restructuring of Bank Assets
- Restructuring of Bank Liabilities
- Sectoral restructuring: Liquidation of IBRC (Anglo/Irish Nationwide); Merger of AIB/EBS; Sale of affiliates; Foreign equity in Bank of Ireland

Allocation of losses/cost of capital injections 2009-2011 (€bn)



Honohan (June 2012)

Gross cost to State of domestic bank recapitalisation

€ bn	AIB/EBS	BoI	IL&P	IBRC	Total	% of GDP**
Pre-PCAR 2011:						
Government Preference Shares (2009) –NPRF	3.5	3.5*			7.0	4%
Ordinary Share Capital (2009) – Exchequer				4.0	4.0	3%
Promissory Notes (2010)	0.3			30.6	30.9	20%
Special Investment Shares (2010) – Exchequer	0.6			0.1	0.7	0%
Ordinary Share Capital (2010) –NPRF	3.7				3.7	2%
Total pre-PCAR 2011	**8.1**	**3.5**		**34.7**	**46.3**	**30%**
PCAR 2011:						
Capital from Exchequer	3.9		2.7		6.6	4%
NPRF Capital	8.8	1.2			10.0	6%
Total PCAR 2011	**12.7**	**1.2**	**2.7**		**16.5**	**11%**
Purchase of Irish Life			1.3		1.3	
Total Recapitalisation from the State	**20.8**	**4.7**	**4.0**	**34.7**	**64.1**	**41%**
Source of Funds:						
Promissory Notes	0.3			30.6	30.9	20%
Exchequer	4.5		4.0	4.1	12.6	8%
NPRF	16.0	4.7			20.7	13%

Source: Department of Finance

**€1.7bn of BoI's government preference shares were converted into ordinary shares in May/June 2010 (€1.8bn government preference shares remain in existence).*
*** 2011 GDP*

Ireland took the necessary step of transparently recapitalising its domestic banks in 2011;

The cost of bank recaps 2009-2011 amounted to c.41% of 2011 GDP;

As other European nations now face similar obstacles to Ireland, Europe is seeking alternative ways of breaking the sovereign-bank links

Bank Loan Book

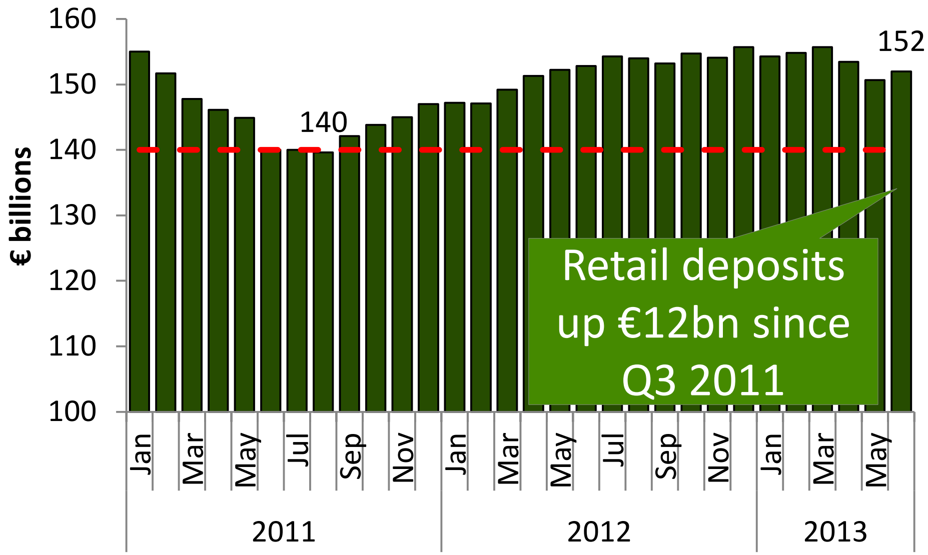
- NAMA – commercial property (12,000 loans; €73.8 billion face value; transfer price €31.8 billion)
- Mortgage debt (owner occupied; buy to let): unemployment risk; negative equity; strategic default
- (Unsecured personal debt; business-sector debt)
- Current resolution process (personal insolvency bill; resolution targets; repossession legal fix)

Bank Liabilities

- Recovery in deposit base
- Decline in loan-to-deposit ratios
- Elimination of ELA; decline in ECB liquidity
- Elimination of ELG scheme (March 2013) for new deposits
- New non-guaranteed bond issues
- Funding of loss-making "mortgage trackers" ?

