Ireland's EU-IMF Program: Preliminary Lessons

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Outline

I. What was the Program Strategy?

II. How Did the Program Work in Practice?

III. What Challenges Remain?

IV. What can be Learned from this Experience?

I. WHAT WAS THE PROGRAM STRATEGY?

Substantial Pre-Program Response

Financial

- Government issues near-blanket guarantee 9/'08
- Commercial property loans to NAMA (€74bn @ 57% dscnt)
- Nationalization of failed banks (Anglo, INBS)
- Injections into banks (€46.3bn, 30% GDP)

Fiscal

- 6.2% of GDP in measures 2009-10
- (4.3% spending cuts, 2% revenue)

Structural

- Croke Park Agreement: 14% wage cut, no further cuts till 2014, voluntary redundancy, but restructure

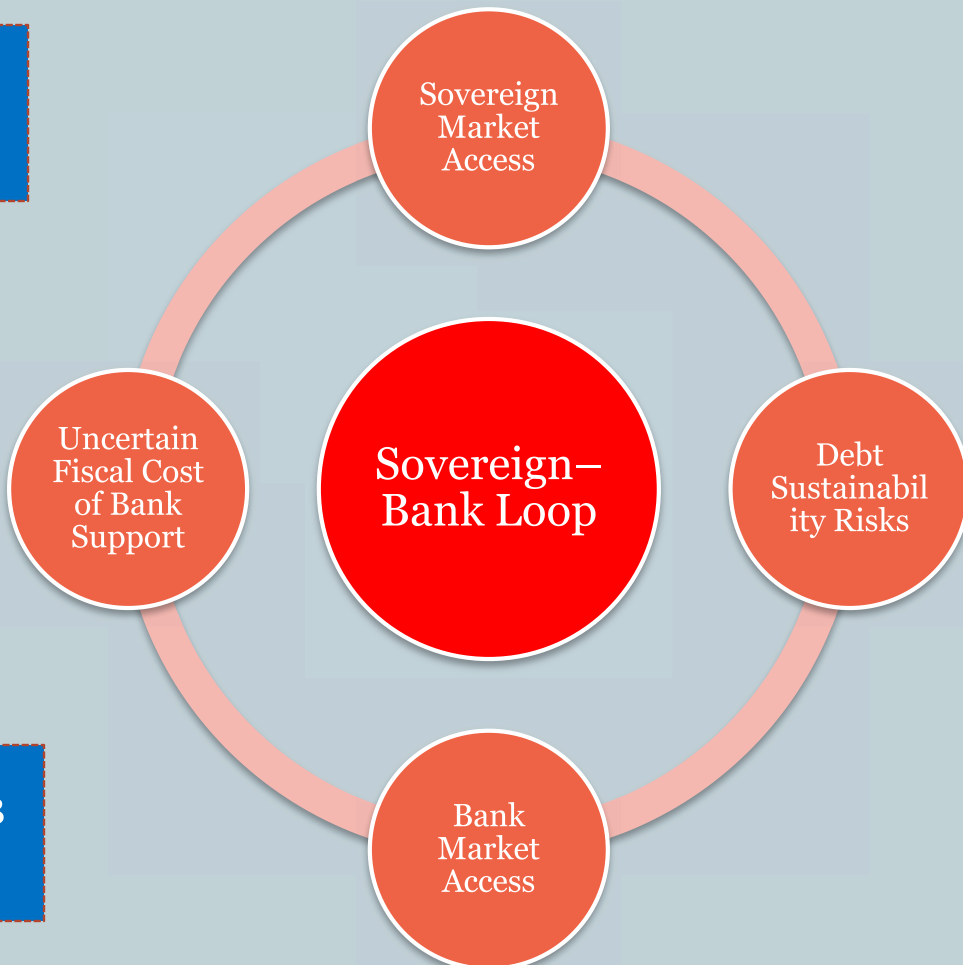
Challenges

- **Public debt** already over 90% of GDP in 2010
- **Bank capital** needs unclear
  - rough estimate up to €35 bn, 20% of GDP
- **Public deficit** over 10 percent of GDP
- **Recovery Prospects** in doubt
  - Fiscal consolidation could have greater drag than expected
  - Private debt deleveraging
  - Price level had deflated 8%—would it continue?
  - Euro Area risks were not foreseen

Sovereign-Bank Loop…

Bank Creditor Burden Sharing?

