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Economic Adjustment Programme for Ireland — Winter 2011 Review

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European Commission

Directorate-General for Economic and Financial Affairs

Economic Adjustment Programme for Ireland

Winter 2011 Review

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EXECUTIVE SUMMARY

The Irish economy is estimated to have returned to growth in 2011, thanks to the strong performance of its export sector. Domestic demand continues to contract, reflecting necessary repairing of stretched balance sheets and—especially as the year has progressed—concerns about the outlook for the euro area and its potential spillovers to Ireland's nascent recovery.

Against an increasingly challenging background, the Irish authorities continue to rigorously implement their adjustment programme, which is supported by the EU and the IMF. The general government deficit is estimated to have been well below the programme ceiling in 2011. The authorities have appropriately increased the amount of consolidation underpinning the 2012 budget to offset expected fiscal pressures from the deterioration in the macroeconomic outlook, thus confirming their commitment to do "whatever it takes" to ensure that the deficit-reduction path underpinning the Excessive Deficit Procedure is achieved.

As to financial sector reform, the recapitalisation of domestic banks envisaged by the 2011 PCAR has been substantively completed, with only EUR 1.3 billion remaining to be injected into ILP following the separation and sale of its life insurance assets (this is expected to be achieved over the next few months, so that the recapitalisation takes place by June). In the aggregate, domestic banks' deleveraging has exceeded the programme's targets for 2011 as a whole. The reorganisation of the sector and the upgrading of the regulatory and supervisory frameworks are also proceeding according to plans. Discussions have focused on how best to adapt the reform strategy to the more challenging economic and financial environment and underpin the viability of the domestic banks, with a view to improving prospects for their timely return to market funding and, ultimately, private ownership. These discussions are continuing.

Progress was also made in key structural areas, where proposals have been designed and discussed to introduce water charges by the end of the programme and improve targeting of social support expenditure. Draft legislation was also introduced to reform the sectoral wage setting arrangements, which is necessary to help the labour market adjust to the changed economic background and thus contribute to reducing very high and increasingly long-term unemployment.

The authorities also shared with staff a draft document with the main contours of their strategy to ensure that state-owned assets fully contribute to enhancing the efficiency and competitiveness of the economy and to reducing the government's financing needs. This was further discussed during the mission and milestones for its implementation were subjected to programme conditionality for the future reviews.

Reflecting this strong performance under the programme, financial market confidence in Ireland has continued to improve. Spreads on bond yields have narrowed considerably, and the debt management agency has successfully executed a debt exchange, issuing about EUR 3.5 billion of a 3-year bond maturing in 2015, while simultaneously redeeming a corresponding amount of a security maturing in 2014. This reduces refinancing risks in the period immediately following the scheduled end of the EU/IMF programme.

Despite the significant progress, much remains to be done. Key challenges and risks in the period ahead are associated with the potential for further financial turbulence in the euro area and the weakening of the export demand outlook; related increasing headwinds to bank deleveraging and funding, including heightened concerns on their persistent reliance on the Eurosystem over the long run; the complexity of the financial sector reorganisation; and intensifying short-term pressures on the budget should economic activity prove softer than anticipated. To minimise vulnerabilities, continued steadfast implementation of the programme remains essential.

1. Introduction

This report covers recent macroeconomic developments, programme implementation, and the main challenges ahead as assessed by 10-19 January joint EC/ECB/IMF staff mission to Dublin in the context of the fifth review of the economic adjustment programme, as well as the associated policy discussions with the Irish authorities.[1]

2. Macroeconomic and financial developments

The Irish economy is estimated to have returned to positive growth in 2011. On one hand, following stronger-than-expected growth in the first half of the year (1.8% and 1.4% q-o-q in the first and second quarters respectively), third-quarter data were weaker than anticipated (with GDP contracting by 1.9% q-o-q), especially in terms of domestic demand

[1] This report reflects information as of 15 February.

and, in particular, investment.[2] Exports, on the other hand, held up rather well despite the slowdown in Ireland's main trading partners (the 4-quarter moving average was still up 5% y-o-y in the third quarter of 2011), leading the current account for 2011 as a whole to an expected surplus. This performance can be attributed to ongoing competitiveness gains (supported by overall wage moderation and productivity increases) and a relatively non-cyclical product mix (e.g., pharmaceuticals, agricultural and food sectors). Overall, staff have revised down somewhat the growth forecast for 2011 (to 0.9%) and the estimated nominal GDP (by some 0.3%). Headline inflation remained low (1.1% at end 2011), broadly in line with expectations, despite pressures from imported energy.

Employment, however, continues to contract. Employment fell by 2½% in the year to the third quarter, and by an estimated 2¼% in 2011 as a whole, as employment-intensive domestic demand continues to contract and export growth has been concentrated in sectors which are not labour-intensive. Lower labour force participation and some net outward migration have contained the increase in the unemployment rate, which was 14.2% in 2011, up by 0.6pp over 2010. In particular the number of long-term unemployed has continued to grow (to almost 177,200, or 56.3% of total unemployed in Q3). After 5 quarters of small declines, growth in nominal wages and labour costs turned positive (albeit relatively modestly so) in the third quarter of 2011, though still below measured productivity growth, so that unit labour costs continue to decline. While positive for the prospects of a turn-around in domestic demand, this development nonetheless requires close monitoring to the extent that first signs of upward wage pressures at these high unemployment levels could indicate a high level of structural unemployment. The main concern, of course, is that skill mismatches might make it difficult for a very large number of former construction and manufacturing workers to be absorbed by enterprises in export-oriented sectors.

Fiscal performance remains on track. Based on central government's end-2011 cash outturn, the 2011 deficit is estimated at 9.9% of GDP, well below the programme ceiling (10.6% of GDP).[3] This better-than-expected estimate reflects primarily some savings in capital and current expenditure (including on interest payments). Only some of these savings

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[2] Given Ireland's small and very open economy, quarterly figures are particularly volatile and subject to revision. Thus they should be interpreted with caution.

[3] Pending receipt of the final version of the business plans for the banks involved, the Irish statistical authorities (Central Statistics Office, CSO) provisionally treat capital injections and other bank support measures as financial transactions. By March 2012 at the latest, CSO, in consultation with Eurostat, will decide whether such statistical treatment complies with the rules of the European System of Accounts (ESA95). It is important to recall that banking support measures are in any case excluded from the headline deficit numbers as far as assessing compliance with the programme's deficit targets is concerned.

will be unwound in 2012,[4] thus creating some buffers against deficit-increasing pressures (see below).

Financial markets are increasingly responsive to the solid adherence to the programme, but sentiment remains vulnerable to renewed bouts of turbulence in the wider euro area. Reflecting the rigorous stress test exercise for domestic banks (PCAR 2011), an emerging track record of adherence to the programme's consolidation path, and economic developments broadly in line with expectations, Irish yields have been on a downward path since mid-2011 (Figure 2). The Irish sovereign term structure has continued to inch downward, with the yield on bonds with 9-year outstanding maturity falling below 7% in early February (Figure 3).

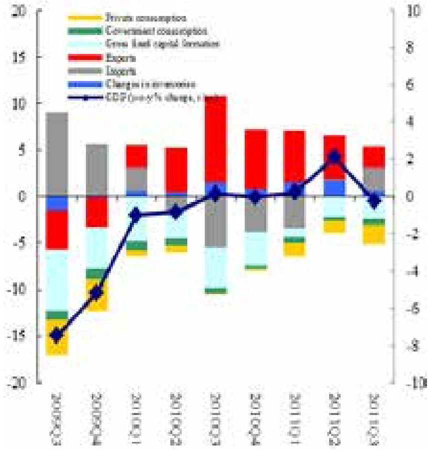
Deposit outflows from domestically-owned banks (henceforth, "PCAR" banks)[5] appear to have stabilised. The previously negative trends in retail and corporate deposits turned positive in the third and fourth quarters of 2011 respectively, with net inflows of approximately EUR 7.1 billion across the two segments in the two quarters to December. For 2011 as a whole, retail deposits have remained flat, as inflows of EUR 6.2 billion in the PCAR banks' UK branches have offset an almost equal decline in the Irish market (incidentally, only limited flight of retail depositors to non-domestic banks appears to have taken place, with branches of foreign banks in Ireland seeing an increase of only EUR 1.8 billion against a EUR 5.9 billion decline in PCAR banks' retail deposits). Corporate deposits decreased by EUR 7.5 billion, mostly in the Irish market.

[4] Presently, only unused capital budget allocations can be carried over into the following year (up to 10% of the annual allocation). The new budgetary framework is envisaged to allow in the future for carryover of unused current expenditure allocations as well (up to a maximum 5% of the annual allocation), to increase incentives for prudent use of these appropriations. This provision is not yet in force.

[5] These are the banks that were subject to the 2011 Prudential Capital Assessment Review (PCAR), i.e. AIB (including EBS), BoI and ILP.

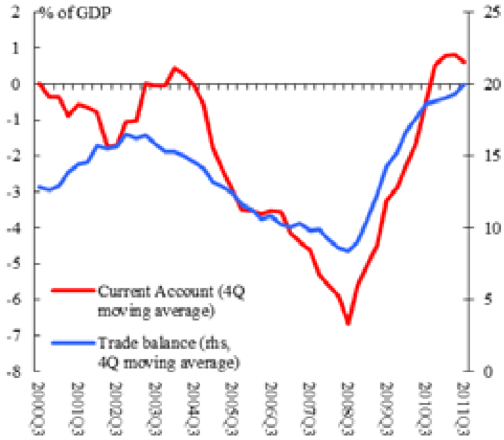
Figure 1: Macroeconomic developments

Year-on-year GDP growth was essentially flat in the third quarter of 2011.



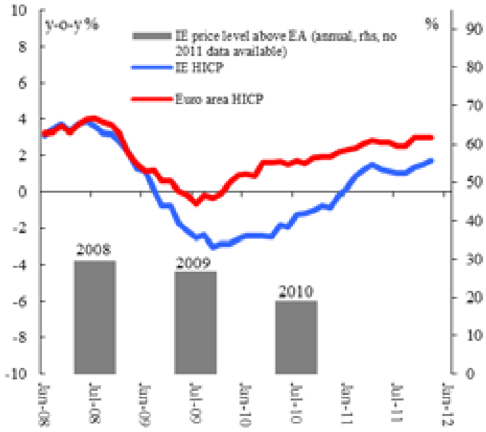
Source: CSO

The trade balance continues to improve, with current account back in surplus.



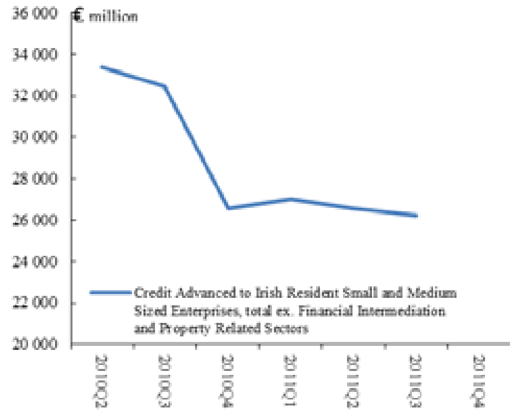
Source: CSO

After falling for two years, the price level is converging to the euro area average.



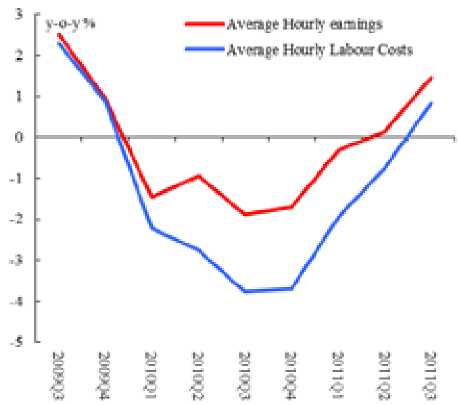
Source: Eurostat

Credit outstanding to indigenous SMEs continues to fall.



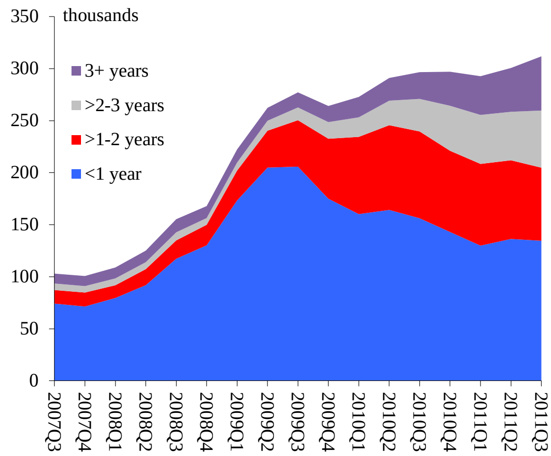
Source: Central Bank of Ireland

Hourly labour costs returned to growth in the third quarter of 2011...



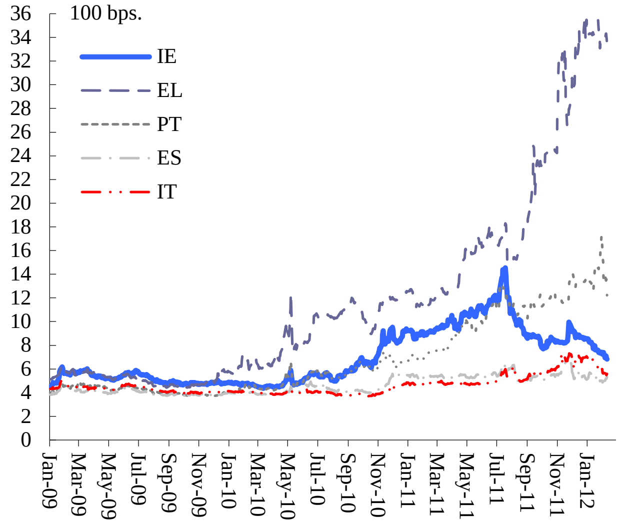
Source: CSO

…while unemployment stabilises (though with a rising share of long -term unemployed)



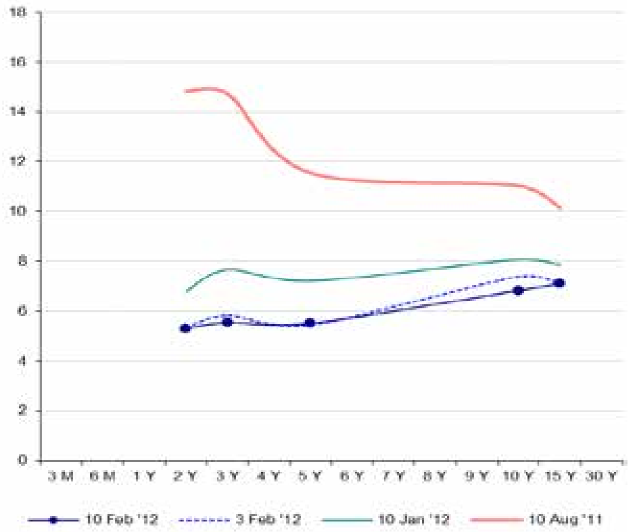
Source: CSO

Figure 2: Yields on 10-year government bonds, selected euro area countries



Source: Bloomberg.
Note: for Ireland, yield on a 9-year bond is depicted.

Figure 3: Yield curve on Irish government bonds (select dates)



Source: Bloomberg

To date, PCAR banks have also managed to downsize their balance sheets in line with programme deleveraging targets. On aggregate, PCAR banks had met their full-year 2011 deleveraging target of EUR 32 billion already by November. This represents some 45% of the total quantum of deleveraging required to be completed by the end of the programme. Considering all domestically-owned banks including IBRC, total deleveraging of EUR 40.5 billion had been completed by end-November 2011. By the end of 2011, some EUR 14.5 billion of asset disposals were either completed or contractually agreed, amid very challenging market conditions, with the remainder of the deleveraging mainly achieved by amortisations and run-offs on core and non-core loan portfolios.[6]

Reliance on Eurosystem funding has correspondingly declined. In addition to the stabilisation of deposit outflows, BoI and ILP have been able to raise wholesale market funding (the equivalent of EUR 4.3 billion and EUR 2.6 billion, respectively, in 2011), albeit on a secured basis and utilising predominantly UK—as opposed to Irish—assets.[7] These positive developments, combined with the PCAR 2011 recapitalisations and the ongoing deleveraging, have reduced "covered"[8] banks' reliance on central bank funding from a peak of EUR 154 billion in February 2011 to EUR 109 billion as of end-December 2011, well below the low end of the range of previous forecasts.

However, the quality of banks' loan portfolios continues to deteriorate. As of the third quarter of 2011, total impairments (across the covered banks plus Ulster Bank) had reached EUR 70 billion, or 21% of their entire loan book (see figure 4 for the PCAR banks' arrears relative to PCAR forecasts). Overall provision coverage had remained flat on the quarter, at 56% in the aggregate (with significant differentiation across institutions). With respect to the mortgage book, provisions increased by 20% between June and September 2011, thereby lifting the coverage ratio from 41% to 46%. Mortgage arrears of over 90 days past-due continued to grow at a constant pace and reached EUR 10.7 billion, or 6.7% of these banks' mortgage book at end-September. Banks' commercial real estate portfolios, as well as corporate and SME loans, have also continued to deteriorate in a context where some macroeconomic variables are projected to be closer to the PCAR adverse rather than base-case scenario (bolded in Table 1 below). Banks have also expressed concerns with the potential for opportunistic borrower behaviour arising from the planned changes to the personal insolvency regime (see section 4.c).

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[6] Customer loan levels appear to be significantly below the PLAR assumptions, but the evidence is mixed as to whether this reflects credit rationing and/or lacking/weak demand for loans. A survey by independent consultant Mazars, commissioned by the DoF and published in November 2011, finds little or no evidence of credit rationing. It documents that 70% of SMEs which applied for credit in the six months to September 2011 received approval (excluding pending applications) and that, of the SMEs which did not request credit, some 80% did not need it and/or had sufficient reserves, while only 7% did so because they believed banks were not lending. Recent research (see http://www.centralbank.ie/publications/Documents/11RT11.pdf) finds on the other hand some evidence that that Irish SMEs are both less likely to have decreased credit demand and more likely to be rejected for credit than a comparable Eurozone SME.

