

Ireland: 2010 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Ireland, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 30, 2010, with the officials of Ireland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 18, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 7, 2010 discussion of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

IRELAND

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Article IV Consultation with Ireland

Approved by Ajai Chopra and Martin Mühleisen

June 18, 2010

EXECUTIVE SUMMARY

The authorities' aggressive measures have helped gain policy credibility and stabilize the economy. The authorities have pressed ahead with the implementation of the National Asset Management Agency (NAMA)—to transfer distressed property development and commercial real estate assets from the books of banks—and have initiated a process of banks' capital enhancement. Ambitious fiscal consolidation is proceeding as planned. The policy credibility has partially insulated Ireland from market pressures. Following near free fall in late 2008 and early 2009, the economy is stabilizing and growth is expected to resume this year.

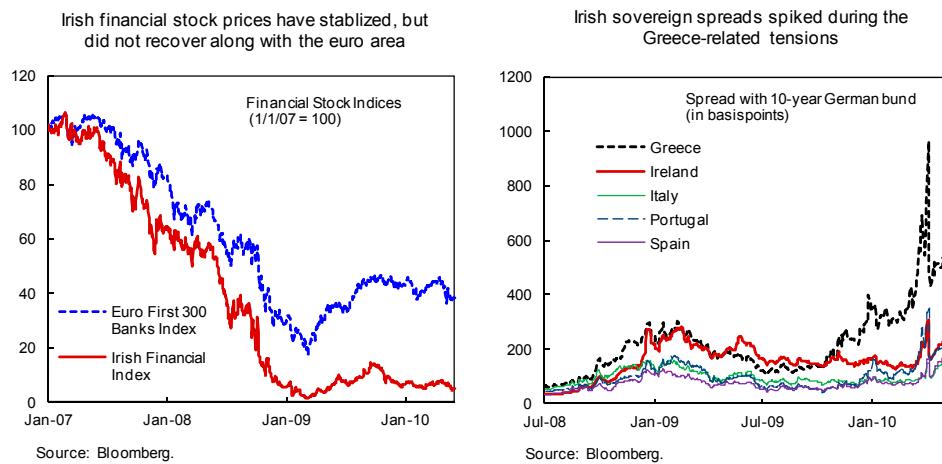
Recovery prospects are weighed down by the ongoing correction of pre-crisis imbalances. Exports offer the most promising source of sustained recovery provided the gains in competitiveness continue. But the relatively low domestic value-added of the most dynamic exports and their high capital intensity imply that the spillovers to domestic growth and employment will be limited. The decline in domestic price levels is needed to restore competitiveness but, in the interim, creates deflationary demand risks. Current policy efforts to boost banks' capital ratios will help, but deleveraging and banks' risk aversion will constrain lending, at least in 2010–11. Along this narrow path to stability and recovery, unforeseen fiscal needs and at times heavily bunched banks' funding needs could generate unwelcome pressures.

Financial sector and fiscal policy require long-haul efforts with active risk management to preserve policy credibility. Orderly disposal of NAMA's assets will help restore the commercial property market, distress of economically-vulnerable homeowners requires attention, and the banking sector itself needs reshaping to a new strategic vision and business model. Reflecting the lessons of the crisis, the ambitious ongoing redesign of the regulatory and supervisory system will be hobbled without a special bank resolution framework. Together, these efforts will facilitate a gradual exit from the government's guarantee of bank liabilities. The authorities' planned fiscal consolidation will require sustained implementation and, if insufficient to reach their goals, should be supplemented by additional measures. A stronger fiscal framework would guide consolidation as the crisis-induced urgency abates.

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I. RETAINING CREDIBILITY¹

1. Through assertive steps to deal with the most potent sources of vulnerability, Irish policymakers have gained significant credibility. Measures to stabilize the banking sector and achieve substantial fiscal consolidation have demonstrated the authorities' resolve to alleviate short-term risks while beginning to tackle their considerable long-term challenges. These actions have reassured the global policy community and international financial markets. The precipitous fall in Irish banks' stock prices has abated. Over the past months, Irish sovereign bond spreads have tended to rise significantly on the days of intensely adverse international market sentiment but otherwise Ireland has been accorded the space to pursue its planned policy trajectory.



2. However, the path from crisis to stability and recovery is a narrow one. With some reversal in the earlier loss of competitiveness and improvements in the global economy, exports will lead the recovery. But spillovers to the domestic economy will be limited because of exports' heavy reliance on imports, their tendency to employ capital-intensive processes, and the sizeable repatriation of profits generated by multinational exporters. Moreover, the unwinding of home-grown imbalances from the boom years—arising from rapid credit growth, inflated property prices, and high wage and price levels—will create deflationary tendencies that act as a drag on growth. Banks remain a source of downside risks from higher than expected losses, uncertainties in global regulatory trends, and continued financial market tensions that restrict access to funding.

3. Along the long-haul path to normalcy, retaining policy credibility will require demonstrated commitment and active risk management. The appropriately ambitious

¹ The staff team comprising Mr. Mody (head), Ms. Barkbu, Mr. Tchaidze (all EUR), Mr. Montes-Negret (MCM), Ms. Luedersen (LEG), and Mr. Melander (SPR) visited Dublin during May 20–31, 2010. Messrs. Hockin and O'Sullivan from the Executive Director's office joined the discussions. Ms. Guscina provided research assistance from headquarters.

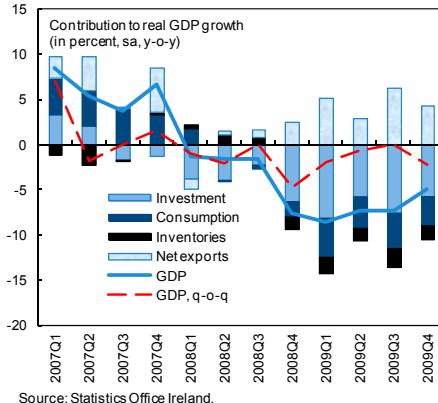
fiscal consolidation plan demands years of tight budgetary control. Likewise, the weaning of the banking sector from public support and its eventual return to good health will proceed at only a measured pace. In the interim, unforeseen fiscal demands may occur. In this context, at times heavily bunched banks' funding needs and episodes of market volatility could generate unwelcome pressures and disruption. With limited fiscal resources for dealing with contingencies, maintaining a steady policy course will require mechanisms for oversight and transparency, and high-quality communication to minimize risks and sustain the political consensus and market confidence.

II. THE NEAR-TERM GROWTH AND EMPLOYMENT OUTLOOK

A. Output

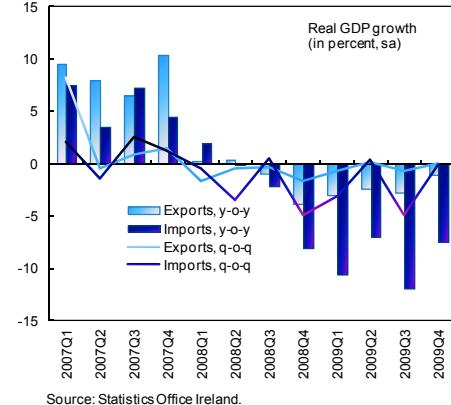
4. Economic contraction continued through 2009. Following a precipitous fall in 2008:Q4, the pace of decline moderated. The economy appeared to stabilize in 2009:Q3, but a q-o-q contraction of 2.3 percent in the final quarter reflected continued underlying weaknesses. For the year, Irish GDP fell by 7.1 percent, reflecting a decline in domestic consumption and investment, particularly construction. Exports declined, but the import contraction was larger, so net exports contributed positively. GNP—income to nationals—fell by 11.3 percent, more steeply than did GDP since the foreign multinationals held up better than the domestic sector.

The fall in GDP was driven by consumption and investment



Source: Statistics Office Ireland.

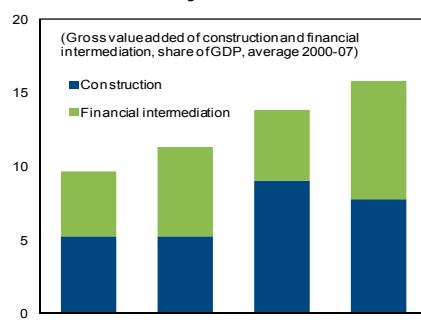
Net exports improved, as imports fell more than exports



Source: Statistics Office Ireland.

5. The extended weakness reflects not just cyclical contraction but structural changes that are reversing past excesses. Pre-crisis growth depended heavily on the construction and financial sectors, which increased their share of GDP to more than 15 percent. In a reinforcing process, housing and commercial development relied on rapid credit growth, leading to overvalued properties and an unsustainable private

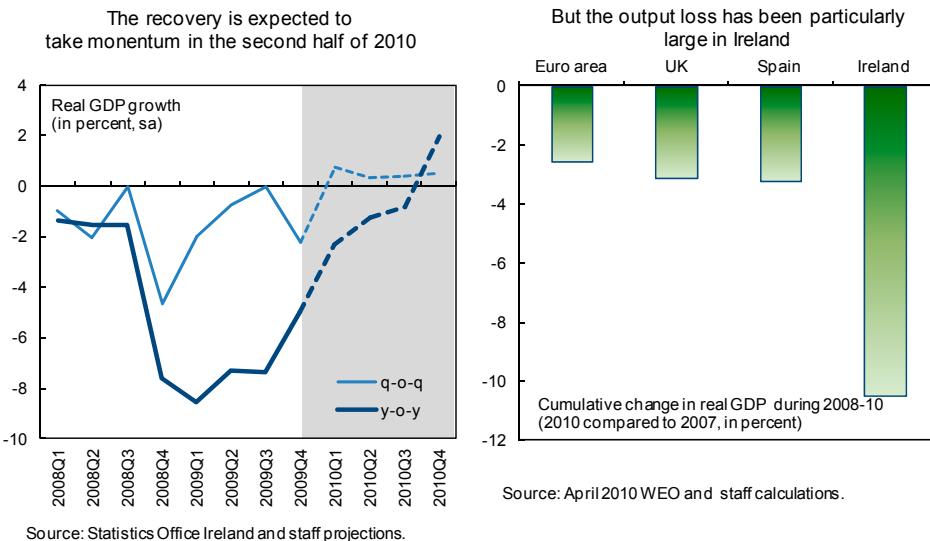
Construction and financial intermediation constitute a large share of GDP in Ireland



Source: Haver Analytics and Eurostat.

credit-to-GDP ratio. In the contraction, that process worked in reverse: increased unemployment and loss of consumer confidence contributed to further weakening of property prices and the banking sector.

6. The economy is projected to resume growth in 2010. Short-term indicators present a mixed picture of prospects. After a sharp rise in January, industrial production has pulled back. Goods exports are recovering from a weak performance in the second half of 2009. Sentiment measures have also shown improvement, but they incorrectly predicted a much stronger 2009:Q4 and do not as yet reflect the recent financial market tensions. Recent unemployment data were disappointing. Consequently, likely outcomes are in a larger than usual zone of uncertainty. Even as the economy recovers through the year, staff projects the GDP for 2010 to be $\frac{1}{2}$ percent lower than in 2009, but with a q4-on-q4 increase of about 2 percent. The authorities have not recently updated their official projections but see scope for a larger cyclical rebound in 2010–11.



Source: Statistics Office Ireland and staff projections.

Ireland - Real GDP growth projections 2010-12

Source	Date	2010	2011	2012
IMF	June 2010	-0.6	2.3	2.5
Department of Finance	Dec. 2009	-1.3	3.3	4.5
Central Bank	April 2010	-0.5	2.8	..
Economic and Social Research Institute	April 2010	-0.5	2.3	..
OECD	May 2010	-0.7	3.0	..
European Commission	May 2010	-0.9	3.0	..
Consensus Forecast	May 2010	-1.0	2.4	..

7. Ireland's openness makes it subject to spillover risks. As a borrower and creditor, Ireland is deeply connected to international financial markets. It, therefore, is subject to international shocks, while also being a potential source of shocks with international implications. Greece's prolonged vulnerability reduced the element of surprise, leading to

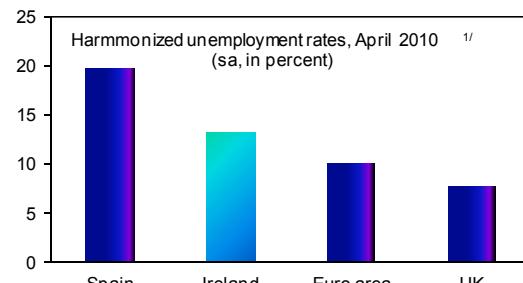
relatively modest spillovers. Irish policy credibility also helped. The Greek exposure of Irish banks covered by the government's guarantee is small.²

B. Employment

8. The high and persistent unemployment reflects ongoing structural changes. The headline unemployment rate increased from 4½ percent in 2007 to 13 percent in 2010:Q1; broader measures that include marginally-attached workers show the unemployment rate closer to 17 percent. The headline rate is likely to peak this year at 13¾ percent before declining to a still high 9½ percent by 2015. In addition to the cyclical component, the large increase in unemployment reflects significant structural changes with the unwinding of the boom years. The sharpest decrease in employment has occurred in construction and manufacturing. Some of these lost jobs may never come back, especially as the duration of unemployment increases, with the attendant depreciation of human capital and future growth prospects (Box 1).

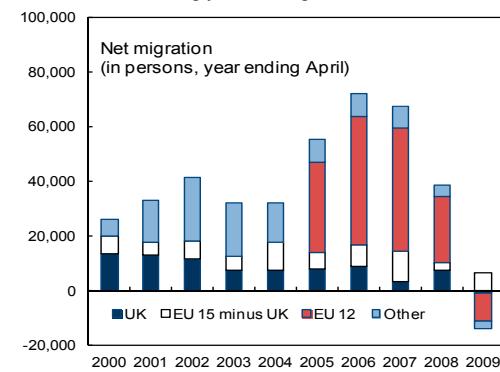
9. Emigration has eased labor market pressures somewhat. Past Irish success has been attributed to the flexibility and openness of its labor market. Immigrants have been welcomed to support growth while the Irish themselves have emigrated when domestic prospects worsened. In this downturn, immigrants from the Central and Eastern European countries have left Ireland in noticeable numbers along with Irish nationals, while immigration has slowed. Based on the 2010:Q1 Labor Force Survey, staff estimates that the unemployment rate could have been as much as 2 percentage points higher without emigration.

Unemployment has become high compared to euro area countries and the UK



1/ March 2010 for the UK.
Source: Eurostat.

Ireland is experiencing net outward migration following years of large net inflows

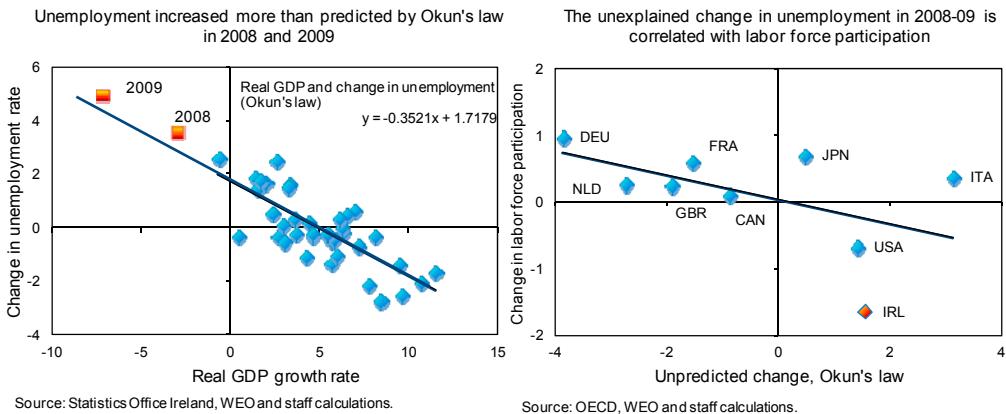


Source: Statistics Office Ireland.

