Ireland: Significant progress on macro, banking and fiscal adjustment

National Treasury Management Agency, November 2010

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Four-year fiscal plan and Budget 2011 in next month

Four-year plan:

- The government will announce its four-year fiscal plan by the end of November
- This will detail the measures to be taken to reduce the General Government Deficit (GGD) to 3% of GDP by 2014
- The Department of Finance has already announced that the fiscal consolidation will amount to a gross €15bn over four years

Budget 2011:

- Budget 2011 is slated for December 7th – although much of its detail will be contained in the four-year plan due by the end of the month
- The government has announced an indicative consolidation of €6bn for 2011, to bring the deficit down to by more than 2.5 percentage points to 9.25-9.5% of GDP
- That compares with the target deficit of 10% of GDP announced for 2011 in last year's Budget (December 2009) and the likely outturn of 12% (excluding banking cost) in 2010

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New Department of Finance growth forecasts show real growth of 2.7% on average in 2011-2014

	2010 base	2011F	2012F	2013F	2014F	2011-2014 ave. annual
Level real GDP Dec09	100	103.3	107.9	112.6	117.1	
Real GDP growth Dec09		3.3%	4.5%	4.3%	4.0%	4.0%
Level real GDP Nov10	100	101.8	105.1	108.2	111.2	
Real GDP growth Nov10		1.75%	3.25%	3.0%	2.75%	2.7%
Level Nominal GDP Dec09	100	105.6	112.6	119.9	127.3	
Nominal GDP growth Dec09		5.6%	6.7%	6.5%	6.1%	6.2%
Level Nominal GDP Nov10	100	102.5	106.9	111.5	116.6	
Nominal GDP growth Nov10		2.5%	4.3%	4.3%	4.5%	3.9%
GDP deflator Dec09		2.2%	2.1%	2.1%	2.0%	2.1%
GDP deflator Nov10		0.75%	1.00%	1.25%	1.75%	1.2%
Nominal (€m) old	160925	169900	181250	192975	204800	
Nominal (€m) new	157300	161200	168100	175400	183500	

NTMA indicative borrowing 2010-2014*

€bn, unless stated	2010	2011	2012	2013	2014
Exchequer Deficit	19.25	16.0	12.0	9.75	5.5
Debt Redemption	1.2	4.4	5.6	6.0	10.0
Banks' Promissory Notes	0.0	3.1	3.1	3.1	3.1
Gross Funding need	20.5	23.5	20.7	18.9	18.6
Underlying General Government Deficit % of GDP	12.0	9.2-9.5	6.75-7.25	5.25-5.5	2.75-3
General Government Deficit % of GDP (includes Promissory Notes of €31bn in 2010)	31.5	9.2-9.5	6.75-7.25	5.25-5.5	2.75-3

*** Indicative borrowing based on information contained in the Information Note on the Economic and Budgetary Outlook 2011-2014 published by the Department of Finance on 4 November 2010 ahead of the Four-Year Budgetary Plan. <u>The future borrowing plan for the NTMA is subject to the final exchequer borrowing requirement in the Four-Year Budgetary Plan and Budget 2011</u>**

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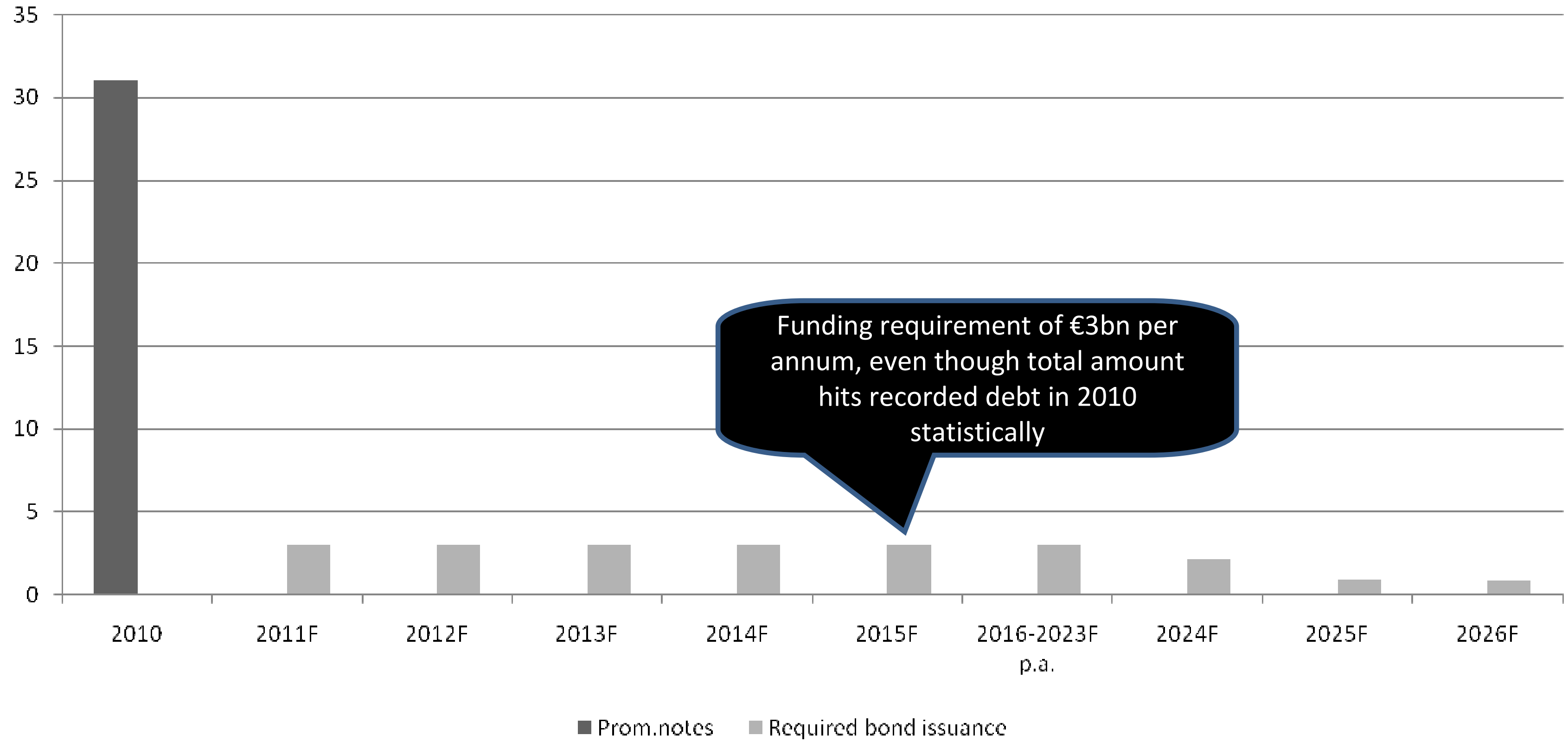
Focus on funding requirement, not statistical treatment I

- In April 2010 Eurostat reclassified the €4bn recapitalisation of Anglo Irish Bank in 2009 as a 'capital transfer' (expenditure) rather than a 'financial transaction'
- The effect was a statistical retrospective increase in the 2009 General Government Deficit (GGD) from 11.9% to 14.4% of GDP
- That €4bn was borrowed in 2009 and had already been included in the end-2009 Government debt figures
- In contrast, the statistical treatment is clear in 2010
- The €31bn committed in promissory notes will count towards the deficit and debt because they are being used to fill a capital hole in Anglo Irish Bank and INBS. As a result, the 2010 GGD may reach 31% of GDP as a once-off.
- **But the promissory notes do not affect funding in 2010. From 2011, they will lift annual bond issuance by about €3.1bn per annum. The hit is taken statistically now, but the funding is spread out over 10-15 years**

Focus on funding requirement, not statistical treatment II

- In 2011 and 2012, the government will take an interest holiday on the promissory notes. This is in accordance with Eurostat ESA-95 rules.
- This does not affect either the cash amount to be received by the banks as promised nor the government's borrowing requirement.
- In effect, in 2011 and 2012 the €3.1bn paid to the banks (Anglo, Irish Nationwide and EBS) will consists of principal only
- From 2013 the coupons will be stepped up so that the amount of interest paid over the full term (to 2025) will be unchanged
- The accounting treatment of the promissory notes on the bank balance sheets will be unaffected
- **There is no impact on the General Government deficit in 2011 and 2012. In 2013 and 2014, the interest accrued on the promissory notes will raise the General Government deficit by about 1% of GDP.**

Promissory notes provided now, but market funding spread over at least 10 years



Source: NTMA

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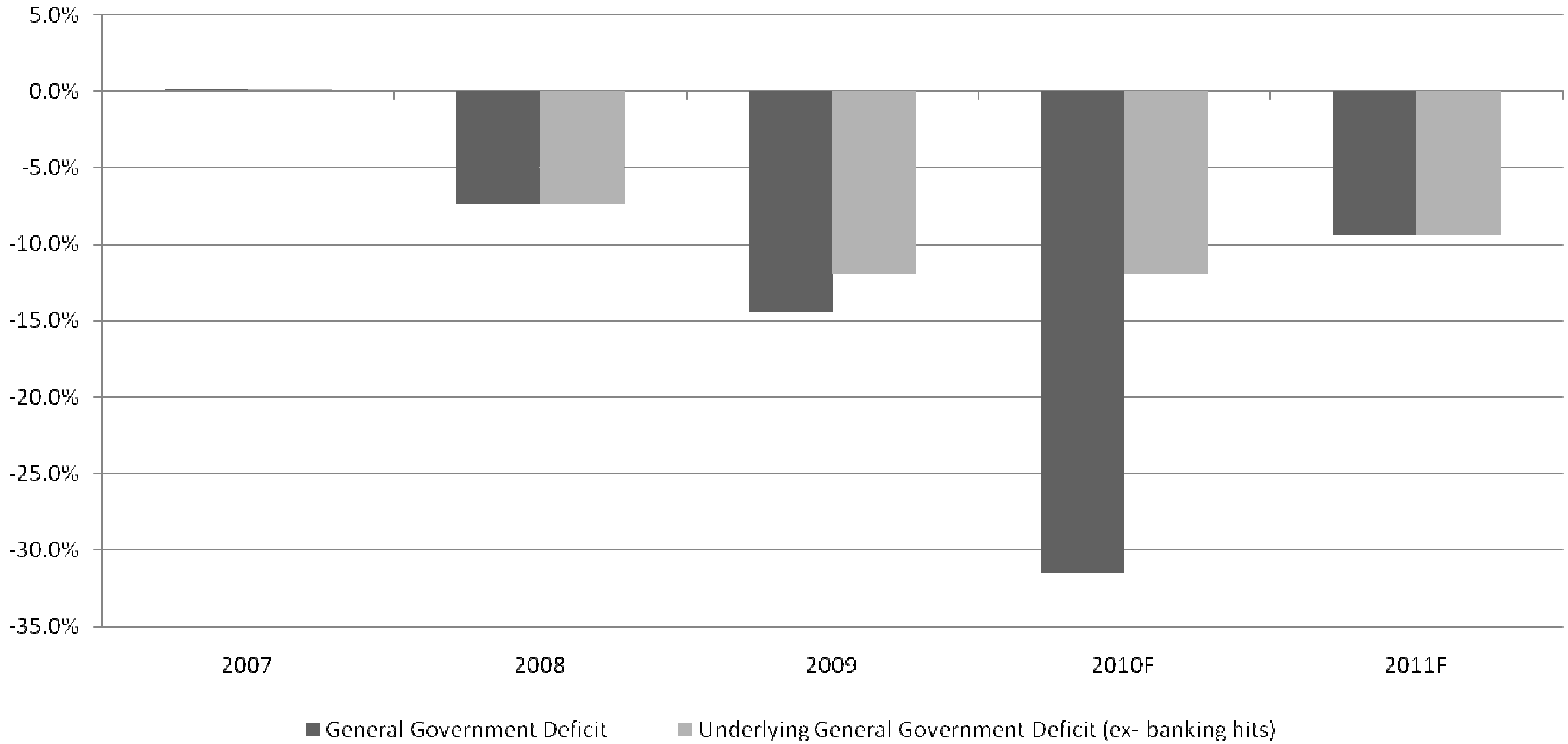
Underlying deficit to fall to 9.25-9.5% of GDP in 2011



