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Economic Adjustment Programme for Ireland
Summer 2011 Review

Directorate-General for Economic and Financial Affairs

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EXECUTIVE SUMMARY

A joint European Commission/ECB/IMF mission visited Dublin on 6-15 July 2011 to conduct the third review of the economic adjustment programme for Ireland. This report provides a detailed assessment of compliance and summarises the main finding of the mission.

The Irish programme is well on track. Important progress has been made in the areas of fiscal consolidation, strengthening of the domestic financial sector and growth-enhancing structural reforms in line with the programme conditionality.

Growth is expected to return to positive territory in 2011. Strong exports - aided by progress in recovering the lost cost competitiveness – are driving the recovery. Growth is likely to be modest, however, since domestic demand remains subdued as much needed balance sheet repair continues.

Fiscal performance so far this year has been strong. The government deficit for 2011 as a whole is projected to be well below the 10.6% of GDP programme ceiling. In line with programme commitments, the Government has established the Irish Fiscal Advisory Council to provide an independent assessment of the government's fiscal stance.

Important reforms are being implemented to restore the healthy functioning of the banking sector. In particular, the recapitalisation of the domestic banks was completed by the end-July programme deadline, with a few burden-sharing schemes to be completed by end year and some ongoing asset disposal transactions. The budgetary costs are significantly lower than originally anticipated thanks to burden sharing with subordinated debt holders and – in an important sign of the increasing confidence of investors towards Ireland's prospects – a sizable injection of private capital into Bank of Ireland. Banks are also making progress towards the agreed deleveraging targets toward reducing the size of their balance sheets. Two planned mergers (of Allied Irish Banks with EBS Building Society and of Anglo Irish Bank with INBS) have been completed ahead of schedule, and bank boards are being renewed.

Structural reforms are also being advanced. To improve the functioning of the labour market and enhance job creation, the government is working with the social partners to reform the framework of sectoral wage agreements. The authorities are also making progress towards removing restrictions on trade and competition in sheltered sectors and legislation was passed to progressively increase the state pension age from 65 to 68 by 2028.

The programme remains well-financed. The successful conclusion of the third review will release the third instalment of EU assistance, in the amount of EUR 5.5 billion There is no need for the Irish sovereign to tap the international bond market until the second half of 2013, but it is the stated intention of the authorities to re-enter the market sooner, also to keep a sufficiently large cash buffer for the post-programme period.

Programme implementation has been strong so far but risks remain. Lower global growth could impact negatively on export growth, and Ireland's sovereign standing remains vulnerable to broader euro area developments. Challenges remain in the implementation of both the financial sector reform strategy and necessary fiscal consolidation measures.

INTRODUCTION

A joint European Commission/ECB/IMF mission visited Dublin on 6-15 July to conduct the third review of the economic adjustment programme for Ireland. The mission took place against the background of continued turbulence on sovereign debt markets, stemming from heightened concerns about debt sustainability in some euro area Member States. Indeed, Moody's downgraded Ireland to sub-investment grade on 12 July. Discussions therefore focused on how best to enhance policy credibility, and thus increase Ireland's resilience in case of further financial market disruptions.

The mission found that the programme remains well on track. The Irish authorities have met the agreed programme milestones through the end of 2011Q2, with the fiscal balance in the first half of the year coming in below the programmed ceiling, and significant further progress made towards a streamlined and stronger domestic financial sector. Future programme milestones are also within reach. While sizeable challenges remain ahead, staff analysis shows that continued implementation of the programme will buttress the long term sustainability of Ireland's public finances, in particular by putting the debt ratio on a steady declining path beginning from 2013-14.

On this basis, and after informing the Economic and Financial Committee (EFC), Commission Services recommend the conclusion of the third review, and the release of the third instalment of the EU financial assistance, in the amount of EUR 5.5 billion (further EUR 1.5 billion and EUR 0.5 billion are expected to be disbursed by the IMF and the UK, respectively). The EUR 5.5 billion EFSM/EFSF instalment would include the planned disbursement of EUR 2.5 billion in the third quarter (or October) and allow EUR 3 billion to be disbursed during the first half of the fourth quarter before the conclusion of the fourth review. The adjustment from EUR 2.5 billion to EUR 5.5 billion thus constitutes a re-phasing within the second half of 2011, but no change from the current financing plan as regards disbursements per quarter (the additional EUR 3.0 billion would be disbursed in Q4 as planned, though rather at the beginning of the quarter, i.e. October, than at the end). This adjustment would help ensure strong cash buffers throughout the fourth quarter. Without this adjustment, the procedural and funding delay between reviews and disbursement would have implied that the EFSF/EFSM issuances for Ireland in the fourth quarter would not take place before mid-December. This could give rise to difficulties given the low liquidity in the market at year-end. A wider window of issuance would thus facilitate EFSF fund-raising in the market.