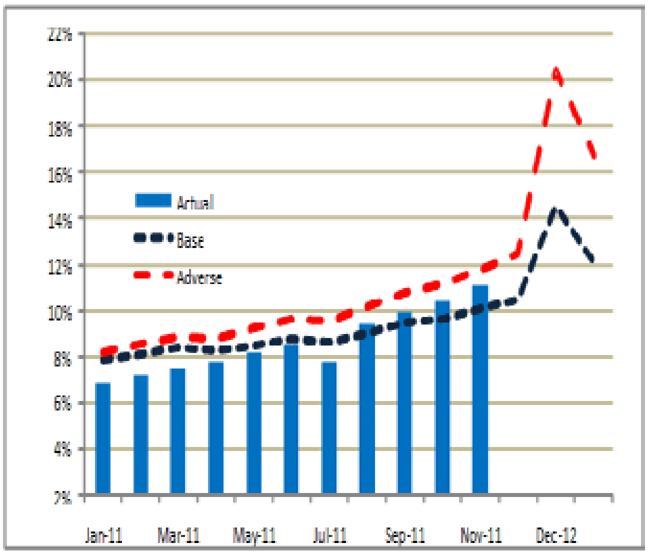
[7] ILP raised a limited amount of funding secured on Irish assets.

[8] That is, banks covered by the Extended Liability Guarantee Scheme. These are AIB (including EBS), BoI, ILP and IBRC.

Table 1: Comparison of key forecasts with PCAR 2011 scenarios

Scenario	PCAR 2011 Baseline			PCAR 2011 Adverse			Fifth Review Forecast		
Year	2011	2012	2013	2011	2012	2013	2011	2012	2013
GDP	0.9	1.9	2.5	-1.6	0.3	1.4	0.9	**0.5**	2.0
Unemployment rate	13.4	12.7	11.5	14.9	15.8	15.6	**14.3**	**14.5**	**13.7**
House prices	-13.4	-14.4	0.5	-17.4	-18.8	0.5	-13.2	n/a	n/a
HICP	0.4	0.6	1.6	0.1	0.6	1.0	1.2	1.6	**1.2**

Figure 4: Actual versus projected arrears



Notes:
(1) In percent of loan book. Aggregate data for BoI, AIB (including EBS) and ILP.
(2) "Base" and "Adverse" refer to the two main macroeconomic scenarios underlying the 2011 PCAR exercise. For these, BlackRock performed the forecasts/analysis on behalf of the CBI using CBI-provided macro-economic projections.

3. PROGRAMME IMPLEMENTATION

Programme implementation remains strong. All programme conditionality for 2011Q4 has been met, and available information suggests that policy conditionality associated with future reviews is also broadly on track to be observed. In particular:

- The government has announced, in its Medium-Term Fiscal Statement and the 2012 Budget, an **ambitious fiscal consolidation plan for the 2012-15 period**, consistent with the programme's deficit ceilings and a deficit below 3% of GDP by 2015. The budget also spelled out binding multi-year ceilings on expenditure at the level of ministerial spending groups (see section 4.b below).
- **The still pending recapitalisation** of BoI was completed without a need for further government support following the successful repurchase by BoI of several tranches

of its residential mortgage-backed securities.[9] For ILP,[10] the state will, subject to government approval, purchase Irish Life from ILP, following the suspension of the planned sale of Irish Life to external investors in late November due to euro area debt market turbulence. Furthermore, the government has confirmed that, as per programme understanding, it will provide, if needed, any remaining balance of the required capital of about EUR 1.3 billion, following the purchase of Irish Life (see section 4.c below). A deadline of the second quarter of 2012 was agreed in this respect (the financing plan has been suitably adjusted, see section 5 below).

- The authorities have liaised thoroughly with programme partners on the progress made in terms of **deleveraging and reorganisation** of covered banks. In particular, aggregate deleveraging is ahead of schedule. Looking ahead, however, the market environment may materially deteriorate as a result of the expected increase in the supply of competing assets as banks across Europe strive to improve their liquidity and leverage metrics. Reorganisation is advancing. As regards the credit union sector, the state has provided EUR 250 million to the Resolution Fund established under the Central Bank and Credit Institutions (Resolution) Act 2011, to facilitate the resolution process in line with programme requirements. Following an application from the CBI, the High Court has appointed a special manager for one large troubled credit union. Constructive discussions have also taken place as regards the **future of ILP**, and these are scheduled to continue (see section 4.c below).
- In accordance with programme requirements, the central bank has drafted **guidelines on loss provisioning and collateral valuation for banks**.
- As regards the **labour market**, legislation was introduced to reform the legal framework for Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs). Staff consider that this legislation is broadly consistent with programme undertakings and objectives (namely, increasing labour market flexibility to facilitate the significant employment reallocation required to underpin the recovery of the domestic economic). Discussions during the mission have identified areas where the legislation could be further improved (see section 4.d below).

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[9] Following the completion of a tender process, BoI announced on 2 December 2011, that it accepted for purchase approximately EUR 1.1 billion in aggregate (amortised) principal amount outstanding of its Kildare and Brunel mortgage backed securities; the aggregate Core Tier 1 accretion to BoI from all the transactions was approximately EUR 350 million (the outstanding PCAR 2011 requirement).

[10] The end-December 2011 programme deadline for recapitalisation explicitly foresaw an exception for ILP in connection with the uncertainty associated with the sale of its life insurance assets.

- The authorities have provided to programme partners progress reports on the introduction of **water charges** and on ongoing reforms to **better target social support—**both reform efforts appear to be on track and will be further monitored in future reviews.
- The authorities have closely liaised with DG COMP on how to **improve the draft Competition (Amendment) bill** and several amendments have been presented as a result (section 4.d).
- On the envisaged **asset disposal programme**, the authorities have provided an interim draft in December. This was considered not sufficiently ambitious. A revised programme was subsequently provided and milestones for its implementation were subjected to programme conditionality for the future reviews (see section 4.d and Annex).

4. POLICY DISCUSSIONS

A. MACROECONOMIC OUTLOOK

There was broad agreement that downside risks to the near-term macroeconomic outlook have intensified, mainly as a result of the slowdown in trading partners' growth (especially in the euro area). Staff therefore lowered the real 2012 GDP growth forecast to 0.5%, down from 1.0% in the fourth review (Table 2). The revision also accounts for a sharper contraction in domestic demand, reflecting the drag on confidence of the continuing euro area sovereign debt crisis and continuing contraction in domestic credit. The authorities’ latest forecast, set out in Budget 2012, is for real GDP growth of 1.3% this year. As is the norm, they will reassess their forecast for the macroeconomic outlook in the context of the Stability Programme scheduled for submission by end-April 2012.[11]

Despite having a lower forecast for growth in 2012, staff consider that the authorities' forecast nominal GDP growth for 2012 remains achievable. The depreciation of the euro against the dollar (down some 3% over the last three months) is set to have a positive impact on the export deflator (the price of Irish exports rises as the dollar appreciates). Inflation for 2012 has also been revised up from 1.3% to 1.6% to incorporate the effect of announced

[11] Even though such update is no longer required for EU member states under a financial assistance programme, the authorities have indicated that they plan to submit it this year as well, as they see it part of their enhanced fiscal framework.

increases in some administered prices (i.e., insurance and energy). Thus staff forecast for GDP deflator growth has been revised upwards by 0.2pp.

Table 2: Updated near-term macro-economic framework

	Staff Current Forecasts			Autumn 2011 (fourth review)			Authorities' forecasts (2012 Budget)		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
	% change on previous year (unless otherwise specified)								
Real GDP growth	0.9	0.5	2.0	1.1	1.0	2.3	1.0	1.3	2.4
Private consumption	-2.8	-1.6	0.5	-2.4	-1.3	0.5	-2.5	-1.3	0
Public consumption	-3.0	-2.4	-1.8	-2.9	-1.8	-2.4	-3.0	-2.2	-2.2
Fixed investment	-14.0	-4.6	3.0	-10.5	0.6	4.2	-11.0	-1.0	3.2
Domestic demand (contribution)	-3.6	-1.7	0.2	-3.0	-0.9	0.2	-3.1	-1.2	0.0
Inventories (contribution)	0.9	0.0	0.0	0.9	0.0	0.0	0.7	0.1	0.0
Exports	4.2	2.8	3.8	4.5	3.8	4.3	4.6	3.6	4.5
Imports	0.8	1.0	2.7	1.6	2.4	3.0	1.6	1.6	2.8
Net trade (contribution)	3.6	2.2	1.8	3.2	1.9	2.1	3.3	2.4	2.5
Employment	-2.2	-0.8	0.7	-1.9	-0.6	0.6	-1.9	-0.2	0.8
Unemployment rate (level)	14.3	14.5	13.7	14.4	14.2	13.5	14.3	14.1	13.5
GDP deflator	-1.0	1.4	1.2	-0.9	1.2	1.3	-1.5	1.1	1.0
HICP inflation	1.2	1.6	1.2	1.1	1.3	1.2	1.2	1.9	1.4
Current account (% of GDP)	0.4	1.6	2.1	0.7	1.5	1.9	0.5	1.7	2.5
Nominal GDP (EUR billion)	155.8	158.8	164.0	156.3	159.7	165.4	155.3	159.1	164.6

The continued weakness of the domestic economy means that the outlook for the labour market remains poor. Employment is forecast to fall in 2012 by a further 0.8%, as job growth in exporting sectors is unlikely to offset the continuing contraction in public employment and the downsizing of the financial sector. Unemployment is set to peak at 14.5% in 2012 and fall only gradually thereafter. In the medium-term unemployment is set to stay elevated (at around 12%) for a number of reasons. First, demand for labour will increase only slowly in line with the gradual recovery in the domestic economy, as exports tend to be less labour-intensive. Second, despite recent steps in the right direction, labour market activation policy in Ireland remains weak both in relation to European standards and in relation to the challenge represented by the large number of long-term unemployed whose skills face little or no demand. Third, once demand for employment improves, it is likely to be met at least in part by increased participation (and, possibly, higher inward migration flows).

Risks to the near-term growth outlook are tilted to the downside, particularly because of continued uncertainty surrounding the near-term prospects for euro area growth.[12] For 2013, staff have lowered their forecast for real GDP growth from 2.3% to 2.0% as uncertainty about the external outlook remains, although a small positive contribution from domestic demand growth is still expected after five full years of contraction. However, any further weakening of global demand would impact Irish export growth with knock-on effects for domestic demand (although compositional effects mean that Irish exports are more likely to be resilient in a downturn). Moreover, the more difficult market for deleveraging could speed up the contraction in credit to indigenous SMEs (already down 8.2% in the year to Q3 2011) which would mean that investment by indigenous firms could remain at currently depressed levels for some time. Similarly, a more prolonged and/or sharper adjustment in the house prices would limit/postpone a recovery in private domestic demand. On the upside, the very low interest rate environment may allow households to repair their balance sheets without impacting excessively on private consumption; while exchange rate developments may be of benefit to the export sector.

B. FISCAL POLICY

Discussions focused on the measures included in the 2012 budget, which were found prudently costed and consistent with the 2012 programme deficit ceiling. There was broad agreement that, in light of the increasing macroeconomic risks, rigorous budget implementation is essential. The authorities reiterated their commitment to do "whatever it takes" to ensure the achievement of the consolidation objectives of the programme.

The budget is consistent with a 2012 fiscal deficit target of 8.6% of GDP, in line with the programme targets.[13] The 2012 budget implemented a consolidation effort of EUR 3.8 billion, comprising of EUR 2.15 billion in *new* expenditure measures, EUR 1.1 billion in *new* revenue measures and a carryover from revenue measures introduced in the 2011 budget of EUR 0.6 billion.[14] Risks are mostly associated with the macroeconomic outlook, which could exert downward pressures on tax revenue and upward

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[12] Although the outlook for UK growth has also been revised down, the recent small appreciation of sterling is positive for the indigenous manufacturing sector which exports mainly to the UK.

[13] The deficit projections for 2012 and outer years do not include possible direct effects of planned or yet-to-be-specified banking support measures, which are provisionally considered as financial transactions until the decision on appropriate classification is reached by CSO, in consultation with Eurostat (see also footnote 3). Such measures are in any case excluded from the headline deficit numbers as far as assessing compliance with the programme's deficit targets is concerned.

[14] Taking account of the additional carryover of EUR 0.5 billion, resulting predominantly from the Universal Social Charge implemented in the 2011 budget, total consolidation amounts to EUR 4.3 billion.

pressures on social expenditure should it weaken further. Against this, staff consider that there are some buffers in the budget, e.g. the above-mentioned positive base effect from lower-than-forecast expenditure outturn in 2011 and prudent budgetary estimates. The authorities reiterated their commitment to do "whatever it takes" to ensure that the fiscal targets underpinning the programme are delivered, as they see this as paramount to maintain the credibility of their policy framework.

Looking beyond 2012, the forecast deficit path is broadly in line with the programme and EDP consolidation targets (Figure 6), with the 2015 deficit forecast to remain just below the 3% ceiling envisaged under the EDP. In reiterating their commitments to take remedial actions in case of deviations from the agreed deficit path, the authorities have indicated that the recently completed expenditure review identifies a broad menu of prudently-costed consolidation options, and that technical work continues in order both to ensure that they can be activated quickly if/as needed, and to identify other possible measures. Staff encouraged the authorities to use the April 2012 update of the Stability Programme to reassess the deficit forecasts and further specify the measures underpinning the adjustment path towards the 3% of GDP 2015 deficit goal.

The mission received assurances from the authorities that their strategy to reduce the public service pay bill by numbers' reductions and efficiency gains remains on track. Large increases in the public service pay bill in the years to 2008 contributed to the build-up of the fiscal imbalances. As part of the adjustment, gross rates of public service pay were reduced by about 14% cumulatively over 2009 and 2010 through the application of a public service specific levy (the "pension related deduction") and subsequent cuts in gross pay rates. The government now intends to rely primarily on numbers reduction to further curtail the pay bill. In this respect, by 2015 the number of public service employees is to be reduced to 282 500, i.e. 23500 fewer than at end-2010. This would bring the total reduction in staffing to 37500 since the peak in 2008 and generate savings of about EUR 2.5 billion (or 15%) in the government's gross pay bill. The reductions are facilitated by accelerated retirements[15] and preliminary indications suggest that these will be larger than expected in 2012, facilitating the achievement of the 2015 targets. The government considers that the so-

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[15] Many public service employees can retire between the age of 60 and the age of 65. Pensions and retirement lump sums are calculated based on the final pay. The 2010 budget reduced public service pay, but a "grace period" was established until which pension calculations are to be based on pre-cut pay rates. The 2011 budget reduced pensions for existing public service pensioners by 4% on average and extended this "grace period" until end-February 2012. Thus, those retiring after this deadline will be subject to lower pensions and lump sums (on average by some 7%).

called "Croke Park" agreement, reached with unions in 2010 and trading off a series of productivity improvements (including more flexible working arrangements, use of shared services and greater staff mobility) in exchange for a commitment by the government not to impose further nominal pay cuts, is helping to maintain service delivery as numbers fall. The authorities also pointed out that the average public service wage will decline over time as an effective pay freeze to 2014 has been agreed under the Croke Park agreement (which, given the low but positive forecast inflation over the period, will likely lead to reductions in real wages in coming years) and new entrants to the public service start at the lowest level of the pay scale, which was also reduced by 10% in 2011. It was agreed to keep the effectiveness of the "Croke Park" approach in delivering productivity improvements under continuous review.

The authorities have further advanced their consultations with stakeholders on the draft of the fiscal responsibility legislation. Staff reiterated the importance of (i) enshrining in the law the independence of the newly-established Irish Fiscal Advisory Council; and (ii) ensuring that the fiscal rules are in line with the emerging European-level principles and rules. Considering that the latter are being finalized, and in order to ensure the ultimate quality of the final product, it was agreed to postpone the programme deadline associated with the introduction of this legislation to Parliament to the end of the second quarter. Meanwhile, the principles of an enhanced fiscal framework are already applied on administrative basis. Multi-annual expenditure ceilings have been set for each government department until 2014 (Figure 6) based on the menu list of saving measures for 2013-14 from the Comprehensive Expenditure Review. Such expenditure reviews will be repeated every three years to tailor expenditure ceilings in line with any change in priorities and reflecting output-based budget performance assessments.

Box 1: Income distribution effects of consolidation measures

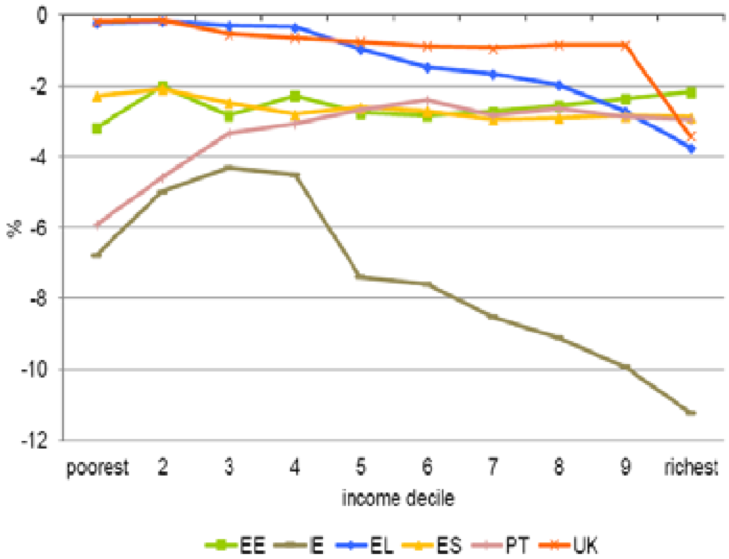
The Social Situation Observatory's study,[16] commissioned and financially supported by the Directorate General for Employment, Social Affairs and Equal Opportunities of the European Commission, compares the distributional impact of consolidation measures implemented over the period 2009-2011 in six European countries, namely Estonia, Ireland, Greece, Portugal, Spain and the United Kingdom.