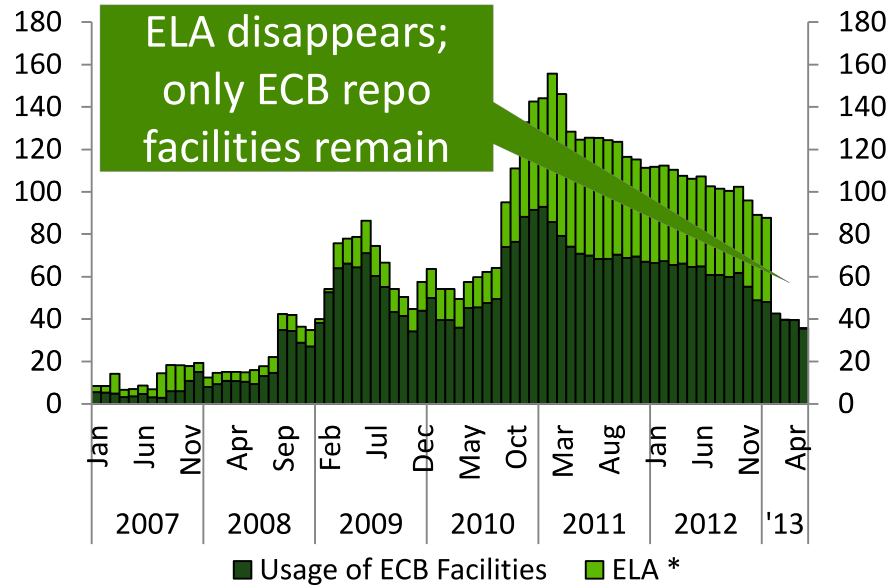
Bank deposits have stabilised; Drawings on ECB facilities reduced

Covered Banks' retail & corp. deposits



Source: CBI & DoF (excludes (i) NTMA pre-recapitalisation deposits, (ii) AIB Poland)

Covered Bank's ECB and ELA facilities (€bn)



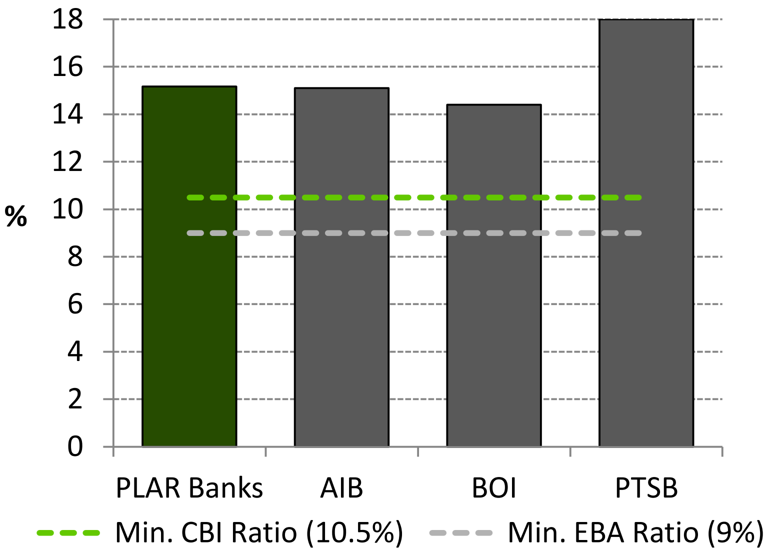
Source : CBI (* ELA proxied by sum of CBI's other claims on euro area credit institutions and other assets)