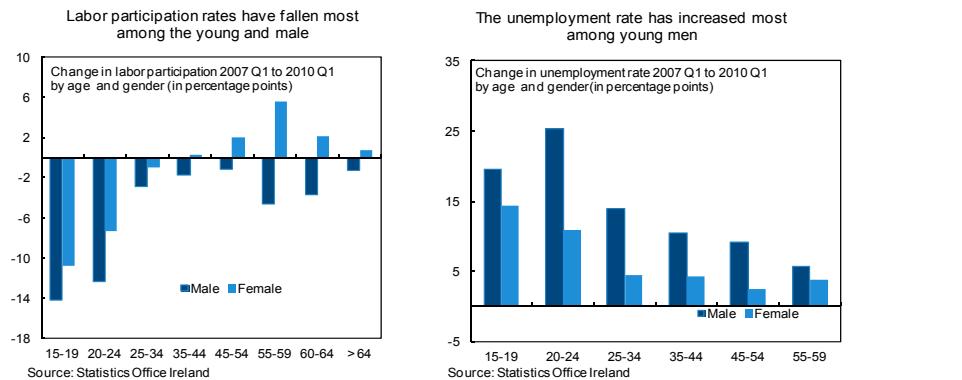
² According to the Bank for International Settlements, Irish-based banks' exposure to Greece was \$8.5 billion (3½ percent of GDP) at end-2009, but this refers predominantly to banks in the International Financial Services Center. The exposure of Irish banks covered by the government's guarantee is of the order of €40 million.

Box 1. Unemployment in Ireland

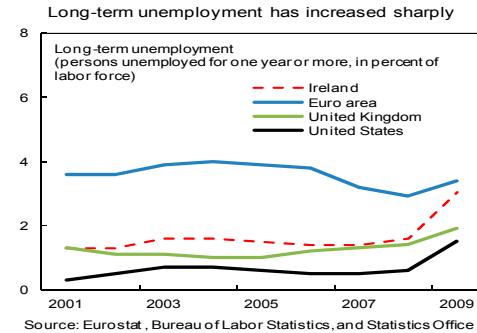
The unemployment response to the recession has been greater than predicted by historical patterns. On the basis of Okun's law, the “unexplained” increase in unemployment over 2008–09 is 1.6 percentage points. Weakness in the labor market is also reflected in discouraged Irish workers who have left the labor force in large numbers, absent which the unemployment rate would have been higher.



Labor participation fell mainly among the younger population. Since the young are likely to return to the labor force as the economy recovers, the unemployment rate will tend to remain high. The fall in participation among older males is more of a concern since they may find it increasingly difficult to return to work.



In past years, Irish long-term unemployment has been relatively low, but it has more than doubled since 2007. Persistent unemployment may become a policy challenge going forward, and the younger generation could face discouragement and loss of human capital.



III. THE STRENGTH AND SHAPE OF THE RECOVERY

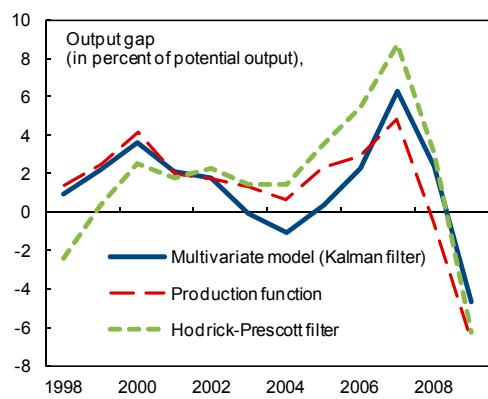
10. The pace of recovery remains constrained by continuing imbalances. Staff projects that GDP growth will gradually recover to 3½ percent by 2015. This modest pace of recovery is due to a decline in potential growth that predates the crisis but was accentuated by it (Box 2). By staff's estimates, the potential growth rate will rise gradually to about 2½ percent by 2015 as the internal imbalances—arising from rapid credit growth, overvalued property prices, and high price and wage levels—are corrected (Figure 1). The analysis cautions that the Irish economy may be in a regime with the relatively-modest potential growth and the high unemployment reinforcing each other. The authorities recognize these dislocations but are more optimistic about the medium-term growth prospects. They judge that the traditional flexibility and international openness of the Irish labor market will provide a self-correcting mechanism towards more robust growth.

Box 2. Potential Output Growth after the Crisis

By 2007, Irish GDP growth had become unsustainable. Three different estimation methods suggest that the output was above potential by 5–7 percent in 2007. The collapse in output since then has taken it below potential, with estimates of the 2009 output gap ranging from -3½ to -7 percent.

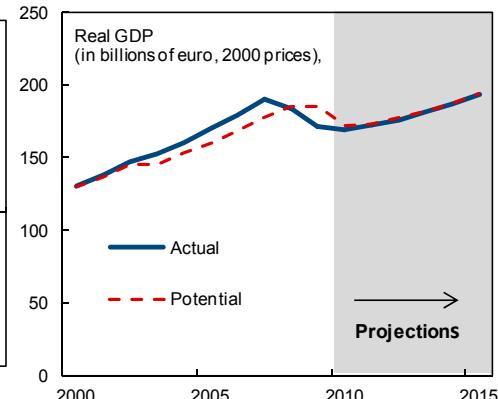
Ireland's potential growth had been declining before the crisis and has been temporarily further reduced. The pre-crisis slowdown in the potential growth rate reflected a maturing of the economy and the absence of new sources of sustainable growth. Following the crisis, lower investment rates, the fallout of the banking crisis, and higher structural unemployment have further dampened the growth potential. Staff sees potential growth rising from the current 1 percent to about 2½ percent, closing the output gap by 2015.

After years of growth above potential a large negative output gap has emerged



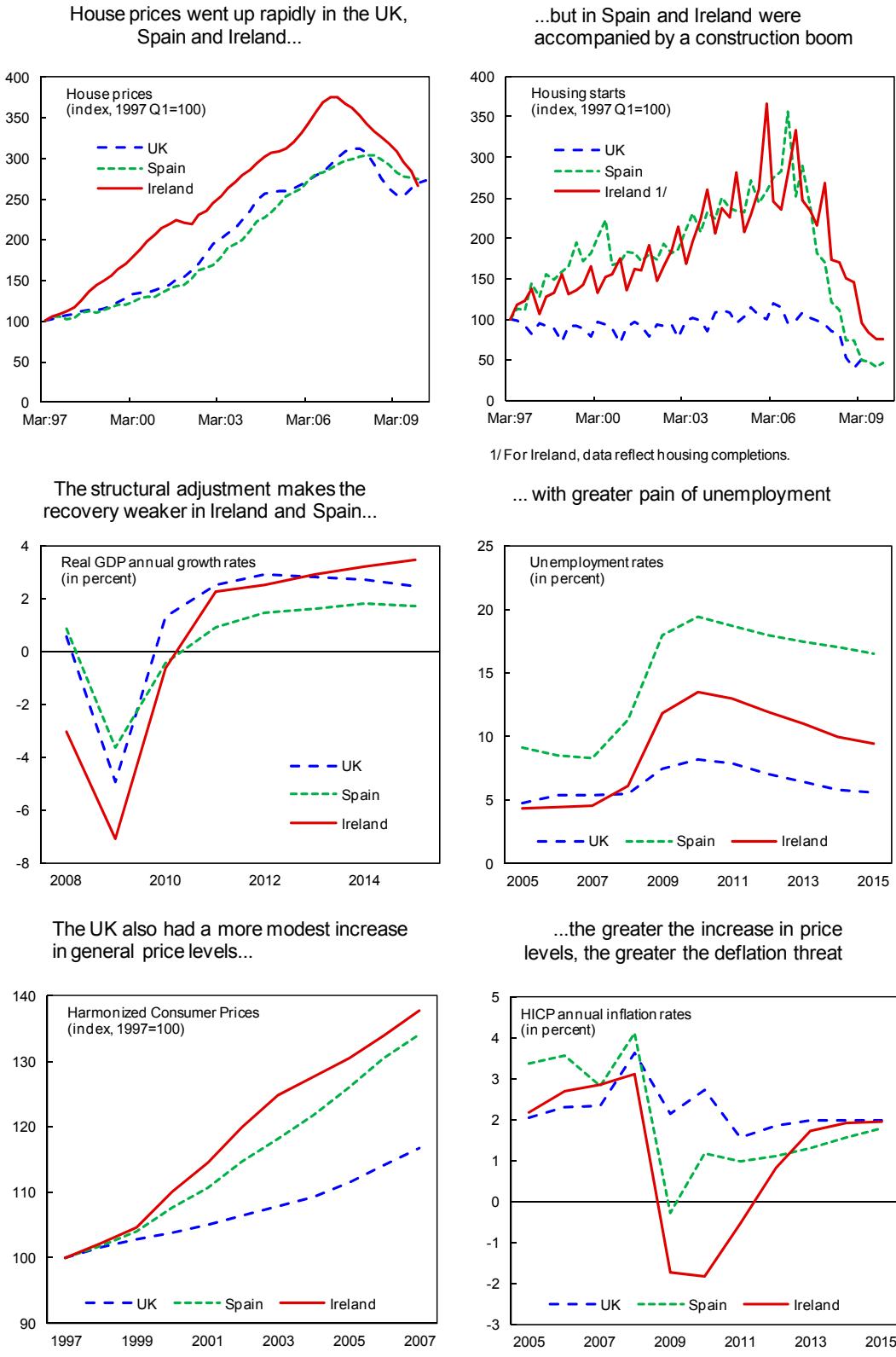
Source: Statistics Office Ireland, OECD, and staff projections.

The loss in potential output is expected to be permanent



Source: Statistics Office Ireland and staff projections.

Figure 1: What goes up fast, comes down hard

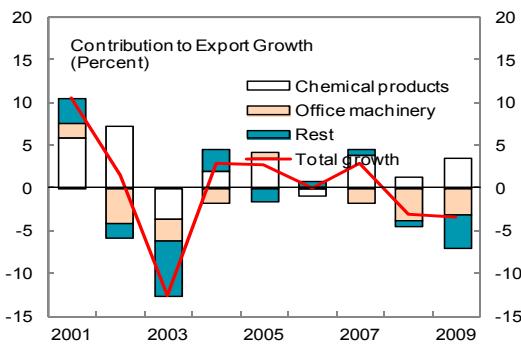


Source: Haver Analytics, April 2010 WEO, and staff calculations.

A. An Export-Led Recovery?

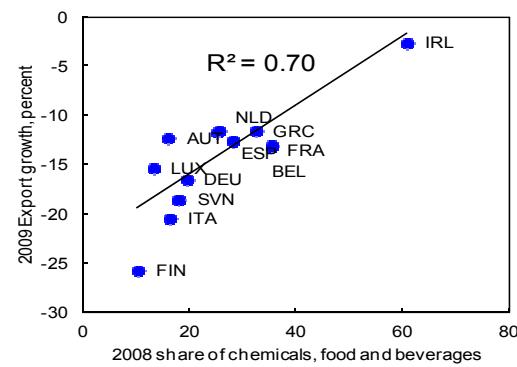
11. Irish exports fell less in the recent global downturn than did exports elsewhere. While German export volumes fell by 14½ percent in 2009, the contraction of Irish exports was only 2¼ percent. A large chemicals' export base helped as global chemicals' trade, particularly of pharmaceuticals, held up even as another traditional Irish export, office machinery, fell sharply. Set against weak domestic demand, exports will likely lead the recovery. The question is whether exports will create a new dynamic that raises the economy to a higher performance trajectory.

While exports of office machinery declined, those of chemical products continued to increase



Source: WEO, UN Comtrade, and Stastics Office Ireland.

Irish exports fell less than exports in other countries

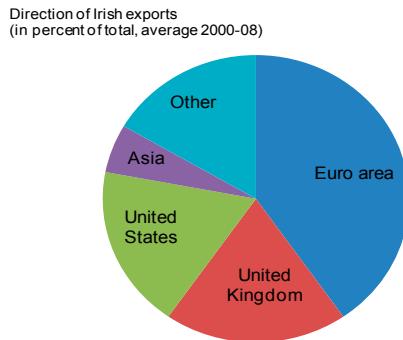


Source: WEO, UN Comtrade, and Stastics Office Ireland.

12. Irish export dynamics have been tied to inward foreign investment.

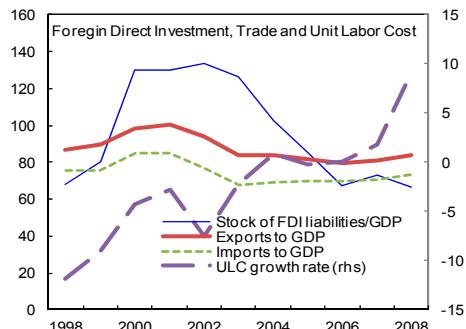
Multinationals, particularly from the United States, substantially raised their presence in Ireland in the late 1990s, linking Ireland to global supply networks of electronics and chemical products. This engagement in global supply chains was aided by wage moderation in the 1990s and by an educated labor force. Ireland's export-to-GDP ratio rose. But, given the heavy import content of the exports, so did the import-to-GDP ratio. U.S. multinationals use Ireland as a base for exports to European markets, and about two-thirds of Irish exports are destined for Europe.

Exports are mainly to the euro area, UK and US



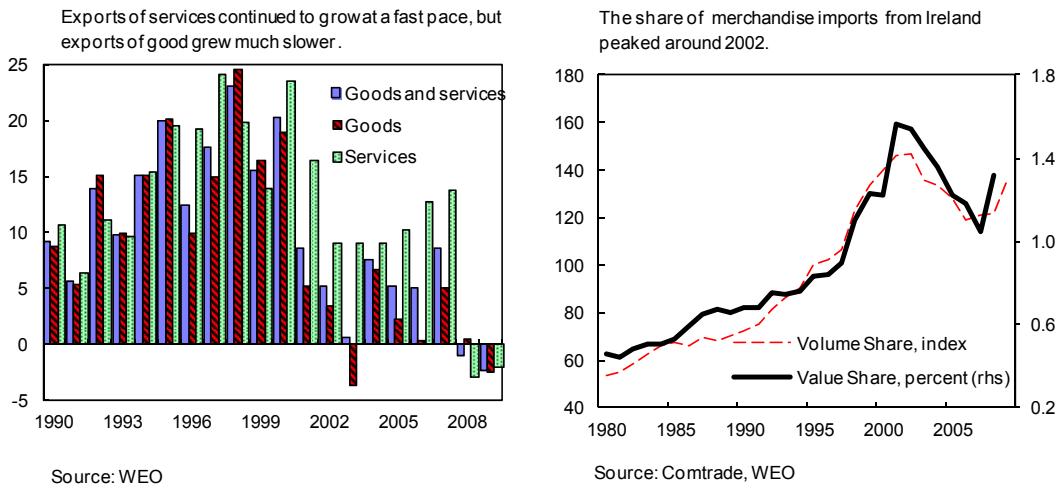
Source: Direction of Trade Statistics database.

Ireland is attracting less investments, as unit labor cost increases erode competitiveness



Sources: Haver Analytics, WEO, and IMF staff calculations.

13. Even before the crisis hit, the rapid rise of Irish wage levels and increasing global competition had diminished traditional Irish advantages. The departure of Dell, a large manufacturing employer, to Poland in early 2009 was symbolic of a loss of edge in low-end manufacturing. Ireland's share of the value of global and European manufactured exports, which had risen sharply between 1995 and 2001, fell steadily thereafter. In recent years, export growth has been sustained, though at lower levels than in the 1990s, by the repositioning of Ireland as a service exporter and "knowledge hub."