The analysis captures only first-round effects on household income distribution of changes in direct personal taxes, cash benefits, and public sector pay. In other words, the impact of the consolidation measures on the structure of labour markets or on households' labour supply is not taken into consideration. Micro-simulations are based on the EU partial equilibrium model EUROMOD and the Irish national model SWITCH.

The results show that, as a result of the fiscal adjustment, the Irish households experienced in relative terms the largest reductions in income across the whole income distribution, reflecting the earlier start of consolidation in Ireland. The study also found that the distributional impact of Ireland's consolidation measures was among the most progressive in the sample, though with a hump-shaped profile (households in mid-to-low deciles of the income distribution—predominantly pensioners—experienced proportionally lower declines than households in the lowest and highest deciles). In terms of Ireland's individual consolidation measures, cuts in benefits have a larger effect on low-income households, while reductions in public sector wages and changes in income tax and social contributions are found to impact proportionately more on high-income households.

Based on the available evidence for the other European countries included in the study, the recent VAT increases in Ireland—which are not included in the model—are likely to reduce the overall progressivity of Ireland's consolidation efforts.

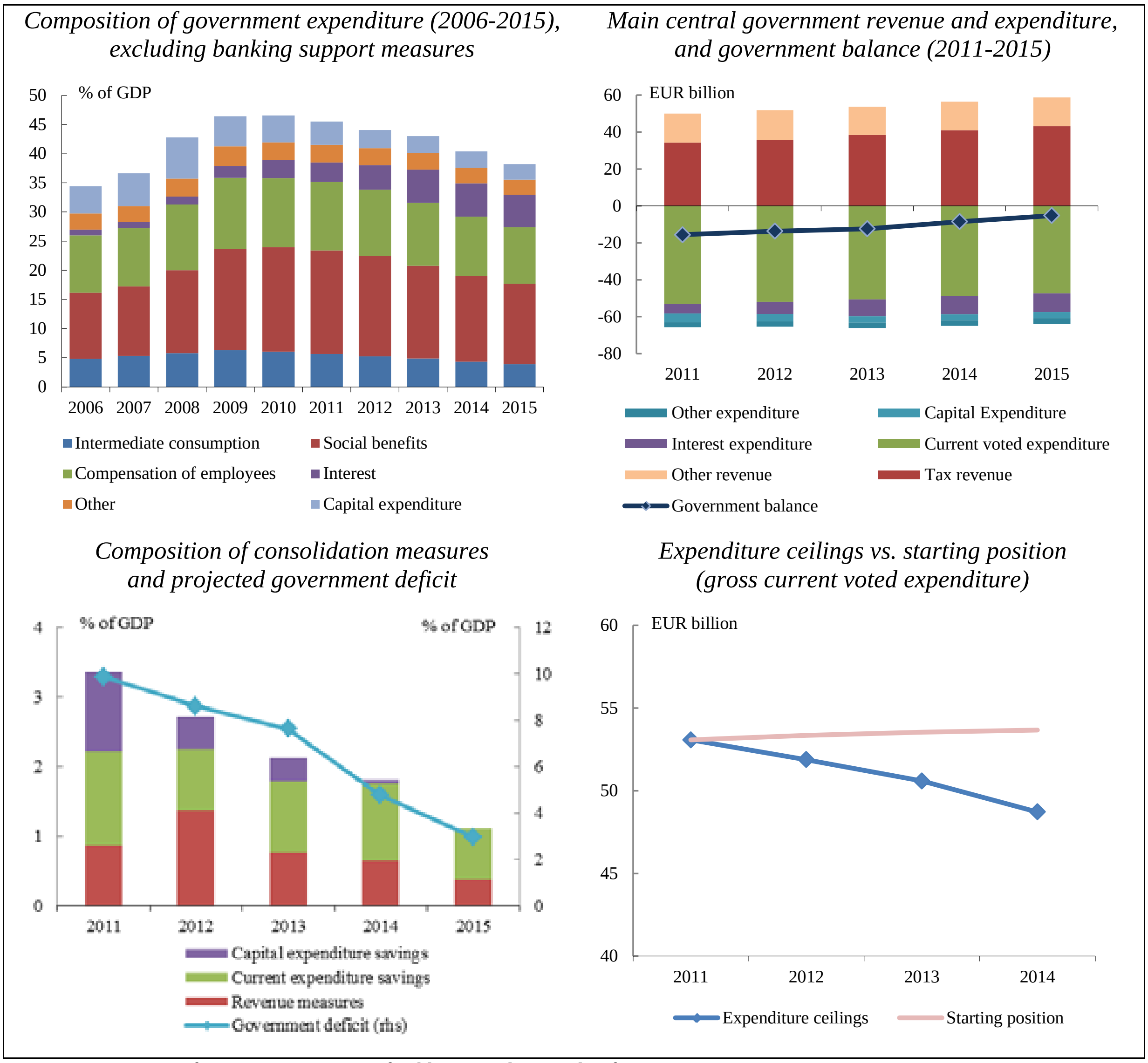
Figure 5: Percentage change in household disposal income due to austerity measures



Source: SSO (http://www.socialsituation.eu/research-notes/SSO2011%20RN2%20Austerity%20measures_final.pdf)

[16] Social Situation Observatory, "The distributional effects of austerity measures: A comparison of six EU countries", Research Note 2/2011.

Figure 6: Composition of realized and projected fiscal consolidation



Source: Department of Finance, Department of Public Expenditure and Reform, Commission services estimates

Table 3: Updated fiscal forecast

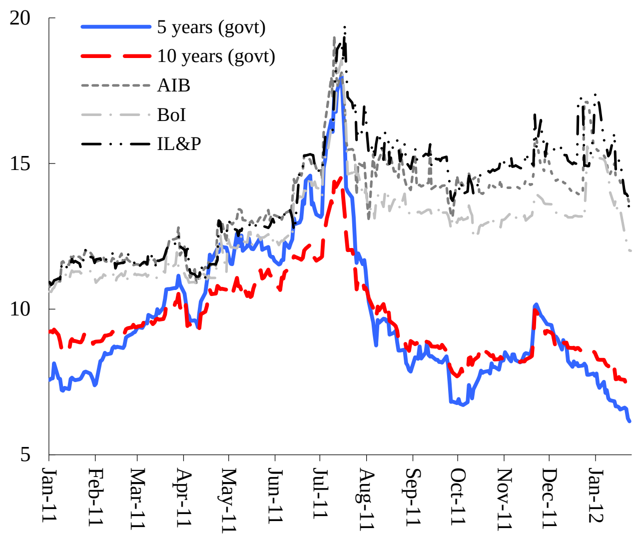
	2010	Current forecast 2011	Autumn 2011 review 2011	Current forecast 2012	Autumn 2011 review 2012	Current forecast 2013	Autumn 2011 review 2013	Current forecast 2014	Current forecast 2015
					% of GDP				
Indirect taxes	11.4	11.5	11.4	11.4	11.3	11.5	11.5	11.7	11.4
Direct taxes	10.5	12.2	12.1	12.5	12.5	12.7	12.7	13.1	13.2
Social contributions	7.5	6.8	6.7	6.6	6.7	6.4	6.5	6.3	6.2
Sales	3.1	3.1	3.1	2.8	2.7	2.5	2.5	2.4	2.4
Other current revenue	1.5	1.1	1.1	1.2	1.2	1.2	1.1	1.1	1.0
Total current revenue	**34.0**	**34.7**	**34.5**	**34.5**	**34.4**	**34.4**	**34.2**	**34.6**	**34.2**
Capital transfers received	1.5	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Total revenue	**35.5**	**35.6**	**35.4**	**35.5**	**35.3**	**35.4**	**35.2**	**35.6**	**35.2**
Compensation of employees	11.8	11.7	11.7	11.3	11.3	10.8	10.7	10.2	9.7
Intermediate consumption	6.0	5.7	5.6	5.2	5.2	4.9	4.9	4.3	3.9
Social transfers in kind via market producers	2.1	2.0	2.0	1.9	1.9	1.6	1.6	1.5	1.3
Social transfers other than in kind	15.9	15.7	15.9	15.3	15.2	14.3	14.2	13.2	12.6
Interest paid	3.1	3.4	3.4	4.2	4.2	5.7	5.6	5.7	5.6
Subsidies	0.5	0.6	0.6	0.5	0.6	0.5	0.5	0.5	0.4
Other current expenditure	2.4	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.1
Total current expenditure	**41.9**	**41.5**	**41.6**	**40.9**	**40.7**	**40.1**	**39.8**	**37.6**	**35.5**
Gross fixed capital formation	3.8	3.1	3.1	2.5	2.5	2.1	2.1	2.0	1.9
Other capital expenditure	21.1	0.9	0.9	0.6	0.6	0.9	0.8	0.8	0.8
Total expenditure	**66.8**	**45.5**	**45.6**	**44.1**	**43.8**	**43.0**	**42.7**	**40.4**	**38.2**
General Government balance (EDP)	**-31.3**	**-9.9**	**-10.1**	**-8.6**	**-8.5**	**-7.6**	**-7.5**	**-4.8**	**-3.0**
					EUR billion				
Indirect taxes	17.8	17.8	17.9	18.0	18.0	18.9	18.9	20.0	20.4
Direct taxes	16.4	19.0	18.9	19.9	20.0	20.8	21.0	22.3	23.7
Social contributions	11.7	10.5	10.5	10.4	10.6	10.5	10.7	10.8	11.0
Sales	4.9	4.9	4.9	4.5	4.3	4.1	4.2	4.2	4.2
Other current revenue	2.3	1.8	1.8	2.0	1.9	2.0	1.8	1.8	1.8
Total current revenue	**53.1**	**54.0**	**53.9**	**54.8**	**54.9**	**56.4**	**56.6**	**59.2**	**61.2**
Capital transfers received	2.3	1.5	1.5	1.5	1.5	1.7	1.7	1.8	1.8
Total revenue	**55.4**	**55.5**	**55.4**	**56.3**	**56.4**	**58.1**	**58.3**	**60.9**	**63.0**
Compensation of employees	18.4	18.2	18.2	18.0	18.0	17.6	17.6	17.4	17.3
Intermediate consumption	9.4	8.8	8.8	8.3	8.3	8.0	8.0	7.4	6.9
Social transfers in kind via market producers	3.3	3.1	3.1	3.0	3.0	2.7	2.7	2.5	2.3
Social transfers other than in kind	24.7	24.5	24.8	24.3	24.2	23.4	23.4	22.6	22.5
Interest paid	4.9	5.2	5.2	6.7	6.7	9.3	9.3	9.8	10.0
Subsidies	0.8	1.0	1.0	0.9	1.0	0.8	0.9	0.8	0.8
Other current expenditure	3.8	3.8	3.8	3.7	3.7	3.8	3.8	3.8	3.8
Total current expenditure	**65.4**	**64.7**	**65.0**	**65.0**	**64.9**	**65.7**	**65.8**	**64.3**	**63.5**
Gross fixed capital formation	5.9	4.8	4.8	4.0	4.0	3.5	3.5	3.4	3.4
Other capital expenditure	32.9	1.4	1.4	1.0	1.0	1.4	1.4	1.4	1.4
Total expenditure	**104.2**	**70.9**	**71.2**	**70.0**	**69.9**	**70.6**	**70.7**	**69.1**	**68.3**
General Government balance (EDP)	**-48.8**	**-15.4**	**-15.9**	**-13.7**	**-13.5**	**-12.5**	**-12.4**	**-8.1**	**-5.3**

C. FINANCIAL SECTOR POLICIES

Despite the progress outlined above, covered banks continue to face challenges, including funding pressures against a deteriorating backdrop for further deleveraging and intensifying risks to their return to profitability (increasing costs of deposits, rising repayment arrears and non-performing loans). Although covered banks are adequately capitalized, it is *essential to ensure their viability, while at the same time improving the quality of collateral supporting the banks' resort to Eurosystem liquidity operations, and minimizing the risks that the necessary deleveraging unduly constrains the availability of credit, which could hold back the recovery of the domestic economy. These challenges are under ongoing discussion and will be closely monitored during the next review missions.*

Funding pressures for covered banks remain elevated. In the current environment, covered banks' ability to tap secured funding, although improved in 2011, are still considerably impaired. Thus banks' reliance on central bank funding is expected to remain high in the short term, particularly in light of upcoming refinancing needs (some EUR 13 billion in covered banks' senior bonds are due for repayment in 2012 and it is unlikely that these can be refinanced in the market at current unsustainable yields—see Figure 7). Banks' efforts to reduce reliance on central bank funding, which might well be a prerequisite for regaining market access, could lead to excessive competition for deposits (which, in the view of some banks, is already taking place), pushing up banks' financing costs and jeopardizing prospects for an early return to profitability.

Figure 7: Bond yields—PCAR banks vs Irish government



Source: Bloomberg

Moreover, the deleveraging process, which was ahead of schedule for the two largest PCAR banks in 2011, might be entering a more difficult phase. So far, asset disposals have concentrated on UK and US assets, prices of which have not declined as much as those of Irish assets and where the market has proved more liquid than expected (buyers for these assets have also turned out to have lower than assumed cost of capital). As the disposal of non-core assets progresses, some domestic assets will have to be sold as well.[17] Hence, banks might find it increasingly difficult to continue meeting their deleveraging targets without accepting higher haircuts on the assets they sell. Moreover, asset disposals in general might become more difficult going forward as banks across the world, and particularly in Europe, are also likely to deleverage amidst tightening funding constraints and recapitalisation needs according to the EBA stress test requirements.

While reiterating their commitment to the programme's ultimate deleveraging objectives, the authorities asked to explore possible refinements of the programme's deleveraging framework. They suggested that the emphasis on loan-to-deposit ratio (LDR) metrics to benchmark the deleveraging causes unintended adverse consequences for the financial system and the economy as a whole. First, the LDR metric may be pushing banks to over-compete for deposits, thereby increasing their cost of funding and potentially jeopardising their prospects for a timely return to sustainable profitability, and eventually to private ownership. Second, it might encourage some banks to dispose of some of their *core* assets or refrain from extending new loans, increasing the risk to the availability of credit to the domestic private sector. Finally, it does not recognize the PCAR banks' recent efforts to mobilize market funding including where secured by non-core asset portfolios, as the underlying portfolios in question are still accounted as on-balance sheet items, even in cases when term funding is sourced against them.[18] It was agreed to consider possible refinements to the monitoring framework while retaining the programme's overall objectives in this area. One possibility that will be explored further is to base the monitoring of the deleveraging process on other metrics, such as the quantum of required asset disposals in nominal terms and the net stable funding ratio (NSFR, to be defined and implemented under Basel III). The authorities will make concrete proposals, which will be assessed in the context of the next reviews.

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[17] As a reminder, the 2011 PCAR envisaged total disposals for the PCAR banks of EUR 34 billion by 2013 (or 49% of the envisaged EUR 70 billion total deleveraging). As reported above, some EUR 14.5 billion of these disposals have already been effected. The Irish assets to be sold represent 18% of the expected EUR 34 billion disposals.

[18] Under IFRS, unless the entire capital structure of a securitised portfolio is transferred to a third party, the originator of the assets is deemed to retain the majority of risks and rewards associated with the portfolio (as the it typically retains the first-loss tranche), hence warranting its full consolidation on the originator's balance sheet. Furthermore, consolidation of the full portfolio is required even if the entire capital structure is transferred to a third party when there are derivative transactions (necessary in order to hedge either interest rate or FX risk as part of the securitisation) to which the originator is a party.

It was agreed that the 2012 PCAR exercise will retain the rigour and distinctive methodological features of the well-received 2011 PCAR exercise, including the independent loan loss forecast. In preparation of the 2012 PCAR, the authorities have undertaken to commission an independent asset quality review of AIB, BoI and ILP's loan portfolios in the first half of 2012. They will also validate bank data and review the covered banks' practices as to provisioning, income and impairment recognition, and risk-weighting, as well as banks' loan portfolio resolution strategies and systems. Methodological aspects of the exercise will be agreed between the authorities and EC/ECB/IMF staff.

The authorities have revised their strategy to complete ILP's recapitalisation. The envisaged sale of ILP's insurance company Irish Life could not be completed as planned by end December 2011 due to the escalation of the euro area debt crisis. Nevertheless, Irish Life is a profitable business with over EUR 31 billion assets under management and between 22% and 38% market shares across all life insurance business segments in Ireland. The authorities have indicated that they intend, subject to government approval, to acquire Irish Life[19] and confirmed that an additional call on public funds of up to EUR 1.3 billion would be required to complete the acquisition of Irish Life and recapitalisation of ILP, for which an end-June 2012 deadline was agreed.[20]

Several options were discussed to strengthen ILP's restructuring plan, and talks are set to continue. ILP's viability has been called into question in particular because of its heavy exposure to structurally loss-making legacy tracker mortgages.[21] The restructuring plan of ILP submitted to the EC in July 2011 was found to require additional work as it did not adequately ensure the bank's long-term viability. Discussions between EC/ECB/IMF staff and the authorities therefore continue with a view to reaching a joint position on how best to underpin ILP's viability while minimizing additional costs to the state and safeguarding financial stability.

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[19] EUR 1 billion in capital sourced via LME's with ILP subordinate bondholders can only benefit Group Core Tier I upon the legal separation of ILP's banking and insurance businesses.

[20] The sale of Irish Life is required in order to complete the recapitalisation of ILP, as it would enable the release of some EUR 1 billion in capital generated from LMEs, in addition to regulatory capital relief at the Group level (calculated on the basis of proceeds received from the sale of Irish Life less book value of the insurance business, plus regulatory deduction on ILP own funds).