Source: Department of Finance Information note November 2010

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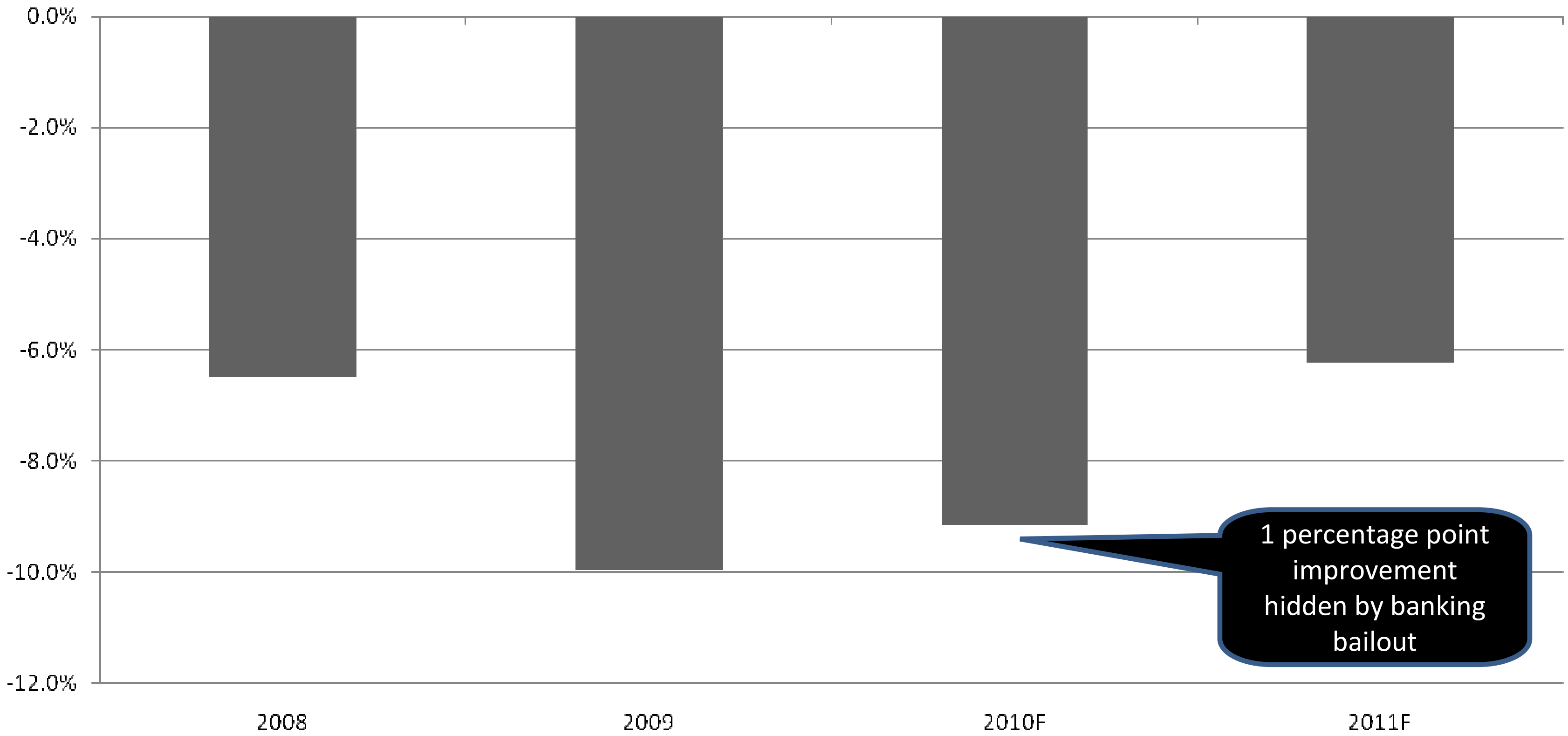
Primary deficit (ex-interest payments) peaked in 2009: shows fruits of fiscal measures already introduced



Source: NTMA calculations; Department of Finance

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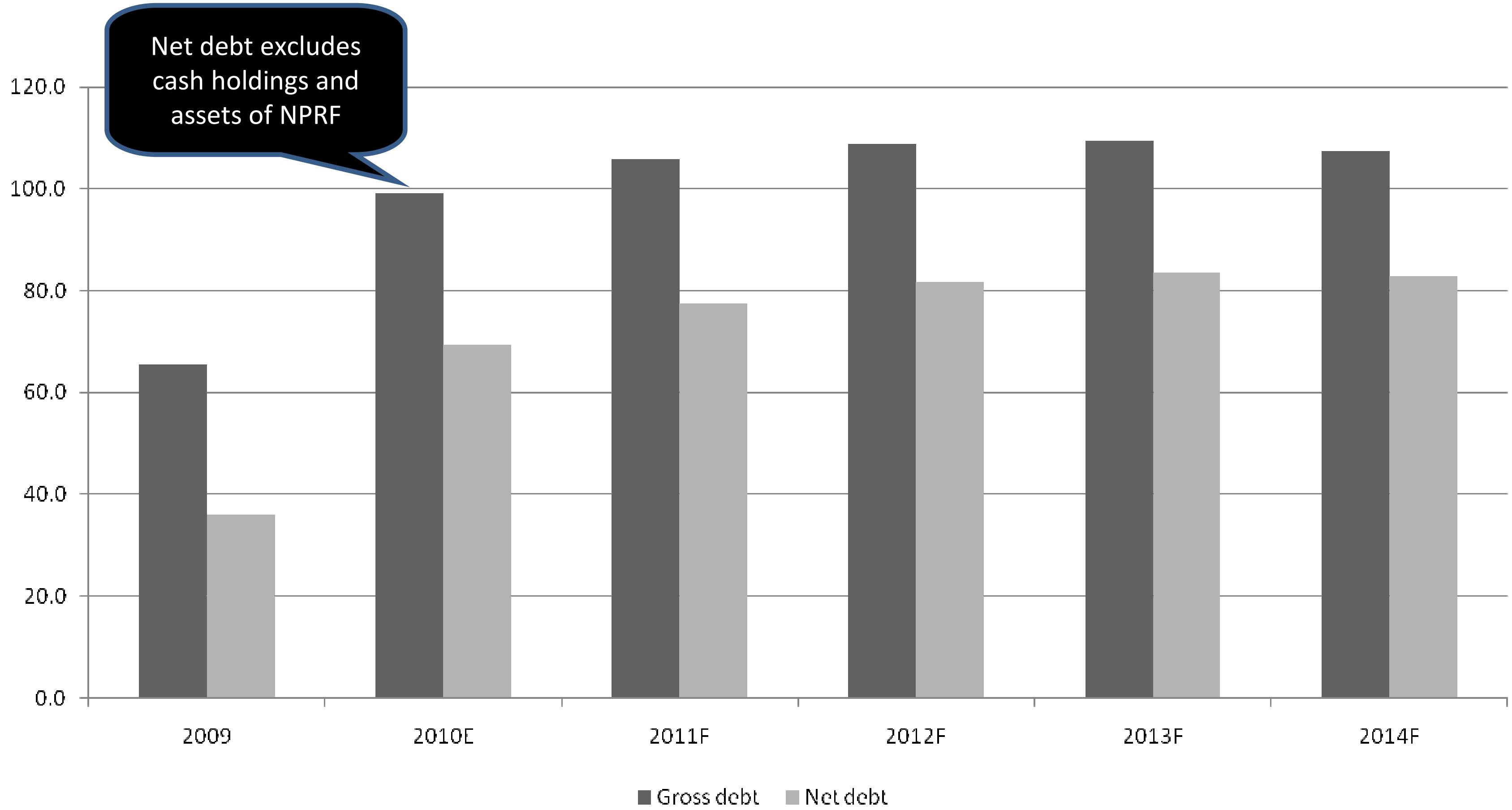
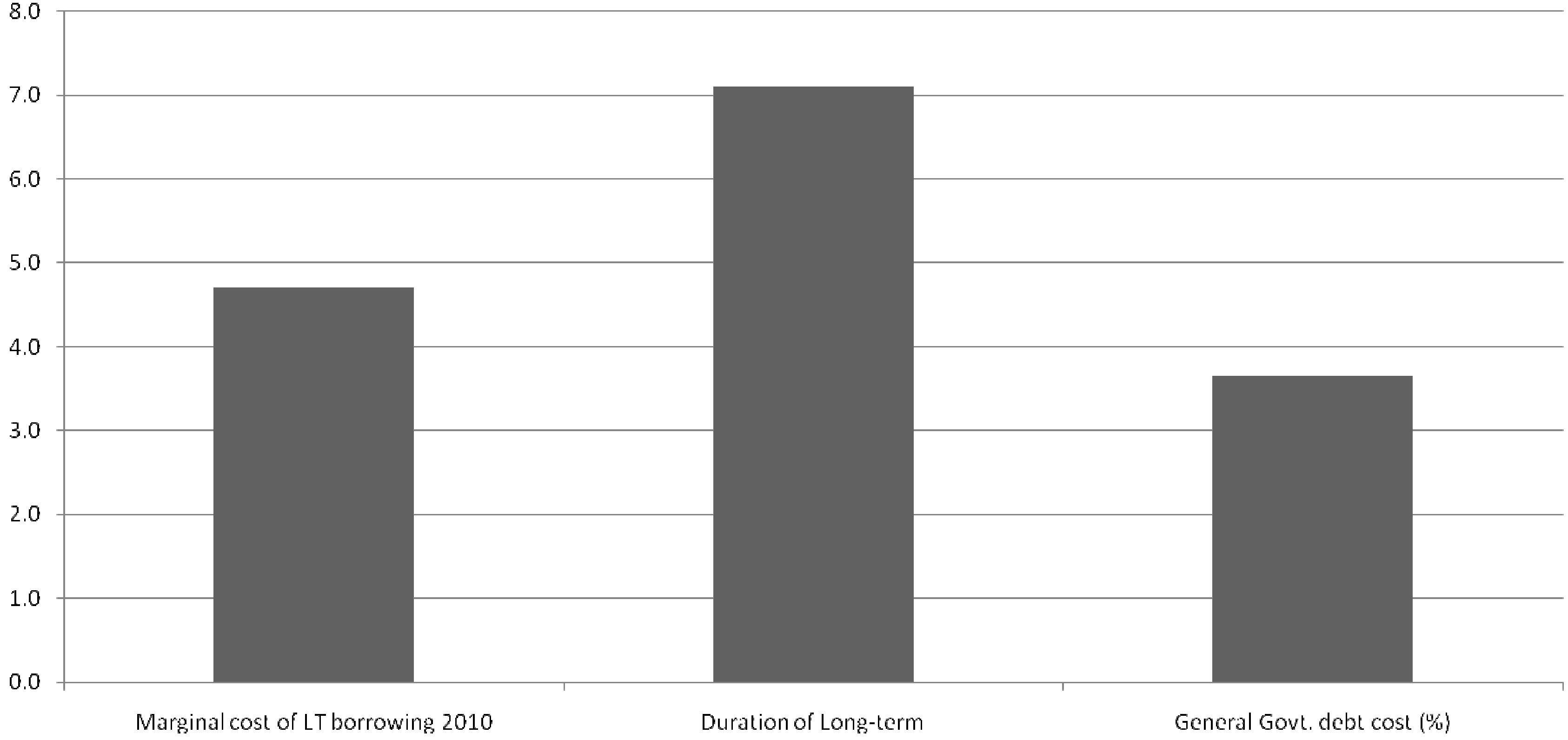
Net debt to peak below 85% of GDP