Share of Imports of Services from Ireland					
	2004	2005	2006	2007	2008
UK	9.2	9.3	9.2	10.7	11.1
US	2.2	1.6	2.0	2.2	1.8
France	4.0	3.8	3.4	4.9	5.0
Germany	3.0	3.6	3.3	3.5	3.5
Italy	3.2	3.5	4.8	5.0	5.1
Spain	2.3	2.5	2.6	2.9	3.0

Source: Eurostat

14. The recent decline in unit labor costs from their high levels will need to be sustained to close the competitiveness gap and make a material difference to growth prospects. The CGER estimates suggest that the real effective exchange rate is broadly in line with medium-term fundamentals. However, the high Irish price and wage levels will require a period of "internal devaluation" over the next few years to support export growth. Nominal private sector wages rose to new heights through the end of 2008 before hourly wages started declining in early 2009. For now, however, unit labor costs have fallen primarily because of improvements in labor productivity. In turn, the productivity increase reflects mainly compositional shifts in the labor force as the relatively-unproductive construction industry has contracted. Thus staff was concerned that productivity increases

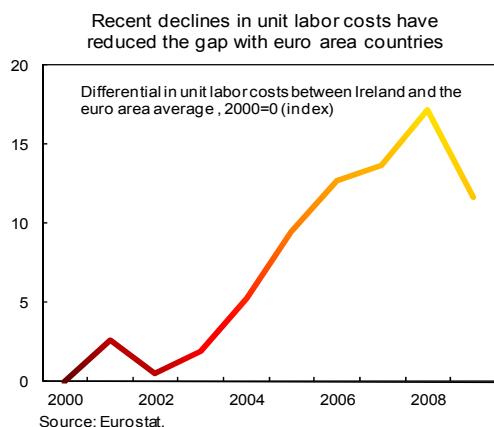
may not continue and, hence, the decline in unit labor costs to competitive levels is not yet assured. The authorities expect wage compression to continue on account of continuing weakness in and flexibility of the Irish labor market.

Ireland: Application of the CGER methodology			
	Macro-Balances	External Sustainability	Equilibrium Real Exchange Rate
Current account norm 1/	-2.3	-3.0	...
Underlying current account balance 1/	-0.6	-0.6	...
Competitiveness gap 2/	-1.6	-3.9	6.0

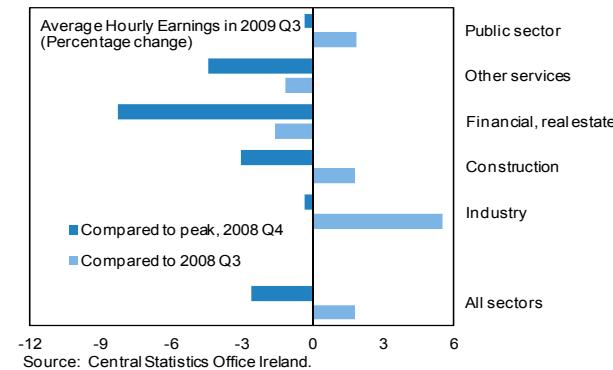
Source: IMF staff calculations.

1/ In percent of GDP.

2/ Adjusted for multilateral consistency



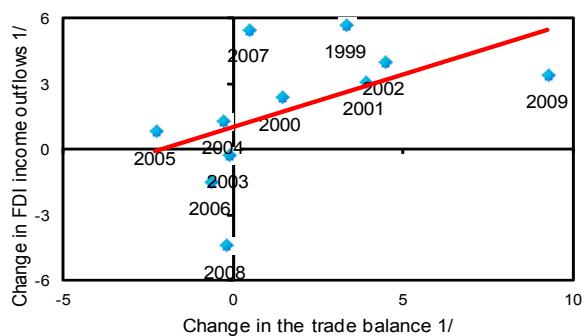
Hourly wages have increased on an annual basis, but the most recent quarters point to falling hourly wages



15. While stressing recent improvements in competitiveness, the authorities agreed that the short-term prospects of Irish exports depend largely on partner country growth. Given the structure of exports, the authorities were mindful that narrow measures of competitiveness were insufficient. They viewed the recent depreciation of the euro as helpful and the gains in unit labor costs as a necessary, though not a sufficient, condition for export growth. Partner country growth is important, but the focus of Irish exports on Europe is not helpful. Among major trading blocs, Europe is recovering at the slowest pace. By staff's projections, annual export growth will rise only gradually to 4–5 percent in 2013–15. For exports to grow faster continuing identification of new niches to counter lower-wage competition would be required.

16. Even with faster growth, the spillover from exports to the domestic economy will remain limited. An increase in Ireland's exports, being highly correlated with an increase in imports, generates a much smaller increase in domestic value-added. Moreover, foreigners have large claims on the

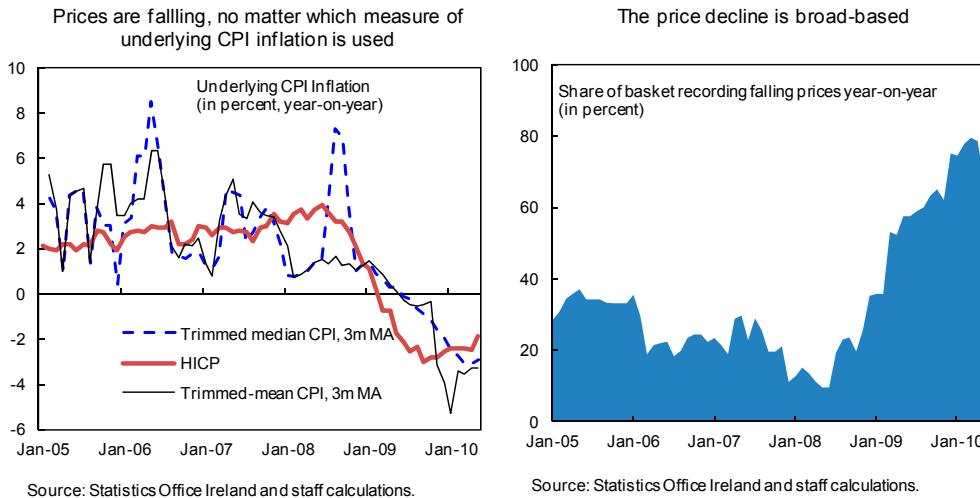
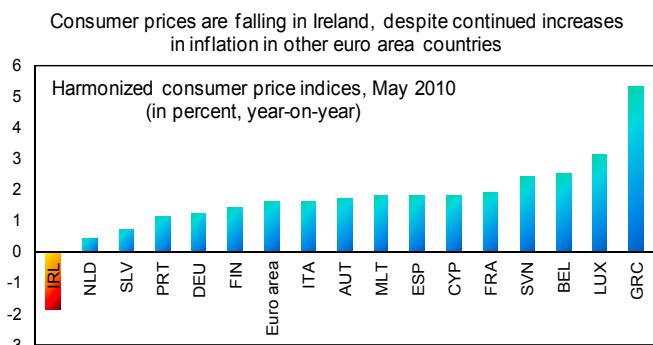
Improvements in trade balance lead to higher income outflows.



value-added generated in the export activity, as demonstrated by high correlation between the change in net trade and the change in income outflow on account of direct investment—the exceptions being the crisis years when imports fell for domestic reasons. Finally, Irish exporting activity has traditionally been relatively capital intensive, becoming more so with the downscaling of lower-skilled electronic assembly.

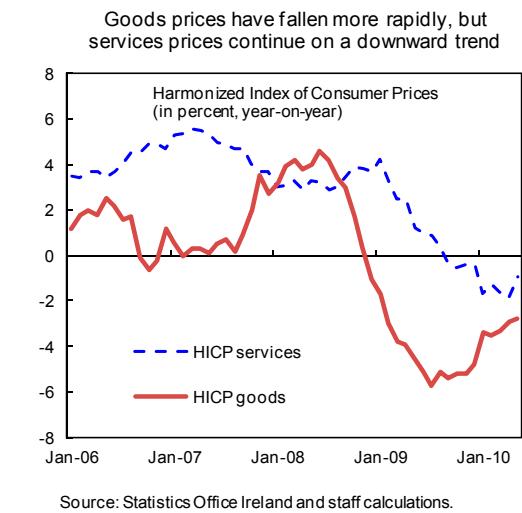
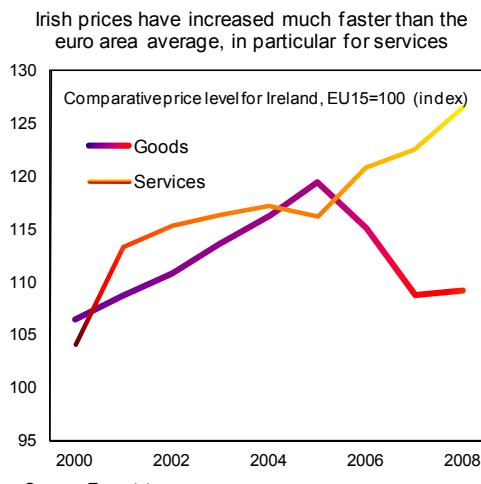
B. The Deflationary Drag

17. **Prices have fallen.** With output below potential and high unemployment, Irish prices have fallen while they have been stable or even rising elsewhere in the eurozone. The annual pace of price decline was 2½ percent in April, but moderated to 1.9 percent in May, largely due to higher energy costs. When the volatile components are removed from the core inflation index, the trimmed estimates show more rapid price decline. The fraction of components of the price index across which prices are falling peaked at 80 percent in April, but remained at a high of 67 percent in May.



18. **The decline in prices reflects the high Irish price levels prior to the crisis and the collapse in domestic demand.** Despite Ireland's extensive trade relationships with the U.K., the depreciation of the British pound relative to the euro does not, in staff's view, appear to be a primary source of the price decline. Irish import prices seem to have fallen after goods prices. Rather, Irish price levels were substantially higher than eurozone price levels prior to the crisis, mainly reflecting higher services prices but also higher goods prices (possibly

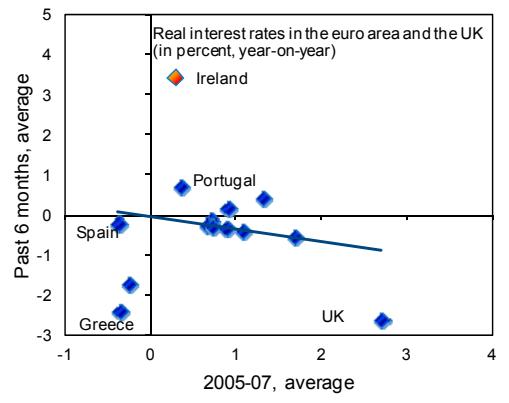
because of the domestic distribution component). The ongoing fall in domestic demand implies that the adjustment to eurozone price levels will continue in the short term.



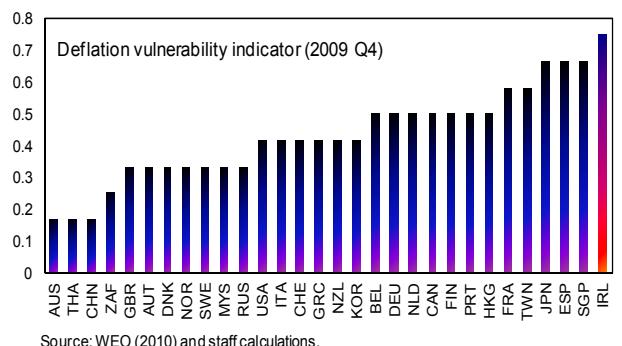
19. **Real interest rates have risen sharply.** In the boom years, Irish prices were rising more rapidly than average eurozone prices. This implied that real interest rates were especially low—and supported the boom. Following the crisis, there has been a tendency for countries with prior low real interest rates to flip to high real rates as they had greater imbalances to unwind. Ireland is an extreme example of this reversal.

20. **Staff projects that Irish prices will continue to fall in the next two years.** Ireland is currently among the most vulnerable nations to continued deflation. An index, capturing deflationary pressure based on indicators such as GDP growth, the output gap, the real exchange rate, equity prices, housing prices, credit growth, and monetary aggregates, suggests that Irish deflation is likely to persist into next year. After a 1.8 percent decline in prices this year, staff projects a further fall of 0.5 percent in 2011. The authorities expect inflation to turn positive next year. They view staff's focus on domestic demand as unduly influenced by the experience of larger economies and, noting recent month-on-month price increases, emphasize that in Ireland's small

Real interests were low in Ireland during the boom, but are now higher than in other countries



The deflation vulnerability indicator ranks Ireland as the most vulnerable country to deflationary pressures

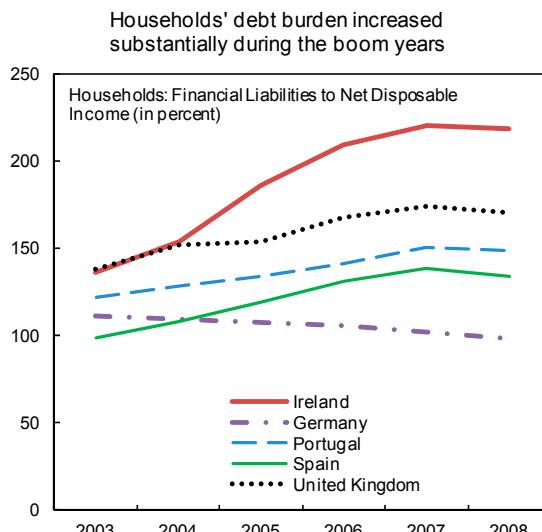


open-economy setting, exchange rate movements and short-run energy and food price increases would prevent further deflation.

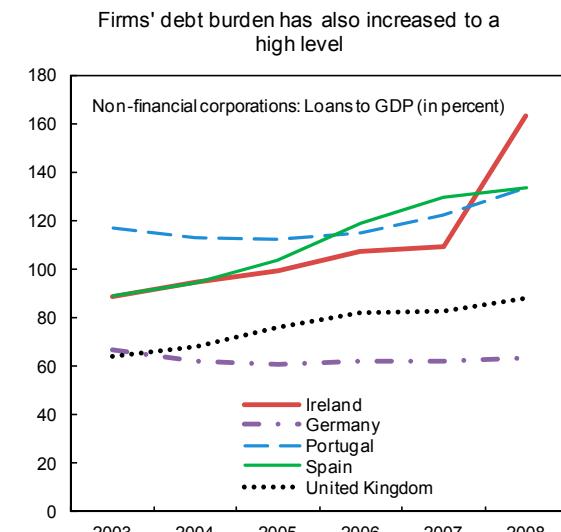
	2005	2006	2007	2008	2009
Output gap widened more than -2 percent in past four Q?	no	no	no	yes	yes
Is growth in last three years < 2/3 growth in previous 10 years?	no	no	no	yes	yes
Has the equity index declined by more than 30 percent in the past 3 years?	no	no	no	yes	yes
Have nominal housing prices fallen more than 5 percent over the past year?	no	no	no	yes	yes
Is broad money growing slower than base money < 2 percent for last 2 years?	no	no	no	yes	yes
Is GDP inflation < 0.5?	no	no	no	no	yes
Is the latest output gap lower than -2 percent?	no	no	yes	no	yes
Is CPI inflation < 0.5?	no	no	no	no	yes
Is core CPI inflation < 0.5?	no	no	no	no	yes
Has the real exchange rate appreciated more than 4 percent over the past year?	no	yes	yes	no	no
Is Q4/Q4 credit growth < Q4/Q4 nominal GDP growth?	no	no	no	no	no
Has cumulative credit growth been less than 10 percent over the past 3 years?	no	no	no	no	no

Source: WEO (2010) and staff calculations.