[21] ILP has about EUR 16 billion in tracker mortgages. These consist of variable rate mortgages, where the debtor pays a fixed spread over Euribor (ECB main refinancing rate). This spread is in the order of 125 bps. While it might have been sufficient to cover banks' costs and profits on issuance, this spread is definitely too small now given much higher banks' risk premia on funding.

The authorities are implementing their strategy to strengthen the credit union sector. In late 2011 they transferred EUR 250 million to the credit institution resolution fund, which is planned to be recouped in full over time through a levy on credit institutions to be introduced by September 2012. Following an application from the CBI, the High Court has also recently appointed a special manager to oversee a large troubled credit union in order to protect savings. The authorities have confirmed that they are on track to present legislation to strengthen the sector's regulatory framework by the end of June this year, as per programme conditionality.

The mission also sought an update on NAMA's operations. Deleveraging to date has proceeded in line, or ahead, of plans. While this has involved sale of NAMA's better-quality assets abroad, this was a strategic decision to take advantage of market prices which were expected to weaken, which has indeed happened. While cash-flow has to date been strong, allowing for earlier repayment of EUR 1.25 billion of NAMA debt, the overall quality of the loan portfolio is deteriorating, with the share of performing loans down to 23% as of end-June 2011 and further inching down in the second half of 2011. Company management anticipates to meet its deleveraging targets (repaying EUR 7.5 billion, or 25% of its senior debt, by end-2013), but expressed some concerns about post-programme deleveraging, as this will depend crucially on whether the domestic commercial property market will have stabilized by then.

The authorities have continued implementing their strategy to strengthen the supervisory framework. The CBI has developed a comprehensive template of asset quality and credit risk management disclosures following a best practice review which staff are confident will further enhance users' understanding of the loan portfolios' asset quality profile and credit risk management practices of covered banks. Late in 2011 the CBI has also issued to covered banks revised guidelines on provisioning, collateral valuation and disclosures. The principal objectives of the impairment provisioning guidelines are to induce covered banks to: (i) recognise their incurred loan losses as early as possible within the scope of International Financial Reporting Standards ("IFRS"); and (ii) adopt a more consistent and conservative approach to the measurement of impairment provisions across all loan portfolios. Preliminary figures for 2011 show that covered banks have made important efforts to register new impairments. However, not in all banks loan loss coverage has materially improved.

Staff suggested ways to strengthen the guidelines, including by: (i) clarifying a few remaining ambiguities; (ii) reducing allowed discretion in their application; (iii) shifting emphasis from the value of collateral to the creditworthiness of the borrower when determining provision requirements; and iv) ensuring proper recognition of problematic loans which may appear to be performing only thanks to forbearance and loan restructuring. The authorities have undertaken to review the implementation of the guidelines by covered banks during 2012.

Progress continues to be made towards reforming the personal insolvency framework, including amendments to the Bankruptcy Act and the creation of structured non-judicial settlement and restructuring systems. An important element of the authorities' strategy in this regard, as reflected in the Heads of the Personal Insolvency Bill approved by the government and published on 24th January 2011, is the proposed establishment of a dedicated Insolvency Service to oversee the main elements of the out-of-court debt resolution process. These include:

(i) debt relief certificates (DRCs). These certificates are intended to benefit persons who have no assets and no income and are unable to pay relatively small unsecured debts (the debt obligation needs to meet certain conditions, including being not larger than EUR 20,000);

(ii) debt settlement arrangements (DSAs). These are meant to allow the settlement of unsecured debts larger than EUR 20,000 between a debtor (who has income and assets) and two or more creditors; and

(iii) personal insolvency arrangements (PIAs), which allow for the agreed settlement and/or restructuring of both secured and unsecured debts larger than EUR 20,000 (up to a ceiling of EUR 3 million) between a debtor (who has income and assets) and one or more creditors.

The legislation will be carefully drafted to prevent expectations of debt forgiveness for solvent debtors. While the inclusion of secured debt (e.g. mortgages) in the non-judicial framework can be an important element in facilitating the development of adequate strategies to address the pertinent issue of mortgage distress, it should be carefully formulated in order to prevent an adverse impact on borrower behaviour and unintended consequences for the profitability of Irish banks. Thus the authorities appropriately intend to permit DSAs and PIAs only on a voluntary basis so that the consent of the debtor and a majority of the creditors would be required. As regards the reform of the 1988 Bankruptcy

Act, the key element of the authorities' strategy is the reduction of the automatic discharge period from the current 12 years to 3 years, which aims to make the bankruptcy process less punitive and costly for consumers, while ensuring that banks' incentives to supply credit in future are not unduly affected. The discharge period can be extended to 8 years where the debtor has been uncooperative, dishonest or engaged in wrongful conduct. Provision is also made for income payment orders for up to 5 years from the bankruptcy discharge. Following completion of on-going consultation with relevant government departments and the Attorney General and further refinement, the Personal Insolvency Bill is expected to be published in full by the end-April 2012 programme deadline.

D. STRUCTURAL REFORMS

The draft law reforming the sectoral wage setting arrangements[22] was seen as broadly in line with the programme objectives, i.e. making wage-setting systems (which cover some 23% of private sector employment) more flexible. The main features of the draft legislation include: (i) a streamlining of the number of EROs; (ii) provisions to make arrangements more responsive to sectoral and economy-wide shocks; and (iii) removal of non wage-setting aspects from EROs. Staff discussed with the authorities how to further strengthen the employment orientation of the legislation. It was agreed that the authorities will present amendments to the Industrial Relations (Amendment) Bill in particular to: (i) provide that the inability-to-pay clause[23] in EROs and REAs will allow two consecutive exemptions within the overall two-year time limit (rather than a single one as at present), where this is necessary to safeguard employment, and (ii) ensure that the process for the granting of a variation to an REA is conducted in a timely manner, which will improve the responsiveness to economic shocks. The law is scheduled to be enacted by May 2012. In practice, the process of restoring reformed EROs after the High Court ruled the old system unconstitutional will take time, and looks likely to be completed before the last quarter of this year at the earliest. It is thus expected that the revised EROs will accordingly be leaner and more employment-friendly, as currently the labour market is only regulated by generally applicable legislation, such as the national minimum wage.

The mission also discussed the reduction in the redundancy payment rebate to employers and its potential negative side effects for the labour market. The 2012 Budget

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[22] These are known as employment regulation orders (EROs)–a kind of sectoral minimum wage—and registered employment agreements (REAs)–legally enforceable sector-wide collective agreements.

[23] Firms in financial difficulties can be granted a temporary derogation from the conditions of the EROs and REAs by the Labour Court to protect these firms and their employment.

reduced the rebate from social insurance funds received by employers for statutory redundancy payment from 60% to 15%. This more than doubles the effective cost of redundancies for firms.[24] As such, this measure could reduce incentives to hire, since firms anticipate potential redundancy costs. The government acknowledged this potential effect, but pointed out that not many countries have such rebates and that redundancy costs which are comparatively lower than the EU average also represent a threat to employment, since multinational firms could find it cheaper to downsize their Irish operations relative to their operations elsewhere in Europe. The potential effects of this measure on effective labour costs, job creation, and segmentation merit being monitored over the programme period.

The authorities have defined the main contours of their plans to better mobilize state assets to increase overall economic efficiency and contribute to reducing financing pressures and gross debt. They have identified assets for possible disposal in several sectors, and have begun exploring the main policy, regulatory, legislative, corporate governance and financial issues that will have to be addressed before the sale process can begin in earnest. This due diligence is expected to be completed by March. Other concrete steps to advance the sale process have been agreed and are subject to programme conditionality throughout 2012 and in 2013. These will be further developed as the analytical work proceeds, and in consideration of market conditions, in the context of future reviews. On the authorities' request, it was agreed that a share of the realized proceeds be used to fund government plans for employment-enhancing measures, provided EDP ceilings are respected.

The mission also discussed the authorities' strategy to pave the way for the introduction of water charging before the end of the EU/IMF programme. The strategy, based on an independent assessment, consists of creating a single regulated public water utility to replace the current system of local authority control of water services and move to near-universal metering as the basis for water charging. The decision to install meters is driven by the need to encourage conservation, ensure sustainable consumption, and permit usage-based water charges. The government intends to fund the installation of meters using a loan from the National Pension Reserve Fund (NPRF) on commercial terms. The newly-consolidated capital base and improved operational capacity of a single public water utility, together with the net present value from a regulated future income stream, would create considerable

[24] Measured in days of wage per year of service, the cost of redundancy for Irish firms (about 12 days) is now above the EU average (10 days), whereas it used to be substantially lower (about 6 days).

benefit for the sovereign. The authorities will provide an update on progress to develop a detailed implementation plan for the strategy by end Q1 2012 (the plan itself must be presented by end-April 2012).

The authorities are taking further welcome steps to enhance the competition law framework following discussions in the fourth review (October 2011) and in close liaison with DG COMP. Further amendments to the Competition (Amendment) Bill 2011 were presented to parliament on 14 December 2011 as a result of these consultations. In addition, the authorities are seeking to introduce an additional amendment allowing agreements by an undertaking to the Competition Authority to be made a rule of court, having due regard to Ireland's constitutional framework. Going forward, it will be essential to ensure that the Competition Authority is endowed with and maintains adequate staffing to fulfil both its new and existing obligations, even against the challenging background of required reductions in overall public service numbers. The authorities are due to report to programme partners the results of a review of the appropriateness of the staffing of the Irish Competition Authority by end-Q1 2012.

Good progress is being made towards the envisaged update of retail planning guidelines. The authorities are now integrating the results of a public consultation. The finalised guidelines (to be issued end-April 2012) will, *inter alia,* increase the retail cap, streamline the planning process, reduce the power of incumbents, and be more sensitive to consumer interests.

5. Financing issues

The successful completion of the fifth review would trigger the release of EUR 5.8 billion from the EFSF/EFSM. A further EUR 3.2 billion would be disbursed by the IMF and EUR 0.7 billion by bilateral EU contributors, i.e. UK, Sweden and Denmark (negotiations with the latter two countries were reported by the authorities to be nearing completion, and staff encouraged the authorities to finalise them without delay). After this tranche, EU (including bilateral loans) and IMF will have provided EUR 47.9 billion under the programme, representing 71% of the total financial assistance of EUR 67.5 billion.

The cash balances at end-2011 were larger than had been anticipated in the fourth review (October mission), mainly reflecting more short-term funding, with proceeds from retail funding and commercial borrowing exceeding forecasts. Moreover, some contingencies, which had been prudently provisioned for (including collateral requirements from the authorities' hedges against exchange rate risks and interest rate volatility), did not materialize and the collateral requirements from the authorities' hedges against exchange rate risks and interest rate volatility[25] turned out to be lower than estimated (all of the above positive developments are shown as lower gross financing needs in Table 4 below—see note 3).

Table 4: Financing requirements 2011-2013, in billion EUR

	2010	2011					2012					2013	2010-2013
	Dec	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Year	Total
A. Gross financing needs public sector 1/	7.9	12.8	5.2	3.2	7.5	28.8	17.2	4.3	2.6	3.8	27.8	22.6	87.0
B. Bank recapitalisation	0.0	0.0	19.0	-1.7	-0.8	16.5	0.0	1.6	0.0	0.0	1.6	0.0	18.1
C. Market financing 2/ 3/	0.5	0.7	0.3	0.2	0.3	1.4	0.9	0.5	1.1	1.5	3.9	14.2	20.1
Net financing needs (A.+B.-C.)	7.3	12.1	23.9	1.4	6.5	43.9	16.3	5.3	1.5	2.3	25.4	8.4	85.0
E. Use of Irish financial assets 4/	7.3	-5.7	19.5	-2.1	-2.3	9.4	2.8	1.2	-1.1	-0.4	2.5	-1.7	17.5
F. EU-IMF loan disbursement	0.0	17.8	4.4	3.5	8.8	34.4	13.5	4.1	2.7	2.6	22.9	10.1	67.5
EFSM/EFSF	0.0	12.0	3.0	2.0	4.5	21.5	9.0	2.3	1.0	1.3	13.6	5.1	40.2
Bilaterals 5/	0.0	0.0	0.0	0.0	0.5	0.5	1.2	0.5	0.7	0.5	2.8	1.5	4.8
IMF	0.0	5.8	1.4	1.5	3.8	12.5	3.2	1.4	0.9	0.9	6.5	3.6	22.5
Programme financing (E.+F.)	7.3	12.1	23.9	1.4	6.5	43.9	16.3	5.3	1.5	2.3	25.4	8.4	85.0
Memo item													
Projected cash balances at end of period		18.0	8.5	10.6	12.9	12.9	10.0	8.8	10.0	10.4	10.4	12.1	

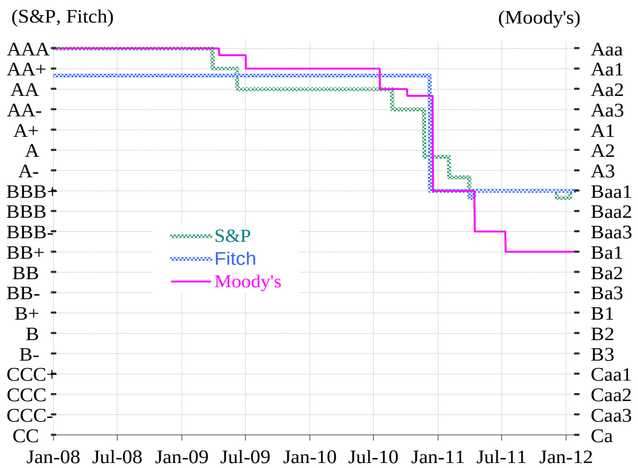
Notes:
The first official financial support under the EU/IMF programme took place in January 2011 (EUR 10.8 billion)
1/ Includes exchequer cash deficit, maturing long-term and short-term debt as well as contingency element.
2/ Includes retail funding, commercial paper, treasury bills and government bonds.
3/ Commercial lending from NAMA is shown as lower funding needs in 2011 (i.e. it lowers line A), but as financing from 2012 onwards (i.e. it increases line C).
4/ Includes Treasury cash reserves and NPRF assets. "-" indicates an increase in cash reserves.
5/ Bilaterals include UK, Sweden and Denmark.

The financing plan has been updated to reflect the changed strategy for the recapitalisation of ILP and the restructuring of the credit unions (Table 4). In the second quarter of 2012, the government has provisioned for interventions of EUR 250 million in the credit union sector (if required) and EUR 1.3 billion to purchase Irish Life from ILP and recapitalise ILP (see section 4.c). These additional expenditures will be covered mainly by the higher than previously envisaged cash buffer and short-term funding. If Irish Life were to be sold to private investors in 2012 or 2013 it would add to the projected financial assets or reduce projected financing needs.

[25] The authorities routinely hedge the interest rate and exchange rate risks associated with the IMF financial assistance, which is denominated in SDR and carries variable interest rates, via swaps which require posting collateral. This increases the effective interest cost to Ireland of the "freely usable" IMF resources (to above 5%).

The Irish sovereign remains intent to issue new debt to the market as soon as market conditions allow. While still high, yields on 10-year Irish government bonds are at their lowest since the inception of the programme. While several euro area Member States were downgraded by one rating agency in January 2012, the Irish rating was kept unchanged by two main rating agencies (figure 8). At the end of January 2012, the debt management agency NTMA successfully swapped EUR 3.5 billion of a bond maturing in January 2014 with an equivalent amount of bonds maturing one year later. This operation was aimed at reducing the repayment hump (around EUR 12 billion) in early 2014, just after the end of the programme. All else equal, it thus reduces the need to keep cash buffers at the end of the programme accordingly (the cash buffer shown in Table 4 was determined before the above-mentioned swap). Domestic retail funding, which exceeded expectations in 2011, will continue in 2012. The authorities plan to start tapping market funding starting in mid-2012 by issuing short-term bills. This was seen as a stepping stone towards the issuance of long-term bonds in 2013. Staff consider the projected net market financing for 2012 of EUR 3.3 billion as realistic.

Figure 8: Ireland's credit ratings



6. RISKS

Good progress notwithstanding, important risks to the programme's ultimate success remain:

- The programme assumes a gradual return of the sovereign to market funding from the second half of this year, with a return to the bond market in the course of 2013. Yet the incipient improvement in market sentiment vis-à-vis Ireland remains fragile, and could evaporate in case of adverse developments elsewhere, putting at risk a return to market funding.

- The growth outlook could continue to deteriorate significantly if the challenges in the peripheral euro area are not addressed and more of Ireland's main trading partners slide into a recession. The covered banks' efforts to deleverage in a stressed market environment could also constrain lending to the domestic economy and augment the risk of a credit crunch and slower growth. Although the fiscal forecasts incorporate some small buffers, a further deterioration of the macroeconomic backdrop could require additional fiscal tightening later in the year, which could have pro-cyclical contractionary effects.

- The reform of the personal debt regime, while necessary, could generate expectations of debt forgiveness, despite the government consistently ruling out blanket forgiveness and reiterating its preference for case-by-case individual arrangements between banks and mortgage borrowers on a strictly voluntary basis. This might lead to a deterioration of the repayment culture and thus adversely impact the quality of banks' loan portfolios, adding to continuing upward trend in non-performing loans across most business segments, and particularly in mortgages. The latter could threaten the timely return to profitability (and hence potentially also to market funding) for PCAR banks.

- Also, the deteriorated macroeconomic environment and market conditions, including increased supply of assets for disposal from European banks, could hinder further progress with bank deleveraging. A slowdown in the downsizing of banks could delay their return to market funding.