Source: NTMA calculations; Department of Finance

Average interest rate on General Government debt is low following completion of 2010 borrowing



Source: NTMA

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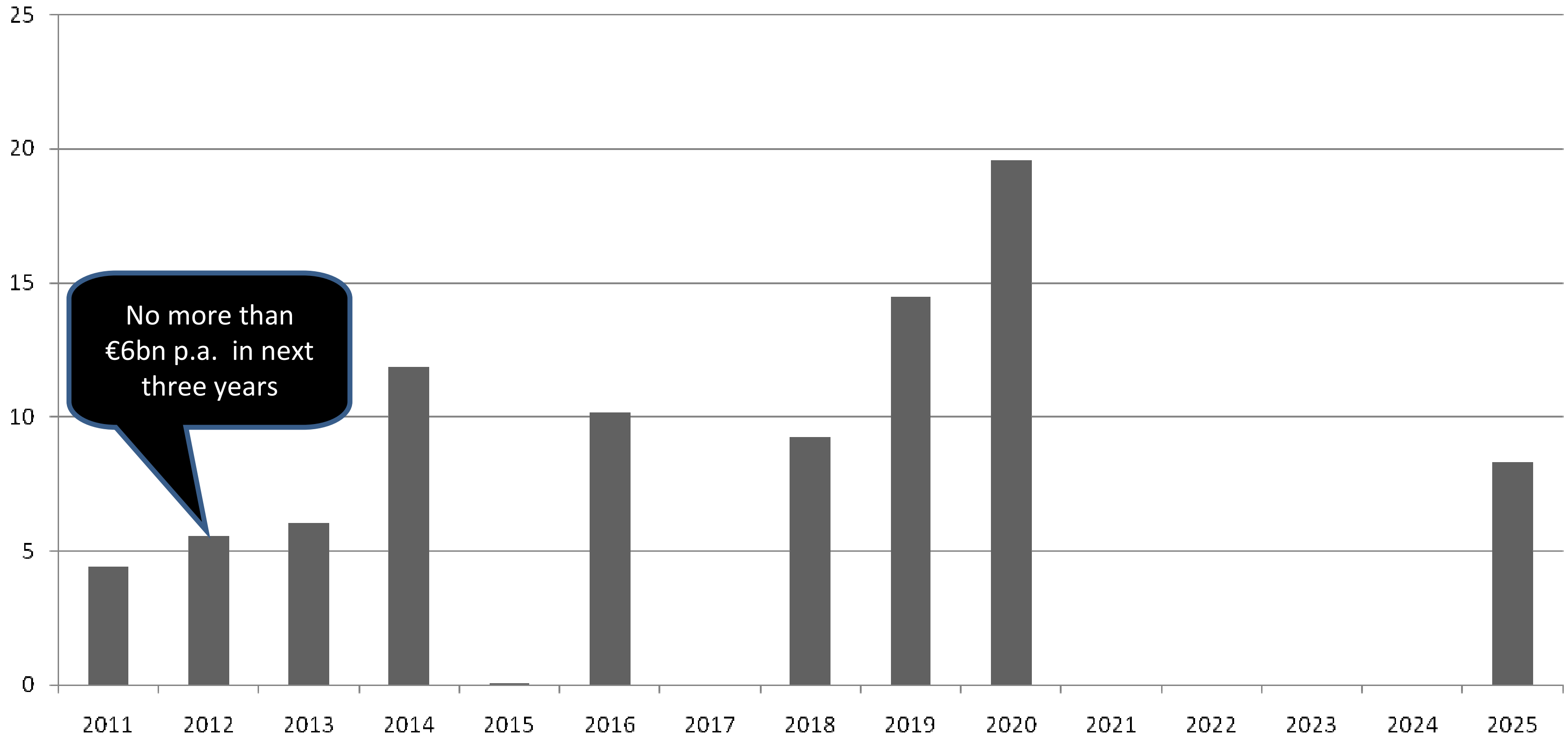
Refinancing risk not significant, as maturity profile is favourable



Source: NTMA

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Ireland's debt burden more manageable, as pensions problem will loom 15 years later than Europe

65+/ total pop (%)	2005	2010	2015	2020	2030	2040
Austria	16.3	17.4	18.3	19.3	23.4	26.4
Belgium	17.2	17.6	19.1	20.7	24.9	27.4
Denmark	15.1	16.8	19.2	20.9	24.1	26.2
Finland	15.9	17.3	20.4	22.8	26.2	27.0
France	16.4	16.7	18.6	20.3	23.4	25.6
Germany	18.9	20.4	21.2	22.7	27.8	31.1
Greece	18.3	18.9	20.1	21.3	24.8	29.4
Ireland	**11.1**	**11.9**	**13.3**	**14.9**	**18.5**	**22.4**
Italy	19.6	20.5	22.1	23.3	27.3	32.2
Japan	20.2	23.1	26.9	29.2	31.8	36.5
Netherlands	14.2	15.5	17.9	19.8	23.4	25.0
Portugal	17.1	17.5	18.7	20.1	23.9	28.2
Spain	16.7	17.4	18.6	20.0	25.1	31.6
Sweden	17.3	18.5	20.2	21.2	22.8	24.0
UK	16.0	16.5	18.0	19.0	21.9	23.7
US	12.4	13.0	14.4	16.1	19.3	20.0

Source: OECD data and forecasts

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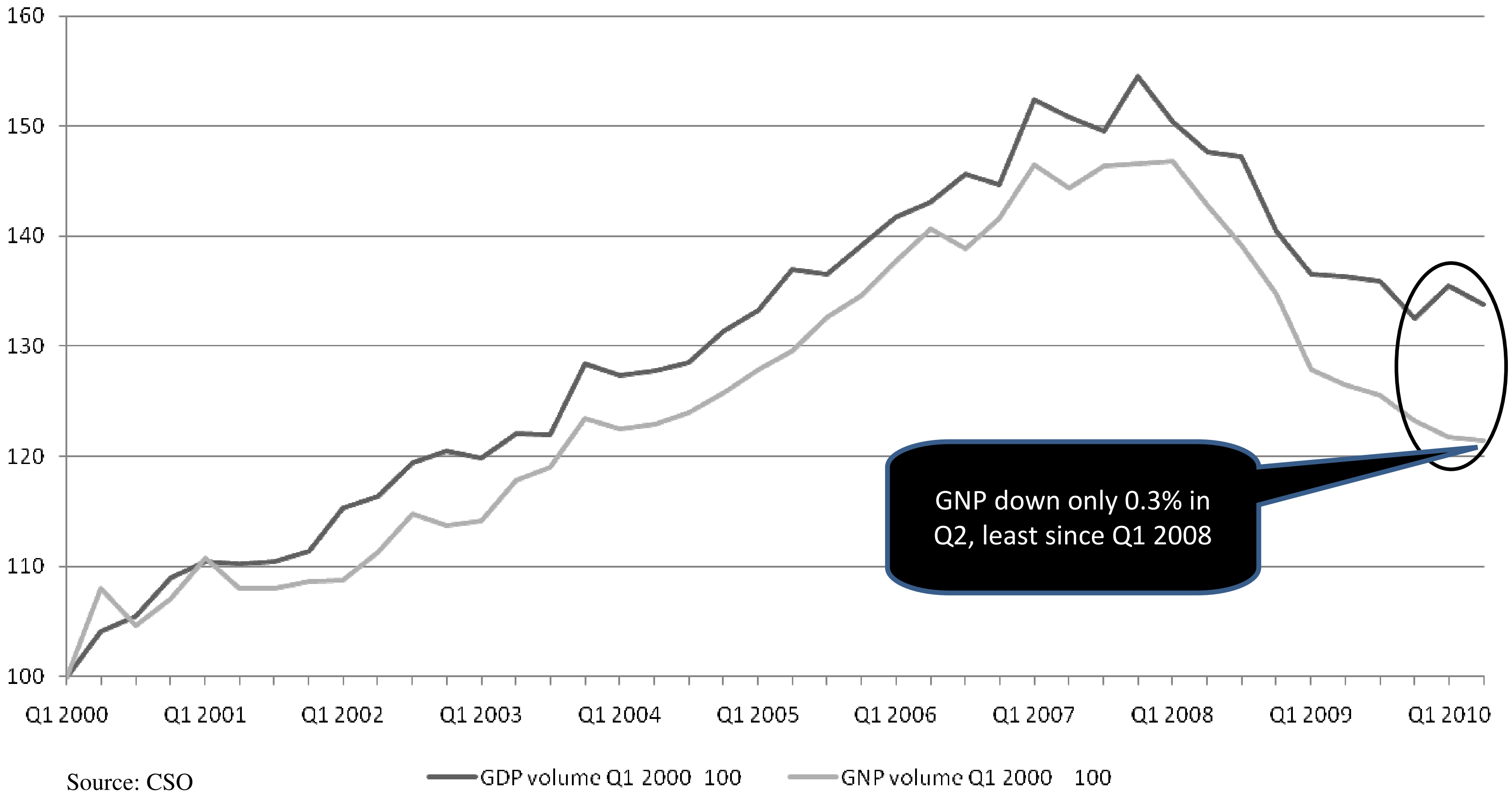
Economy stabilising since end of last year