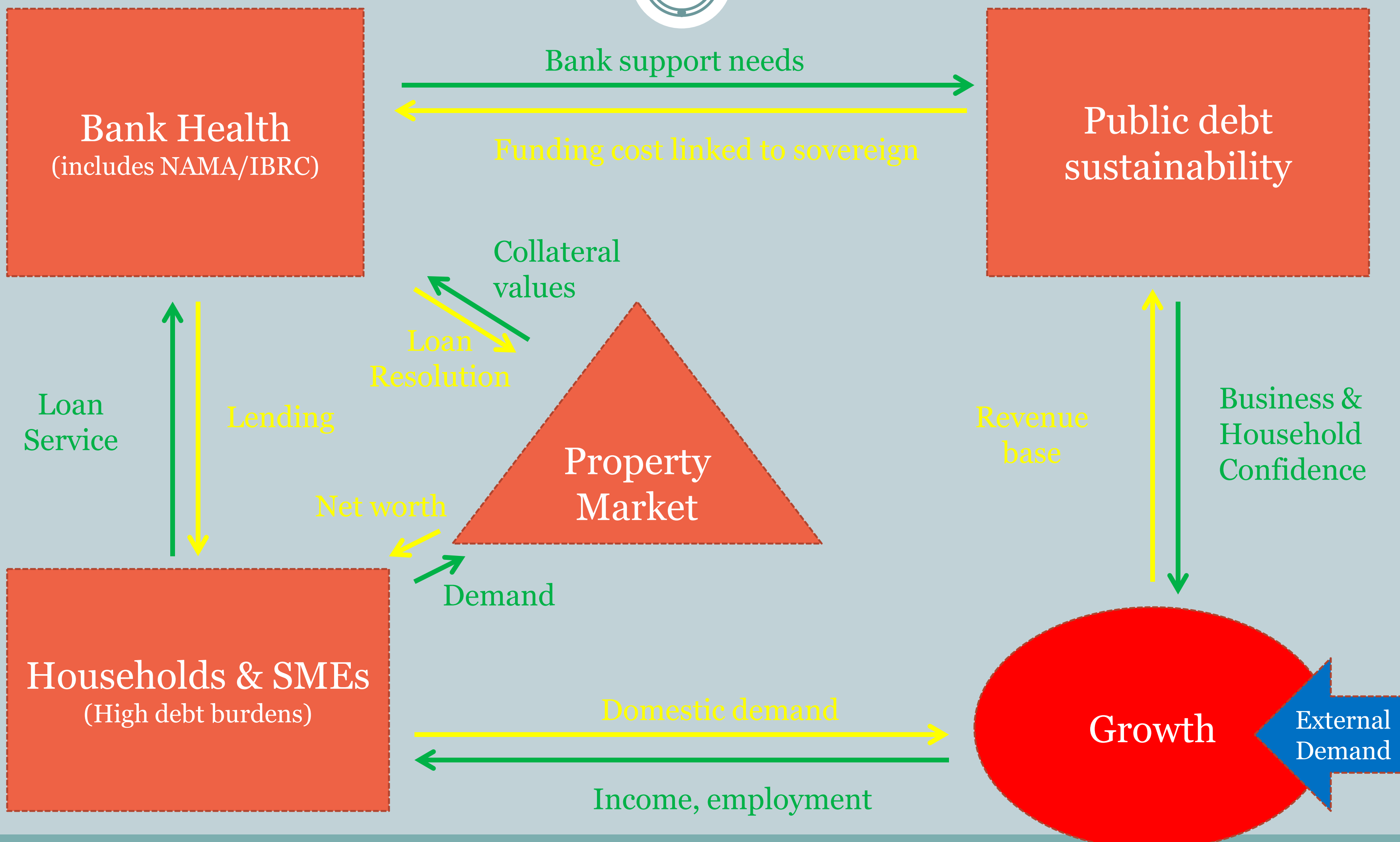
PSI? (Deauville)



Durability of ECB Funding?

European Solution?

...Clouds Recovery Prospects



Program Priorities

1. **Immediate Need:** Restore Financial Stability
   - Recovery and debt sustainability not feasible otherwise

2. **Ultimate Goal:** Regain Market Access by Reducing Uncertainties Around:

   - Financial System Viability
   - Public Debt Sustainability
   - Sustained Economic Recovery

1. Immediate Action: Restoring Financial Stability

- **Program financing** (€85 billion, frontloaded)
  - Dampen concerns about near-term default or PSI
- **Recapitalize Banks**
  - Evaluate Bank Balance Sheets Credibly (PCAR 2011): €24 bn (15% of GDP)
  - Asset Quality Review by independent third party (BlackRock Solutions)
  - Recapitalization funds were deposited in banks by April

  → Remove Doubts regarding ECB Funding (helpful ECB statement)
- **Clear Plan for Banks**
  - BoI and AIB to be "pillar banks" reducing doubts
  - Anglo Irish and INBS in wind down, deposits to be transferred
- **Clarify Burden Sharing by Bank Creditors**
  - Limited to subordinated debt for going concern banks (see below)

Burden Sharing on Senior Bank Debt

- **Bail-in of banks' unsecured senior debt** (in addition to subordinated debt) would reduce public debt
  - Failed banks (Anglo, INBS) versus viable banks
- But: fear of **adverse impact** on Euro Area bank funding
- Program went ahead **without bail-in**
- Staff reports subsequently press for strengthened European support for Irish debt sustainability and Euro Area stability
- EU bank resolution now includes senior debt bail-in

2. Program Policies:
Address Debt Issues While Protecting Growth

A. **Financial sector**:
   A. Restructuring,
   B. Downsizing,
   C. Resolving Impaired Loans,
   D. Supervision & Regulation

B. **Fiscal consolidation**: large and frontloaded, yet phased

C. **Other structural reforms**: not central
   - Current a/c in surplus, competitiveness shortfall not large (5-10% mid-2012), addressed by flat nominal wages over time
   - Business environment positive, employment protection not excessive

A. Financial Sector Policies Overview

i. **Restructuring**
- Exiting failed banks from system at least fiscal cost
- Managing remaining banks to restore viability

ii. **Deleveraging** (Downsizing)
- Aligning assets with deposits while avoiding fire sales
- Needed to reduce ECB funding / help regain market access

iii. **Resolving Impaired Loans**
- Reducing balance sheet uncertainties
- but protecting debt service discipline and bank capital