List of Abbreviations

AIB	Allied Irish Bank
BoI	Bank of Ireland
CBI	Central Bank of Ireland
CSO	Central Statistics Office Ireland
CCR	Centralized Credit Registry
DoF	Department of Finance
DRC	Debt Relief Certificate
DSA	Debt Settlement Arrangement
EC	European Commission
ECB	European Central Bank
EBA	European Banking Authority
EBS	Educational Building Society
EDP	Excessive deficit procedure
EFC	Economic and Financial Committee
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ELG	Eligible Liabilities Guarantee
EROs	Employment Regulation Orders
ESB	Electricity Supply Board
GDP	Gross domestic product
GMS	General Medical Scheme
GP	General Practitioner
HICP	Harmonised Index of Consumer Prices
HoSG	Heads of State or Government
IBRC	Irish Bank Resolution Corporation
IFRS	International Financial Reporting Standards
IFS	International Financial Statistics (IMF)
ILP	Irish Life & Permanent
IMF	International Monetary Fund
INBS	Irish Nationwide Building Society
IT	Information Technology
JLC	Joint Labour Committee
LDR	Loan-to-deposit ratio
LME	Liability Management Exercise
LTV	Loan-to-value ratio
MEFP	Memorandum of Economic and Financial Policies
MoU	Memorandum of Understanding on Specific Economic Conditionality
MTFS	Medium-term Fiscal Statement
NSFR	Net Stable Funding Ratio
NAMA	National Asset Management Agency
PCAR	Prudential Capital Assessment Review
PIA	Personal Insolvency Arrangement
PLAR	Prudential Liquidity Assessment Review
PMI	Purchasing Managers Index
REAs	Registered Employment Agreements
ROI	Republic of Ireland
SDR	Special Drawing Rights
SLO	Subordinated Liability Order
SME	Small and Medium Enterprises
UK	The United Kingdom of Great Britain and Northern Ireland
USC	Universal Social Charge
VAT	Value Added Tax

ANNEX I—COMMISSION SERVICES' MACROECONOMIC PROJECTIONS

Table 1: Use and supply of goods and services (volume)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-0.9	-2.8	-1.6	0.5	1.8	1.9
2. Government consumption expenditure	-3.1	-3.0	-2.4	-1.8	-3.7	-3.2
3. Gross fixed capital formation	-25.1	-14.0	-4.6	3.0	4.4	5.2
4. Final domestic demand	**-5.8**	**-4.4**	**-2.2**	**0.3**	**0.8**	**1.2**
5. Change in inventories						
6. Domestic demand	**-4.9**	**-3.4**	**-2.1**	**0.3**	**0.8**	**1.2**
7. Exports of goods and services	6.3	4.2	2.8	3.8	4.9	4.9
7a. - of which goods	5.6	4.2	2.8	3.8	4.9	4.9
7b. - of which services	7.1	4.2	2.8	3.8	4.9	4.9
8. Final demand	**0.9**	**0.8**	**0.7**	**2.3**	**3.2**	**3.4**
9. Imports of goods and services	2.7	0.8	1.0	2.7	3.8	4.0
9a. - of which goods	-1.8	0.8	1.0	2.6	3.8	4.0
9b. - of which services	5.4	0.8	1.0	2.7	3.8	4.0
10. Gross domestic product at market prices	**-0.4**	**0.9**	**0.5**	**2.0**	**2.7**	**3.0**
Contribution to change in GDP						
11. Final domestic demand	-5.0	-3.6	-1.7	0.2	0.6	0.9
12. Change in inventories + net acq. of valuables	0.9	0.9	0.0	0.0	0.0	0.0
13. External balance of goods and services	3.7	3.6	2.2	1.8	2.2	2.0

Table 2: Use and supply of goods and services (value)

Annual % change	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-3.0	-1.7	0.0	1.9	3.4	3.8
2. Government consumption expenditure	-8.4	-2.1	-1.1	-1.8	-3.1	-2.4
3. Gross fixed capital formation	-28.7	-15.7	-4.6	5.8	8.7	10.5
4. Final domestic demand	**-8.9**	**-3.8**	**-0.9**	**1.5**	**2.6**	**3.4**
5. Change in inventories	-64.5	-177.1	0.0	3.0	-11.0	0.0
6. Domestic demand	**-7.8**	**-2.9**	**-0.8**	**1.5**	**2.5**	**3.4**
7. Exports of goods and services	8.1	5.2	4.4	4.8	5.9	5.9
8. Final demand	**0.4**	**1.6**	**2.2**	**3.5**	**4.6**	**4.9**
9. Imports of goods and services	5.7	4.0	2.4	3.6	4.9	5.3
10. Gross national income at market prices	-3.2	-2.5	-0.1	1.8	3.6	4.2
11. Gross value added at basic prices	-2.0	-0.4	1.9	3.1	4.1	4.8
12. Gross domestic product at market prices	**-2.9**	**-0.1**	**1.9**	**3.3**	**4.3**	**4.6**

Table 3: Implicit price deflators

% change in implicit price deflator	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-2.2	1.1	1.6	1.4	1.6	1.9
2. Government consumption expenditure	-5.5	0.9	1.3	0.1	0.7	0.8
3. Gross fixed capital formation	-4.8	-2.0	0.0	2.7	4.1	5.0
4. Domestic demand	**-3.3**	**0.7**	**1.3**	**1.3**	**1.7**	**2.1**
5. Exports of goods and services	1.7	1.0	1.5	1.0	1.0	1.0
6. Final demand	**-0.6**	**0.9**	**1.4**	**1.1**	**1.3**	**1.4**
7. Imports of goods and services	2.9	3.1	1.4	1.0	1.0	1.3
8. Gross domestic product at market prices	**-2.4**	**-1.0**	**1.4**	**1.2**	**1.5**	**1.6**
HICP	**-1.6**	**1.2**	**1.6**	**1.2**	**1.4**	**1.8**

Table 4: Labour market and cost

Annual % change	2010	2011	2012	2013	2014	2015
1. Labour productivity	4.0	3.1	1.3	1.3	1.4	1.0
2. Compensation of employees per head	-3.0	0.2	0.5	0.8	1.2	1.6
3. Unit labour costs	-5.7	-2.6	-0.8	-0.3	0.0	0.4
4. Total population	0.3	0.3	0.4	0.6	0.9	1.0
5. Population of working age (15-64 years)	0.3	0.5	0.5	0.7	1.1	1.2
6. Total employment	-4.1	-2.2	-0.8	0.7	1.4	2.0
7. Calculated unemployment rate - Eurostat definition (%)	13.7	14.3	14.5	13.7	13.0	12.1

Table 5: External balance

levels	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	82.9	87.3	91.1	95.5	101.1	107.2
2. Imports of goods (fob)	46.4	49.0	50.2	52.0	54.7	57.5
3. Trade balance (goods, fob/fob) (1-2)	**36.5**	**38.3**	**40.9**	**43.5**	**46.5**	**49.6**
3a. p.m. (3) as % of GDP	*23.4*	*24.6*	*25.8*	*26.5*	*27.2*	*27.7*
4. Exports of services	74.7	78.6	82.1	86.0	91.1	96.6
5. Imports of services	81.5	84.0	86.0	89.2	93.4	98.4
6. Services balance (4-5)	**-6.7**	**-5.3**	**-3.9**	**-3.1**	**-2.2**	**-1.8**
6a. p.m. 6 as % of GDP	*-4.3*	*-3.4*	*-2.5*	*-1.9*	*-1.3*	*-1.0*
7. External balance of goods & services (3+6)	**29.8**	**33.0**	**37.0**	**40.3**	**44.2**	**47.8**
7a. p.m. 7 as % of GDP	*19.1*	*21.2*	*23.3*	*24.6*	*25.9*	*26.7*
8. Balance of primary incomes and current	-29.0	-32.3	-34.5	-36.8	-39.4	-41.8
8a. - of which, balance of primary income	*-26.7*	*-29.7*	*-32.8*	*-35.8*	*-38.2*	*-40.4*
8b. - of which, net current Transfers	*-2.3*	*-2.7*	*-1.6*	*-1.0*	*-1.2*	*-1.4*
8c. p.m. 8 as % of GDP	*-18.6*	*-20.8*	*-21.7*	*-22.5*	*-23.0*	*-23.4*
9. Current external balance (7+8)	**0.8**	**0.6**	**2.5**	**3.5**	**4.8**	**6.0**
9a. p.m. 9 as % of GDP	0.5	0.4	1.6	2.1	2.8	3.3
10. Net capital transactions	-0.7	-0.5	-0.3	-0.7	-0.7	-0.7
11. Net lending (+)/ net borrowing (-) (9+10)	**0.1**	**0.1**	**2.2**	**2.8**	**4.1**	**5.3**
11a. p.m. 11 as % of GDP	*0.1*	*0.1*	*1.4*	*1.7*	*2.4*	*3.0*

Table 6: Fiscal accounts

	2008	2009	2010	2011	2012	2013	2014	2015
				% of GDP				
Indirect taxes	12.3	11.3	11.4	11.5	11.4	11.5	11.7	11.4
Direct taxes	11.5	10.6	10.5	12.2	12.5	12.7	13.1	13.2
Social contributions	6.8	7.5	7.5	6.8	6.6	6.4	6.3	6.2
Sales	2.3	2.7	3.1	3.1	2.8	2.5	2.4	2.4
Other current revenue	1.3	1.4	1.5	1.1	1.2	1.2	1.1	1.0
Total current revenue	**34.3**	**33.5**	**34.0**	**34.7**	**34.5**	**34.4**	**34.6**	**34.2**
Capital transfers received	1.2	1.2	1.5	0.9	1.0	1.0	1.0	1.0
Total revenue	**35.5**	**34.7**	**35.5**	**35.6**	**35.5**	**35.4**	**35.6**	**35.2**
Compensation of employees	11.2	12.2	11.8	11.7	11.3	10.8	10.2	9.7
Intermediate consumption	5.8	6.3	6.0	5.7	5.2	4.9	4.3	3.9
Social transfers in kind via market producers	2.0	2.1	2.1	2.0	1.9	1.6	1.5	1.3
Social transfers other than in kind	12.2	15.2	15.9	15.7	15.3	14.3	13.2	12.6
Interest paid	1.4	2.0	3.1	3.4	4.2	5.7	5.7	5.6
Subsidies	0.5	0.6	0.5	0.6	0.5	0.5	0.5	0.4
Other current expenditure	2.5	2.8	2.4	2.4	2.4	2.3	2.2	2.1
Total current expenditure	**35.7**	**41.3**	**41.9**	**41.5**	**40.9**	**40.1**	**37.6**	**35.5**
Gross fixed capital formation	5.2	4.0	3.8	3.1	2.5	2.1	2.0	1.9
Other capital expenditure	1.9	3.6	21.1	0.9	0.6	0.9	0.8	0.8
Total expenditure	**42.8**	**48.9**	**66.8**	**45.5**	**44.1**	**43.0**	**40.4**	**38.2**
General Government balance (EDP)	**-7.3**	**-14.2**	**-31.3**	**-9.9**	**-8.6**	**-7.6**	**-4.8**	**-3.0**
				EUR billion				
Indirect taxes	22.2	18.2	17.8	17.8	18.0	18.9	20.0	20.4
Direct taxes	20.7	17.1	16.4	19.0	19.9	20.8	22.3	23.7
Social contributions	12.3	12.0	11.7	10.5	10.4	10.5	10.8	11.0
Sales	4.2	4.3	4.9	4.9	4.5	4.1	4.2	4.2
Other current revenue	2.4	2.2	2.3	1.8	2.0	2.0	1.8	1.8
Total current revenue	**61.7**	**53.8**	**53.1**	**54.0**	**54.8**	**56.4**	**59.2**	**61.2**
Capital transfers received	2.1	2.0	2.3	1.5	1.5	1.7	1.8	1.8
Total revenue	**63.8**	**55.8**	**55.4**	**55.5**	**56.3**	**58.1**	**60.9**	**63.0**
Compensation of employees	20.2	19.6	18.4	18.2	18.0	17.6	17.4	17.3
Intermediate consumption	10.5	10.2	9.4	8.8	8.3	8.0	7.4	6.9
Social transfers in kind via market producers	3.6	3.4	3.3	3.1	3.0	2.7	2.5	2.3
Social transfers other than in kind	22.0	24.4	24.7	24.5	24.3	23.4	22.6	22.5
Interest paid	2.5	3.3	4.9	5.2	6.7	9.3	9.8	10.0
Subsidies	0.9	0.9	0.8	1.0	0.9	0.8	0.8	0.8
Other current expenditure	4.6	4.5	3.8	3.8	3.7	3.8	3.8	3.8
Total current expenditure	**64.3**	**66.3**	**65.4**	**64.7**	**65.0**	**65.7**	**64.3**	**63.5**
Gross fixed capital formation	9.4	6.5	5.9	4.8	4.0	3.5	3.4	3.4
Other capital expenditure	3.4	5.8	32.9	1.4	1.0	1.4	1.4	1.4
Total expenditure	**77.0**	**78.5**	**104.2**	**70.9**	**70.0**	**70.6**	**69.1**	**68.3**
General Government balance (EDP)	**-13.2**	**-22.8**	**-48.8**	**-15.4**	**-13.7**	**-12.5**	**-8.1**	**-5.3**

Table 7: Debt developments

	2008	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-7.3**	**-14.2**	**-31.3**	**-9.9**	**-8.6**	**-7.6**	**-4.8**	**-3.0**
EDP gross debt (% of GDP)	44.2	65.2	92.5	107.0	113.1	118.6	117.4	114.7
				levels, EUR billion				
EDP deficit	**-13.2**	**-22.8**	**-48.8**	**-15.4**	**-13.7**	**-12.5**	**-8.1**	**-5.3**
Gross debt	79.6	104.6	144.3	166.7	179.5	194.4	200.8	205.0
Change in gross debt	32.4	25.0	39.6	22.4	12.8	14.9	6.3	4.2
Nominal GDP	180.0	160.6	156.0	155.8	158.8	164.0	171.0	178.8
Real GDP	175.7	163.4	162.7	164.1	165.0	168.3	172.9	178.0
Real GDP growth (% change)	**-3.0**	**-7.0**	**-0.4**	**0.9**	**0.5**	**2.0**	**2.7**	**3.0**
Change in gross debt (% of GDP)	18.0	15.6	25.4	14.4	8.1	9.1	3.7	2.4
Stock-flow adjustments (% of GDP)	10.7	1.4	-5.9	4.5	-0.5	1.5	-1.1	-0.6
				% of GDP				
Gross debt ratio	**44.2**	**65.2**	**92.5**	**107.0**	**113.1**	**118.6**	**117.4**	**114.7**
Change in gross debt ratio	19.4	20.9	27.3	14.5	6.1	5.5	-1.1	-2.8
				Contribution to change in gross debt				
Primary balance	6.0	12.1	28.2	6.5	4.4	1.9	-1.0	-2.6
"Snow-ball" effect	2.8	7.5	5.1	3.5	2.2	2.1	0.9	0.5
of which								
Interest expenditure	*1.4*	*2.0*	*3.1*	*3.4*	*4.2*	*5.7*	*5.7*	*5.6*
Real growth effect	*0.8*	*3.5*	*0.3*	*-0.8*	*-0.5*	*-2.2*	*-3.1*	*-3.3*
Inflation effect	*0.6*	*2.0*	*1.6*	*1.0*	*-1.5*	*-1.3*	*-1.7*	*-1.8*
Stock-flow adjustments	**10.7**	**1.4**	**-5.9**	**4.5**	**-0.5**	**1.5**	**-1.1**	**-0.6**
Implicit interest rate	*5.3*	*4.1*	*4.7*	*3.6*	*4.0*	*5.2*	*5.0*	*5.0*

Notes:
Gross debt projections include injections of EUR 16.5 billion into the banking system in 2011 and EUR 1.3 billion in 2012. Cash balances are assumed to increase to around EUR 12 billion in 2013 in line with the programme's financing plan, to then decline to EUR 9 billion in 2015.

Ireland:

Letter of Intent

Dublin, 10 February 2012

Mr. Mario Draghi
President
European Central Bank
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Germany

Mr. Jean-Claude Juncker
Eurogroup President
Ministère des Finances
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Mr. Olli Rehn
Vice-President
Commissioner for Economic and Financial Affairs and the Euro
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Ms. Margrethe Vestager
Minister for Economics and the Interior
Økonomi- og Indenrigsministeriet
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Dear Messrs Draghi, Juncker, Rehn, and Ms. Vestager

1. The Irish Government remains firmly committed to the Programme, as illustrated by our continued strong implementation of its objectives. We continue to rigorously implement our EU/IMF-supported adjustment programme. We have met or bettered all the programme targets and milestones associated with the fifth review. In particular:

· As regards fiscal policy, the general government deficit for 2011 is estimated to have been under 10% of GDP, well below the 10.6% of GDP programme ceiling. We have underpinned our commitment to the 2012 deficit programme ceiling by incorporating in the 2012 budget a larger consolidation (EUR 3.8 billion) than envisaged under the programme (EUR 3.6 billion) reflecting the fact that this is an intermediate target for achieving the primary target of a General Government Deficit of 8.6%. We have identified through a thorough expenditure review and additional revenue measures the broad options for the additional consolidation required to bring the deficit down to below 3% of GDP by 2015, to which we remain committed under the programme and the excessive deficit procedure. We have announced binding multi-year expenditure ceilings at the level of the individual votes, and continue to work on strengthening the fiscal framework, including through forthcoming fiscal responsibility legislation (for which a draft is well advanced and which will align national law with requirements at the European level).

· We continue to advance our financial sector reform strategy. Recapitalisation of domestic banks has been substantively completed, and deleveraging of non-core assets has progressed in line with programme. We remain engaged with our programme partners to ensure that the needed restructuring of the domestic banks is achieved in the most efficient and effective way possible, with due regard to State Aid rules. We have begun in earnest the restructuring of the credit union sector, for which we have made available EUR 250 million from the Exchequer in the last quarter of last year. The Central Bank has issued guidance to the Covered Institutions on more conservative and realistic provisioning and enhanced disclosure requirements on asset quality as well as new collateral valuation guidelines for banks.