This staff report describes the policy measures taken towards the achievement of the programme targets, as well as the necessary changes to future policy conditionality, as incorporated in the second update of the Memorandum of Understanding on specific economic policy conditionality (MoU).[1]

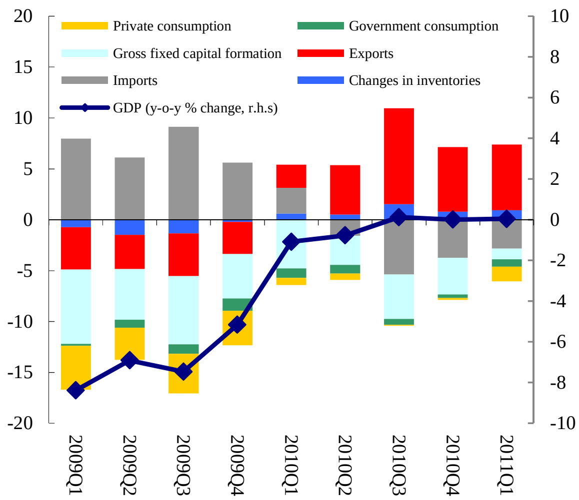
1. MACROECONOMIC AND FINANCIAL BACKGROUND

A timid recovery is underway supported by strong exports while domestic demand is weak, in line with programme projections. Activity indicators suggest that GDP growth is on track to turn positive in 2011, as assumed under the programme. GDP growth was robust in 2011Q1 (1.3% in real terms and 5.1% in nominal terms on a seasonally adjusted, q-o-q basis), offsetting similar declines in the previous quarter (Graph 1). Real exports grew by 3.8% q-o-q, while imports contracted by 0.3% (from a strong basis, though). While private and government consumption continued to contract, investment surprised on the upside (+1.1%). The statistical carryover is now also higher, due to a large revision of the historical series, which led to a smaller GDP contraction in 2010 (-0.4%, instead of -1% before) which will have positive implications for debt and deficit ratios. At the same time, higher-frequency data (PMI, industrial production) appear to foretell an easing of exports growth—which is historically very closely correlated with GDP growth in Ireland (Graph 2). On balance, staff considers appropriate to keep the current near term growth outlook (+0.6% in 2011 and +1.9% in 2012) unchanged (Table 1). This is in line with the latest Reuters GDP consensus –

[1] The report reflects information available as of July 31, 2011.

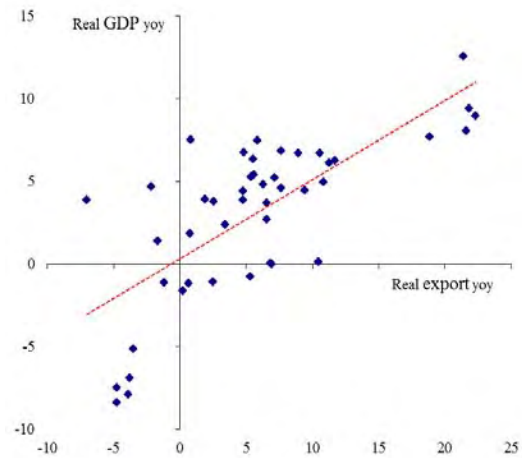
which points to improving expectations for the first time in some time (Graph 3), and leaves the macroeconomic assessment broadly similar to that agreed at the negotiation of the programme in November 2010.[2]

Graph 1: Contributions to y-o-y GDP growth



Source: CSO

Graph 2: Real export growth and GDP growth (2000Q1-2011Q1)



Source: CSO

Inflation has returned to positive territory, mostly a reflection of higher oil prices, although price pressure remains subdued. After peaking at 1.5% y-o-y in April, HICP inflation declined to 1.1% in June, on track towards the 1.1% programme forecast for 2011 as a whole. Risks around the latter remain balanced, with domestic inflation remaining muted in line with weak demand (core inflation is only at 0.3%) while external energy prices will see some further pass-through as the year progresses.