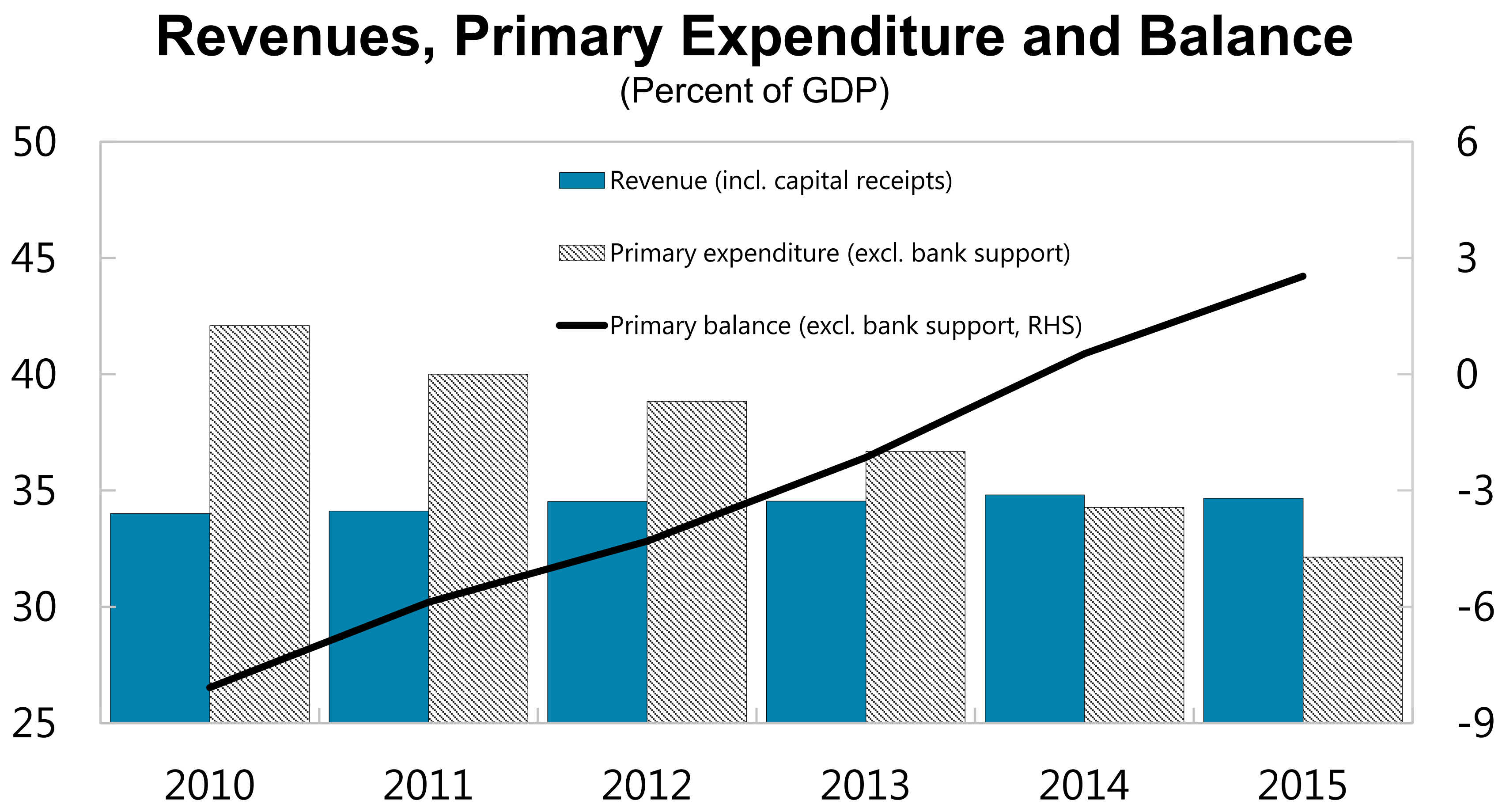
iv. **Supervision and regulation**
- Strengthening legislative powers, increasing resources, revising provisioning guidelines, bank resolution regime

B. Fiscal Consolidation:
Frontloaded & Phased

- Authorities had already built fiscal credibility
  - Took 6.2% of GDP in measures in 2009-10
  - National Recovery Plan had specific measures for 2011-14
- Credible medium-term consolidation
  - phased consolidation: revised EDP decision
  - 3% deficit by 2015 (initial EDP decision was 2014)

	2011	2012	2013	2014	2015
EDP ceiling (%GDP)	10.6	8.6	7.5	5.1	2.9
Consolidation Effort (€bn)	6.0	3.8	3.5	3.1	2.0
Consolidation Effort (%GDP)	3.5	2.7	2.1	1.8	1.1

Expenditure is brought in line with revenue gradually



Contain Fiscal Procyclicality

Anchor: headline deficit vs. consolidation effort

- IMF focus on steady consolidation effort path
- EC considers structural adjustment late in program
- Irish authorities prefer headline deficit as political anchor, also difficulties in measuring effort or structural adjustment.

IMF monitored primary Exchequer deficit:

- Adjustor for revenue deviations from projections means the ***main fiscal effect of the cycle would be excluded***
- In effect ***a ceiling on primary expenditure***
- In practice the adjustor was not utilized

Program Design Recognizes Trade-Offs

- **Trade-Offs to be balanced include:**
  - Fiscal Consolidation Pace vs. Domestic Demand Recovery
  - Bank Deleveraging Pace vs. Disposal Cost & Lending
  - Loan Resolution Pace vs. Restructuring Cost/Durability
- **Policy framework seeks to limit risks:**

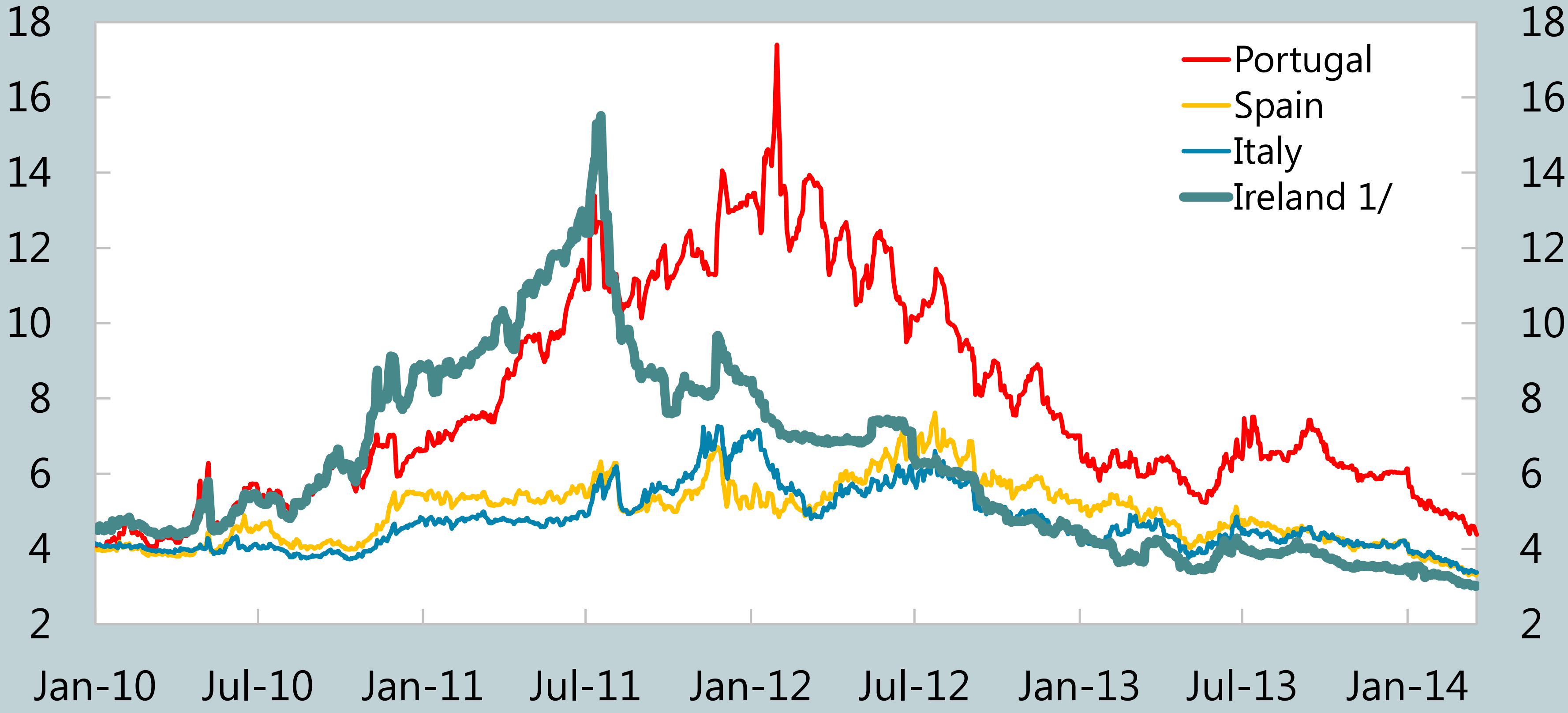
Policy	Target	Safeguards
Fiscal consolidation	Phased over 5 years	Avoid pro-cyclical measures for growth deviations
Bank deleveraging	Phased over 3 years, mostly offshore assets	No fire sales
NPL resolution	Mortgage arrears targets phased during 2013-14	Awaited legal reforms (insolvency and repossession)
Privatization	Up to 2% GDP	Sale depends on market conditions