· We have also made significant progress in the structural reform agenda of the programme. Proposals were prepared and discussed with our programme partners on strategies to: (i) introduce water charges by the end of the EU/IMF programme and (ii) improve targeting of our social support expenditure. We have also introduced legislation, expected to be taken up by our Parliament in the weeks ahead, to reform sectoral wage-setting arrangements to facilitate the needed adjustment in the labour market. Finally, we have also agreed, in broad terms, an ambitious approach to be pursued to ensure that state-owned assets are efficiently mobilized to reduce the government financing needs and provide some additional resources for reinvestment in job creation initiatives in the economy, while also increasing the overall efficiency of the economy.

2. This performance is all the more noteworthy against the background of a more challenging external outlook, resulting mostly from the lingering uncertainty in relation to euro area sovereign debt developments, as witnessed by the recent downgrades of several euro area member states. From this perspective our continued strong implementation of the programme remains essential, as does the commitment of our euro area partners to continue to support Ireland's efforts as long as its adjustment remains on track. Real economic growth resumed last year, with an estimated increase of 1%, and,

notwithstanding the risks to the forecasts, further positive growth is expected this year. This growth will continue to be export led, and will be supported by continued strong foreign direct investment and further competitiveness improvements, which will help offset the impact of the slowdown in our export markets. There have also been some positive developments on the outlook for government funding. Yields on Irish Government debt have continued to fall. The benchmark 2016 and 2020 maturities currently yield [5.6%] and [7.1%] respectively. In addition, the National Treasury Management Agency has re-engaged with the bond market and extended some €3.5 billion of debt maturing just after the programme ends. This is a significant first step in terms of managing Ireland's post programme funding requirements. These developments can be directly related to our strong programme implementation. We will nevertheless remain alert to the substantial risks in the international economic environment.

3. In the attached fourth update of the Memorandum of Understanding on Specific Economic Conditionality (MoU), we set out our plans to further advance towards meeting the programme objectives. Based on the strength of these policies, and in light of our performance under the programme and our continued commitment, we request the completion of the fifth review and the release of the fifth EFSF/EFSM disbursement of EUR 5.8 billion.

4. We are confident that the policies set forth in our successive Letters of Intent, from that of 3 December 2010 up to and including this letter, are adequate to achieve the objectives of our programme. The degree of uncertainty and margins of error surrounding macroeconomic and fiscal projections over the period remain high, due mainly, but not exclusively, to international events. While we do not envisage that revisions will be needed, we stand ready to take any corrective actions that may become necessary to meet changing circumstances. As indicated in the MoU, we will consult with the staff of the European Commission, the ECB and the International Monetary Fund on the adoption of such actions in advance in the event that revision of the policies contained in this letter and the attached MoU becomes necessary.

5. This letter is being copied to Mme Lagarde.

Sincerely,

Michael Noonan, T.D.,	Patrick Honohan
Minister for Finance	Governor of the Central Bank of Ireland

IRELAND

MEMORANDUM OF UNDERSTANDING
ON
SPECIFIC ECONOMIC POLICY CONDITIONALITY

(FOURTH UPDATE)

1 MARCH 2012

With regard to Council Regulation (EU) n° 407/2010 of 11 May 2010 establishing a European Financial Stabilisation Mechanism (EFSM), and in particular Article 3(5) thereof, this fourth update of the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU) details the general economic policy conditions as embedded in Council Implementing Decision 2011/77/EU of 7 December 2010 on granting Union financial assistance to Ireland.

The quarterly disbursement of financial assistance from the European EFSM[26] will be subject to quarterly reviews of conditionality for the duration of the programme. Release of the instalments will be based on observance of quantitative performance criteria, respect for EU Council Decisions and Recommendations in the context of the excessive deficit procedure, and a positive evaluation of progress made with respect to policy criteria in the Memorandum of Economic and Financial Policies (MEFP) and this updated MoU, which details and further specifies the criteria that will be assessed for the successive reviews up to the end of 2013. If targets are expected to be missed, additional action will be taken.

For the duration of the EU/IMF financial assistance programme the Irish authorities will take all the necessary measures to ensure a successful implementation of the programme and minimise the costs to the taxpayers, while protecting the most vulnerable. In particular, they commit to:

- Rigorously implement fiscal policy consistent with the requirements of the excessive deficit procedure. In particular, the Department of Finance and the Department of Public Expenditure and Reform will continue to ensure effective tax collection and tight supervision of expenditure commitments by the line departments to ensure that the primary deficit target in cash (see Table 1 of MEFP and the Technical Memorandum of Understanding, TMU) and the general Government nominal budget deficit on ESA95 basis as set out in the EU Council Recommendation on excessive deficit procedures are achieved. Any additional unplanned revenues must be allocated to debt reduction. Moreover, the nominal value of Social Welfare pensions will not be increased.

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[26] On 28 November 2010 Eurogroup and ECOFIN Ministers issued a statement clarifying that euro-area and EU financial support will be provided on the basis of the programme which has been negotiated with the Irish authorities by the Commission and the IMF, in liaison with the ECB. Further to the Union support from the EFSM, loans from the EU and its Member States will include contributions from the European Financial Stability Facility (EFSF) and bilateral lending support from the United Kingdom, Sweden, and Denmark. The Loan Facility Agreements on these financing contributions will specify that the disbursements there under are subject to the compliance with the conditions of this Memorandum.

- Continuously monitor financial markets to exploit opportunities to return to commercial funding as soon as possible.
- Ensure that no further exemptions to the competition law framework will be granted unless they are entirely consistent with the goals of the EU/IMF Programme and the needs of the economy.
- Consult ex-ante with the European Commission, the ECB and the IMF on the adoption of policies that are not included in this Memorandum but that could have a material impact on the achievement of programme objectives.

To facilitate programme monitoring, the authorities will provide the European Commission, the ECB and the IMF with:

- All information required to monitor progress during programme implementation and to track the economic and financial situation.
- A compliance report on the fulfilment of the conditionality prior to the release of the instalments.
- Reliable and regular availability of budgetary and other data as detailed in Annex 1.

2. Actions for the sixth review (actions to be completed by end Q1-2012)

Financial sector reforms

Capitalisation

· The authorities will report on the evolution of regulatory capital up to end December 2011, within the banks covered by the PCAR and will present and discuss their findings with the staff of the European Commission, the ECB and the IMF by end February 2012.

Deleveraging

· The authorities, in consultation with the staff of the European Commission, IMF and ECB, will assess banks' performance vis-à-vis the agreed asset disposal targets. In line with the adjusted monitoring system set up, actual and forecast loan-to-deposit ratios (LDRs) and asset disposals shall be reported by the banks to the Central Bank of Ireland every six months. The Central Bank will oversee the remedial actions to be taken by any bank in case of actual or likely breach of the targets. In addition to providing the six-monthly report, the authorities will update the staff of the European Commission, the IMF and the ECB on progress in the intervening quarters.

· The authorities will present proposals to improve the calibration of the Net Stable Funding Ratio (NSFR) within a Core Balance Sheet with a view to replacing LDRs as the main target in the deleveraging process.

· The authorities, in consultation with staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the Liquidity Coverage Ratio (LCR) in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the ECB and the IMF

· By end February, the authorities will prepare a preliminary proposal for financial and operational restructuring to address ILP's vulnerabilities, taking the perspective of the state on alternative restructuring options. This work builds on a preliminary analysis of restructuring options recently completed by the bank, and will benefit from third party reviews.

Supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank action plan for strengthening supervision of credit institutions and discuss it together with the staff of European Commission, the ECB and the IMF.

Structural reforms

Efficient social support expenditure

· The Department of Social Protection will submit to Government the comprehensive programme of reforms that can help better targeting of social support to those on lower incomes, and ensure that work pays for welfare recipients.

Competition

· Following the introduction of amendments to the Competition (Amendment) Bill at committee stage, the authorities will seek to introduce an amendment allowing commitments by an undertaking to the Competition Authority to be made a rule of court having due regard to Ireland's constitutional framework.

· The authorities will undertake a review of the resourcing of the Competition Authority and report on whether it is sufficient to allow adequate enforcement capacity of the legislative framework.

Water charges

· In light of the results of a public consultation process, the authorities will provide programme partners with an update on progress toward the transfer of water service provision from local authorities to a regulated water utility and plans for the roll-out of a domestic water metering programme with a view to starting charging by the end of the EU – IMF Programme period.

Labour market reform

· Building on the Industrial Relations (Amendment) Bill 2011, the authorities will present amendments to the Dáil in particular to: (i) Strengthen the inability to pay clause for EROs and REAs by providing that the inability to pay clause will allow two consecutive exemptions within the overall two year time limit where this is necessary to safeguard employment, and (ii) ensure that the process for the granting of a variation to an REA is conducted in a timely manner

Activation of the unemployed

· The authorities will take steps to strengthen activation and training policies to help jobseekers get back to work and will commission and publish an external evaluation of the data and reporting systems required, under the new 'Pathways to Work' approach, to enable ongoing evaluation of activation and training policies, including whether:

- the large numbers of unemployed across all regions, including the long-term unemployed, have adequate incentives and skills needed to return to work;
- more effective interventions are being put in place, including with respect to group interventions (3 to 6 months) and ongoing interventions (post 6 months); and
- penalty sanctions are being imposed (including the number and level of sanctions).

· Based on its recommendations the Department of Social Protection will prepare an implementation plan.

State assets

· The Government is committed to an ambitious programme of state asset disposals designed to enhance the efficiency and competitiveness of the economy, reduce sovereign financing needs, and provide additional resources for reinvestment in the economy. This will involve an orderly process of disposals in a manner which allows time to implement necessary regulatory reforms and to ensure that value is secured.

· Detailed analytical work will be completed in the first quarter of 2012 in relation to the suitability for disposal of a number of state-owned assets, with the assistance of NewERA – the Government's key financial adviser in relation to the management and/or disposal of these state assets. This work will identify the policy, regulatory, legislative, corporate governance and financial issues that may need to be addressed. The Government will provide details on this asset disposal programme for discussion with programme partners.

3. Actions for the seventh review (actions to be completed by end Q2-2012)

Financial sector reforms

Capitalisation

· Government will ensure that the recapitalisation of IL&P, as identified in the 2011 Prudential Capital Assessment Review, is completed, following the suspension of the sale of Irish Life.

· In preparation for PCAR 2012 for AIB, BoI and IL&P we will by end June 2012: (i) perform an asset quality review of Irish banks' portfolios using an independent advisor; (ii) validate bank data to ensure consistency; (iii) review provisioning, income and loan impairment recognition practices; and (iv) engage with the banks on their loan portfolio resolution strategies and systems.

Deleveraging

· The authorities will provide an update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the staff of the European Commission, the ECB and the IMF. In addition, the authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

· In addition, the authorities will establish draft rules for the creation and subsequent holding of liquidity buffers by banks in preparation of the new Capital Requirements Regulation which will enter into force in January 2013.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will make a decision on the proposed way ahead for ILP by end April and will prepare an updated restructuring plan that will detail the actions needed to ensure the bank's long-term viability, in line with EC state aid rules, by end June 2012. The plan should not be premised on there being additional capital injections from the State, and should safeguard financial stability.

· As recommended by the interim report of the Commission on Credit Unions, the legal provision that requires, under the terms of the Deposit Guarantee Scheme, credit unions to maintain an amount in the Deposit Protection account at the Central Bank will be commenced by regulations in 2012. Taking into account the interim report of the Commission on Credit Unions and any further recommendations made by the Commission on Credit Unions, the authorities will develop a legislative framework for the restructuring of the sector. The authorities will publish legislation to strengthen the regulatory framework, including making legislative provision for effective governance standards and prudential requirements.

Financial Supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

Structural reforms

Personal debt regime

· Government will introduce legislation to reform the personal debt regime to the Houses of the Oireachtas with the objective of increasing the speed and efficiency of proceedings, while at the same time mitigating moral hazard and maintaining credit discipline.

Utility sectors

· Based on the results of the assessment of the efficiency of the electricity and gas sectors, the authorities will further strengthen the regulatory and market reform programme in consultation with staff of the European Commission Services, with a view to increase efficiency, improve governance, strengthen competition and improve these sectors' ability to contribute towards covering Ireland's financing needs and improving its growth potential and economic recovery.

· The authorities will supply programme partners with a detailed, time-bound implementation plan by end-April 2012 for the transfer of water service provision from local authorities to a regulated water utility and a plan for the roll-out of a domestic water metering programme with a view to starting charging by the end of the EU – IMF Programme period.

Retail sector

· By end April 2012, having reflected on the outcome of a public consultation on updated retail planning guidelines, the authorities will issue finalised retail planning guidelines taking into account the agreed changes to the retail size caps.

Competition

· The authorities will ensure that resourcing of the Competition Authority is sufficient to ensure adequate enforcement capacity of the legislative framework on the basis of the review undertaken in Q1 2012.

Efficient social support expenditure

· The Department of Social Protection will provide an evaluation of the actions taken in respect of job seekers payments recipients who do not attend employment activation interviews.

State assets

· Government will outline in detail the specific regulatory, legislative, corporate governance and financial reforms which need to be taken, ensuring consistency with relevant EU legislation where necessary, to allow for the asset sale programme to proceed, and an ambitious calendar with indicative timelines for sales will be set out.

Structural fiscal reforms

Fiscal framework

· Government will introduce a Fiscal Responsibility Bill consistent with the economic governance framework at the EU level, including provisions for a medium-term budgetary framework and fiscal rules. The Bill will also put the Fiscal Advisory Council on a statutory footing, formalising the Council's independence through clear arrangements for adequate funding over time and for Council membership, including consultation with the relevant committee of the Oireachtas for nomination, appointment, extension and termination.

4. Actions for the eighth review (actions to be completed by end Q3-2012)

Financial sector reforms

Capitalisation

The authorities will agree with the staff of the European Commission, IMF and ECB on the specific features of the methodology for the PCAR 2012 exercise building on the strengths of the PCAR 2011. In addition, and as part of the PCAR 2012, we will complete the assessment of banks' approaches to the risk weighting of assets.

Deleveraging

· Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6^{th} Review (Q1 – 2012).

· The authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the ECB and the IMF.

Financial Supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

· Government will present to Dáil Éireann legislation to establish a statutory credit risk register.

Structural reforms

State assets

· Government will report to programme partners on progress, including details of the timetable for publication of necessary legislation to allow the asset disposal programme to proceed and carry out identified reforms of corporate governance in state-owned assets.

5. Actions for the ninth review (actions to be completed by end Q4-2012)

Fiscal consolidation

· Government will propose a budget for 2013 aiming at a further reduction of the general Government deficit in line with the fiscal targets set out in the Council Recommendation in the context of the excessive deficit procedure and including the detailed presentation of consolidation measures which, on the basis of the aggregate budgetary projections set out in the Medium Term Fiscal Statement (MTFS) of November 2011, will amount to at least €3.5 billion. The following measures are proposed for 2013 on the basis of the MTFS:

- Revenue measures to raise at least €1.25 billion[27], including:
  - A broadening of personal income tax base
  - A restructuring of motor taxation
  - A reduction in general tax expenditures.
  - An increase in excise duty and other indirect taxes.
- Expenditure reductions necessary to achieve an upper limit on voted expenditure of €54 billion, which will involve consolidation measures of €2.25 billion on the basis of the MTFS, including:
  - Social expenditure reductions.
  - Reduction in the total pay and pensions bill.
  - Other programme expenditure, and reductions in capital expenditure.

Without prejudice to the minimum consolidation amount referred to in the previous paragraph and in consultation with the staff of the European Commission, the IMF and the ECB, the Government may substitute one or more of the above measures with others of equally good quality based on the options identified in the Comprehensive Review of Expenditure (CRE).

Financial sector reforms

Capitalisation

· PCAR 2012 results will ideally be published in coordination with EBA and in any event no later than end-November 2012. Before publication, the results of the PCAR for 2012 will be discussed with the staff of European Commission, the ECB and the IMF. The results and methodology will then be published in full and on a bank-by-bank basis. The authorities will continue to ensure that banks are adequately capitalised.

Deleveraging

· An update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the staff of the European

[27] Inclusive of carryover from 2012.

Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the ECB and the IMF.

Financial Supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will review the implementation of the Provisioning and Disclosure guidelines in the covered banks.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

Structural reforms

Competition

· On the basis of a report from authorities on developments to be provided by end Q4 2012, the authorities in consultation with staff of the European Commission, IMF and the ECB will review whether sufficient progress has been made toward the goal of strengthening competition law enforcement by ensuring the availability of effective sanctions for infringements of Irish competition law and Articles 101 and 102 of the Treaty on the Functioning of the European Union and the functioning of the Competition Authority, and whether additional measures will be required

Efficient social support expenditure

· The authorities will provide an evaluation of progress in relation to labour market activation measures to enable the unemployed to return to active employment against the targets set out in the 'Pathways to Work' plan.

State assets

· Government will complete the identified regulatory, legislative, corporate governance and financial reforms and will discuss with programme partners the specific assets to be brought to market in 2013.

6. Actions for the tenth review (actions to be completed by end Q1-2013)

Financial sector reforms

Capitalisation

· The authorities will report on the evolution of regulatory capital up to the end of December 2012, within the banks covered by the PCAR and will present and discuss their findings with the staff of the European Commission, the ECB and the IMF by end February 2013.

Deleveraging

· Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6th Review (Q1 – 2012).

· The authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

· In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the ECB and the IMF.

Financial supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

7. Actions for the eleventh review (actions to be completed by end Q2-2013)

Financial sector reforms

Deleveraging

· The authorities will present an update on progress of the banks' implementation of their deleveraging plans under the PLAR 2011 and any related actions will be discussed with the staff of the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

· The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the staff of the European Commission, the ECB and the IMF.

Financial supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

Structural reforms

State assets

· Government will report to programme partners on the quantum of the proceeds of any realised asset sales to date

8. Actions for the twelfth review (actions to be completed by end Q3-2013)

Financial sector reforms

Capitalisation

· The 2013 PCAR exercise will begin in the context of the 2013 European Banking Authority (EBA) stress tests. The authorities will agree with the staff of the European Commission, IMF and ECB on the specific features of the methodology building on the strengths of the PCAR 2011 and 2012.