21. Given the sharp increase in leverage, this will be a drag on the pace of recovery. In order to achieve the required internal devaluation, some fall in Irish prices is necessary. However, in the transition to lower price levels, deflation will slow the pace of recovery. The debt of households and businesses, fueled by the low real interest rates before the crisis and with unchanged nominal values, has now to be repaid in an environment of falling prices, higher real interest rates, and low GDP growth rates. These factors lead staff to conclude that the normally-sharp bounce back to close the output gap after a large output decline will be muted on account of the deflationary drag.



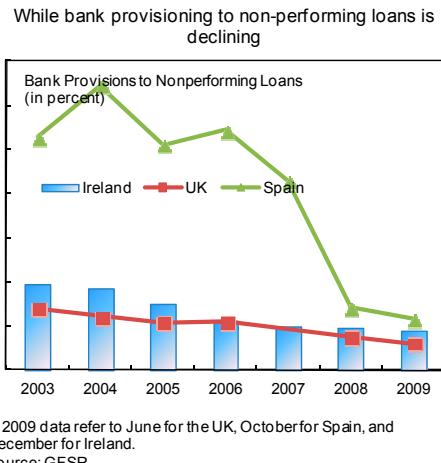
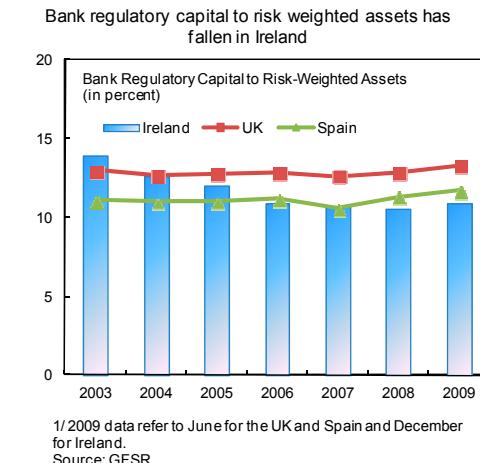
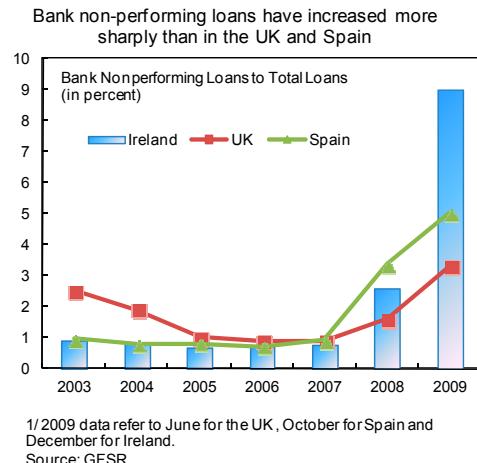
Source: OECD, Eurostat, and staff calculations.



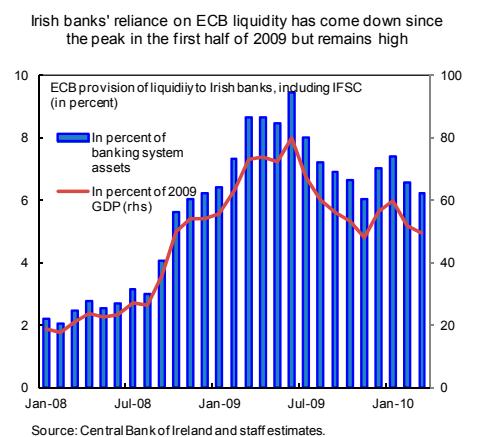
Source: OECD, Eurostat, and staff calculations.

C. Macro-Financial Linkages

22. As banks emerge from the worst phase of the crisis, they remain weak. While capital ratios of the eurozone banks have risen since the crisis, they have declined for the large Irish banks. Banks' reliance on wholesale funding—and, hence, high loan-to-deposit ratios—has yet to be corrected significantly. The ratio of nonperforming loans (NPLs) to all loans increased from $\frac{3}{4}$ percent at end-2007 to 9 percent at end-2009 and can only be expected to increase further, particularly if rescheduled loans fall into arrears. In the meantime, the ability to provision for these NPLs has declined sharply.



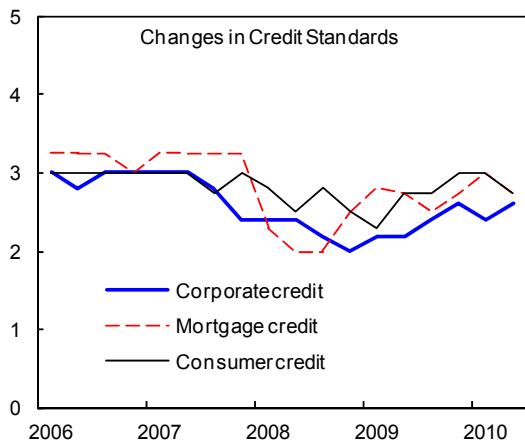
23. Liquidity pressures remain serious. The authorities estimate that over €70 billion (44 percent of GDP) of banks' obligations will mature by September this year. This includes long-term debt, commercial paper, certificates of deposit, and interbank deposits. The maturity of the long-term debt is tied to the expiration of the two-year blanket guarantee provided in September 2008, covering all banks' liabilities. The rollover needs may be somewhat less since some debt has been pre-funded and the deleveraging will diminish the banks' financing requirements. Nevertheless, the sizeable rollover of banks' funding in the third quarter of this year will outstrip the sovereign's direct annual borrowing needs. Through September, the Government's Eligible Liabilities



Guarantee scheme will cover new issuance of up to five years' maturity, subject to review by the European Commission. Depending on market conditions, an extension of this scheme may be needed. Irish banks have also been heavy users of ECB liquidity facilities. The stock of retail bank deposits has been either flat or declining.

24. In response to constrained capital and liquidity, banks have tightened credit standards. Banks' credit standards for firms have tightened continuously since mid-2007. Standards for mortgage and consumer credit, having tightened, are stabilizing. Staff analysis shows that as Irish banks become weaker, credit standards tighten, restricting credit (Box 3). The observed decline in the net flow of credit is, thus, consistent with tighter lending standards. The authorities rightly noted that credit demand had also fallen, and banks were reporting that they were currently limited by lack of good lending prospects. Staff and the authorities agreed that distinguishing supply and demand effects was difficult and staff analysis was cautionary regarding the ability of the banks to lend for a recovery.

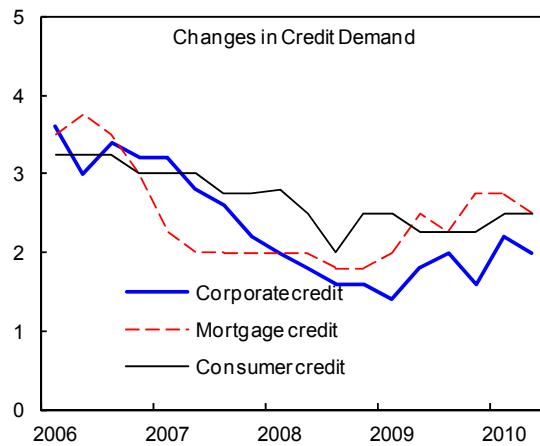
The easy pre-crisis lending standards have been tightened



Source: Central Bank of Ireland.

Note: 1 = tightened considerably; 2 = tightened somewhat; 3 = basically unchanged; 4 = eased somewhat; 5 = eased considerably.

And after a sharp fall, demand is gradually stabilizing



Source: Central Bank of Ireland.

Note: 1 = decreased considerably; 2 = decreased somewhat; 3 = basically unchanged; 4 = increased somewhat; 5 = increased considerably.

Box 3. Macro-Financial Linkages

Banks' health is an important determinant of their willingness to lend. For Ireland, the statistical evidence suggests that the ratio of bank stock prices relative to the overall stock market—a proxy for bank health—helps explain bank lending standards. A fall of 0.5 in this ratio is estimated to cause a gradual tightening of consumer and corporate lending standards by about $\frac{1}{3}$ and 1, respectively, on a scale between one and five (one denotes a considerable tightening of standards and five a considerable easing).

Bank lending standards have an important effect on different types of credit. The average quarterly tightening of lending standards in Ireland during the latest tightening cycle has been approximately 0.1. Such tightening is estimated to cause credit contraction of 0.15 percent of GDP for consumer loans and 0.5 percent of GDP for mortgage and corporate loans. Relative to the gross new lending that occurred in the last quarter of 2009, this corresponds to about 5 percent of consumer loans, 3 percent of mortgage loans and 1 percent of corporate loans.

Credit availability matters for consumption and investment decisions as well as house prices. An increase in consumer credit of one euro is associated with increased consumption of 80 cents with a one-quarter lag and a further 80 cents after one year. A corporate loan of one euro is associated with increased investment of 30 cents contemporaneously and an additional 40 cents after three quarters. Mortgage credit has a significant contemporaneous effect on house prices, which indirectly affects residential investment.

25. **Recognizing these developments, the authorities have raised targets for core-Tier 1 capital.** Weakness of the financial sector, fall in real estate prices, and high unemployment could continue to reinforce each other. For this reason, current policy efforts to boost banks' capital ratios are important and will help counter these tendencies. The Financial Regulator has set a target ratio of 8 percent for core-Tier 1 capital (of which 7 percent is to be equity capital) taking into account losses arising from the ongoing transfer of loans to NAMA as well as future expected losses on non-NAMA assets until 2012. The required capital injections will also ensure that banks' core-Tier 1 capital would remain above 4 percent in a stress scenario.

26. **But these efforts may be insufficient to finance the early phases of the recovery.** The recent rights issue by one major bank indicates that some private capital is returning to banks; but the authorities are committed to fill the remaining gaps to ensure that bank capital will not be a constraint on lending. However, as they recognize, deleveraging to reduce the loan-to-deposit ratio and banks' risk aversion will likely constrain lending and the pace of economic recovery, at least in 2010–11. Higher than expected losses, uncertainties in global

regulatory trends, and renewed financial market tensions—that may restrict access to funding—create downside risks. In this environment, targets for SME lending, which have been imposed on two major banks in 2010–11, could have adverse effects on credit quality and hence require strong prudential safeguards, as the nonperforming loans of this sector have grown rapidly.

IV. FINANCIAL SECTOR: RESTRUCTURING AND STABILITY

27. The next steps in the financial sector agenda are usefully thought of in two parts. Restructuring measures are needed to address the continued fallout from the crisis; and a stronger framework for financial stability, which incorporates lessons from the crisis, will limit future instability. Together, these measures should help phase out of the government’s guarantees of bank liabilities.

A. Restructuring

28. First, NAMA should schedule an orderly disposal of the property assets acquired. NAMA is to manage the assets acquired with the aim of achieving the best possible return for the taxpayer over a 7–10 year timeframe (Box 4). The authorities agreed a holistic approach to NAMA’s success was needed. Rather than aiming to time the market for an upturn in property prices, the goal should be to reduce the large overhang of property in state hands (which could keep investors on the sidelines and prices low), restart market transactions and, thus, help normalize the property market. The lesson from the experience of all asset management companies—including those that dealt primarily with commercial real estate (in Sweden and the Resolution Trust Corporation (RTC) in the United States)—is that a sound and transparent process for the management of asset sales is needed, but moving ahead with early sales is important.³ Governance of NAMA is strengthened by its independent board. However, given the government’s large presence in the property market, implementing the provisions for the oversight of NAMA’s operations, is vital.

³ In Sweden the objective of early sales coincided fortuitously with a quick economic recovery under favorable external conditions. In the U.S., after delays proved costly, a more aggressive timetable was adopted.

Box 4. The National Asset Management Agency

The National Asset Management Agency (NAMA) was established in late 2009 to take over distressed property-development and commercial real estate assets from five of the banks covered by the government's guarantee on banks' liabilities. Under the completed first tranche, NAMA has acquired loans with a book value of €15.3 billion for about €7.7 billion, representing an average discount of 50 percent. In total, about €81 billion worth of loans are to be acquired at a deep discount by the end of this year.

The participating institutions receive government-guaranteed securities in return for the assets purchased by NAMA. Assuming an average discount of 50 percent, NAMA would ultimately issue about €41 billion of securities in total, up to 5 percent of which would not have to be honored if the proceeds from the asset sales fall short. The purchase and management of acquired assets is delegated to a Special Purpose Vehicle with 51 percent private ownership but under NAMA's control. For this reason, the NAMA-issued securities are to be treated as off-balance sheet in the Irish budget. A contingent liability—of 25 percent of GDP—will be extinguished if NAMA recovers its outlays.

For the banks, the loans sales will reduce the uncertainty about the soundness of their balance sheets and increase their liquidity reserves. Replacing risky property-related loans with risk-free NAMA bonds reduces banks' risk-weighted assets and hence improves capital adequacy. Capital shortfalls due to the NAMA discounts are being met by a combination of private and public capital injections.

29. The increasing economic stress will require targeted support for homeowners.

With increasing arrears and reschedulings, the Financial Regulator has cautioned that homeowner distress may be the “biggest legacy” of the crisis. The Regulator has required banks to wait 12 months from when arrears arise to initiate repossession on a primary residence if the borrower is engaged in restructuring arrangements. Government programs also assist with interest payments for mortgages originated in recent years and interest supplement to the neediest. The authorities noted that further support measures raise the risk of moral hazard, and, hence, of strategic default, and create a perception of unfairness. A working group on Mortgage Arrears and Personal Debt Review is studying available options. Mindful of these considerations, staff proposed that, with persisting unemployment, additional support measures may be needed for a narrowly-targeted group of vulnerable homeowners to limit the economic and social fallout of the crisis. With their capital bolstered by the state, banks could absorb the initial costs, perhaps basing themselves on the welfare system to identify eligible beneficiaries.

30. This process will be aided by an overdue shift to a more efficient and balanced personal insolvency regime. The authorities noted that discussions were ongoing regarding inclusion in the law of an optional out-of-court resolution mechanism, and whether this may

apply to small businesses as well as individuals. This would allow a more timely and flexible, as well as less costly alternative to the current legal framework. Staff pointed out that a repayment period of three to five years and the removal of overly punitive elements such as imprisonment for nonpayment of civil debts would bring the regime more in line with European practices.

31. The authorities' intent to proactively reshape the system is appropriate. Some evolutionary restructuring is occurring: some foreign banks are scaling down their Irish operations. Currently, however, the authorities are focused on bank-by-bank restructuring of banks benefiting from government support. While much of this relies on disposal of noncore assets, in one case, the authorities are also contemplating a “good bank/bad bank” split of the residual operations after moving some of the riskier assets to NAMA. Staff strongly supported the authorities’ move to mandating a strategic unit within the National Treasury Management Agency, which also houses NAMA, to foster a market-oriented approach to achieve a future viable and competitive banking system.

B. Financial Stability

32. Considerable progress has been achieved in establishing a more assertive regulatory and supervisory system. Following evolving international practice, the authorities have set targets for higher and better quality capital, while also focusing on improved liquidity management. They are moving to strengthen the governance of banks’ boards, raise the fitness and probity requirements of senior managers and board members, and create further safeguards against related-party lending. In parallel, the *de facto* consolidation of the Central Bank and the Financial Regulator, the bill to formalize this arrangement (including more accountability of the Regulator), the new risk-based supervisory approach, and plans to upgrade onsite supervision are all steps in the right direction. The key challenge is to ensure that these plans are implemented in a timely manner through adequate resources and enhanced enforcement powers.