III. HOW DID THE PROGRAM WORK IN PRACTICE?

Euro Area Crisis worse than expected

Ten-Year Sovereign Bond Yields

(Percent)



Source: Bloomberg.

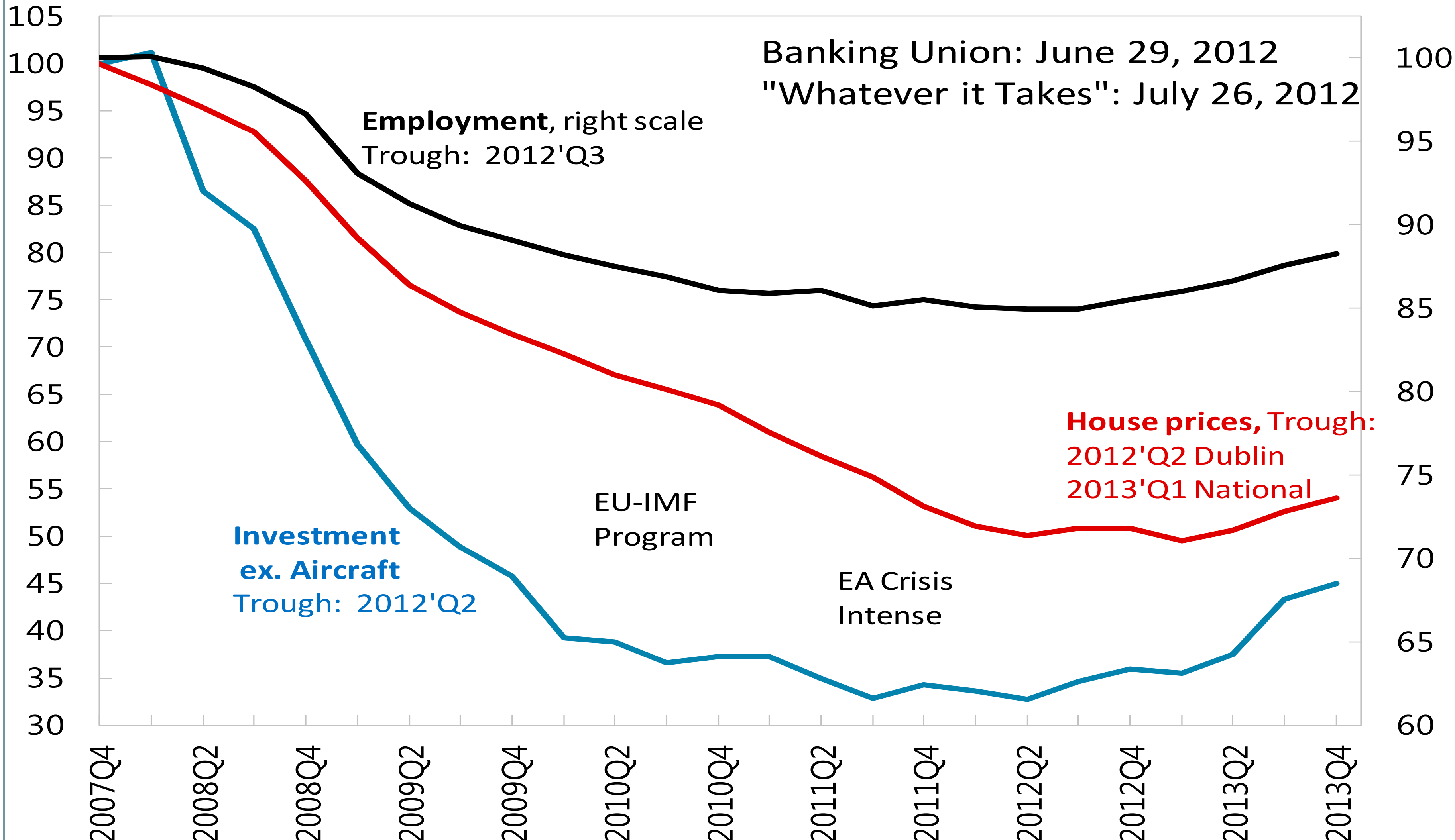
1/ Prior to 15 March 2013 a treasury bond maturing in 2020 is used for Ireland.