· The authorities will report on the evolution of regulatory capital up to the end of June 2013, within the banks covered by the PCAR and will present and discuss their findings with the staff of the European Commission, the ECB and the IMF by end August 2013.

Deleveraging

· Asset disposal monitoring – as per requirement under Financial Sector Reforms in 6th Review (Q1 – 2012).

· The authorities, in consultation with the staff of the European Commission, IMF, and ECB, will monitor closely the evolution of the NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

· In addition, the authorities will monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the European Commission, the ECB and the IMF.

Financial Supervision

· The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland's action plan for strengthening supervision of credit institutions and discuss it together with the staff of the European Commission, the ECB and the IMF.

· The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.

9. Actions for the thirteenth review (actions to be completed by end Q4-2013)

Financial sector reforms

Capitalisation

· PCAR 2013 will be completed. Before publication, the results of the PCAR for 2013 will be discussed with the staff of European Commission, the ECB and the IMF. The results and methodology will then be published in full and on a bank-by-bank basis. The authorities will continue to ensure that banks are adequately capitalised.

Deleveraging

· The authorities will produce a final report of the banks' implementation of their deleveraging plans under the PLAR 2011. Their compliance with the asset disposal and deleveraging targets will be discussed with the European Commission, the ECB and the IMF. In addition, the Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

· The authorities will also monitor the liquidity buffers held by banks in accordance with the Capital Requirements Regulation effective since January 2013.

Reorganisation

· The authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions, including any steps to strengthen the credit union sector, and discuss it together with the European Commission, the ECB and the IMF.

Financial Supervision

- The authorities will present a comprehensive report on progress in implementing the Central Bank of Ireland’s action plan for strengthening supervision of credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The authorities will report on banks' progress with the implementation of their mortgage arrears resolution strategies.
- The authorities will ensure that the statutory credit risk register is operational.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the staff of the European Commission, the ECB and the IMF by the Irish authorities on a regular basis. The External Programme Compliance Unit (EPCU) of the Department of Finance will coordinate and collect data and information and forward to all external programme partners.

To be provided by the Department of Finance in consultation with the Department of Public Expenditure and Reform as appropriate		
Ref.	Report	Frequency
F.1	Monthly data on adherence to budget targets (Exchequer statement, details on Exchequer revenues and expenditure with information on Social Insurance Fund to follow as soon as practicable).	Monthly, 10 days after the end of each month
F.2	Updated monthly report on the Exchequer Balance and General Government Balance outlook for the remainder of the year which shows transition from the Exchequer Balance to the General Government Balance (using presentation in Table 1 and Table 2A of the EDP notification).	Monthly, 20 days after the end of each month
F.3	Quarterly data on main revenue and expenditure items of local Government.	Quarterly, 90 days after the end of each quarter
F.4	Quarterly data on the public service wage bill, number of employees and average wage (using the presentation of the Pay and Pension Bill with further details on pay and pension costs of local authorities).	Quarterly, 30 days after the end of each quarter
F.5	Quarterly data on general Government accounts, and general Government debt as per the relevant EU regulations on statistics.	Quarterly accrual data, 90 days after the end of each quarter
F.6	Updated annual plans of the general Government balance and its breakdown into revenue and expenditure components for the current year and the following four years, using presentation in the stability programme's standard table on general Government budgetary prospects.	30 days after EDP notifications
F.7	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for Non-Commercial State Agencies	Quarterly , 30 working days after the end of each quarter
F.8	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for local authorities	Quarterly , 30 working days after the end of each quarter
F.9	Data on short- and medium- /long-term debt falling due (all instruments) over the next 36 months for State- owned commercial	Quarterly, 30 working days after the end of each

	enterprises (interest and amortisation)	quarter
F.10	Assessment report of the management of activation policies and on the outcome of job seekers' search activities and participation in labour market programmes.	Quarterly, 30 working days after the end of each quarter.
To be provided by the NTMA		
N.1	Monthly information on the Government's cash position with indication of sources as well of number of days covered	Monthly, three working days after the end of each month
N.2	Data on below-the-line financing for central Government.	Monthly, no later than 15 days after the end of each month
N.3	Data on public debt and new guarantees issued by central Government to public enterprises and the private sector.	Monthly, 30 working days after the end of each month
N.4	Data on short-, medium- and long-term debt falling due (all instruments) over the next 36 months (interest and amortisation) for the National Debt.	Monthly , 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the Exchequer Borrowing Requirement / National Debt in the next 12 months	Monthly, 30 working days after the end of each month
To be provided by the Central Bank of Ireland		
C.1	The Central Bank of Ireland’s balance sheet.	Weekly, next working day
C.2	Individual maturity profiles (amortisation only) for each of the domestic banks will be provided as of the last Friday of each month.	Monthly, 30 working days after each month end.
C.3	Detailed financial and regulatory information (consolidated data) on domestic individual Irish banks and the banking sector in total especially regarding profitability (P&L), balance sheet, asset quality, regulatory capital; PLAR funding plan forecasts	Quarterly, 35 working days after the end of each quarter
C.4	Detailed information on deposits for the last Friday of each month.	Monthly, 30 working days after each month end.
C.5	Data on liabilities covered under the ELG Scheme for each of the Covered Institutions.	Monthly, 30 working days after each month end.
C.6	Deleveraging committee minutes and deleveraging sales progress sheets, detailing pricing, quantum, and other relevant result metrics.	Monthly, reflecting committee meetings held each month
C.7	Deleveraging reports including (i) progress achieved towards interim target; (ii) forecast of LDR and NSFR for the end of the next period; and (iii) actual and planned asset disposals.	3 monthly, 10 working days after the end of the reference period.

Ireland: Memorandum of Economic and Financial Policies

A. RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

1. **The economic recovery has slowed after solid growth in the first half of 2011.** Led by strong net exports, real GDP rose by ¾ percent in the first three quarters of 2011 on an annual basis. Recent indicators suggest continued softness in domestic demand with GDP growth in 2011 estimated at about 1 percent. The current account is estimated to have remained in a small surplus, and annual HICP inflation averaged about 1¼ percent for 2011. Ireland's bond yields have improved considerably to 6.7% for the 9-year bond in early February 2012 having peaked at almost 14% in July 2011. Ireland maintained its credit rating amidst downgrades for a number of euro area countries early in 2012, a recognition of our strong programme adherence.

1. **Weak external conditions pose risks in 2012, and to ensure the achievement of programme objectives we will continue to refine the program and maintain our record of strong policy implementation.** Downside risks to Ireland's economic outlook have increased, especially in relation to potential developments in the euro area. While Irish banks made strong progress with the needed deleveraging in 2011, there are signs that increased asset disposals planned by European banks, and limited availability of funding, will impair market conditions going forward. Accordingly, a refinement of the deleveraging framework is needed to minimise risks to core lending and bank funding costs. In addition, technical work on is underway on potential approaches to reinforce the prospects for the government and banks to regain market access.

B. FINANCIAL SECTOR POLICIES

2. **We will continue to press forward with reforms to restore the health of the Irish financial system and address the challenges remaining.** Bank recapitalisation is largely completed and our front-loaded deleveraging programme met its 2011 targets. Looking ahead, we remain firmly committed to the goal of our Financial Measures Programme to restore the banks' long-term viability, and will continue to refine its implementation as needed based on experience and to adapt to external risks.

Bank deleveraging, resilience, and transparency

3. **Major progress in downsizing our banking system was made in 2011, and we are working to refine the deleveraging framework to minimize risks to lending to the economy and discourage excessive competition for deposits.** We have put in place a framework including governance structures to complete the targeted €70 billion bank deleveraging by end 2013, of which €34 billion of assets are slated for disposal. The two pillar banks met the 2011 deleveraging targets with almost €15 billion of these assets sold at significantly better pricing than anticipated in the PCAR/PLAR 2011 exercise. Total deleveraging achieved across banks covered by the ELG and the IBRC was €40.5 billion through end November 2011 against full year 2011 expected deleveraging of €34.7 billion. Based on experience, we are working to refine our deleveraging framework, with more emphasis on the net stable funding ratio for the banks' core balance sheets as

we move towards adoption of the Basel III liquidity requirements. The revised framework is intended to become effective after end-June 2012. In the period until end-June 2012, the target for non-core asset disposal will be defined solely in nominal terms, with no interim target with respect to the loan-to-deposit ratio.

4. **For PCAR 2012, we plan to maintain the distinctive rigor and standards of PCAR 2011, especially the independent loan loss forecasts, while aiming to align its timing with the EBA's EU-wide stress test**. In preparation for PCAR 2012 for AIB, BoI and IL&P we will by end June 2012: (i) perform an asset quality review of Irish banks' portfolios using an independent advisor; (ii) validate bank data to ensure consistency; (iii) review provisioning, income and loan impairment recognition practices; and (iv) engage with the banks on their loan portfolio resolution strategies and systems. The authorities will agree with the staff of the European Commission, IMF and ECB on the specific features of the methodology for the PCAR 2012 exercise not later than end September 2012. In addition, and as part of the PCAR 2012, we will complete the assessment of banks' approaches to the risk weighting of assets. PCAR 2012 results will ideally be published in coordination with EBA and in any event no later than end-November 2012 (proposed structural benchmark).

5. **The 2011 financial statements of the banks covered by the ELG will be prepared on the basis of new more conservative and realistic provisioning and disclosure guidelines.** With technical support of an internationally recognized auditing firm, we have completed an international peer review of our disclosure practices and developed a stringent template of the loans and receivables disclosures within IFRS and tailored it to reflect the Irish banking circumstances and needs of various stakeholders. We have developed stricter guidelines to ensure Irish covered banks use a more conservative and consistent approach to provisioning within IFRS in relation to impairment triggers and provisioning model inputs. In 2012, we will review the implementation of the guidelines in the covered banks. Additionally, current draft guidelines on loan collateral valuation will be strengthened further by introducing provisions to encourage banks to regularly exchange information on the quality of collateral appraisers.

Completing the financial sector reform agenda

6. **We will complete by end-June 2012 the recapitalisation of ILP.** Following the suspension of the sale of Irish Life, we have decided that a government purchase of this company will be the most effective mechanism to finalize the recapitalisation of ILP, and complete the separation of ILP and Irish Life that is already well-advanced at the operational level. Irish Life is a valuable asset for the State and will continue to be managed on an independent commercial basis to ensure that value, and we will continue to work to dispose of Irish Life as soon as market conditions permit.

7. **We are finalizing the determination of the way forward for ILP**. During February, we will prepare a preliminary proposal for financial and operational restructuring to address ILP's vulnerabilities, taking the perspective of the state on alternative restructuring options. This work builds on a preliminary analysis of

restructuring options recently completed by the bank, and will benefit from third party reviews. The authorities will make a decision on the proposed way ahead by end April. We will prepare an updated restructuring plan for ILP that will detail the actions needed to ensure the bank's long-term viability, in line with EC state aid rules, by end June 2012. The plan should not be premised on there being additional capital injections from the State, and should safeguard financial stability.

8. **We are implementing our strategy to restore the viability and solvency of the credit union sector.** Following the commencement of the Central Bank and Credit Institutions (Resolution) Act 2011, we have transferred €250 million of exchequer resources to the credit institutions resolution fund. With this infrastructure in place, we have embarked on the first resolution interventions and will be proceeding with further resolution actions required. The costs of resolving vulnerable institutions will be recouped over time through a charge levied across credit institutions. Regulations underpinning this levy will be adopted by end-September 2012 (proposed structural benchmark). We are on track to achieve our end-June benchmark of publishing the legislation to strengthen the regulatory framework of the credit union sector, following consultations with the stakeholders beginning in March 2012 and taking account of the recommendations of the Commission on Credit Unions.

Strengthening financial supervision and governance

9. **We are finalizing relationship frameworks with the covered banks to ensure their core businesses will be run on a commercial, cost effective and independent basis designed to ensure the value of the banks as an asset to the State.** These frameworks for the core businesses of AIB, BoI and IL&P contain clear guidelines to: (i) ensure the Minister for Finance's relationship with the domestic banks is in line with best institutional shareholder practices; (ii) rule out intervention by the Minister for Finance in day-to-day management and commercial decisions (including in relation to lending) and preserve independence of the banks' boards; and (iii) allow the banks appropriate discretion to define their own strategies, budgets, and business plans. The frameworks will be published by end-March 2012.

10. **We have made significant progress toward strengthening banks' boards.** In June 2011, the Central Bank wrote to the fifty-five incumbent directors in the State supported banks seeking information in relation to their future intentions and giving notice that those who would remain in place following the 1 January 2012 would be subject to review under new powers available to the Central Bank in the Central Bank Reform Act 2010. There has been a very high level of renewal of directorships in the covered banks and almost all directors were appointed after September 2008. Incumbent and new board members and senior bank managers are being subjected to rigorous fit and proper tests by the Central Bank of Ireland to ensure that they have the appropriate skills and background.

11. **We continue to enhance banking supervision and supervisory capacity.** We have completed reviews of the effectiveness of banks' internal audit functions, the role

and effectiveness of board risk committees, and frameworks for remuneration policies and practices. Corresponding recommendations and requirements have been issued to banks as part of their risk mitigation programmes. The delivery of risk mitigation actions within appropriate timelines is monitored as part of the Central Bank's internal risk and governance panels. We have increased staff resources devoted to banking supervision and are providing training tailored to the needs of the Irish banking system. By mid-2012, our new supervisory engagement model and framework for bank risk assessment (PRISM) which we implemented in November 2011 will have become fully operational.

Enhancing asset quality

12. **We are promoting efforts by lenders to address loan arrears and unsustainable debt, thereby reducing uncertainty regarding bank assets and facilitating a recovery in domestic demand** A high-level steering group involving government departments and the CBI has been formed to deepen work in a number of key areas and follow up on the Inter-Departmental Mortgage Arrears Working Group (30th September 2011) Report recommendations. At the CBI's request, banks submitted their strategies for dealing with mortgage arrears at end-November. The CBI is in the process of providing feedback, and it will monitor implementation under the strategies on a quarterly basis, supported by enhanced data, including on buy-to-let properties. A mortgage-to-rent scheme is being piloted under which housing associations would buy properties and rent them back to owners eligible for social housing, and efforts are underway to develop an independent mortgage advisory function for households needing support on this issue.

13. **Reforms to the personal insolvency framework will underpin the resolution of unsustainable debt while safeguarding Ireland's traditional debt service discipline.** We developed a strategy for personal insolvency reform last year, and refined it further in early 2012, and plan to publish legislation by end- April 2012. The bill will seek to uphold Ireland's strong payment culture while creating a more efficient and modernized bankruptcy process; establishing non-judicial debt settlement and enforcement mechanisms, including an appropriate framework for secured debt such as mortgages; and providing streamlined procedures for those with very limited debt, assets, and income. The government intends as a priority to secure passage and in parallel put in place the infrastructure needed to support the effective implementation of the new insolvency framework.

14. **Steps are also being taken to help SMEs, including those facing financial difficulties.** The revised Code of Conduct for Business Lending to Small and Medium Enterprises took effect in January 2012. It requires that lenders have proper procedures in place, including minimum communication and information standards, for dealing with borrowers that are willing to cooperate. In parallel with the approach taken on mortgage arrears, banks will be required to submit to the CBI their strategies for dealing with SME arrears by end-June 2012.

15. **An effective credit register is an essential building block for sound lending decisions and is a valuable supervisory tool**. Ministerial approval for the proposed legislative framework was received in September. An outline of the proposed legislation will be discussed with stakeholders. We have made progress in developing a register that will deliver comprehensive, reliable and accurate data on each individual borrower. We are on track to publish legislation by end-September 2012 as envisaged and will work in parallel on the practical arrangements with a view to having the system in operation as quickly as possible.

C. FISCAL POLICIES

16. **The substantial fiscal consolidation targeted for 2011 has been achieved by a significant margin.** The front-loaded consolidation effort in 2011 was implemented consistently during the year, and the general government deficit is expected to be about 10 percent of GDP, well within the program's target of 10.6 percent of GDP. Indeed, this over-performance was achieved despite weakness in domestic demand and in related revenues owing to firm control over both current and capital expenditures.

17. **We will implement Budget 2012 in the same prudent manner, while cushioning the impact on growth.** Budget 2012 incorporates €3.8 billion in fiscal consolidation measures and we are finalizing the necessary legislation to implement Budget 2012.[28] This effort exceeds the originally programmed amount of €3.6 billion in order to deliver the program's 2012 general government deficit target of 8.6 percent of GDP despite significantly weaker macroeconomic conditions than earlier envisaged, demonstrating our commitment to putting the budget on a sound footing. At the same time, Budget 2012 includes measures to boost economic activity and create jobs, such as prioritizing capital investments that increase the capacity for the economy to grow, targeted tax incentives for employers and the property sector, the introduction of new training, job placement and work experience places, and welfare reforms to incentivize work.

18. **The general government deficit is firmly set on a declining path to below 3 percent of GDP by 2015.** Budget 2012 set out clear policy directions for medium-term fiscal consolidation anchored by binding current expenditure ceilings through 2014 and capital expenditure ceilings through 2016, together with the announcement of a target to reduce public service employment numbers to 282,500 by 2015. To better facilitate planning by households and businesses, we will progressively elaborate Budget 2012's specification of the consolidation effort over 2013-15. We have already identified measures for the latter period, representing more than half of the total adjustment of €8.6 billion, and we are actively studying options including those identified by the rigorous 2011 Comprehensive Review of Expenditure (CRE). The expiration of favourable retirement terms at end-February 2012, and the completion over the coming

[28] Taking account of the additional €0.4 billion in carryover from the Universal Social Charge which was introduced as part of Budget 2011, total adjustment is on the order of €4.2 billion.

months of reviews (including on environmental taxes, a value-based property tax, and social welfare supports) will help advance this process.