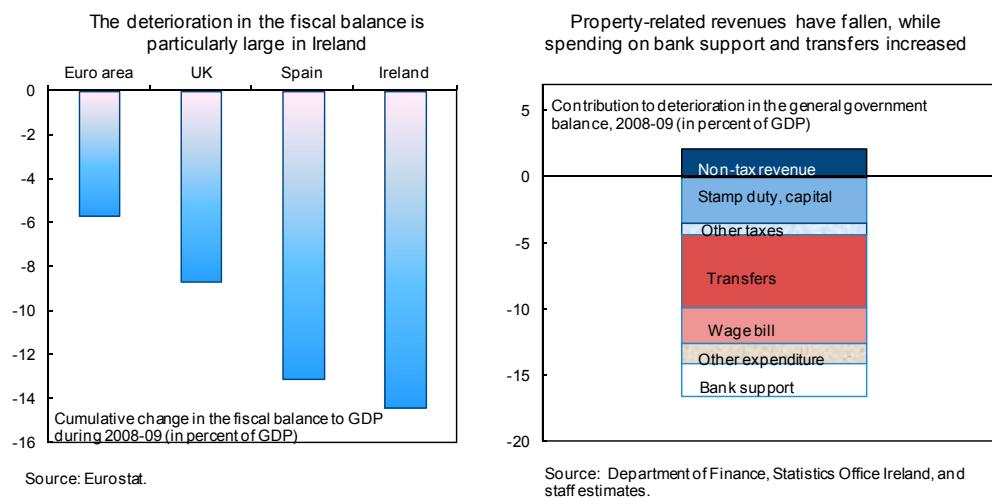
33. More immediate attention is needed to establish a special bank resolution framework. Recent discussions at the European level emphasize timely bank resolution, triggered by more prudent thresholds. This, in turn, requires a legal framework allowing for broader resolution tools such as the establishment of bridge banks and the assumption of liabilities and the purchase of assets. Some European countries have begun to establish special resolution regimes, with the U.K. taking the lead. The authorities recognize the merits of a special bank resolution framework, and the delay in establishing one reflects discussion on choices with respect to the tools suitable for Ireland. Staff emphasized that early action to introduce a special bank resolution mechanism is needed to meet contingencies and strengthen the stability framework. The operational arrangements of the deposit guarantee scheme are being bolstered, and the authorities recognize the need for additional premiums from banks when they return to greater normalcy.

34. **To complement regulatory safeguards, and to reduce and meet the costs of future crises, a financial stability charge could be contemplated.** Such a charge would have two elements. A risk-adjusted levy, tied to a credible resolution mechanism, would provide resources for a resolution fund to be used for future crises. A financial activities tax, levied on the profits and remuneration (of senior executives) would represent a fair contribution from the sector to general revenues but also serve the purpose of reducing the sector's size and, hence, its systemic risk. Such tax measures remain controversial but are being contemplated in a number of other countries. The authorities noted that Ireland would be guided by the evolving international practice and these initiatives may need to be deferred until more normal conditions apply.

V. THE FISCAL OUTLOOK AND CONSOLIDATION AGENDA

A. The Outlook

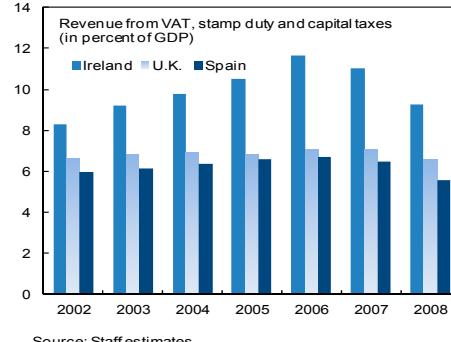
35. **To counter the deteriorating fiscal position, the authorities moved early to make substantial, balanced, and lasting consolidation efforts.** As the fiscal situation deteriorated and a large structural deficit emerged (Box 5), the authorities acted repeatedly to take additional measures and raise the ambition of their fiscal consolidation goals. This was achieved in a remarkably socially-cohesive manner and represented a balance of economic and social considerations. The strong upfront measures are expected to yield a net adjustment of 5½ percent of GDP over 2009–10. The 2010 budget focused on expenditure measures: reductions in the wage bill, social welfare benefits, and public services spending, in particular health care and education. The scope of public service pensions was reduced for new entrants, starting in 2010. Within the imperative to consolidate, efforts were made to maintain activity and employment, and safeguard those worst hit by the recession. Revenue measures included a carbon tax, to provide incentives for low-carbon energy.



Box 5. Asset Booms and Structural Fiscal Balances

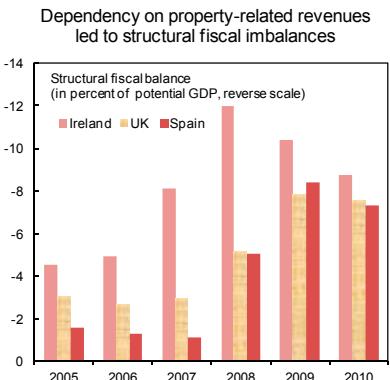
Tax revenues were boosted by the property bubble. For Ireland, revenues from capital taxes and stamp duties increased from 2 percent in 2000 to 4 percent of GDP in 2007, while VAT increased one percentage point of GDP to 7½ percent over that period. At their peak in 2007, these revenues represented over a third of total current revenues. In contrast, they were one fifth of current revenues in Spain and the U.K., two other countries with large asset booms.

Revenues from VAT, stamp duty and capital taxes were more buoyant in Ireland



Source: Staff estimates.

These asset-related revenues encouraged increases in structural expenditures.



Source: Staff estimates.
1/ The estimates of the structural balances across countries are not directly comparable, as the estimates for Ireland directly incorporate the effect of asset-related imbalances.

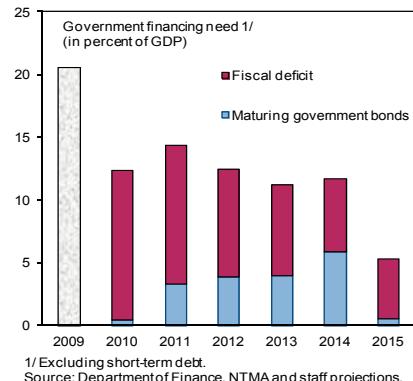
When adjusting for the impact of asset prices, the Irish structural deficit reached 8 percent in 2007, spiking to 12 percent of GDP in 2008. Spain and the U.K. also experienced sharp but smaller increases in structural deficits. However, after fiscal adjustment of 5½ percent of GDP, the Irish structural deficit is expected to decline to 8½ percent of GDP in 2010, while discretionary fiscal stimulus has raised the structural deficits in Spain and the U.K.

36. The 2010 budget adheres to the consolidation track, but risks remain. The authorities project the 2010 deficit to be 11½ percent of GDP. Because of lower nominal 2009 GDP than assumed in the 2010 budget and a weaker growth projection, staff projects lower revenues, leading to a deficit of 11.9 percent of GDP in 2010. The accounting treatment of the government's equity injections into the troubled banks is still being determined but could raise the 2010 headline deficit substantially.⁴ The authorities noted that the associated fiscal outlays have already been incorporated into the official debt figures.

⁴ A re-classification of a capital injection (2½ percent of GDP) as a capital transfer raised the 2009 deficit to 14½ percent of GDP. In the first half of 2010, the government issued promissory notes worth 8½ percent of GDP to increase capital in one bank and two building societies. If these injections are considered capital transfers, the 2010 deficit would increase by this amount. As it would represent a once-off adjustment, it would not impact on the trajectory of the deficit for 2011. The further possible capital injection of 5 percent of GDP would add correspondingly to the 2010 deficit.

37. The remaining sovereign financing need in 2010 is limited. The average maturity of Irish treasury bonds is high—at 7½ years—and the rollover need is therefore limited. For 2010, about three quarters of the planned government bond issuance (€20 billion) had been obtained as of June. The annual financing needs in 2011–12 are projected at about the 2010 level. The authorities maintain sizeable cash balances, financed by short-term debt, which could act as a buffer against any temporary difficulties in issuing long-term debt.

The gross financing need is expected to remain below the 2009 level in the medium term



38. Staff supports the appropriately ambitious fiscal consolidation plan through 2014 but cautioned that the required adjustment may be larger than projected by the authorities. The consolidation plan, outlined in the December 2009 Stability Programme Update, aims to reduce the deficit to below 3 percent of GDP by 2014. The plan envisages fiscal adjustment of 4½ percent of GDP over 2011–14, of which about 1 percent of GDP represents reductions in capital expenditures. The staff's macroeconomic projections imply that the required medium-term adjustment could be larger than projected by the authorities. Starting from a higher projected deficit in 2010 and based on less optimistic macroeconomic projections, staff estimates that the adjustment need over 2011–14 would be 6½ percent of GDP, 2 percentage points of GDP higher than the authorities do. The authorities concurred with staff on the importance of meeting the targets they have set within the agreed timeframe.

Ireland - Fiscal Projections 2009-14
(Percent of GDP)

	2009	2010	2011	2012	2013	2014
Revenue	33.6	34.5	34.9	36.4	36.8	36.9
Tax revenue (incl. capital tax)	21.8	21.1	22.0	23.5	23.9	24.1
Social insurance contribution	5.5	5.7	5.7	5.7	5.7	5.7
Other current revenues	5.2	6.3	5.8	5.8	5.8	5.8
Capital revenues	1.0	1.3	1.3	1.3	1.3	1.3
Expenditure	47.9	46.4	46.0	45.0	44.0	42.8
Wages and salaries	12.1	11.2	10.7	10.2	9.8	9.5
Goods and services	6.0	5.8	5.7	5.5	5.3	5.1
Current transfers	18.6	19.9	19.9	18.9	18.3	17.3
Interest payments	2.1	2.8	3.3	3.8	4.1	4.4
Other	1.4	1.5	1.7	1.8	1.8	1.8
Capital expenditure	7.7	5.1	4.8	4.8	4.8	4.8
Overall balance	-14.3	-11.9	-11.1	-8.6	-7.3	-5.9
Authorities target 1/	..	-11.6	-10.0	-7.2	-4.9	-2.9
difference due to macropredictions	..	-0.3	-1.1	-1.4	-1.6	-1.8
difference due to assumed measures	..	..	..	..	-0.8	-1.2
Structural balance 2/	-9.8	-8.2	-6.8	-5.9	-5.6	-5.2
General government debt	64.0	86.2	94.7	96.9	97.5	97.7

1/ The difference between the fiscal projections of the Department of Finance and the IMF staff is due in part to assumptions of lower growth on the part of the IMF staff. The IMF staff's baseline fiscal projections for 2011–12 incorporate the adjustment efforts announced by the authorities in their December 2009 Stability Programme Update, although 2/3 of these measures remain to be specified.

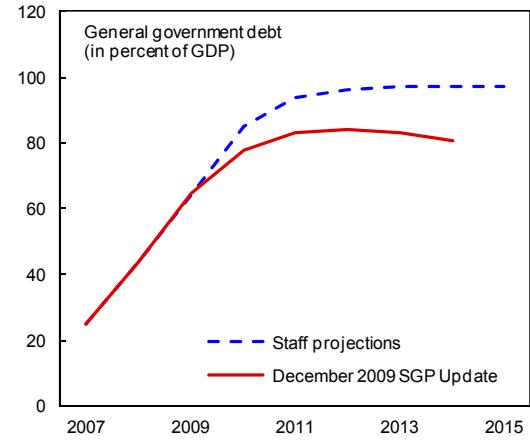
For the remainder of the period, the IMF staff's projections do not incorporate the further adjustments efforts outlined in the Stability Programme Update. However, the Irish authorities have committed to the implementation of these additional adjustment measures, which is supported by their favorable track record to date in taking the necessary actions to attain budgetary targets.

2/ In percent of potential GDP.

Source: December 2009 SGP Update and staff projections.

39. The trajectory of the government's outstanding debt ratio will depend on the size and nature of the support to the financial sector. Since the SGP Update, the authorities have incorporated into their debt projections the promissory notes for bank support that were issued in early 2010. Going forward, staff projects government debt to increase steadily until 2014, but to stabilize below 100 percent. On the basis of Eurostat's preliminary advice, debt issued by NAMA's privately-owned Special Purpose Vehicle does not affect the general government debt, although it would represent a contingent liability of more than 25 percent of GDP in 2010.

General government debt would stabilize at a high level post-crisis



Source: Department of Finance and staff projections.

B. The Consolidation Strategy

40. The authorities agreed that expenditure savings will remain central to achieving the consolidation targets. The recent expenditure commission identified detailed potential reductions yielding savings of €5.3 billion (3½ percent of GDP), of which about €2 billion have been implemented in the 2010 budget. Looking ahead, although capital and multi-annual spending reduction plans have indicated the size of the adjustment needed in each year, they are not backed by sufficient specificity. In response to staff's view that more detail would provide further confidence regarding the durability of their consolidation effort, they noted that initial steps towards establishing a medium-term framework had been taken. Thus, more generally, they foresee efficiency savings from the ongoing public services modernization, particularly in the health and education sectors. To underpin these gains, a draft public service agreement has been ratified by labor unions for the reduction in the number of public service employees through nonreplacement and flexible redeployment. Social welfare transfers were reduced in the previous budget, but entitlement reforms could generate further savings.

41. The authorities recognize that revenue enhancement should contribute to the consolidation. Taking into account the recommendations of the tax commission and consistent with staff advice, the authorities are currently developing proposals to reform income taxation, with the aim to simplify and broaden the income tax base. The reform would include eliminating tax exemptions, reviewing the income tax bands, consolidating the current levies and introducing a universal social charge. The authorities agreed that property taxation would also help broaden the tax base while at the same time making it more stable than the current system of stamp duties. In the transition to a valuation-based tax, a flat tax rate is under consideration.

42. Now is also a good moment to establish an institutional process to reinforce the collective commitment to stable public finances. The authorities recognize the risk of “consolidation fatigue” and, hence, a fraying of the social cohesion needed to complete the consolidation task. In principle, they agreed with staff that institutionalizing the commitment to fiscal goals could prove valuable, and consideration is being given to bolstering the institutional arrangements. The authorities regard with greater favor a medium-term expenditure framework to reduce the uncertainties associated with the consolidation process, while also constraining excesses in good times ahead. They indicated that they are considering how to strengthen institutional arrangements in this regard. . While acknowledging the limitations of fiscal rules and councils, staff maintained that these institutions would enhance policy credibility now and in the future. A fiscal rule, consistent with the Stability and Growth Pact, would create a public metric for sound public finances and a technocratic fiscal council could advise on risks underlying public finances.

VI. STAFF APPRAISAL

43. Ireland is emerging from a deep slump into a modestly-paced recovery. Helped by active policy stabilization measures and, increasingly, by the improved global outlook, GDP is expected to resume growing this year. However, because GDP fell steeply and through much of last year, the 2010 real GDP is expected to be about $\frac{1}{2}$ percent lower than in 2009. As the crisis-related dislocations are corrected, GDP growth should increase gradually to about $3\frac{1}{2}$ percent by 2015, while unemployment should decline from a peak of about $13\frac{3}{4}$ percent this year to still high $9\frac{1}{2}$ percent.

44. A continuation of vigorous policy efforts is required with an emphasis on risk management. The challenge is to wean the banking sector from public support and stabilize public debt in a testing environment of gradual domestic economic recovery and episodic international market tensions. Mindful, therefore, that unforeseen fiscal shocks and, at times, heavily bunched banks’ funding needs could constrain policy options along the narrow path to stability and recovery, active risk management should guide policy priorities. This will require a continued visible demonstration of commitment to the goals set. But with limited fiscal space, the commitment will need to be backed increasingly by mechanisms for accountability and oversight to anticipate and contain slippages and surprises.

45. To address the fallout from the crisis, three restructuring priorities deserve attention. Having acquired risky assets, NAMA’s task would include restoring the commercial property market through an orderly schedule of market transactions. Economically-vulnerable homeowners will likely need narrowly-targeted support, including through banks that have been recapitalized by the state. And, following the stabilization effort through bank-by-bank restructuring, a strategic, market-oriented view should help reshape the banking sector.