Growth Weaker as EA Crisis Drags on and Delays Uncertainty Reduction

% change y/y	2010	2011	2012	2013 Prel.
GDP	-1.1 (-1.1)	2.2 (+1.3)	0.2 (-1.7)	-0.3 (-2.7)
Domestic demand	-4.4 (-0.3)	-1.8 (+0.4)	-1.6 (-2.1)	-0.1 (-1.3)
Exports	6.4 (+0.8)	5.4 (+0.9)	1.6 (-2.9)	0.2 (-4.4)

- **2011**: Growth stronger, primarily exports (over 100% of GDP)
- **Growth substantially weaker in 2012-13**
  - Exports hit by (i) slump in EA, (ii) pharmaceutical "patent cliff"
  - Domestic demand growth recovers, but more slowly:
    - Uncertainty high due to EA crisis, investment and jobs delayed
    - Fiscal drag greater than expected?—need to further assess
- [**2013 GDP**: preliminary data likely to be revised in June 2014, as goods imports high relative to flat exports and domestic demand]

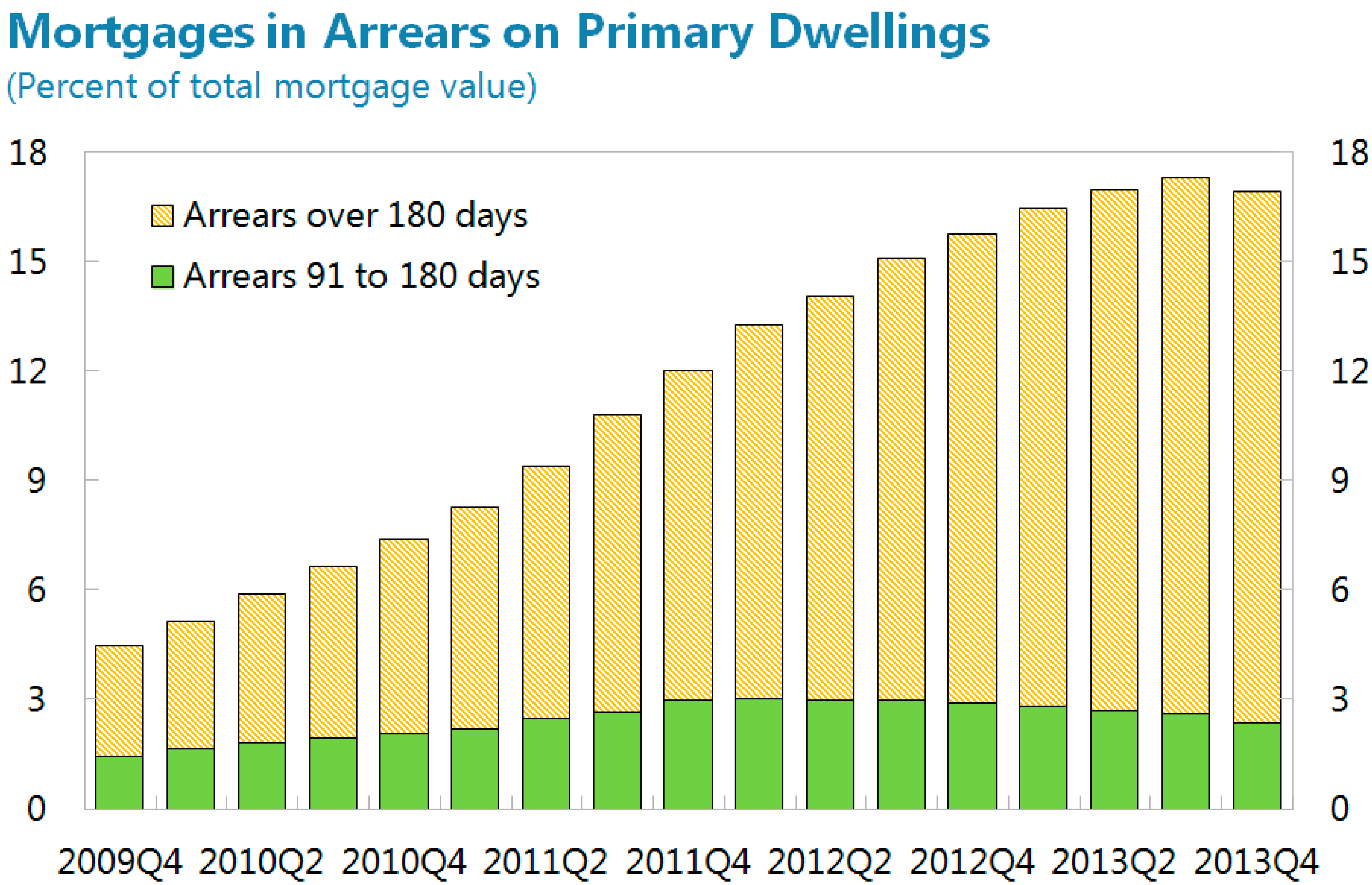
Irish Recovery Follows EA Announcements



Financial Sector Progress

- Recapitalization & Provisioning
  - €24 bn (15% of GDP) in 2011
  - CT1 14.3% (mid-2013)
  - Guidelines tightened in 2011 and 2013
  - BSA suggested additional need → Banks incorporated
- Deleveraging
  - LDR targets: adverse effect for deposit rates
  - Focus on Net-Stable-Funding-Ratio (LT funding/LT assets>1)
  - LDR: 190% end-2010 → 117% mid-2013
  - Eurosystem support €90 bn → €31bn
- Supervision
  - Increased resources and new risk-based supervisory approach
  - Legal powers strengthened in July 2013
  - FSAP 2016

Financial Sector: Loan Resolution



Source: Central Bank of Ireland.