Source: CSO

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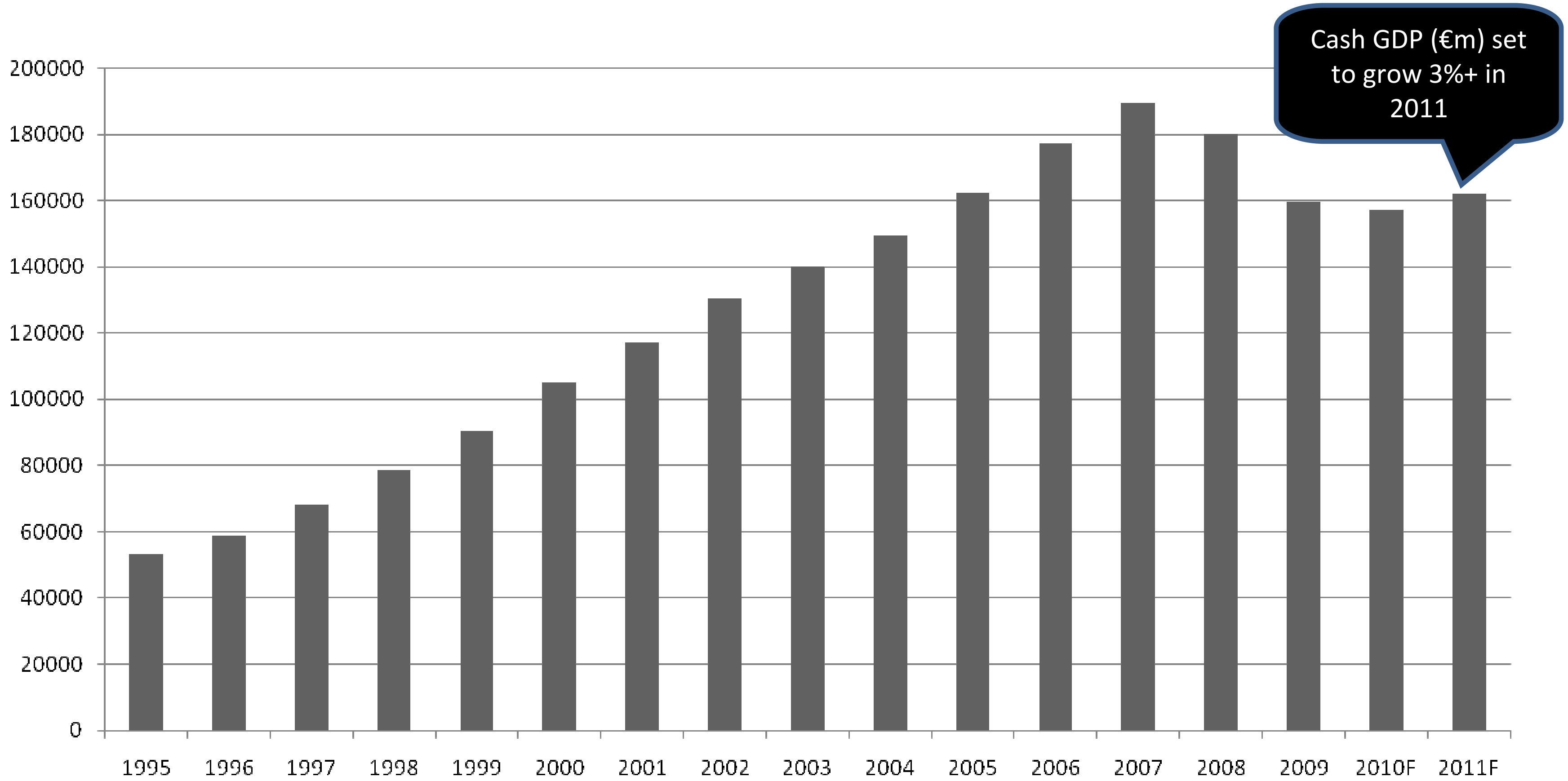
Nominal GDP restored to 2005 level in 2011



Source: CSO; Central Bank of Ireland forecasts

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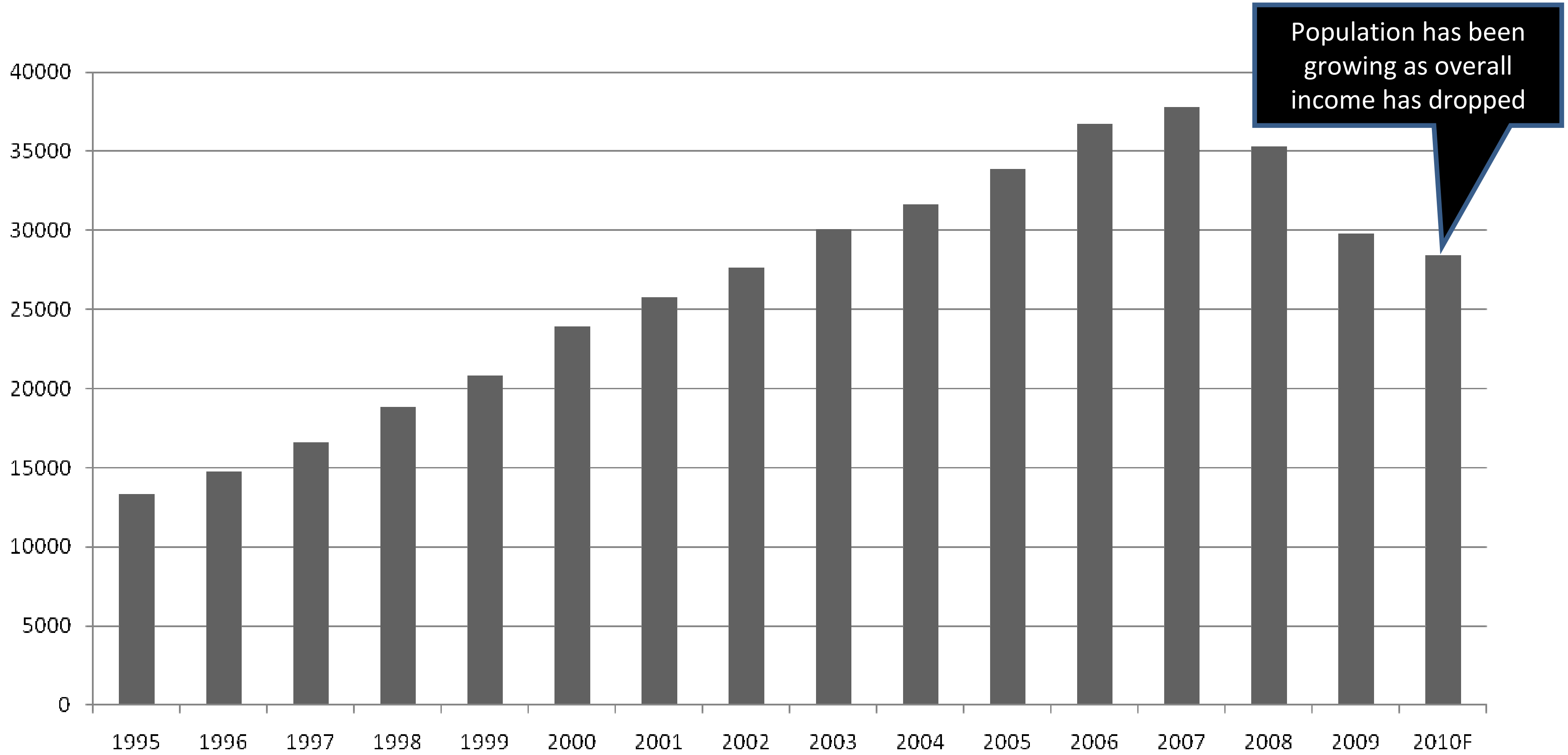
Ireland's income per capita has been hit, but still double 1995 levels



Source: Central Bank of Ireland; NTMA calculations

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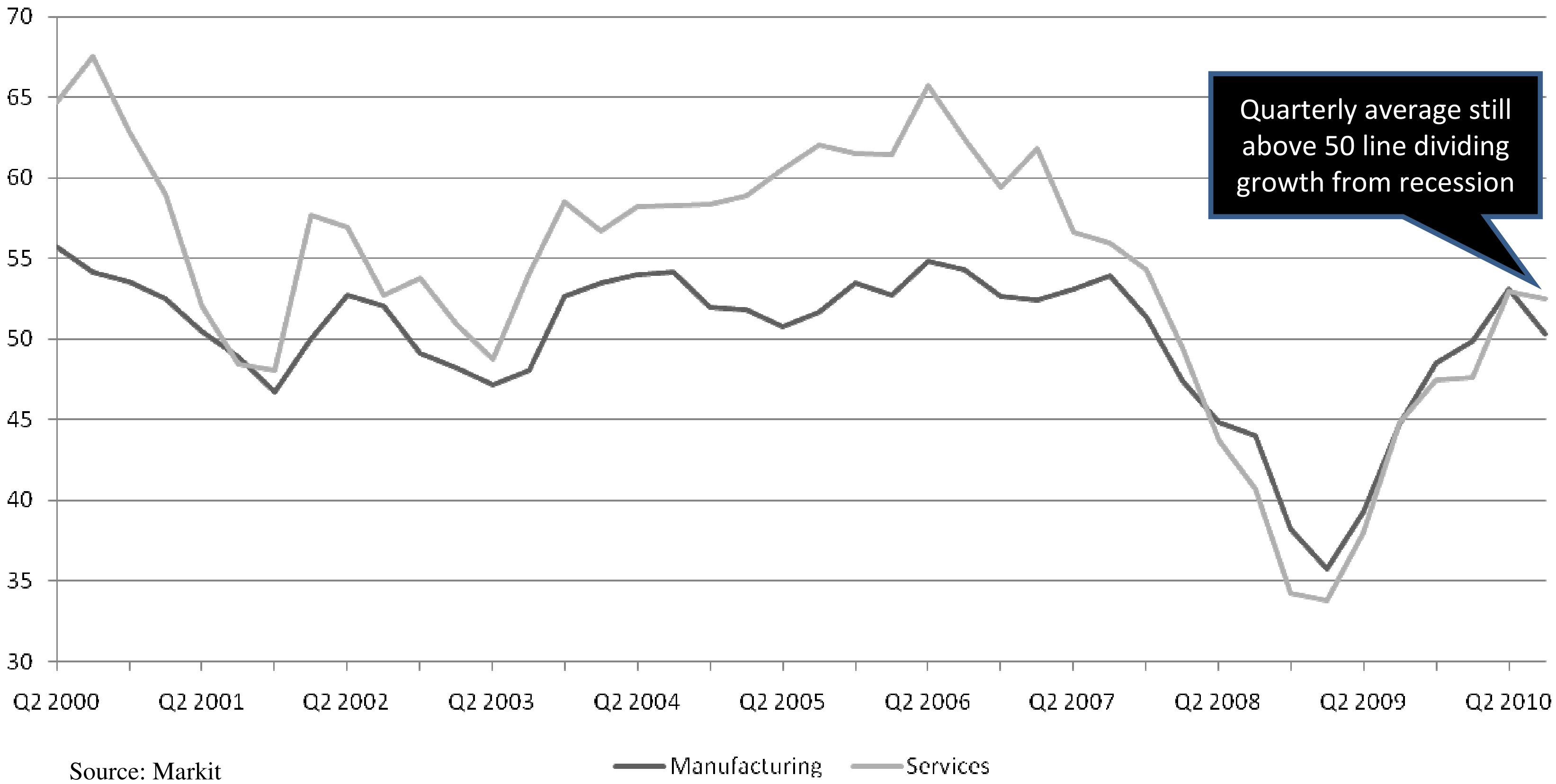
PMI surveys point to slower growth in Q3 in line with global soft patch