46. **Much progress has been made on the financial stability agenda, but a special bank resolution scheme remains an important gap.** The *de facto* combination of the Central Bank and the Financial Regulator is being formalized. The new assertive, risk-based supervisory approach is welcome and needs to be backed by further resources and enforcement powers. The establishment of special bank resolution regime, which has been recognized internationally as a key stability tool, requires immediate attention.

47. **In their 2010 budget, the authorities have stayed on course towards their consolidation goals, but much remains to be done.** The authorities' consolidation target and path remain appropriate. The plan also strikes the right balance with its central reliance on expenditure reduction complemented by necessary revenue enhancement through a broader tax base. However, in a tense market environment for sovereign debt, the authorities should be prepared with additional measures to meet their targets in case of unexpected fiscal demands. The commitment to the consolidation path will be reinforced by greater specificity on the measures foreseen.

48. **This is also a good moment to establish a stronger fiscal framework.** A medium-term fiscal framework incorporating expenditure ceilings is a valuable management tool that will help create greater transparency of fiscal priorities and reduce fiscal volatility. Recognizing their limits, a fiscal rule would be a helpful public metric of fiscal prudence and a technocratic fiscal council would help dampen fiscal risks.

49. **The next Article IV consultation with Ireland is expected to take place on the standard 12-month cycle.**

Table 1. Ireland: Selected Economic Indicators
 (Annual change unless otherwise stated)

	2005	2006	2007	2008	2009	Proj. 2010
National accounts (constant prices)						
GNP	5.6	6.3	4.4	-2.8	-11.3	-1.7
GDP	6.2	5.4	6.0	-3.0	-7.1	-0.6
Domestic demand	8.6	6.1	4.1	-4.4	-13.9	-3.4
Private consumption	6.6	6.6	5.9	-1.0	-7.2	-1.4
Public consumption	3.8	5.8	6.9	2.6	-1.2	-2.0
Gross fixed investment	14.7	4.0	2.3	-15.5	-29.7	-15.0
Net exports 1/	-1.6	-0.6	2.8	0.7	4.7	3.9
Exports of goods and services	5.2	5.1	8.6	-1.0	-2.3	3.0
Imports of goods and services	8.4	6.5	5.6	-2.1	-9.3	-1.8
Gross national saving (in percent of GDP)	23.6	24.6	21.5	16.9	11.1	11.8
Private	19.6	18.7	18.8	21.3	25.0	26.3
Public	4.5	5.9	2.7	-4.4	-13.9	-14.5
Gross investment (in percent of GDP)	27.1	27.9	26.0	21.9	13.9	11.8
Private	23.6	24.2	21.2	16.5	9.3	7.3
Public	3.5	3.7	4.8	5.4	4.5	4.6
Prices, wages and employment						
Harmonized Index of Consumer Prices (annual average)	2.2	2.7	2.9	3.1	-1.7	-1.8
Average wages, all economy	5.1	5.5	5.2	3.5	-1.0	-2.6
Output, manufacturing	4.1	3.1	5.3	-2.1	-6.3	-0.6
GNP/employment	0.6	1.9	0.7	-1.7	-3.5	1.2
Employment	4.9	4.4	3.6	-1.1	-8.1	-2.9
Unemployment rate (in percent)	4.4	4.4	4.6	6.3	11.8	13.5
Money and credit (end-period)						
Irish contribution to euro area money supply: M3	22.1	28.5	9.6	-1.9	-1.5	...
Irish resident private sector credit 2/	28.8	25.9	17.0	7.3	-7.6	...
Financial and asset markets (end-period)						
3-month interbank rate	2.5	3.7	4.6	3.0	0.6	...
10-year government bond	3.3	4.0	4.5	4.4	4.9	...
ISEQ index	16.8	27.8	-26.3	-66.2	27.0	...
House prices (permanent tsb index/ESRI)	9.3	11.8	-7.3	-9.1	-18.5	...
Public finance (in percent of GDP)						
General government balance	1.6	2.9	0.1	-7.3	-14.3	-11.9
Primary balance	2.7	3.8	0.9	-6.2	-12.2	-9.1
General government debt	27.3	24.9	25.0	43.9	64.0	86.2
External trade and balance of payments						
Balance of goods and services (percent of GDP)	11.7	10.3	9.8	10.1	16.9	20.4
Current account (percent of GDP)	-3.5	-3.6	-5.3	-5.2	-2.9	-0.3
Official reserves (in billions of euros, end-period)	0.7	0.6	0.6	0.7	1.5	...
Effective exchange rates (1999Q1=100, annual average)						
Nominal	104.1	104.4	107.4	113.0	112.5	...
Real (CPI based)	115.4	116.0	120.1	125.6	121.9	...
Memorandum items:						
Population (in millions)	4.1	4.2	4.3	4.4	4.5	4.5
GDP per capita (in euros)	39,211	41,690	43,732	41,115	36,674	35,624

Sources: Department of Finance; Central Bank of Ireland; IFS; Bloomberg; and Fund staff calculations.

1/ Contribution to growth. However, the data for exports and imports of goods and services are annual growth rates.

2/ Adjusted change, which includes the effects of transactions between credit institutions and non-bank international financial companies and valuation effects arising from exchange rate movements.

Table 2. Ireland: Summary of Balance of Payments

	2005	2006	2007	2008	2009	2010	2011	2012	Proj.
(In billions of euros)									
Current account balance	-5.7	-6.3	-10.1	-9.4	-4.8	-0.4	-0.8	-1.1	
Balance of goods and services	18.9	18.2	18.7	18.4	27.7	32.5	36.2	39.2	
Trade balance	28.2	25.0	19.8	23.8	32.6	38.7	41.4	42.7	
Exports of goods	82.7	83.2	84.1	81.5	78.0	86.3	90.6	93.7	
Imports of goods	-54.5	-58.2	-64.3	-57.7	-45.3	-47.6	-49.2	-51.0	
Services balance	-9.3	-6.8	-1.1	-5.4	-5.0	-6.1	-5.1	-3.5	
Credit	48.2	57.1	68.0	69.2	69.3	66.4	68.0	72.6	
Debit	-57.5	-63.9	-69.1	-74.6	-74.3	-72.5	-73.1	-76.2	
Of which: Royalties									
Credit	0.6	0.7	0.9	0.9	1.2	...	...	...
Debit	-15.5	-17.5	-17.5	-20.6	-23.9	...	...	...
Income balance	-24.9	-24.0	-27.8	-26.8	-31.6	-32.5	-33.9	-37.0	
Credit	43.4	66.1	84.9	83.8	53.7	57.7	56.3	50.5	
Debit	68.3	90.1	112.7	110.6	85.3	90.1	90.1	87.5	
Current transfers (net)	0.3	-0.5	-1.0	-1.1	-0.9	-0.5	-3.2	-3.3	
Capital and financial account balance	-0.2	5.0	12.1	16.1	-3.7	0.4	0.8	1.1	
Capital account balance	0.3	0.2	0.0	0.1	0.0	...	...	...
Financial account	-0.5	4.8	12.1	16.1	-3.7	...	...	...
Direct investment	-37.0	-16.6	2.6	-22.9	3.0	...	...	...
Portfolio investment	52.7	8.1	-7.3	-39.4	29.9	...	...	...
Other investment	-17.7	13.2	16.7	78.4	-36.8	...	...	...
Change in reserve assets	1.5	0.1	0.0	-0.1	0.1	...	...	...
Net errors and omissions	5.9	1.3	-2.0	-6.7	8.5	...	...	...
(In percent of GDP)									
Current account balance	-3.5	-3.6	-5.3	-5.2	-2.9	-0.3	-0.5	-0.6	
Balance on goods and services	11.7	10.3	9.8	10.1	16.9	20.4	22.1	22.9	
Trade balance	17.4	14.2	10.4	13.1	20.0	24.3	25.2	24.9	
Services balance	-5.7	-3.8	-0.6	-3.0	-3.0	-3.9	-3.1	-2.0	
Income balance	-15.3	-13.6	-14.7	-14.7	-19.3	-20.4	-20.6	-21.6	
Current transfers	0.2	-0.3	-0.5	-0.6	-0.6	-0.3	-1.9	-1.9	
Capital and financial account balance	-0.1	2.8	6.4	8.9	-2.3	0.3	0.5	0.6	
Of which:									
Direct investment	-22.8	-9.4	1.4	-12.6	1.9	...	...	...
Portfolio investment	32.5	4.6	-3.8	-21.6	18.3	...	...	...
Other investment	-10.9	7.5	8.8	43.1	-22.5	...	...	...
Memorandum items (percent of GDP)									
Reserve assets	0.5	0.4	0.3	0.4	0.9	...	...	...
Gross external debt	698.8	757.4	811.7	931.0	985.3	...	...	...
General government	16.6	15.4	15.9	31.8	46.0	...	...	...
Monetary authorities	2.9	1.5	0.4	24.5	32.7	...	...	...
Monetary financial institutions	343.3	381.8	409.9	422.3	404.2	...	...	...
Other sectors	239.6	267.9	288.2	341.9	373.9	...	...	...
Direct investment debt	96.3	90.7	97.4	110.6	128.5	...	...	...
Net international investment position	-24.7	-5.3	-19.5	-58.4	-67.0	...	...	...
Foreign assets	1037.3	1137.9	1196.3	1206.8	1386.5	...	...	...
Foreign liabilities	1062.0	1143.3	1215.8	1265.2	1453.5	...	...	...

Sources: The Central Statistics Office; and Fund staff estimates.

Table 3. Ireland: General Government Finances
(In percent of GDP)

	Actual					Staff Projections 1/					
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Current balance	5.1	6.5	4.7	-1.1	-7.6	-8.1	-7.6	-5.1	-3.8	-2.4	-1.4
Current revenue, of which:	33.7	35.3	34.6	32.9	32.5	33.2	33.6	35.1	35.5	35.6	35.7
Tax revenue (including taxes on capital)	25.8	27.2	26.2	23.7	21.8	21.1	22.0	23.5	23.9	24.1	24.1
Income tax	7.1	7.0	7.1	7.2	7.2	7.2	7.9	8.9	8.9	9.0	9.0
Corporate tax	3.4	3.8	3.4	2.8	2.4	2.0	2.2	2.3	2.3	2.3	2.3
VAT	7.5	7.7	7.5	7.4	6.5	6.3	6.5	6.6	6.6	6.6	6.5
Excise duty	3.3	3.2	3.2	3.0	2.9	2.8	2.8	2.9	3.1	3.2	3.4
Capital taxes	1.4	1.9	1.8	1.0	0.5	0.4	0.4	0.4	0.4	0.4	0.4
Stamp duty	1.6	2.1	1.7	0.9	0.6	0.5	0.5	0.5	0.5	0.5	0.5
Other taxes	1.5	1.5	1.5	1.4	1.8	1.8	1.9	1.9	2.0	2.1	2.1
Social security receipts	4.5	4.6	4.8	5.1	5.5	5.7	5.7	5.7	5.7	5.7	5.7
Miscellaneous	3.4	3.5	3.6	4.2	5.2	6.3	5.8	5.8	5.8	5.8	5.8
Current expenditure, of which:	28.5	28.8	29.9	34.1	40.2	41.3	41.2	40.2	39.2	38.1	37.1
Interest payments	1.0	0.9	0.8	1.0	2.1	2.8	3.3	3.8	4.1	4.4	4.6
Goods and services	5.2	5.3	5.6	5.8	6.0	5.8	5.7	5.5	5.3	5.1	5.0
Compensation of employees	9.2	9.3	9.5	11.0	12.1	11.2	10.7	10.2	9.8	9.5	9.4
Current transfers	12.2	12.4	13.1	15.1	18.6	19.9	19.9	18.9	18.3	17.3	16.3
Depreciation	0.9	0.9	0.9	1.0	1.4	1.5	1.7	1.8	1.8	1.8	1.8
Primary current expenditure	27.5	27.9	29.0	33.1	38.0	38.5	37.9	36.4	35.2	33.7	32.5
Capital balance	-3.5	-3.6	-4.6	-6.1	-6.7	-3.8	-3.5	-3.5	-3.5	-3.5	-3.4
Capital receipts (excluding taxes on capital)	0.9	1.1	1.2	1.0	1.0	1.3	1.3	1.3	1.3	1.3	1.3
Gross capital formation	3.5	3.8	4.8	5.4	4.5	4.6	4.0	4.0	4.0	3.9	3.9
Capital transfers	0.9	0.9	1.1	1.8	3.2	0.5	0.8	0.9	0.9	0.8	0.8
General government balance	1.6	2.9	0.1	-7.3	-14.3	-11.9	-11.1	-8.6	-7.3	-5.9	-4.8
Difference with the Stability and Growth Pact targets	...	...	...	...	...	-0.3	-1.1	-1.4	-2.4	-3.0	...
due to different macroeconomic projections	...	...	...	...	...	-0.3	-1.1	-1.4	-1.6	-1.8	...
due to assumed adjustment measures	...	...	...	...	...	...	...	...	-0.8	-1.2	...
Primary balance	2.7	3.8	0.9	-6.2	-12.2	-9.1	-7.8	-4.8	-3.2	-1.5	-0.2
Memorandum items:											
General government balance, Stability and Growth Pact target	...	...	...	...	...	-11.6	-10.0	-7.2	-4.9	-2.9	...
Structural (as a percent of potential GDP)											
Government balance	-4.2	-4.5	-7.7	-11.7	-9.8	-8.2	-6.8	-5.9	-5.6	-5.2	-4.8
General government gross debt (as percent of GDP)	27.3	24.9	25.0	43.9	64.0	86.2	94.7	96.9	97.5	97.7	97.5
General government net debt (as percent of GDP) 2/	15.9	12.2	12.2	22.8	35.6	57.3	64.5	63.5	70.0	70.4	69.4
Output gap	1.5	3.6	7.1	3.0	-5.0	-6.3	-4.9	-3.5	-2.1	-0.9	0.0
Growth in nominal GDP	8.7	9.0	7.4	-4.2	-10.1	-2.6	3.1	4.4	4.8	5.0	5.3

Sources: Department of Finance; and staff estimates.

1/ The difference between the fiscal projections of the Department of Finance and the IMF staff is due in part to assumptions of lower growth on the part of the IMF staff. The IMF staff's baseline fiscal projections for 2011–12 incorporate the adjustment efforts announced by the authorities in their December 2009 Stability Programme Update, although 2/3 of these measures remain to be specified. For the remainder of the period, the IMF staff's projections do not incorporate the further adjustments efforts outlined in the Stability Programme Update. However, the Irish authorities have committed to the implementation of these additional adjustment measures, which is supported by their favorable track record to date in taking the necessary actions to attain budgetary targets.

2/ Net debt is defined as gross debt minus the value of the National Pensions Reserve Fund, the Social Insurance Fund, and cash balances.