Loan Resolution: Legal Framework

- **Insolvency reforms begin H2 2011**:
  - Cross-government seminar in November
  - Framework:
    - Bankruptcy 12 → 3 years (effective Sept. 2013)
    - Three new procedures; including ***Personal Insolvency Arrangement***.
    - Enacted in late 2012, but not fully operational until Q3 2013
- **Repossession impediment removed June 2013**:
  - 2011 Court ruling: impediment to repossession of properties purchased prior to 2009
  - Political sensitivity: Addressed after personal insolvency reform

Loan Resolution: MARS & MART

Central Bank escalated engagement with banks:

- *Late 2011:* mortgage arrears strategy
- *Early 2012:* assessed capacity to manage impaired assets
- *During 2012:* banks strengthen strategies and capacity,
- But resolution makes no real progress in 2012

→ **Mortgage Arrears Targets (MART) adopted Q1 2013**

- Met modest target of concluding restructuring of 15% by end 2013 (and restructuring offers to 50%)
- More progress likely in 2014, but continue into 2015

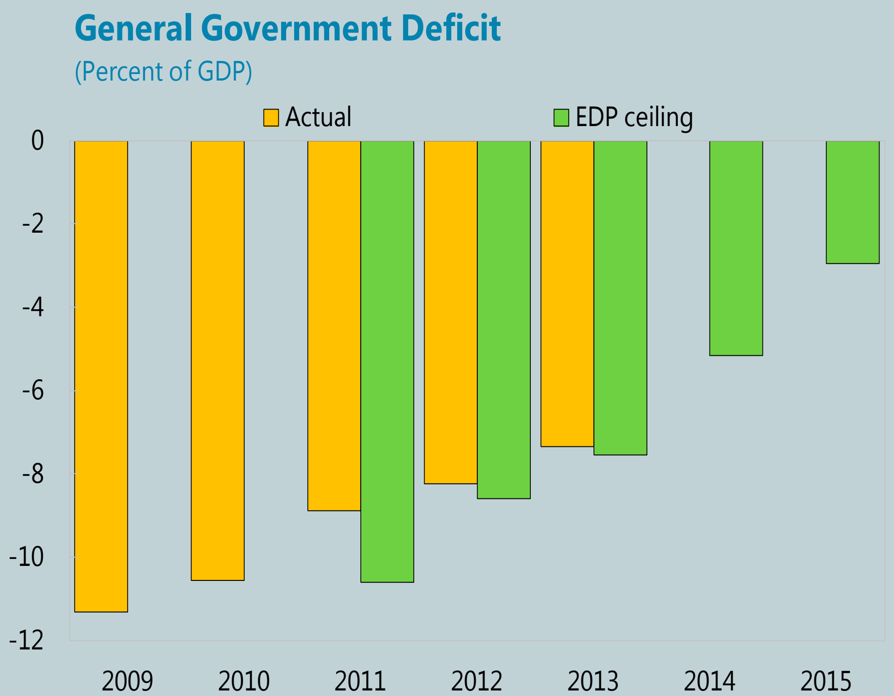
- **SME loan resolution**: targets for 2 banks with SME loans
  - Lower public profile, banks' meeting targets

But major work remains with total NPLs 27% of loans.

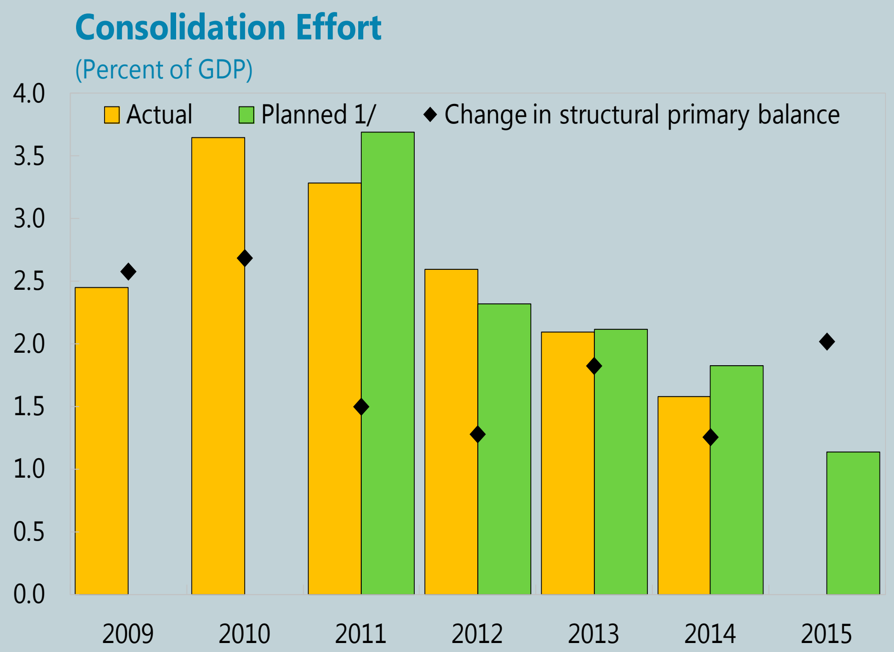
Fiscal Kept on Track Despite Growth Shortfalls

Consistently within deficit ceilings

Agreed effort modestly greater in 2012 and modestly less in 2014



Sources: National authorities; and IMF staff estimates.



Sources: National authorities; and IMF staff estimates.
1/ National Recovery Plan 2011-14 for 2011 and Nov. 2011 MTFS for 2012-15.