Source: Markit

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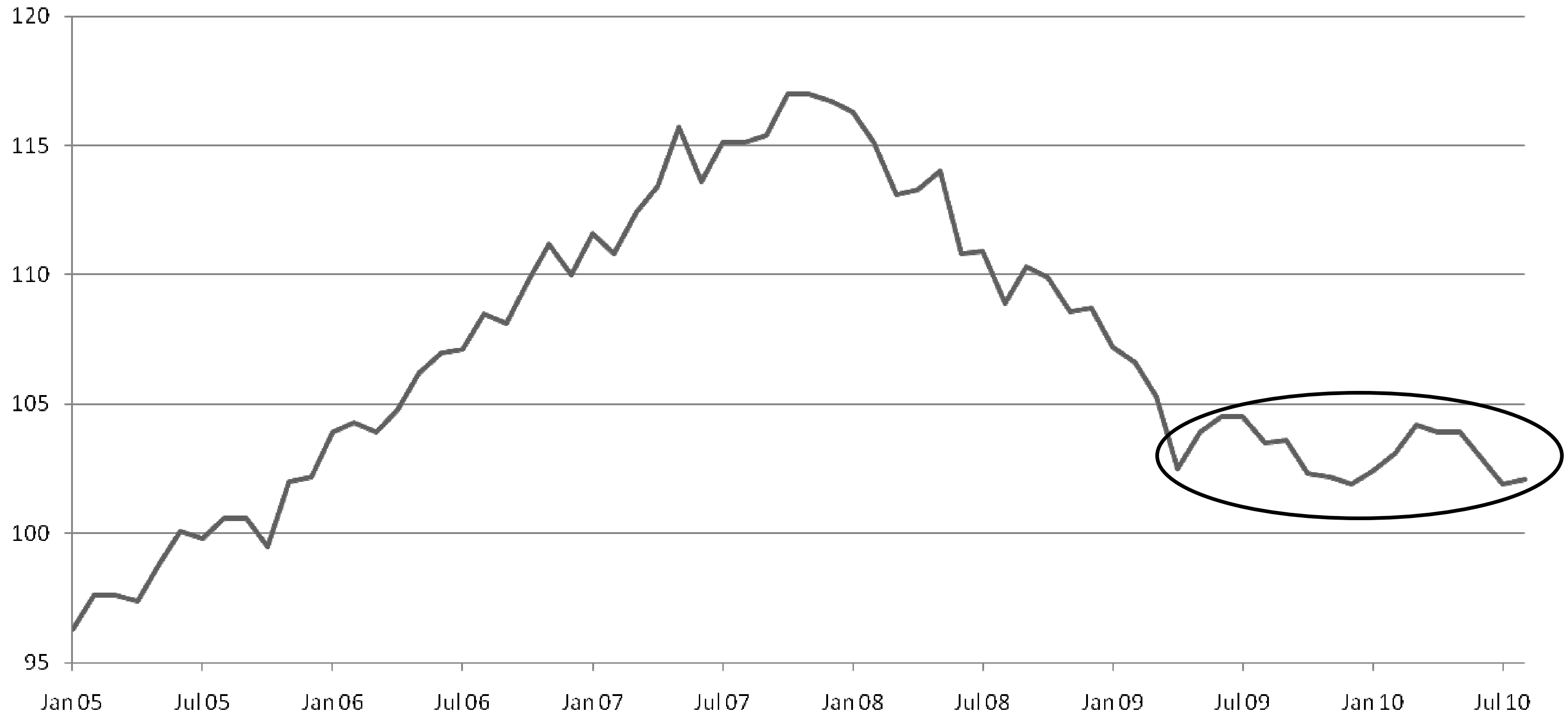
Retail sales have stabilised



Source: CSO

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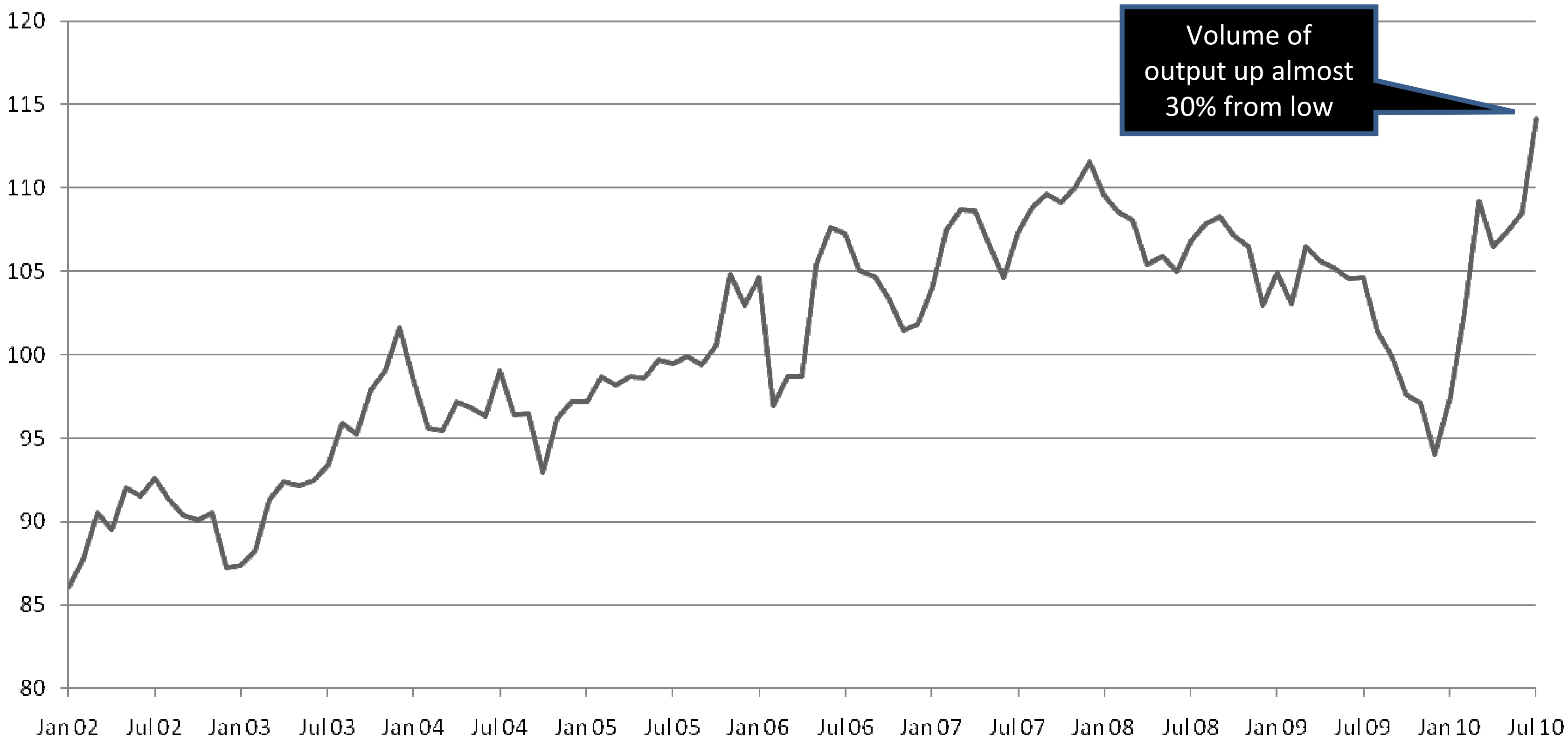
Industrial production has recovered, driven by multinational sector



Source: CSO

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Competitiveness: Ireland ranks highly as a place to do business

- Ireland's position in World competitiveness rankings

  - 1st for corporate taxes
  - 4th for the availability of skilled labour
  - 4th for being open to new ideas
  - 6th for labour productivity
  - 7th for the availability of financial skills
  - 7th for the flexibility and adaptability of people