- As of end-June 2013 Covered Banks' deposits were up €12bn from their trough in Q3 2011
- ELG scheme ended for new liabilities Mar 2013 with no significant impact on deposit volumes
- All 3 Covered Banks returned to market funding: since Nov 2012, >€3bn raised in term repo markets via private placements; €2.5bn in secured covered bond market transactions; €250m in LT2 debt

- Covered Banks' usage of ECB repo facilities has fallen significantly: down to €35bn (June 2013) from peak of €93bn (Jan 2011)
- ECB repo usage now represents c.4.3% of total Eurosystem funding, down from a 2011 peak of c.18.8%

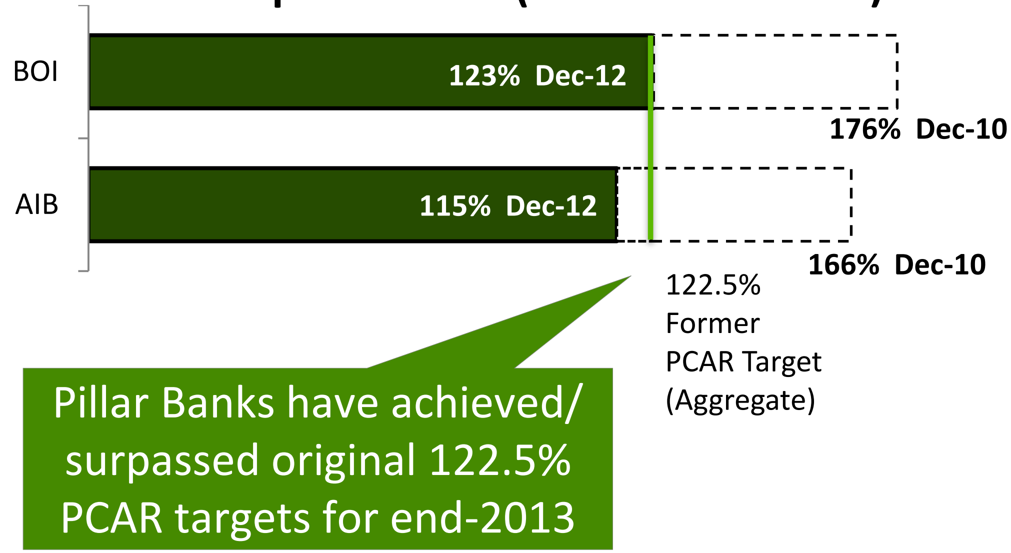
Capital and loan-to-deposit ratios strengthened

Core Tier 1 Capital Ratios (Dec 2012)



Source: Published bank accounts

Loan-to-Deposit Ratios (Dec-10 to Dec-12)