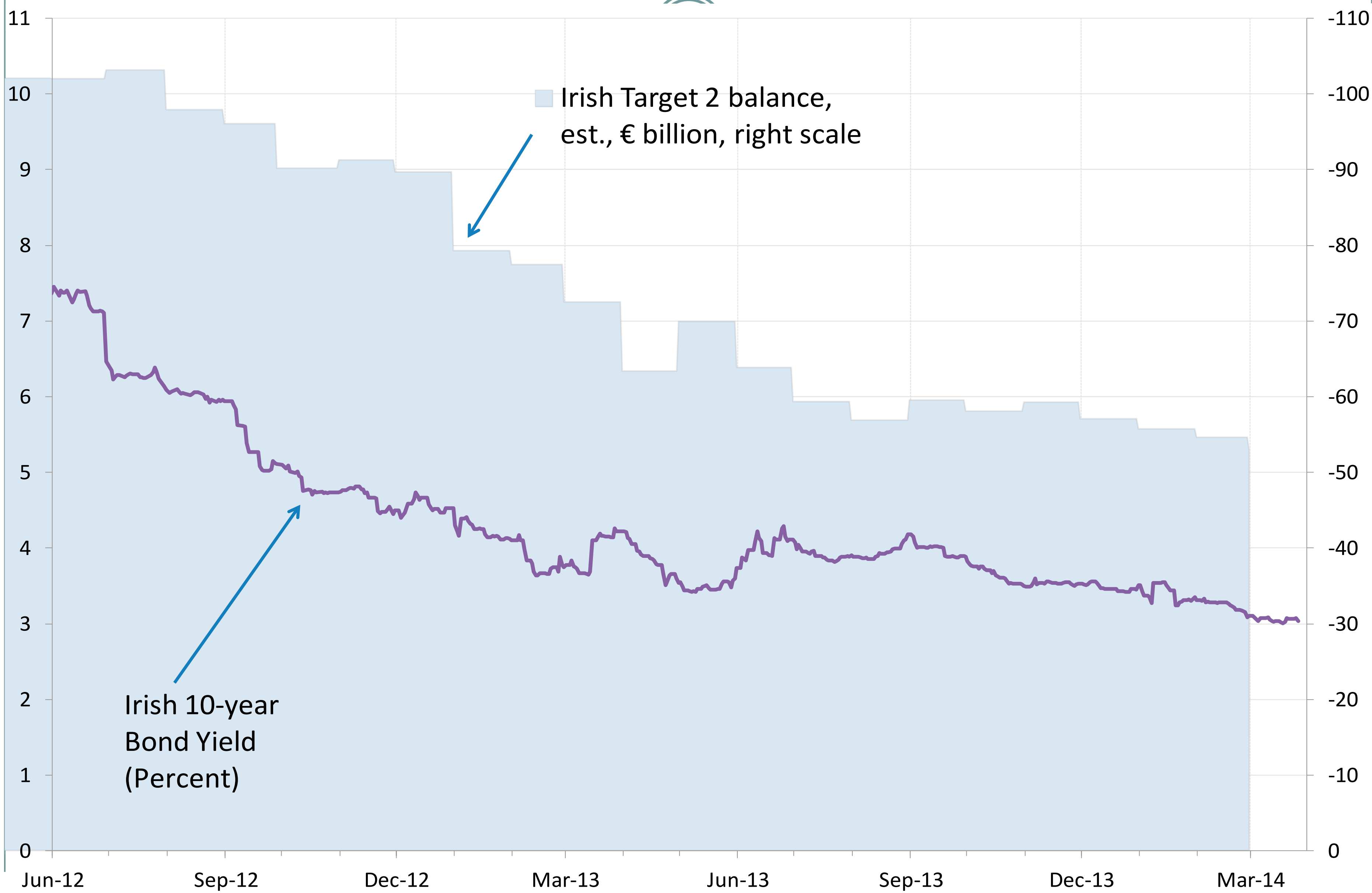
Fiscal Framework Strengthened

- **Fiscal rules from EU Fiscal Compact adopted**
  - General government: budget balance rule, debt rule
  - Fiscal Responsibility Act (2012): implementation approved by a referendum under Irish constitution on May 31 2012
- **Irish Fiscal Advisory Council established**
  - Assesses soundness of fiscal stance (taking rules into account)
  - Endorses budget macroeconomic forecasts for Budget
- **Expenditure Ceilings in place**
  - Aggregate and ministerial level, with three year horizon
  - Update based on a Comprehensive Expenditure Review
- **Transparency enhanced**
  - Fiscal reporting, forecasting, risk analysis being improved
  - Quarterly Government Finance Statistics

EA Support and Policies

- **EU financing terms improved**
  - Mid-2011: Margins on EU loans eliminated
  - June 2013: Maturity extension on EFSF/EFSM loans
- **ECB funding stabilized**
  - Mar. 2011: Waiver of rating requirement for Irish collateral
  - Dec. 2011: 3-year LTRO stabilized bank funding
  - Feb. 2013: Promissory note collateral for ELA (7-8 year maturity) replaced by government bonds (25-40 years)
- **Euro stability steps key turning point in mid-2012**
  - June 29, 2012: Banking Union adopted by EA Summit
  - July 26, 2012: "…, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