Source: IMD World Competitiveness Yearbook 2010

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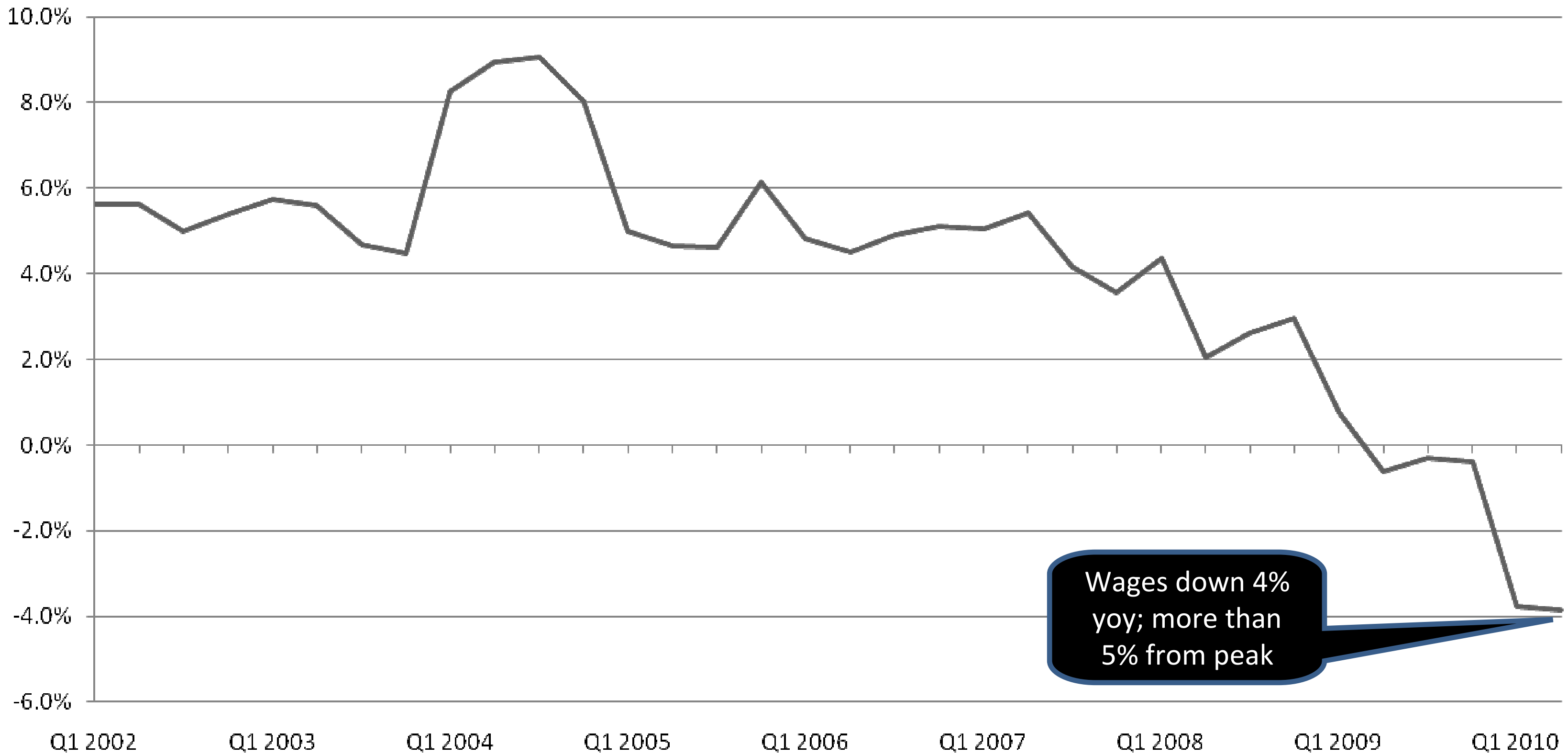
Competitiveness regained: economy-wide nominal wages down significantly



Source: CSO

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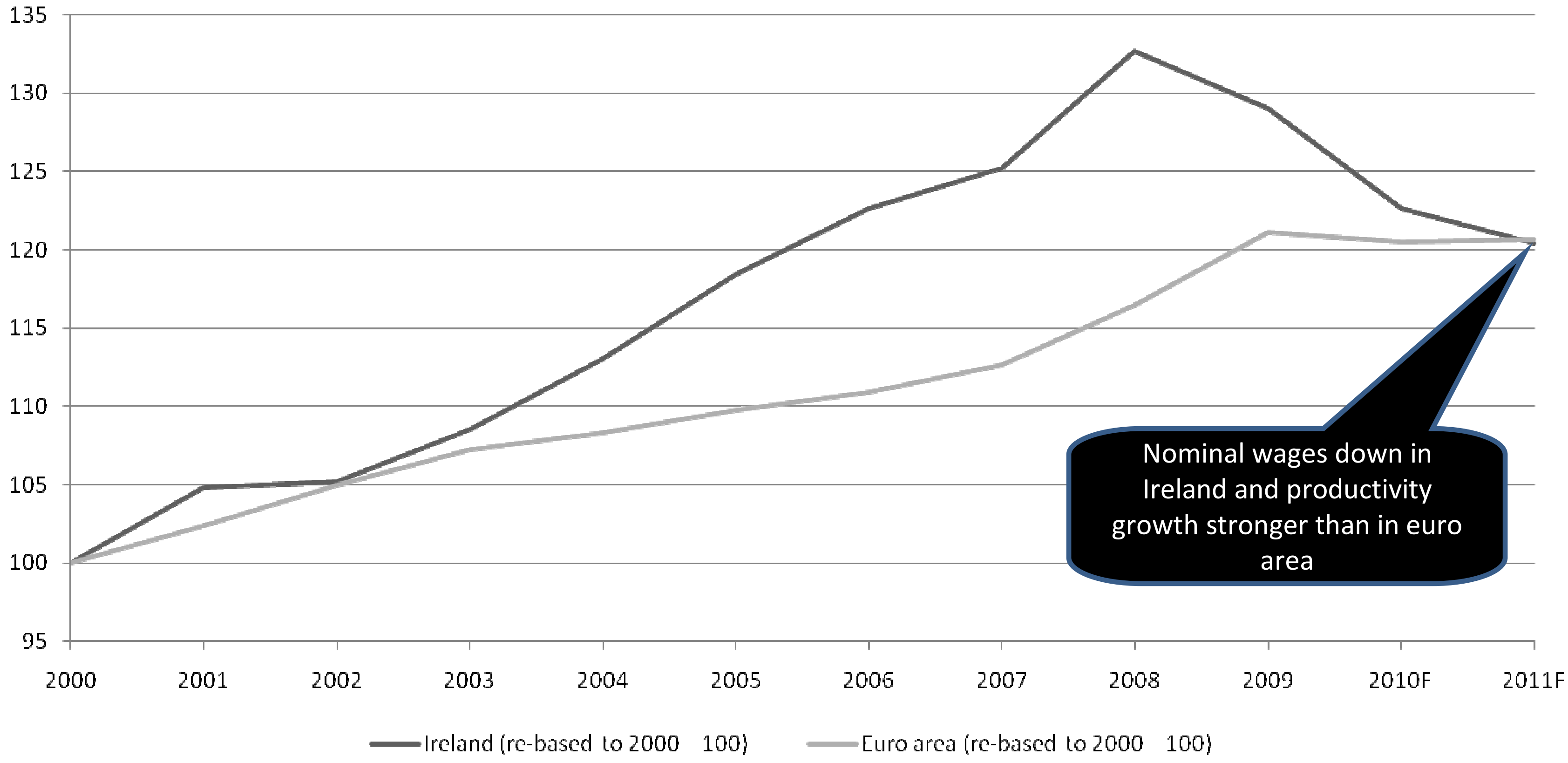
Competitiveness regained: Unit Labour Costs set to converge with euro area by 2011



Source: Eurostat; European Commission forecasts

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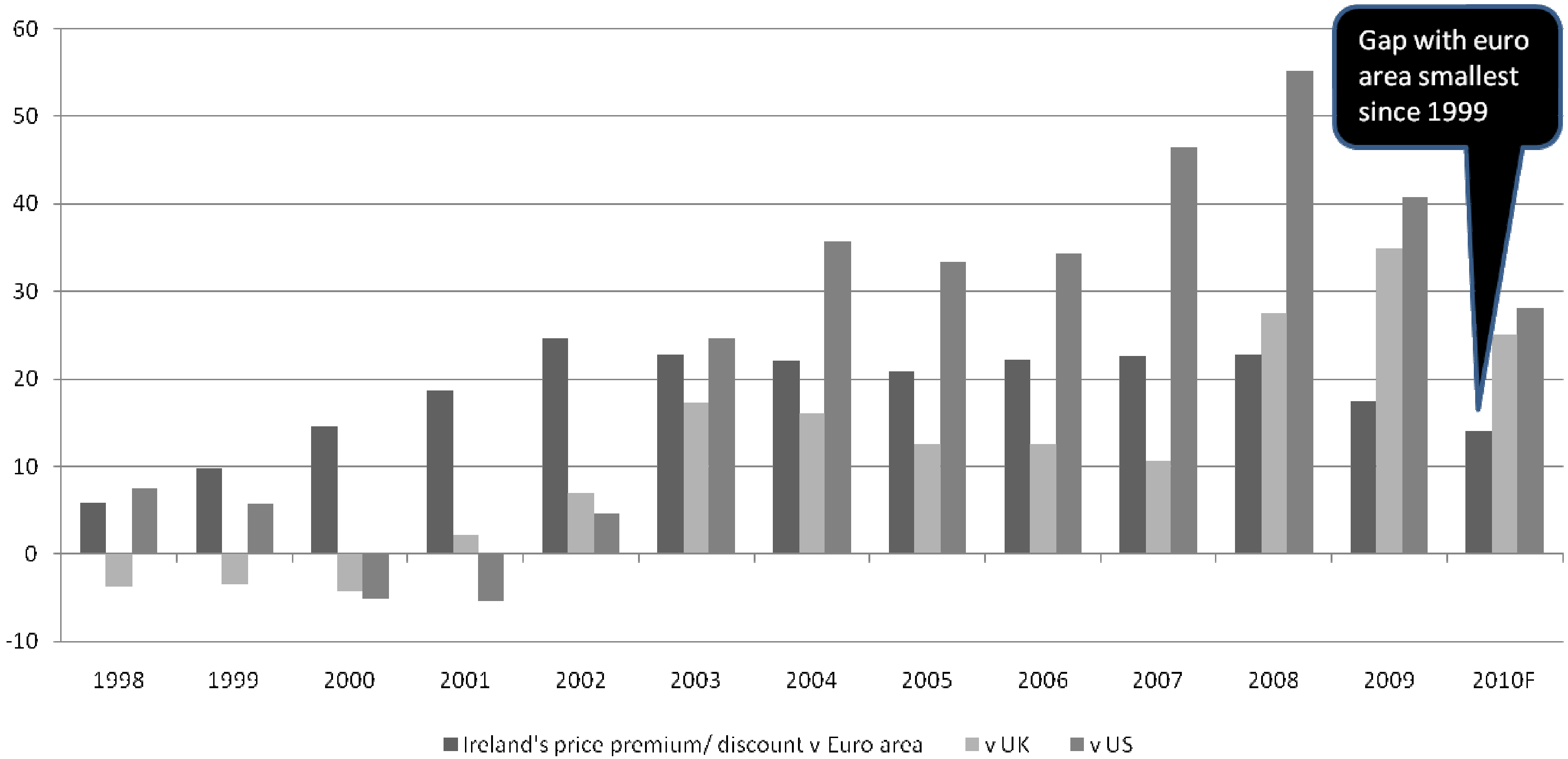
Competitiveness regained: Ireland's price level starting to converge with trading partners