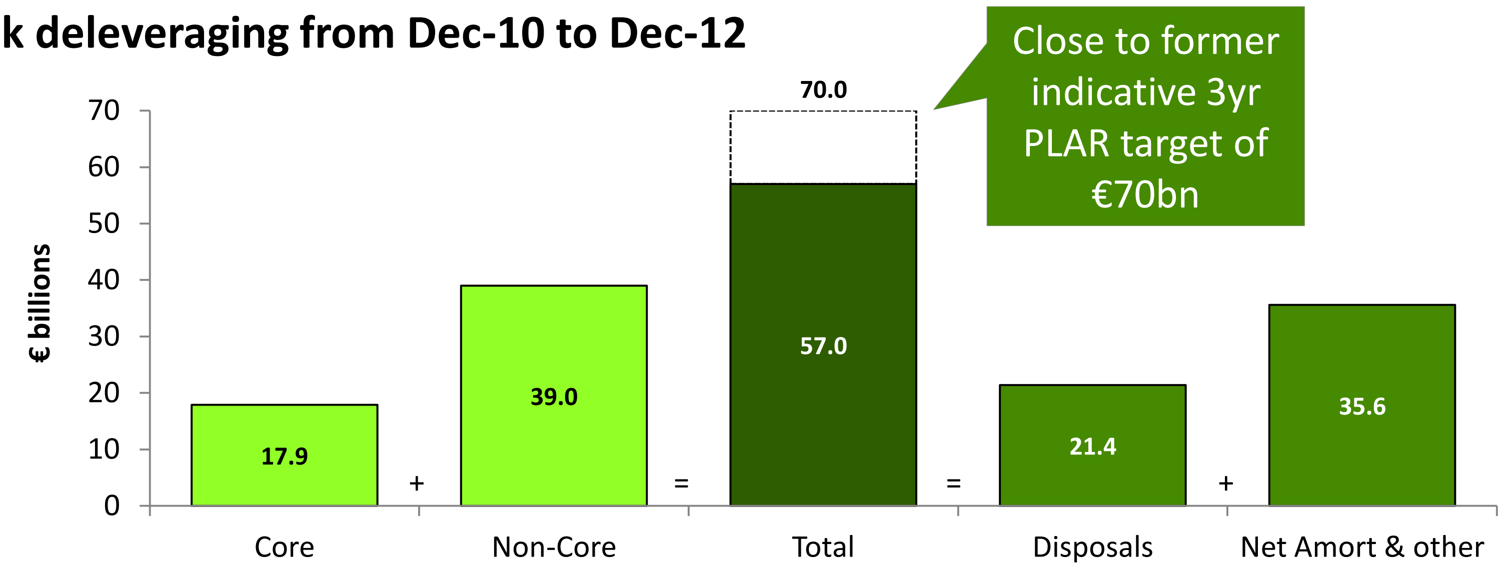


Source: Published bank accounts

- Core Tier 1 capital ratios at the PLAR banks remain well above minimum requirements and among best-capitalised in Europe, with significant buffers available for future losses
- Pillar bank LDRs are at or below former PCAR targets; streamlined deleveraging framework removed LDR targets, thus minimising lending and deposit pricing distortions
- Deleveraging is now assessed based on the 'existing nominal targets for disposal and run-offs of non-core assets in line with the 2011 Financial Measures Programme while avoiding fire sales of assets' (MEFP 4)

Deleveraging programs continue to progress

Bank deleveraging from Dec-10 to Dec-12



Source: Department of Finance

- **Cumulative deleveraging at AIB, BOI & PTSB to end-Dec 2012 of €57bn (81% of 3yr target); €20.8bn achieved in 2012**
- **AIB** - disposals are ahead of plan and the programme is nearing completion. Remaining deleveraging required to reach its target is to be achieved through loan work-out and amortisation
- **BOI** - has completed its disposal plan and the remaining deleveraging is on target and forecast to be achieved through rundown of non-core loan books
- **PTSB** - deleveraging programme postponed pending consideration of EC Restructuring Plan

Future Outlook for Banking System?

- 2013/2014 asset review and stress tests
- Extra capital needed?
- Role of ESM for incremental capital injections (IMF set of principles)?
- Role of SSM
- Sale of existing government equity stakes to foreign investors / ESM?
- Sensitivity to macro and asset price projections

Downside Risk Factors

- Re-ignition of euro crisis. Focal point: 2014 bank stress tests?
- Global increase in long-term interest rates (end of QE, improved growth prospects)
- Political economy: fiscal delay by a mid-term government with a very large majority?

ESM/IMF CCL

- Downside risks also indicate desirability of a CCL facility (of some type)
- Positive signal: risk management in a volatile economy in an uncertain world

Wider Context

- Maintaining fiscal commitment consistent with pro-growth initiatives (tax system reform, sectoral policies, public sector reform)

<u>Post-Troika policy anchors</u>

- Fiscal framework (Fiscal Law, IFAC, European semester)
- Medium-term growth strategy
- Market discipline versus official monitoring