19. **Achievement of the ongoing fiscal consolidation will be underpinned by a coherent set of budgetary reforms:**

- *Institutionalisation of the CRE process*: Following its success in 2011, the next CRE cycle has been set at end 2013/early 2014, and a new Value-for-Money Code introduced to facilitate focused evaluations on an ongoing basis.

- *Performance-Based Budgeting:* The 2012 departmental estimates (to be published at end-February, 2012) will be organized on the basis of strategic programs rather than traditional sub-heads to enable departments to be evaluated on outputs and outcomes.

- *Reform of Allowances, Overtime, and Sick Leave:* We have identified scope for reducing overtime payments including through smarter rostering for emergency services (such as health and police); rationalizing allowances; and boosting public service productivity through changes to sick leave entitlements.

- *Public Service Reform:* To protect public service delivery with a leaner workforce, and achieve efficiency savings across the public service, we are aggregating public procurement nationally and sectorally as appropriate to the greatest possible extent, rolling out a unified Public Service Card to citizens for accessing government services, expanding e-Government, increasing the use of shared services, and rationalizing the number of government bodies.

20. **Furthermore, we are developing important institutional fiscal reforms consistent with the European framework.** Budget 2012 introduced binding medium-term expenditure ceilings by vote-group, which will help impart stability to public finances in the face of temporary shocks, entrench spending discipline, extend planning horizons, and strengthen incentives for good fiscal management. The Irish Fiscal Advisory Council (IFAC) has been operational since July 2011. Its mandate and independence, along with national fiscal rules to ensure prudent fiscal policy, are to be enshrined in a Fiscal Responsibility Bill (FRB). The FRB will also provide for the adequacy of IFAC resources to ensure its sustainability and effectiveness. Given the priority for a robust framework to support long-term debt reduction, the FRB will be published by end-June 2012 to take into account the evolution of the European fiscal framework expected during the first quarter of 2012.

D. STRUCTURAL REFORMS

21. **An ambitious programme of structural reforms to support job creation, increase Ireland's competitiveness and boost potential growth is being put in place.** To facilitate labour market adjustment in sectors where unemployment tends to be high, we have set out reforms of wage-setting arrangements in the Industrial Relations

(Amendment) Bill, which includes measures to streamline and modernise Registered Employment Agreements (REAs). In relation to Employment Regulation Orders (EROs), it allows for a reduction in the number of EROs and the number of minimum wages set in each ERO, and excludes conditions of employment covered in other legislation such as Sunday pay rate. Importantly, it requires greater focus on economic conditions and competitiveness in setting wage rates and in implementing both EROs and REAs. Building on the Industrial Relations (Amendment) Bill 2011, the authorities will present amendments to the Dáil in particular to: (i) strengthen the inability to pay clause for EROs and REAs by providing that the inability to pay clause will allow two consecutive exemptions within the overall two year time limit where this is necessary to safeguard employment, and (ii) ensure that the process for the granting of a variation to an REA is conducted in a timely manner.

22. **We will take steps to strengthen activation and training policies to help jobseekers get back to work under the new Pathways to Work.** The approach seeks to coordinate better the efforts of different government departments, increase the frequency and effectiveness of engagement with jobseekers, and impose sanctions for those that do not take advantage of job search, training, and employment opportunities. We will commission and publish an external evaluation of the data required for **evaluation of whether**:

· the large numbers of unemployed across all regions, including the long-term unemployed, have adequate incentives and skills needed to return to work;

· more effective interventions are being put in place, including with respect to group interventions (3 to 6 months) and ongoing interventions (post 6 months); and

· penalty sanctions are being imposed (including the number and level of sanctions).

23. **Based on the recommendations of the external evaluation, the Department of Social Protection will prepare by end-March 2012 an implementation plan to ensure that adequate data are available.** By end-December 2012, we will provide an evaluation of progress in relation to labour market activation measures to enable the unemployed to return to active employment against the targets set out in the Pathways to Work plan.

24. **We are committed to an ambitious programme of state asset disposals to enhance the efficiency and competitiveness of the economy, reduce sovereign financing needs, and provide additional resources for reinvestment in the economy**. This will involve an orderly process of disposals in a manner which allows time to implement necessary regulatory reforms and ensure that value is secured. Analytical work will be completed in the first quarter of 2012 in relation to the suitability for disposal of a number of state-owned assets. This work will also identify the policy, regulatory, legislative, corporate governance and financial issues that may need to be addressed. Details of this asset disposal programme will be provided for discussion with programme

partners by end March 2012, and by end June 2012 a detailed outline of the necessary preparatory reforms for completion by end 2012 will be provided**.**

25. **Reforms in the water sector is underway, together with a strengthening of competition policy enforcement**. Steps are being taken towards the creation of a regulated water utility and the roll-out beginning in 2012 of a national water metering programme to allow for charging of households. This will enable necessary investment to ensure water quality and supply can take place on a more sustainable basis. Finally, we are introducing changes to the Competition (Amendment) Bill 2011 to enhance the enforcement capacity of the Competition Authority, benefiting consumers and businesses. A review of the resourcing of the Authority to ensure that staffing capacity is sufficient to enforce the new legislative framework is under way.

E. PROGRAMME FINANCING AND MONITORING

26. **The programme remains well financed, and we are continuing preparations to regain market access as envisaged.** Following the improvements in the terms of EU lending agreed in July 2011, negotiations on bilateral agreements with Sweden and Denmark are near conclusion and arrangements are being made to obtain the necessary parliamentary approval where relevant. Subject to such parliamentary approval, the aim is to be able to make the first disbursements under these agreements in the context of the completion of the fifth review. The first disbursements under these agreements will be made in the context of the completion of the fifth review. Building on our strong record of program performance, we are maintaining close contact with a wide range of market participants to facilitate our return to market financing as envisaged under the programme; market conditions permitting, we are seeking to resume Treasury bill issuance in the second half of 2012.

27. **Implementation of the policies under the programme will continue to be monitored through quarterly and continuous performance criteria, indicative targets, structural benchmarks, and quarterly programme reviews, as envisaged in our Letters of Intent since the inception of the arrangement on 3 December 2010 along with this letter**. The programme also continues to be in compliance with requirements under the Memorandum of Understanding on Specific Policy Conditionality. The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria and indicative targets under the programme. The Government's targets for the exchequer primary balance are monitored through quarterly performance criteria and net central government debt is an indicative target (Table 2). As is standard in EU/IMF arrangements, there is a continuous performance criterion on the non-accumulation of external payment arrears. Progress on implementing structural reforms is monitored through structural benchmarks (Tables 1 and 3).

28. **We authorise the IMF and the European Commission to publish the Letter of Intent and its attachments, and the related staff report.**

Table 1. Programme Monitoring

Measure	Date	Status
Quantitative Performance Criteria		
Cumulative exchequer primary balance	End-December 2011	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-December 2011	Observed
Continuous Performance Criteria		
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government	Continuous	Observed
Structural Benchmarks		
Define the criteria to run stringent stress tests scenarios.	End-December 2010	Observed
Agree on terms of reference for the due diligence of bank assets by internationally recognised consulting firms.	End-December 2010	Observed
The Central Bank will direct the recapitalisation of the principal banks (AIB, BoI and EBS) to achieve a capital ratio of 12 percent core tier 1.	End-February 2011	Not observed [1/]
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed [2/]
The Central Bank to complete the assessment of the banks' restructuring plans.	End-March 2011	Observed
Complete the diagnostic evaluation of banks' assets.	End-March 2011	Observed
Complete stress tests (PCAR 2011).	End-March 2011	Observed
Complete a full assessment of credit unions' loan portfolios	End-April 2011	Observed
Finalise plans for the recapitalisation of Irish Life and Permanent.	End-May 2011	Observed
Establish a Fiscal Advisory Council.	End-June 2011	Observed
Complete the recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society.	End-July 2011	Observed
Submit the Supervision and Enforcement Bill to Oireachtas.	End-July 2011	Observed
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society.	End-September 2011	Observed
Publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight.	End-October 2011	Observed [3/]
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book.	End-December 2011	Observed
Finalise a strategy to guide the development of broader legal reforms around personal insolvency, including significant amendments to the Bankruptcy Act 1998 and the creation of a new structured non-judicial debt settlement and enforcement system.	End-December 2011	Observed
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets.	2012 Budget day in early December 2011	Observed

1/ Central Bank directions were issued within the required timeframe, however completion of the capital injections required was postponed by the Minister for Finance until after the General Election. These directions are now superseded by the Central Bank's PCAR directions of 31 March 2011.

2/ In practice this was submitted to the Seanad as discussed in paragraph 21of the MEFP, as the Dáil was dissolved owing to the elections.

3/ Effective end-October 2011 and posted on November 8, 2011.

Table 2. Ireland: Quantitative Performance Criteria and Indicative Targets Under the Economic Programme for 2011–12

	30-Jun-11		30-Sep-11		31-Dec-11		31-Mar-12	30-Jun-12	30-Sep-12	31-Dec-12
	Target 1/	Outcome	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
	(In billions of Euros)									
	Performance Criterion		Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-10.1	-8.4	-20.2	-18.3	-22.3	-21	-7.5	-9.0	-10.6	-10.9
2. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by the central government 3/	0	0	0	0	0	0	0	0	0	0
	Indicative Target		Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt 1/	94.6	91.7	115.9	111.7	117.2	115.7	125.0	128.8	130.9	133.3

1/ Adjusted.

2/ Measured by the exchequer balance excluding interest payments. Cumulative from the start of the relevant calendar year.

3/ Applies on a continuous basis.

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Table 3. Ireland: Upcoming Prior Action and Structural Benchmarks under the Programme for 2012

Measure	Date	Status
Financial sector policies		
Publish legislation to strengthen the regulatory framework including making legislative provision for effective governance standards and prudential requirements for credit unions (MEFP Nov. 28, 2011, ¶19).	End-June 2012	Structural benchmark
Approve regulations to establish a charge levied across credit institutions to recoup over time the costs of resolving vulnerable institutions (MEFP, ¶9).	End-September 2012	Proposed structural benchmark
Publish PCAR 2012 results (MEFP, ¶5).	End-November 2012	Proposed structural benchmark
Fiscal policies		
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence (MEFP, ¶21).	End-June 2012	Modified Structural benchmark

Technical Memorandum of Understanding (TMU)

26 January 2011

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to performance criteria and indicative targets under the arrangement supported by the Extended Fund Facility (EFF). These performance criteria and indicative targets are reported in Table 2 attached to the Memorandum of Economic and Financial Policies (MEFP). This TMU also describes the methods to be used in assessing the programme performance and the information requirements to ensure adequate monitoring of the targets.

2. For programme purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "programme exchange rates", with the exception of the items affecting the government fiscal balances, which will be measured at current exchange rates. The programme exchange rates are those that prevailed on December 30, 2011 as shown on the IMF's website (http://www.imf.org/external/np/fin/data/rms_five.aspx, accessed 19 January 2012), in particular, €1 = 1.2939 U.S. dollar and €1 = 0.842786 SDR.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

Floor on the Exchequer Primary Balance

3. The Exchequer balance is the traditional domestic budgetary aggregate which measures the net surplus or net deficit position of the Exchequer Account. The Exchequer Account is the single bank account of the Central Fund and is held at the Central Bank of Ireland. The annual audited accounts of the Exchequer Account produced by the Department of Finance are known as the Finance Accounts. An unaudited summary known as the Exchequer Statement is produced at the end of each month. Under the Irish Constitution, all Government receipts are paid in to the Central Fund and all Government expenditure is funded from it, unless provided otherwise by law.[29] The Exchequer balance is the difference

[29] Receipts of the Central Fund comprise Exchequer tax revenues, non-tax revenues, receipts from the European Union and other capital receipts. Charges on the Central Fund include the expenditure of Government departments and offices, payments related to the servicing of the national debt, payments to the European Union Budget, the salaries, pensions and allowances of the President, judiciary, and Comptroller & Auditor General and the running costs of the Houses of the Oireachtas (Parliament). Extra-budgetary funds (including the National Pensions Reserve Fund), the Social Insurance Fund, semi-state bodies and local governments are not part of the Exchequer system.

between total receipts into, and total expenditure out of, the Exchequer Account. It measures the sum of the current and capital balances. The current balance is defined as current receipts (tax and non-tax revenue) minus current expenditure (voted expenditure and non-voted expenditure charged directly on the Central Fund, including the Sinking Fund). The capital balance is defined as capital receipts (Sinking Fund and other capital receipts) minus capital expenditure (voted and non-voted expenditure). The Sinking Fund provision is a transfer from the current account to the capital account to reduce national debt and has no effect on the overall Exchequer balance.

4. The performance criteria are set on the Exchequer primary balance (the Exchequer balance excluding net debt interest payments in the service of the National Debt).[30]

5. For the purposes of the programme, the floor on the Exchequer primary balance (quantitative performance criterion) will be adjusted downward by payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. Such payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation), unrequited recapitalisation, and purchases of troubled assets, which are carried out in line with programme objectives. The floor will be adjusted upward by the amount of proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer receipts. The floor will also be adjusted downward for Exchequer outlays for the resolution of credit unions, and upward for any return of such outlays to the Exchequer and also for the recoupment of such outlays by the Exchequer from the Resolution Fund. Any other financial operation by Government to support banks, including the issuance of guarantees or provision of liquidity, will be reported to EC, IMF, and ECB staffs.

[30] Net debt interest payments are as per the end-month Exchequer Statements.

6. The floor on the Exchequer primary balance (quantitative performance criterion) in each year will be measured cumulatively from the start of that calendar year.

Cumulative Exchequer primary balance	(In billions of Euros)
From January 1, 2012:	
End-March 2012 (performance criterion)	-7.5
End-June 2012 (performance criterion)	-9.0
End-September 2012 (indicative target)	-10.6
End-December 2012 (indicative target)	-10.9

7. The performance criterion on the Exchequer primary balance (floor) will be adjusted upward (downward) for the full amount of any over-performance (under-performance) in Exchequer tax revenues, pay-related social insurance contributions (PRSI) and national training fund contributions against the current projection which is listed below:[31]

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2012:	
End-March 2012 (projection)	9.7
End-June 2012 (projection)	19.7
End-September 2012 (projection)	30.7
End-December 2012 (projection)	43.8

[31] Exchequer tax receipts are comprised of income tax (including the universal social charge), value added tax (VAT), corporation tax, excise duties, stamp duties, capital gains tax, capital acquisitions tax and customs duties.

8. Any policy changes, including in administration and enforcement of taxes, which impact the revenue projection set out in paragraph 7 will lead to a reassessment of the adjustor in the context of program reviews.

Ceiling on the Stock of Central Government Net Debt

9. The stock of net central government debt, for the purposes of the programme, is defined as the National Debt less liquid assets of the National Pensions Reserve Fund (NPRF). The National Debt is defined as the total outstanding amount of principal borrowed by central government and not repaid as of the test date, less liquid assets available for redemption of those liabilities at the same date. These liquid assets comprise the Exchequer cash balances (including cash in the Capital Services Redemption Account), Exchequer deposits with commercial banks and other institutions, and investments in investment grade sovereign bills. For the purposes of the programme, NPRF liquid assets include the asset classes listed above, and also all marketable securities such as equities, government bonds and other listed investments. NPRF shares in domestic Irish banks, as well as the NPRF's non-liquid discretionary portfolio are excluded from the definition of liquid assets.

10. For the purposes of the programme, the ceiling on the central government net debt (indicative target) will be adjusted upward by debt arising from payments for bank restructuring carried out under the programme's banking sector support and restructuring strategy. These payments may include, inter alia, loans to banks, investments in their equity (requited recapitalisation); unrequited recapitalisation; and purchases of troubled assets, which are carried out in line with programme objectives. The ceiling will also be adjusted (i) downward by the amount of proceeds from sales of bank equity held by the government or NPRF that are treated as Exchequer or NPRF receipts; (ii) upward for Exchequer outlays for the resolution of credit unions, and downward for any return of such outlays to the Exchequer and also for the recoupment of such outlays by the Exchequer from the Resolution Fund; (iii) downward by the amount liquidated from the NPRF non-liquid discretionary portfolio; and (iv) downward (upward) by valuation gains (losses) in the NPRF liquid portfolio. The programme exchange rates will apply to all non-Euro denominated debt.

11. The ceiling on the outstanding stock of central government net debt will be adjusted upward (downward) by the amount of any final upward (downward) revision to the stock of end-December 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-December 2011 (provisional)	115.7
End-March 2012 (indicative target)	125.0
End-June 2012 (indicative target)	128.8
End-September 2012 (indicative target)	130.9
End-December 2012 (indicative target)	133.3

Non-accumulation of External Payments Arrears by Central Government

12. The central government will accumulate no external payments arrears during the programme period. For the purposes of this performance criterion, an external payment arrear will be defined as a payment by the central government on its contracted or guaranteed external debt that has not been made within five business days after falling due, excluding any contractual grace period. The performance criterion will apply on a continuous basis.

13. The stock of external payments arrears of the central government will be calculated based on the schedule of external payments obligations reported by the National Treasury Management Agency.

II. REPORTING REQUIREMENTS

14. Performance criteria under the programme will be monitored using data supplied to the EC, IMF, and ECB staffs. The Irish authorities will transmit promptly any data revisions in a timely manner.

- The Department of Finance will report the Exchequer primary balance to the EC, IMF and ECB staff, with a lag of no more than seven days after the test date.
- The National Treasury Management Agency will provide provisional figures on the outstanding stock of net government debt with a lag of no more than seven days after the test date. The revised figures will be provided within three months of the test date.

- The National Treasury Management Agency will provide the final stock of the central government system external payments arrears to the EC, IMF and ECB staff, with a lag of not more than seven days after the arrears arise in accordance with the definition of external payments arrears as set forth in paragraph 12 of this memorandum.

- The Central Bank of Ireland will provide on a quarterly basis, bank by bank data on the assets of government guaranteed banks, including loans and provisioning by period overdue (90+days and less than 90 days) and category of borrower, 35 working days after the end of each quarter.