Source: Eurostat; NTMA calculations

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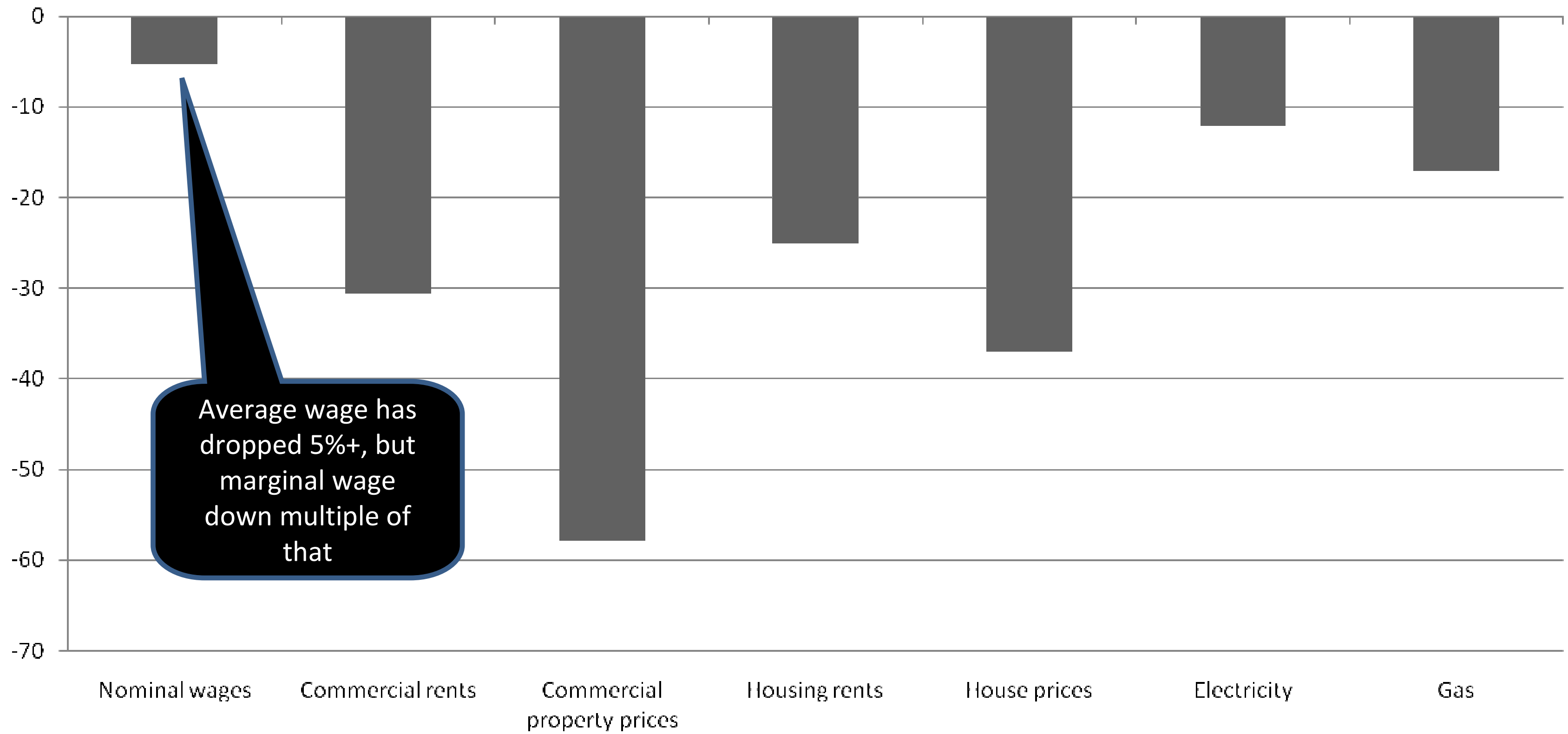
Competitiveness regained: cost of business has dropped dramatically



Source: CSO; IPD; ESRI; NTMA calculations

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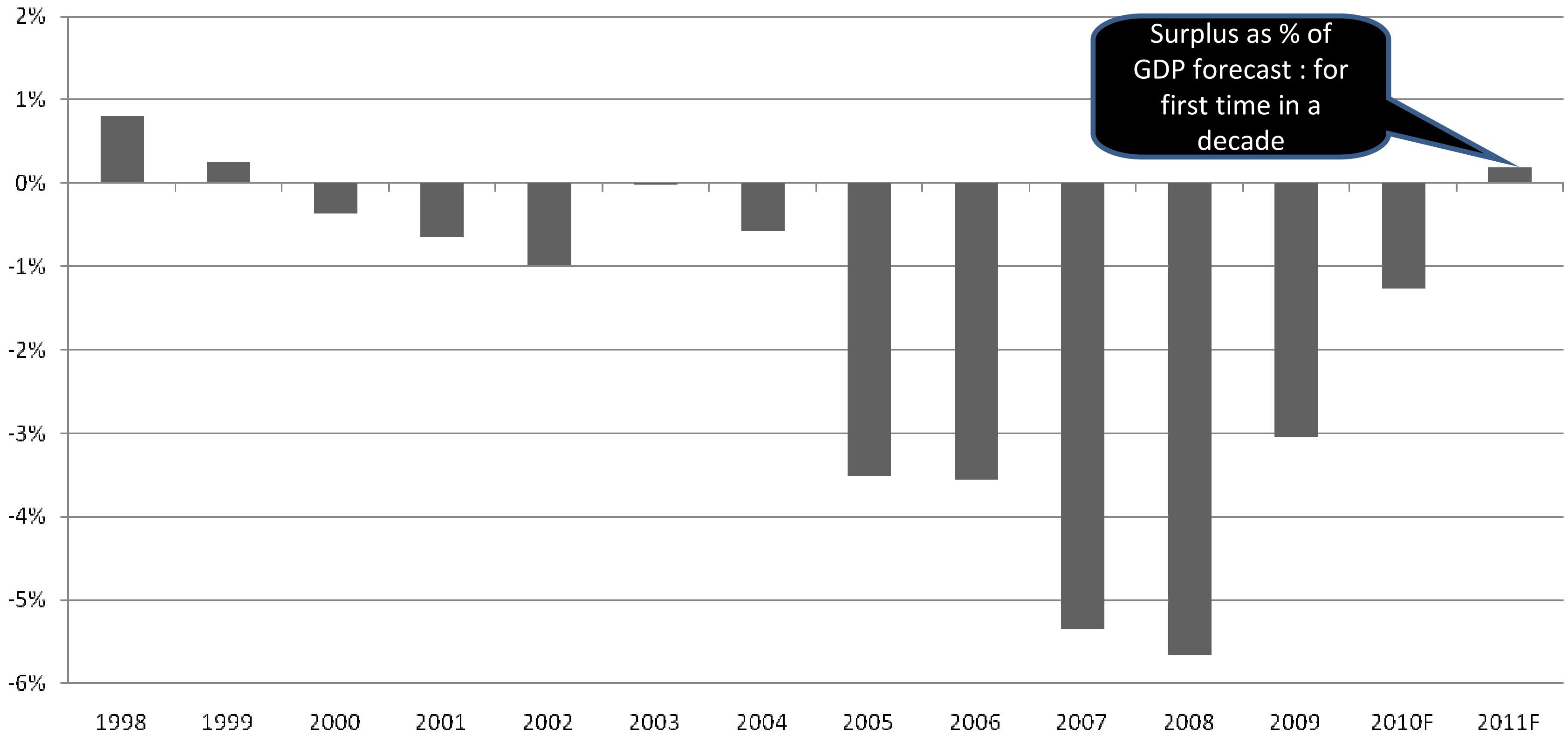
Economy rebalancing: Current account likely to be in surplus in 2011



Source: CSO; Central Bank of Ireland forecasts

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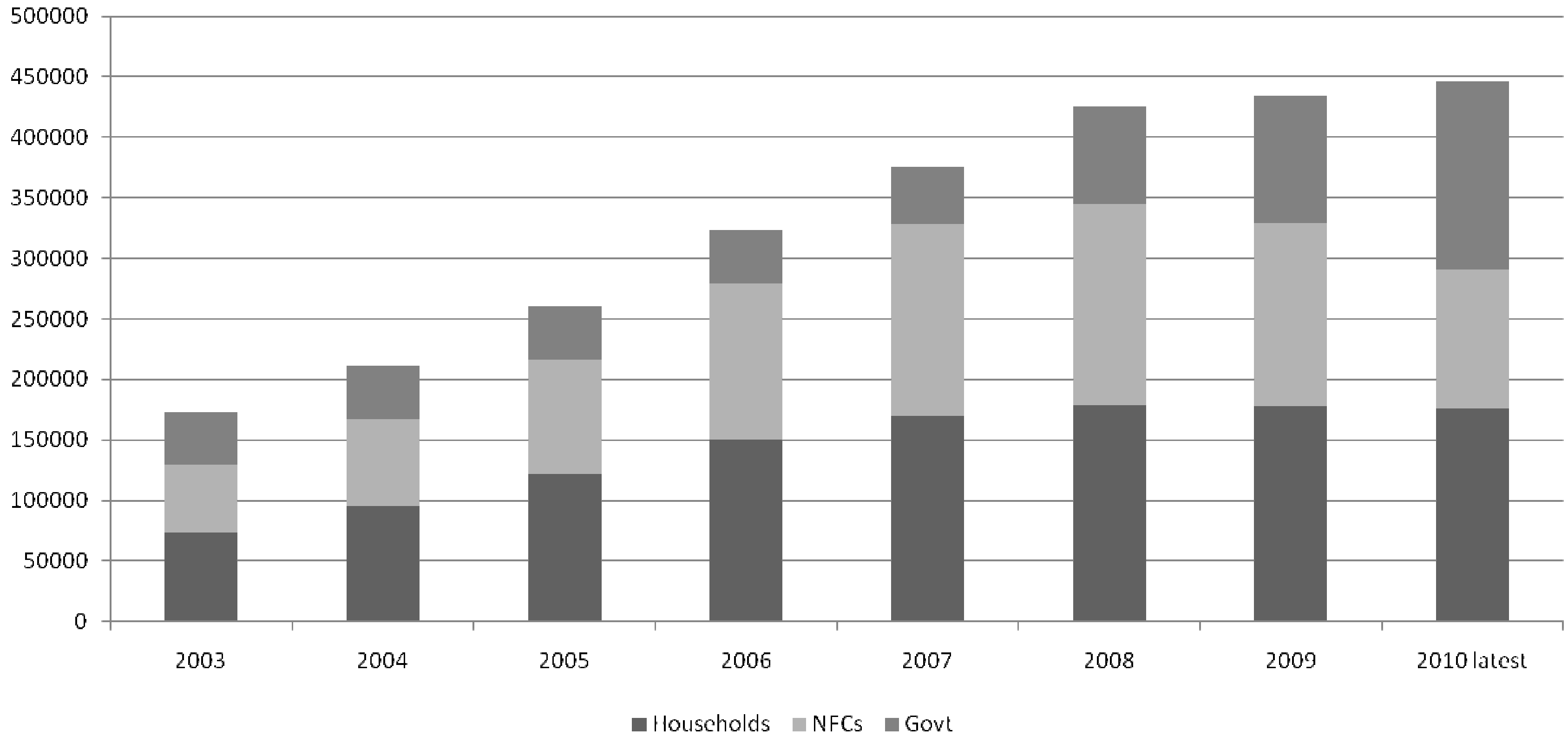
Economy rebalancing: private corporate debt has dropped, as government debt has increased