Table 4. Ireland: Medium-Term Scenario
(Percentage change, unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real GNP	5.6	6.3	4.4	-2.8	-11.3	-1.7	1.8	1.6	2.4	2.5	2.5
Real GDP	6.2	5.4	6.0	-3.0	-7.1	-0.6	2.3	2.5	2.9	3.2	3.5
Real domestic demand	8.6	6.1	4.1	-4.4	-13.9	-3.4	1.3	1.7	2.1	2.0	2.0
Real final domestic demand	8.5	5.7	5.0	-4.6	-12.0	-4.3	0.9	1.7	2.1	2.0	2.0
Private consumption	6.6	6.6	5.9	-1.0	-7.2	-1.4	0.9	2.1	2.5	2.5	2.5
Public consumption	3.8	5.8	6.9	2.6	-1.2	-2.0	-0.5	-0.5	0.0	0.0	0.0
Fixed investment	14.7	4.0	2.3	-15.5	-29.7	-15.0	2.5	2.6	3.0	2.5	2.5
Structures	13.6	5.6	-0.8	-15.5	-33.8	-17.0	2.5	2.8	3.2	2.0	2.0
Residential investment	13.7	2.4	-9.2	-26.4	-38.0	-18.5	2.0	2.5	2.8	2.0	2.0
Non-residential investment	11.4	11.9	8.3	-1.5	-29.8	-15.7	2.9	3.0	3.5	2.0	2.0
Equipment	19.2	-1.4	13.9	-15.4	-15.7	-9.8	2.6	2.3	2.7	3.7	3.6
Change in stocks 1/	0.2	0.4	-0.8	0.2	-1.7	0.8	0.2	0.0	0.0	0.0	0.0
Net exports 1/	-1.6	-0.6	2.8	0.7	4.7	3.9	1.3	1.2	1.3	1.7	1.9
Exports	5.2	5.1	8.6	-1.0	-2.3	3.0	2.4	3.5	3.9	4.3	4.5
Imports	8.4	6.5	5.6	-2.1	-9.3	-1.8	1.3	2.9	3.3	3.3	3.3
Current account 2/	-3.5	-3.6	-5.3	-5.2	-2.9	-0.3	-0.5	-0.6	-0.7	-0.8	-0.9
Gross national saving 2/	23.6	24.6	21.5	16.9	11.1	11.8	11.9	11.7	11.7	11.6	11.3
Private	19.6	18.7	18.8	21.3	25.0	26.3	25.5	21.0	18.9	16.5	14.4
Public	4.5	5.9	2.7	-4.4	-13.9	-14.5	-13.6	-9.3	-7.1	-4.9	-3.2
Gross investment 2/	27.1	27.9	26.0	21.9	13.9	11.8	12.1	12.2	12.2	12.1	12.0
Private	23.6	24.2	21.2	16.5	9.3	7.3	8.2	8.2	8.2	8.2	8.1
Public	3.5	3.7	4.8	5.4	4.5	4.6	4.0	4.0	4.0	3.9	3.9
Prices											
Consumer prices	2.2	2.7	2.9	3.1	-1.7	-1.8	-0.5	0.8	1.7	1.9	1.9
Wages	5.1	5.5	5.2	3.5	-1.0	-2.6	-1.2	0.5	1.3	2.1	2.4
Labor market											
Employment	4.9	4.4	3.6	-1.1	-8.1	-2.9	0.7	1.7	1.9	1.9	1.7
Average unemployment rate	4.4	4.4	4.6	6.3	11.8	13.5	13.0	12.0	11.0	10.0	9.5
Public finance											
General government balance 2/	1.6	2.9	0.1	-7.3	-14.3	-11.9	-11.1	-8.6	-7.3	-5.9	-4.8
General government structural balance 3/	-5.6	-4.5	-7.6	-11.7	-9.8	-8.2	-6.8	-5.9	-5.6	-5.2	-4.8
General government gross debt 2/	27.3	24.9	25.0	43.9	64.0	86.2	94.7	96.9	97.5	97.7	97.5
Output gap 3/	0.6	2.5	6.5	2.8	-5.0	-6.3	-4.9	-3.5	-2.1	-0.9	0.0

Sources: CSO; Department of Finance; and IMF staff calculations.

1/ Contributions to growth.

2/ In percent of GDP.

3/ In percent of potential output.

Table 5. Ireland: Indicators of External and Financial Vulnerability

	2003	2004	2005	2006	2007	2008	2009
External indicators							
Exports (annual percent change, value in euros)	14.2	17.1	6.7	8.0	18.3	6.4	-7.5
Imports (annual percent change, value in euros)	13.1	19.1	10.3	9.9	19.2	6.5	-14.4
Terms of trade (goods, annual percent change)	-0.5	-1.4	1.2	-4.6	-3.3	-4.7	3.3
Current account balance (in percent of GDP)	0.0	-0.6	-3.5	-3.6	-5.3	-5.2	-2.9
Capital and financial account balance (in percent of GDP)	-0.9	2.7	-0.1	2.8	6.4	8.9	-2.3
Of which:							
Inward portfolio investment	74.9	100.2	107.0	125.3	86.2	-5.2	9.6
Inward foreign direct investment	14.4	-5.7	-15.7	-2.5	9.5	-7.5	11.0
Other investment liabilities	57.2	39.8	57.7	74.8	91.9	80.1	-55.3
Public debt in foreign currency (in percent of GDP) 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0
U.S. dollar per euro (period average)	1.13	1.24	1.25	1.26	1.37	1.47	1.39
U.K. pound per euro (period average)	0.69	0.68	0.68	0.68	0.68	0.79	0.89
Financial markets indicators							
General government debt (in percent of GDP)	31.0	29.4	27.3	24.9	25.0	43.9	64.0
Government bond yield (in percent, 10-year, end-period)	4.3	3.5	3.3	4.0	4.5	4.4	4.9
Spread of government bond yield with Germany (in percent, end of period)	-0.3	0.4	0.1	-0.3	0.0	1.3	1.3
Real government bond yield (in percent, 10-year, period average, based on HICP)	0.1	1.9	1.2	1.0	1.6	1.5	6.6
Annual change in ISEQ index (in percent, end of period)	12.2	26.8	16.8	27.8	-26.3	-66.2	27.0
Personal lending interest rate (in percent)	9.9	9.9	10.1	11.2	11.7	11.9	11.1
Standard variable mortgage interest rate (in percent)	3.5	3.5	3.6	4.8	5.4	4.8	3.3
Financial sector risk indicators							
Annual credit growth rates (to Irish resident private sector, in percent)	17.9	26.6	28.8	25.9	17.0	7.3	-7.6
Personal lending as a share of total Irish resident credit (in percent)	42.8	45.7	44.7	42.3	39.6	35.2	35.3
Of which:							
House mortgage finance	34.2	36.7	36.5	34.9	32.8	29.0	29.9
Other housing finance	0.3	0.3	0.2	0.4	0.3	0.3	0.2
Other personal lending	8.3	8.7	7.9	7.0	6.5	5.9	5.2
Irish resident household mortgage debt annual growth rates (in percent) 2/	25.5	26.5	27.1	24.2	13.4	5.9	-0.3
Commercial property lending as a percent of Irish resident credit 3/	15.2	17.4	20.8	26.3	28.3	28.4	26.6
Foreign-currency denominated assets (in percent of total assets)	32.5	29.4	33.9	33.7	36.5	31.7	34.3
Foreign-currency denominated liabilities (in percent of total liabilities)	34.2	32.2	35.9	36.9	41.1	35.5	31.1
Contingent and off-balance sheet accounts (in percent of total assets) 4/	538	662	879	1133	...	...	...
Non-performing loans (in percent of total loans) 5	0.93	0.82	0.68	0.71	0.79	2.6	9.0
Total provisions for loan losses (in percent of total loans)	0.9	0.7	0.5	0.4	0.4	1.3	4.0
Regulatory capital to risk-weighted assets of domestic banks (in percent)	13.9	12.6	12.0	10.9	10.7	10.6	10.9
Bank return on assets (before tax, in percent)	0.9	1.1	0.8	0.8	0.7	...	...
Bank return on equity (before tax, in percent)	17.8	20.7	19.6	19.1	16.4	...	...
Liquid assets of all banks to total assets (liquid asset ratio, in percent)	33.6	33.0	34.2	32.7	28.4	...	...
Liquid assets of all banks to short-term liabilities (in percent)	41.2	40.0	40.2	38.4	34.4	...	...
Deposits to M3 ratio 6/ 7/	1.5	1.4	1.4	1.3	1.4	1.3	1.4
Loan-to-deposit ratio vis-à-vis Irish residents 8/	1.5	1.6	1.8	1.9	2.1	2.2	2.1
vis-à-vis total 8/	1.6	1.7	1.8	1.9	2.1	2.2	2.2
Concentration ratios in the banking sector							
No. of banks accounting for 25 percent of total assets	2.0	2.0	2.0	3.0	3.0	2.0	2.0
No. of banks accounting for 75 percent of total assets	18.0	17.0	16.0	17.0	15.0	14.0	13.0
Share of state-owned banks in total assets (in percent)	0.0	0.0	0.0	0.0	0.0	0.0	6.0
Share of foreign-owned banks in total assets (in percent)	31.0	34.0	32.3	36.3	32.2	62.0	65.0

Sources: Data provided by the authorities; Central Bank of Ireland; International Financial Statistics; Bloomberg; and Fund staff estimates.

1/ Represents non-euro debt of the government sector.

2/ Including securitisations.

3/ Proxied by lending for construction and real estate activities.

4/ Credit equivalent values.

5/ Owing to differences in classification, international comparisons of nonperforming loans are indicative only.

6/ Non-government deposits vis-à-vis Irish and nonresidents to M3 ratio.

7/ The methodology used to compile M3 has been amended in line with Eurosystem requirements. Therefore, there is a break in the series.

8/ Nongovernment credit/nongovernment deposits ratio.

Appendix I. Ireland: Public Sector and External Sustainability

Fiscal Sustainability

General government debt has increased from 25 percent of GDP in 2007 to 64 percent in 2009 as a result of the deterioration in the fiscal position. Under the baseline scenario, the debt ratio is expected to rise to 86 percent of GDP in 2010, reflecting the primary deficit (9 percent of GDP) and fiscal outlays for bank recapitalization (8½ percent of GDP). In the medium term, the primary deficit is expected to be reduced through continued fiscal consolidation efforts and economic growth, stabilizing the debt ratio at about 98 percent of GDP in 2014–15.

The debt sustainability analysis illustrates the importance of continued fiscal consolidation. Under a scenario where the primary balance is kept constant at the 2009 level, general government debt would reach 125 percent of GDP in 2015. The sustainability of the fiscal position is also sensitive to exogenous macroeconomic shocks, as indicated by the bound tests (Figure A1).

External Sustainability

From being balanced in 2007, the net external position went into a 60 percent of GDP deficit in 2008 (Table A2). For FDI, assets and liabilities continued to be largely balanced on a consolidated basis. The deterioration can mainly be attributed to an increase in monetary financial institutions' foreign liabilities, which was not matched by an increase in foreign assets. A part of this increase is related to the activities of the International Financial Services Center, which accounted for 75 percent of total foreign assets and 70 percent of total foreign liabilities in 2008.

Table A1. Ireland: Public Sector Debt Sustainability Framework, 2005–15
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing primary balance 9/ -0.3	
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: Public sector debt 1/	27.3	24.9	25.0	43.9	64.0	86.2	94.7	96.9	97.5	97.7	97.5	-0.3
Of which: foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in public sector debt	-2.1	-2.4	0.1	18.9	20.1	22.2	8.5	2.2	0.6	0.2	-0.1	
Identified debt-creating flows (4+7+12)	-4.0	-5.2	-1.8	8.4	19.2	13.6	8.5	4.6	2.8	1.2	-0.1	
Primary deficit	-2.7	-3.8	-0.9	6.2	12.2	9.1	7.8	4.8	3.2	1.5	0.2	
Revenue and grants	34.6	36.4	35.8	34.0	33.6	34.5	34.9	36.4	36.8	36.9	37.0	
Primary (noninterest) expenditure	31.9	32.6	34.9	40.2	45.8	43.6	42.7	41.2	40.0	38.4	37.2	
Automatic debt dynamics 2/	-1.3	-1.4	-0.9	2.1	7.0	4.5	0.7	-0.2	-0.4	-0.3	-0.3	
Contribution from interest rate/growth differential 3/	-1.3	-1.4	-0.9	2.1	7.0	4.5	0.7	-0.2	-0.4	-0.3	-0.3	
Of which: contribution from real interest rate	0.4	0.0	0.5	1.3	3.6	4.1	2.6	2.0	2.3	2.7	2.9	
Of which: contribution from real GDP growth	-1.7	-1.3	-1.4	0.8	3.5	0.4	-1.9	-2.3	-2.7	-3.0	-3.2	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.9	2.8	1.8	10.6	0.9	8.6	0.0	-2.3	-2.2	-1.1	0.0	
Public sector debt-to-revenue ratio 1/	78.8	68.5	69.9	129.3	190.6	250.1	271.1	266.3	265.2	264.3	263.6	
Gross financing need 6/	-1.6	-2.9	-0.1	7.3	14.3	22.0	20.8	17.9	13.9	10.1	7.8	
In billions of U.S. dollars	-3.3	-6.5	-0.1	19.4	32.0	48.3	47.4	42.9	35.1	26.9	21.9	
Scenario with key variables at their historical averages 7/						86.2	84.1	79.8	75.6	72.7	70.9	-1.5
Scenario with no policy change (constant primary balance) in 2010-2015						86.2	96.0	102.6	109.0	116.7	125.5	-0.4
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	6.2	5.4	6.0	-3.0	-7.1	-0.6	2.3	2.5	2.9	3.2	3.5	
Average nominal interest rate on public debt (in percent) 8/	3.9	3.6	3.6	4.0	4.3	4.3	3.9	4.2	4.4	4.8	5.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.5	0.1	2.4	5.1	7.5	6.2	3.1	2.3	2.5	3.0	3.2	
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.2	0.8	9.2	7.3	-6.8	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.4	3.5	1.3	-1.2	-3.2	-1.9	0.8	1.9	1.8	1.8	1.8	
Growth of real primary spending (deflated by GDP deflator, in percent)	7.1	7.5	13.5	11.8	5.7	-5.4	0.2	-1.1	-0.1	-0.8	0.2	
Primary deficit	-2.7	-3.8	-0.9	6.2	12.2	9.1	7.8	4.8	3.2	1.5	0.2	

Sources: Central Statistics Office, Department of Finance, and IMF staff calculations.

1/ Gross general government debt.

2/ Derived as $[(r - p(1+g)) - g + ae(1+r)] / (1+g+p+gp)$ times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $ae(1+r)$.

5/ For projections, this line includes exchange rate changes.