Irish Bond Yields Down 4½% Since mid-2012



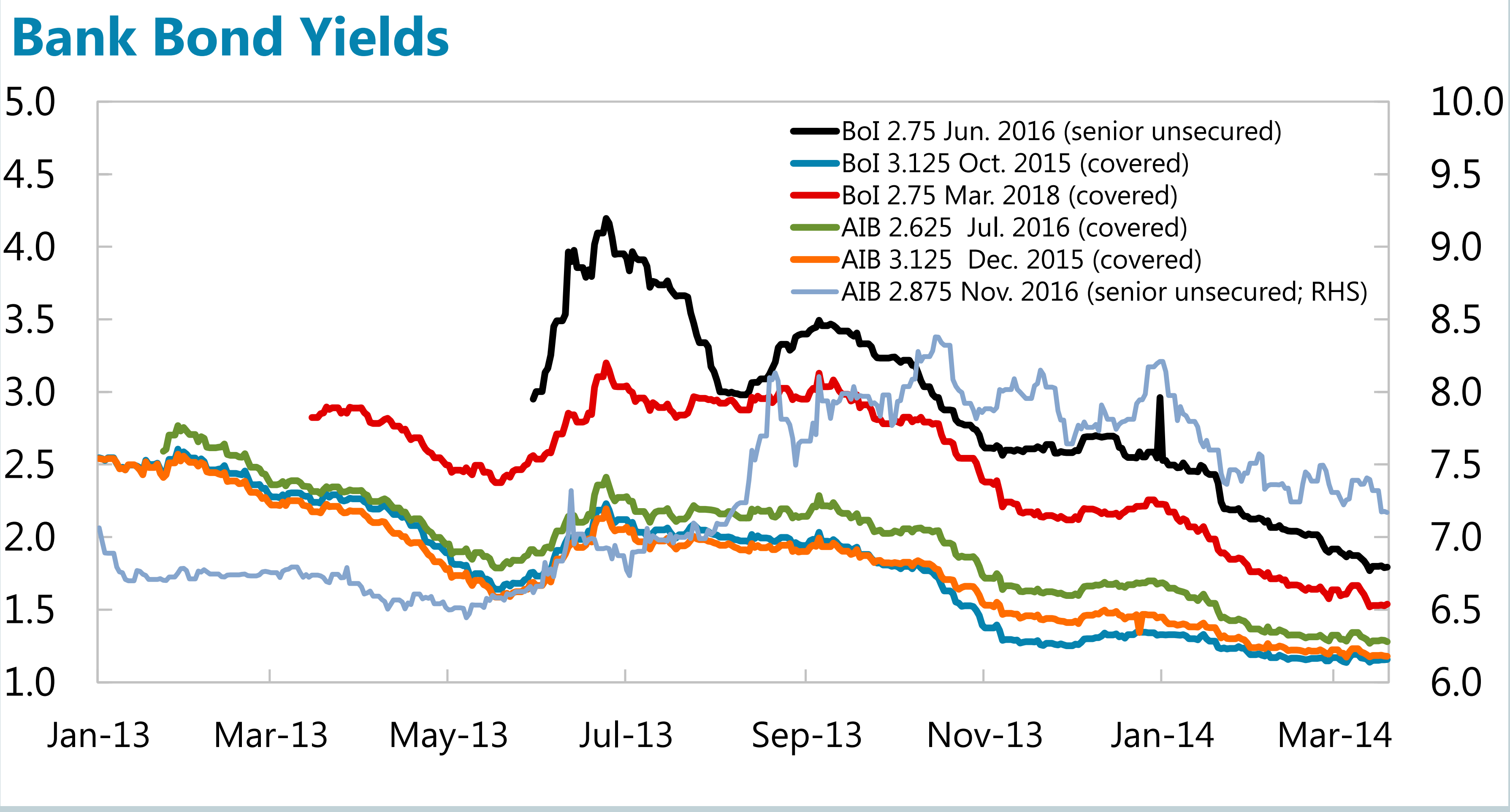
Sovereign—Step by Step Re-entry

- Feb. 2012: Bond exchange of €3.5 billion
- July 2012: First T-bill issuance
- Sequence of well subscribed syndicated bond issues:

Date	Maturity	Amount	Yield
Aug. 2012	5-year 8-year	€3.9 billion €1.3 billion	5.9% 6.1%
Jan. 2013	5-year	€2.5 billion	3.3%
Mar. 2013	10-year	€5 billion	4.15%
Jan. 2014	10-year	€3.75 billion	3.5%

- Moody's last to upgrade to investment grade (Jan & May '14)
- March 2014: First bond auction 10-year, €1 bn, yield 2.967%
- Maintained cash buffer €20 bn (>1 year financing needs)

Banks—Tagging on the Heels of Sovereign



IV. WHAT CHALLENGES REMAIN?

Remaining Challenges

Lasting economic recovery for Ireland entails:

- **Reduce high public debt (124% of GDP)**
  → sustained primary surpluses
  → expenditure reforms and tax base broadening
- **Restore banks' capacity to support economy**
  → resolve extensive NPLs (27%)
  → improve profitability
- **Revive consumption and investment**
  → private B/S repair: HH debt 200% of Disposable Income
- **raising employment from low levels**
  → sectoral & regional shifts, esp. for long-term unemployed

Fiscal: Complete consolidation

- Ensure public debt on declining trajectory
- Balanced pace of adjustment
- Durable Savings: health, education, social protection
- Protect core services and vulnerable
- Broaden tax base

Financial Sector: robust credit flow

Complete sustainable solutions for mortgage arrears	• Banks to adjust solutions to address HH circumstances • Information and incentives to engage • Timely and predictable repossession procedures
Further reduce uncertainties regarding bank health	• Ensure adequate provision level • ESM direct recap backstop to SSM CA
Revive lending	• Regain profitability • Align bank funding cost with interest rates • European solution to facilitate recovery in EA

Reduce Unemployment

Resolve SME loan arrears and facilitate restructuring

Streamline role of courts in SME examinership

Strengthen employment services

V. WHAT CAN BE LEARNED FROM THIS EXPERIENCE?

Preliminary Lessons: Objectives

- Program “bought” time → used for reforms
  - Implement range of fiscal and financial reforms
  - EA reforms
  - Scale of some problems may reduce: debt sustainability, NPLs

- Arrest pernicious feedback loops
  - Interactions between weak B/S of banks, HH, companies, government
  - Support from partners in monetary union

Preliminary Lessons: Program

- Focus on macro-financial critical policies
  - Limited capacity (eg. legislation drafting)
  - Dropped non-critical elements (eg. minimum wage)
  - Concentrated on macro-critical reforms → focused reforms (eg consolidation)
- Adaptability
  - Changed deleveraging targets → accomplished same objective
- Safeguards
  - No fire sales, no procyclicality, privatization dependent on market conditions
- Ownership
  - Policy design; Intense debate; Social cohesion

Preliminary Lessons: Financial Crisis

- Systemic bank crisis: Speed & Decisiveness
  - Act quickly: PCAR restored credibility
  - Viable banks: recapitalize, restructure, restore to functionality
  - Non-viable banks: resolve
- Liquidity versus Solvency
  - Err on side of caution
  - Bank guarantee narrowed options later
- Recapitalization must be followed by reforms
- Loan resolution may need time to minimize losses

Preliminary Lessons: Fiscal Policy

- Phased fiscal consolidation
  - Medium-term adjustment consistent with confidence
  - Financing availability
- Ownership key to implementation
  - Political sustainability
- Automatic Stabilizers
  - Avoid procyclical response to temporary shocks

Preliminary Lessons: Debt Issues

- Debt sustainability: deficit <u>and</u> growth matter
- Burden sharing
  - Risk-takers must be allowed to incur losses
  - Sovereign debt sustainability
  - Political sustainability
  - Formal framework helps to set expectations

Preliminary Lessons: Engagement

- Cooperation within Troika
  - Collaborate to seek common positions
  - Key issues note
  - MEFP drafting sessions
- Cooperation with Authorities
  - External Programme Compliance Unit
  - Candid and intense discussions
  - Strong ownership
- Stakeholder dialogue
  - Direct experience with vulnerable parts of society
  - Encouraged fairness and equity
- Media contact: explain objectives and tools

THANK YOU!

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