Source: Central Bank of Ireland; NTMA calculations

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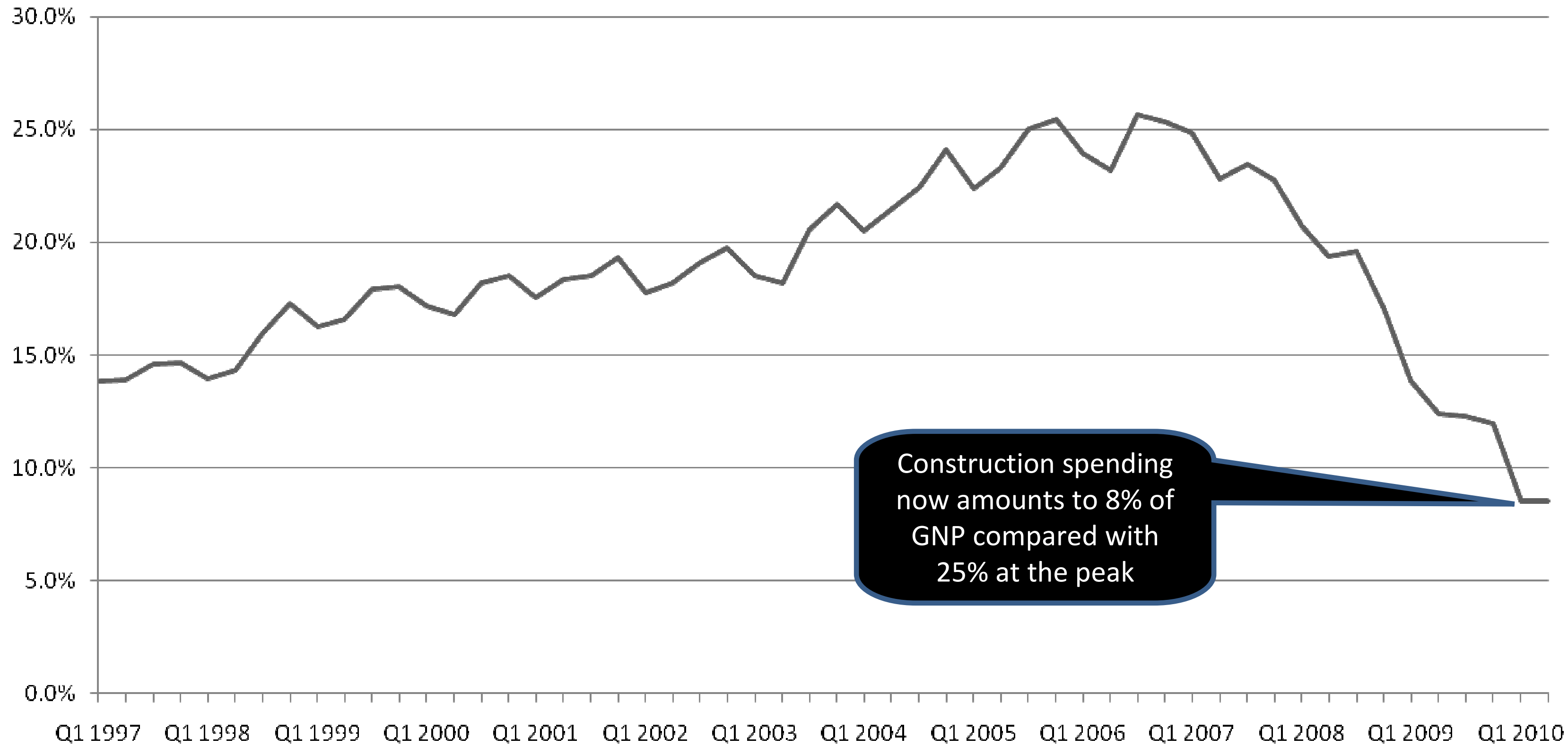
Economy rebalancing: Construction now well below average European share of economy



Source: CSO; NTMA calculations

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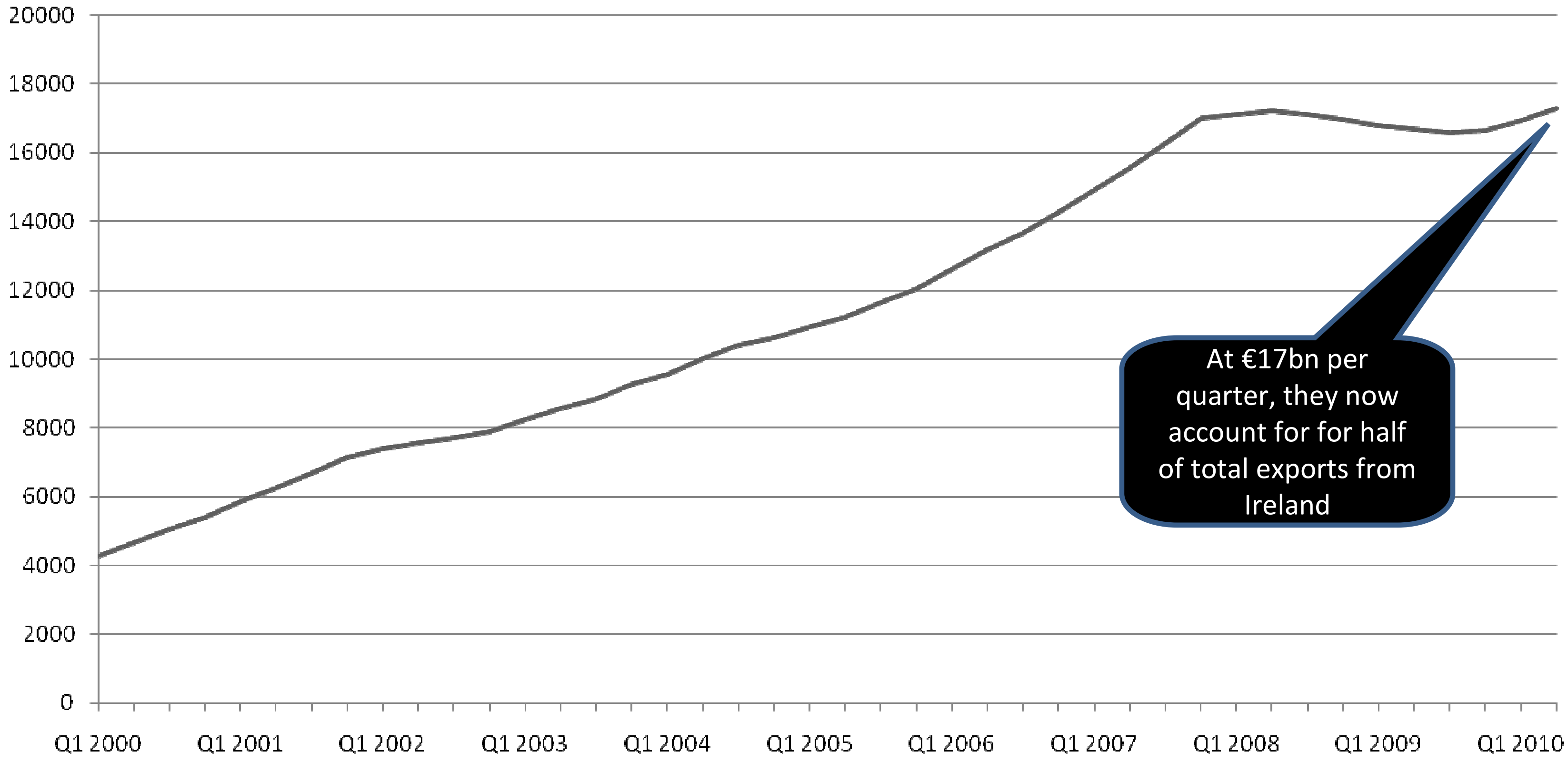
Service exports more than doubled even during construction bubble: will drive future growth



Source: CSO

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Summary of government banking initiatives I

- Measures taken by Government to protect the stability of the banking system :
  - Bank Guarantee Scheme introduced in September 2008 for two years
  - Extension of guarantee: Eligible Liabilities Guarantee Scheme of December 2009 for issuance of guaranteed debt up to 5 years maturity
  - Nationalisation of **Anglo Irish Bank** in January 2009
  - Recapitalisation of the banks
  - Setting up of **National Asset Management Agency (NAMA)**

Summary of government banking initiatives II

- Measures taken by Government to protect the stability of the banking system :

  - Anglo Irish Bank re-capitalised to the tune of €29.3bn by way of promissory notes; severe stress case would see additional €5bn injection
  - Anglo split into asset recovery bank and funding banks: workout over 10-15 years
  - Cost to be reduced by burden-sharing with subordinated bondholders
  - **Irish Nationwide (INBS)** recapitalised with €5.4bn in promissory notes; no viable future as independent entity
  - **Educational Building Society (EBS)** recapitalised with €250m in promissory notes and special investment share; currently subject to sale process

Summary of government banking initiatives III

- Measures taken by Government to protect the stability of the banking system :

  - **Allied Irish Bank (AIB)** capital needs total €10.4bn following second PCAR review. It raised €2.5bn in sale of Polish subsidiary. The capital boost from the sale of its M&T stake in the US was €0.9bn. It hopes to raise c. €1.5bn from further asset sales (although UK sales process is proceeding slowly).
  - AIB's residual capital requirement of €5.4bn will come from private share offering underwritten by NPRF. The NPRF already holds €3.5bn in preference shares: if required €1.7bn of these will be converted plus fresh cash investment from NPRF for the balance of the shares (€3.7bn).
  - **Bank of Ireland (BoI)** raised €2.9bn in rights issue earlier this year, through which NPRF converted €1.7bn of preference shares to equity. The NPRF continues to hold €1.8bn in preference shares. BoI is now recapitalised.
  - **Irish Life & Permanent** has not required any direct government support

NAMA introduced to clean up bank balance sheets: necessary condition to re-start credit multiplier

- NAMA will buy approximately €74bn of property-related and associated loans (performing and non-performing) from the banks at a severe discount to the book value of the loans
- 33% of loans are outside the Republic of Ireland, with 6% in Northern Ireland, and the balance overseas, mainly in the UK (21%)
- Approved by the European Commission
- NAMA will pay the banks for these assets with Government-guaranteed securities
- The banks can access liquidity in the market and from the ECB repo facility with these securities
- Bank balance sheets cleaned up, avoiding Japan-style denial of losses

NAMA off-balance sheet for statistical purposes, but heavy discounts mean that asset value recoverable

- NAMA liabilities are off-balance sheet: government-guaranteed bonds issued bonds are not included in Eurostat definition of General Government Debt

- Income from the >25% of NAMA's assets which are performing will cover cost of servicing the additional debt

- The first two tranches of loans were transferred by August 2010. Nominal value of the loans was €27.2bn, for which NAMA paid €13bn in securities (52.3% disc.).

- NAMA may pay €31bn for a final consideration of €74bn: discount of 58%

- EU requirement that all loans to be transferred by February 2011