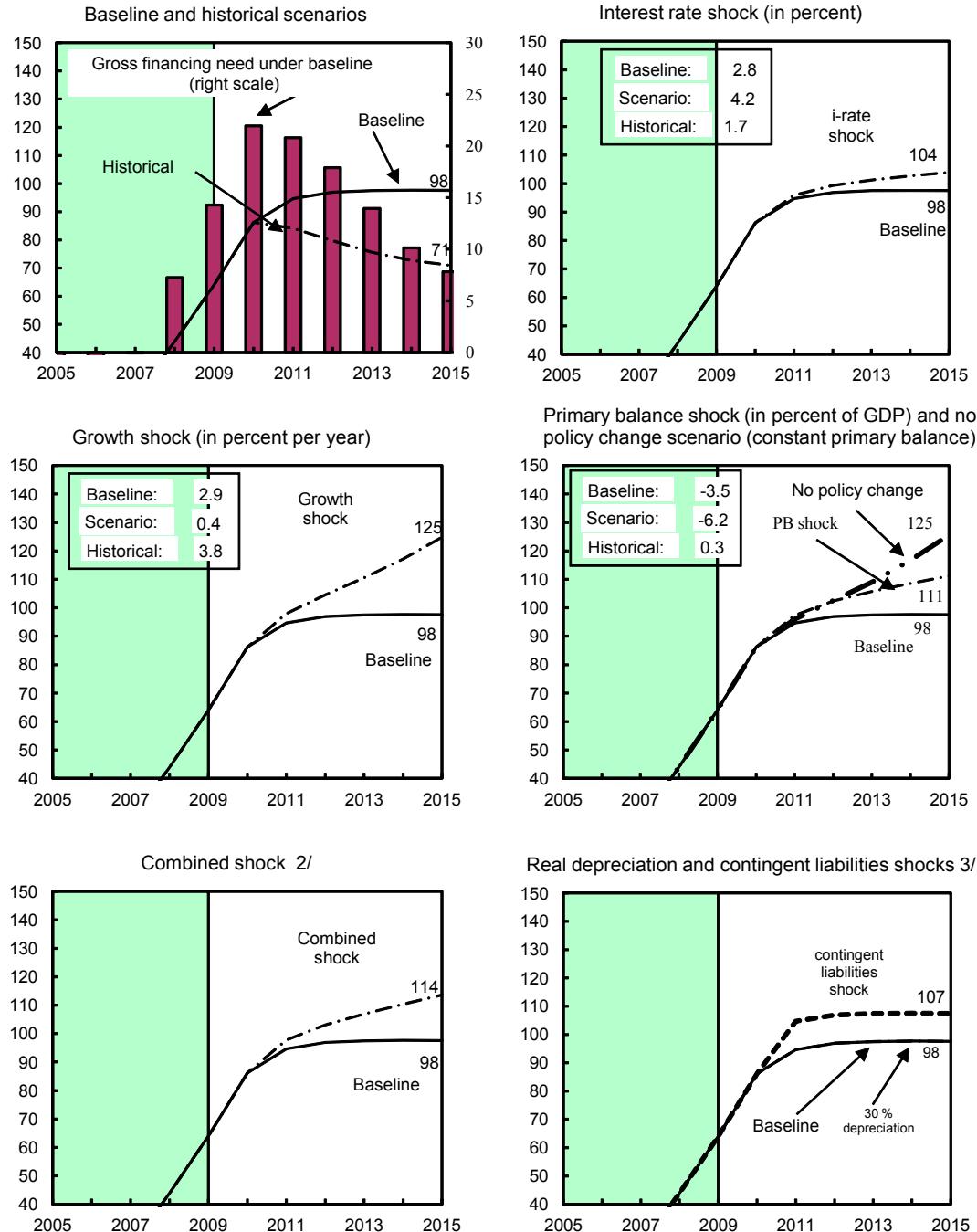
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A1. Ireland: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009 with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table A2. Ireland: Net Investment Position
(In percent of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Assets	649	727	712	775	866	1,037	1,135	1,196	1,207	1,386
Direct investment abroad	29	40	43	42	53	54	52	54	68	..
Portfolio investment abroad	350	420	420	474	528	618	694	705	643	..
Other investment abroad	265	262	245	257	284	364	389	437	496	..
Reserve assets	6	5	4	2	1	0	0	0	0	..
Liabilities	657	742	730	795	884	1,062	1,140	1,216	1,265	1,453
Direct investment to Ireland	130	130	134	127	102	85	67	73	67	..
Portfolio investment to Ireland	296	352	343	389	484	633	690	701	651	..
Other investment to Ireland	230	260	253	280	298	343	383	442	548	..
Net investment position	-8	-15	-18	-20	-18	-25	-5	-19	-58	-67
Direct investment, net	-102	-90	-91	-85	-50	-31	-15	-19	1	..
Portfolio investment, net	54	68	77	85	45	-15	4	5	-8	..
Other investment, net	34	2	-8	-23	-14	21	6	-5	-52	..
Reserve assets	6	5	4	2	1	0	0	0	0	..
Memorandum items										
Net investment position (excl. FDI)	94	75	73	65	32	6	10	0	-60	..
Change in net investment position	-58.5	-7.3	-2.7	-2.2	2.1	-6.6	19.3	-14.1	-39.0	..
Of which: current account balance	-0.4	-0.6	-1.0	0.0	-0.6	-3.5	-3.6	-5.3	-5.2	-2.9
Other 1/	-58.1	-6.6	-1.7	-2.2	2.7	-3.1	22.9	-8.8	-33.8	..

Source: Central Statistics Office.

1/ Includes valuation changes and errors and omissions.

INTERNATIONAL MONETARY FUND
IRELAND

Staff Report for the 2010 Article IV Consultation—Informational Annex

Prepared by the European Department

June 18, 2009

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I. FUND RELATIONS

(As of May 31, 2010)

I. **Membership Status:** Joined August 8, 1957; Article VIII

	SDR Million	Percent of Quota
Quota	838.40	100.00
Fund holdings of currency	628.20	74.93
Reserve position in Fund	210.22	25.07
III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	775.42	100.00
Holdings	752.32	97.02
IV. Outstanding Purchases and Loans: None		
V. Financial Arrangements: None		
VI. Projected Payments to the Fund (SDR million; based on existing use of resources and present holdings of SDRs):		

	Forthcoming				
	2010	2011	2012	2013	2014
Principal					
Charges/Interest	<u>0.03</u>	<u>0.06</u>	<u>0.06</u>	<u>0.06</u>	<u>0.06</u>
Total	0.03	0.06	0.06	0.06	0.06

VII. Article IV Consultations:

A staff team comprising Mr. Mody (head), Ms. Barkbu, Mr. Tchaidze (all EUR), Mr. Montes-Negret (MCM), Ms. Luedersen (LEG), and Mr. Melander (SPR) visited Dublin on May 20–31, 2010, to conduct the 2010 Article IV consultation discussions. Messrs. Hockin and O’Sullivan from the Executive Director’s office joined the discussions.

The mission met with the Minister for Finance, the Governor of the Central Bank and the Head of Financial Regulation, as well as other senior officials from the Department of Finance, the Central Bank and the Irish Financial Regulatory Authority, the National Treasury Management Agency (NTMA), and the National Asset Management Agency (NAMA). Other interlocutors included representatives of the Department for Enterprise, Trade and Innovation, Ireland's National Training and Employment Authority (FÁS), the Competition Authority, the Central Statistics Office Ireland, the Mortgage Arrears and Personal Debt Review Group, the Attorney General’s Office, Enterprise Ireland, the

Economic and Social Research Institute (ESRI), the Irish Banking Federation, major Irish banks, stockbrokers, law firms, the Irish Congress of Trade Unions, the Irish Business and Employers' Confederation, and several academics.

The last Article IV consultation was concluded on June 15, 2009 (IMF Country Report No. 09/195). Article IV consultations with Ireland are on the standard 12-month cycle.

VIII. Exchange Rate Arrangement and Exchange Restrictions

Ireland's currency is the euro, which floats freely and independently against other currencies.

Ireland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains an exchange system free of restrictions on payments and transfers for current international transactions, other than restrictions notified to the Fund under Decision No. 144 (52/51).

IX. Technical Assistance: None

X. Resident Representative: None

II. STATISTICAL ISSUES

A. Assessment of Data Adequacy for Surveillance	
General: Data provision is broadly adequate for surveillance.	
<p>National accounts and real sector data. Quarterly national accounts are currently published within three months of its reference period. Other real sector data are relatively timely, with industrial production and retail sales data published within six weeks and employment data within 3 months of the reference period, but some non-SDDS series are published one and a half years later (e.g., household disposable income). Employment and unit labor costs, and national income and expenditure data are usually available with a three-month lag.</p>	
<p>Wages and earnings statistics. The quarterly Earnings, Hours and Employment Costs Survey has replaced the four-yearly Labor Cost Survey, and also replaces all other existing short-term earnings surveys. The results are comparable across sectors and include more detail on components of earnings and labor costs than was available before. However, data are only available with more than six months lag.</p>	
<p>Government finance statistics. The authorities publish Exchequer returns on a monthly and quarterly basis, but only annual data are available for the general government balance. Timely data on local government consolidated operations are not available.</p>	
<p>External data. Quarterly balance of payments data are compiled by the Central Statistics Office and are based on statistical surveys combined with administrative data. These data are closely integrated with the compilation of national accounts and are in line with the Balance of Payments Manual, Fifth edition (BPM5), although the historical data covers only years starting from 1998. Furthermore, some discrepancies remain between exports and imports data from the national accounts and the balance of payments. Data on the international investment position are published with a six months lag.</p>	
B. Data Standards and Quality	
<p>Ireland is subject to the statistical requirements and timeliness and reporting standards of Eurostat and the European Central Bank (ECB). Ireland subscribes to the Fund's Special Data Dissemination Standard and uses SDDS flexibility option on the timeliness of the wages and earnings and central government debt data.</p>	<p>No data ROSC is available.</p>

Ireland: Table of Common Indicators Required for Surveillance
 (as of June 18, 2010)

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶
Exchange Rates	6/18/10	6/18/10	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	April 2010	05/31/10	M	M	M
Reserve/Base Money	April 2010	05/31/10	M	M	M
Broad Money	April 2010	05/31/10	M	M	M
Central Bank Balance Sheet	April 2010	05/31/10	M	M	M
Consolidated Balance Sheet of the Banking System	April 2010	05/31/10	M	M	M
Interest Rates ²	6/18/10	6/18/10	D	D	D
Consumer Price Index	May 2010	06/10/10	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2009	4/22/10	A	A	A
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	May 2010	6/2/10	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	2009	4/22/10	Q	Q	Q
External Current Account Balance	2009:Q4	3/25/10	Q	Q	Q
Exports and Imports of Goods and Services	2009:Q4	3/25/10	Q	Q	Q
GDP/GNP	2009:Q4	3/25/10	Q	Q	Q
Gross External Debt	2009:Q4	3/31/10	Q	Q	Q

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Not Available (NA).



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 10/86
FOR IMMEDIATE RELEASE
July 14, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with Ireland

On July 7, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Ireland.¹

Background

The Irish economy is undergoing a profound adjustment to unwind the imbalances created during the boom years. Over the past decade, rapid credit growth fueled the property bubble, while increasing banks' exposure to the property market. Economic activity became heavily dependent on the construction and financial sectors. High price and wage growth created a competitiveness gap. When, around the onset of the global financial crisis, the domestic property bubble deflated, the balance sheets of households, banks, and the government were severely damaged. Average national house prices, having fallen by 34 percent from the peak, are yet to stabilize.

Over 2008–09, output contracted by about 10 percent. Domestic consumption and investment fell sharply while exports declined less during the global downturn than did exports elsewhere. Unemployment increased from 4½ percent in 2007 to about 13 percent in March 2010. Recent indicators point to a return to economic growth during this year, but following its earlier steep fall, GDP in 2010 is projected to be about ½ percent lower than in 2009. With output below potential and high unemployment, prices declined by 1.7 percent in 2009 and staff projects a further fall of 1.8 percent in this year.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: <http://www.imf.org/external/np/sec/misctools/qualifiers.htm>.

Under heavy pressure as the domestic crisis weakened asset quality and profitability and access to international wholesale funding tightened, the banking sector required extensive support from the government and European Central Bank (ECB) liquidity provision. Banks' borrowing is supported by government guarantees, the National Asset Management Agency (NAMA) has started acquiring distressed property development and commercial real estate assets from banks at a sizeable discount, and, following stress-testing by the Financial Regulator, the government is contributing to banks' capital enhancement.

Public finances were in balance over 2003–07, but were reliant on rapid growth and property-related revenues. As economic activity fell and bank recapitalization costs materialized, the general government deficit increased to 14½ percent of GDP in 2009. Gross public debt increased from 25 percent of GDP in 2006 to 64 percent of GDP in 2009. The government has implemented a series of consolidation measures to help contain the deficit below 12 percent in 2010. The authorities' multi-year plan is intended to achieve a sustainable fiscal position.

Despite the policy credibility achieved through these efforts, renewed market pressures in recent weeks point to the challenges ahead.

Executive Board Assessment

Executive Directors considered that the authorities' decisive measures to support the banking sector and advance fiscal consolidation have helped gain policy credibility and stabilize the economy. Directors encouraged the authorities to sustain these efforts and actively manage risks going forward.

Directors noted that vulnerabilities remain elevated as evidenced by continued pressures in sovereign debt and bank funding markets. With limited fiscal resources for dealing with contingencies, maintaining a steady policy course will require effective mechanisms for oversight and transparency, and high-quality communication to minimize risks and sustain market confidence.

Directors concurred with staff's analysis that the speed of the recovery is likely to be moderate with relatively limited growth and high unemployment. Growth prospects are weighed down by the ongoing correction of pre-crisis imbalances. The unwinding of these imbalances—arising from rapid credit growth, inflated property prices, and high wage and price levels—could limit the upside potential. In this context, Directors noted that structural reforms aimed at regaining competitiveness and boosting potential output are necessary to put the recovery on a sustainable track.

Recognizing that much progress had been made to strengthen the banking sector, Directors observed that a sizeable agenda remains. They welcomed the transfer of banks' distressed property development and commercial real estate assets to the NAMA and the complementary decision to raise banks' capital targets. Going forward, the orderly disposal of NAMA's assets will help restore the commercial property market. While mindful of the moral hazard risks,

Directors noted that narrowly-targeted support measures for vulnerable homeowners would limit the economic and social fallout of the crisis. Directors also welcomed the authorities' intent to proactively reshape the banking system, noting the importance of using a strategic, but market-oriented, approach.

Directors emphasized the need to strengthen the financial stability framework. They welcomed recent institutional changes to enhance regulation and the proposed new risk-based supervisory approach. They also encouraged an early action to introduce a special bank resolution mechanism, which would further strengthen the stability framework and add to the set of tools available to meet contingencies.

Acknowledging the authorities' significant fiscal efforts to date, Directors underscored the importance of adhering to the further consolidation targets going forward. They noted that the authorities' ambitious targets remained appropriate, but their achievement would require continued resolve. Directors agreed that the consolidation plan would benefit from greater specificity. Many Directors also encouraged the authorities to stand ready to adopt additional measures to reach the fiscal goals and retain hard-earned credibility in the event of unfavorable developments.

Directors encouraged the authorities to move further towards a medium-term budget framework. This could help provide the structure to reduce the uncertainties associated with the consolidation process. Directors also recommended that the authorities consider adopting a fiscal rule and establish a fiscal council to advise on risks underlying public finances. Such mechanisms could help enhance policy credibility now and in the future.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2010 Article IV Consultation with Ireland is also available.

Ireland: Selected Economic Indicators 1/

	2005	2006	2007	2008	2009
Real Economy (change in percent)					
Real GDP	6.2	5.4	6.0	-3.0	-7.1
Real GNP	5.6	6.3	4.4	-2.8	-11.3
Domestic demand	8.6	6.1	4.1	-4.4	-13.9
Exports of goods and services	5.2	5.1	8.6	-1.0	-2.3
Imports of goods and services	8.4	6.5	5.6	-2.1	-9.3
HICP	2.2	2.7	2.9	3.1	-1.7
Unemployment rate (in percent)	4.4	4.4	4.5	6.1	11.8
Public Finances (percent of GDP)					
General government balance	1.6	2.9	0.1	-7.2	-14.3
Structural balance 2/	-5.6	-6.1	-8.1	-12.0	-9.8
General government debt	27.3	24.8	24.9	44.0	64.0
Money and Credit (end-period, percent change)					
M3 3/	19.8	30.8	9.7	-1.9	-8.7
Private sector credit 4/	28.8	25.9	17.0	7.3	-6.0
Interest rates (end-period)					
Three-month treasury bill	2.5	3.7	4.6	3.0	0.6
10-year government bond yield	3.3	4.0	4.5	4.4	4.9
Balance of Payments (percent of GDP)					
Trade balance (goods and services)	11.7	10.3	9.8	10.1	16.9
Current account	-3.5	-3.6	-5.3	-5.2	-2.9
Reserves (in billions of euros)	0.7	0.7	0.6	0.7	1.5
Exchange Rate					
Exchange rate regime			Member of euro area		
Euros per U.S. dollar	0.8	0.8	0.7	0.7	0.7
Nominal effective rate (1999Q1=100)	104.1	104.4	107.4	113.0	112.5
Real effective rate (1999Q1=100, CPI based)	115.4	116.0	120.1	125.6	121.9

Sources: Central Statistics Office; Department of Finance, Datastream and IMF International Financial Statistics.

1/ Based on data until June 18, 2010.

2/ In percent of potential GDP.

3/ The methodology used to compile M3 has been amended in line with Eurosystem requirements. Therefore, there is a break in the series.

4/ Adjusted change, which includes the effects of transactions between credit institutions and nonbank international financial companies and valuation effects arising from exchange rate movements.