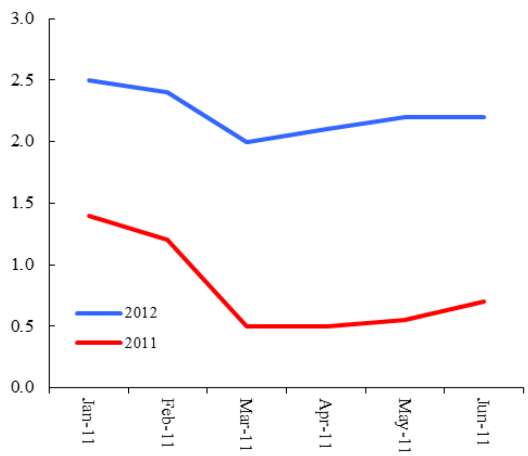
The labour market remains weak overall, but appears to have begun to stabilise:

- *Unemployment* fell slightly in both seasonally adjusted and unadjusted terms in the first quarter of 2011, standing at 14.0%, somewhat below programme expectations.

[2] The authorities' latest official projections in the April 2011 Stability Programme Update envisage GDP growth to reach 0.8% in 2011.

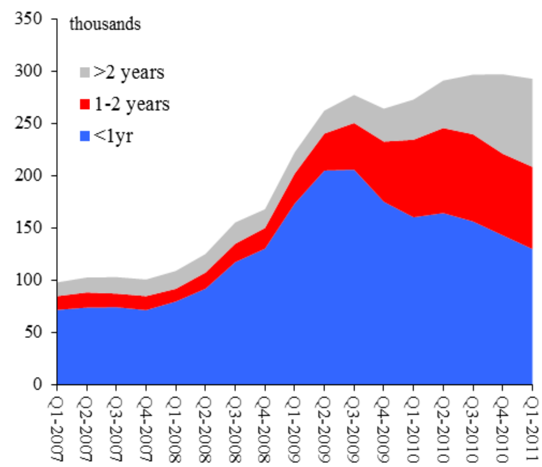
Higher-frequency claimant-based unemployment count for both May and June supports this story of stabilisation. The share of long-term (more than one year) unemployed comprised 55% in Q1 of 2011, of which more than half seeking work for over two years (Graph 4). There is a clear risk that the increasing long unemployment spells develop into structural unemployment. Limiting this risk requires considerable attention going forward.

Graph 3: Reuters consensus y-o-y GDP growth)



Source: Reuters

Graph 4: Unemployment (survey-based)

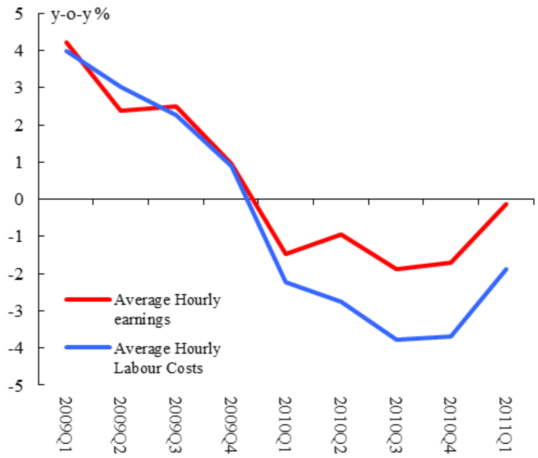


Source: CSO

- *Employment* continued to contract albeit at a declining pace (down by 2.9% in the year to the first quarter), with sectors exposed to the domestic economy seeing the largest falls (construction, retail trade) while exporting sectors (such as ICT and business services) have begun recording year-on-year gains. Falling employment is being absorbed somewhat by continued decline in *labour force participation* and reversal of the strong boom-era net inward migration. As a result staff's unemployment forecast for 2011 has been lowered from 14.5% as of April 2011 to 14.3% in this review, despite a higher projected decline in employment for the year as a whole -1.9%.

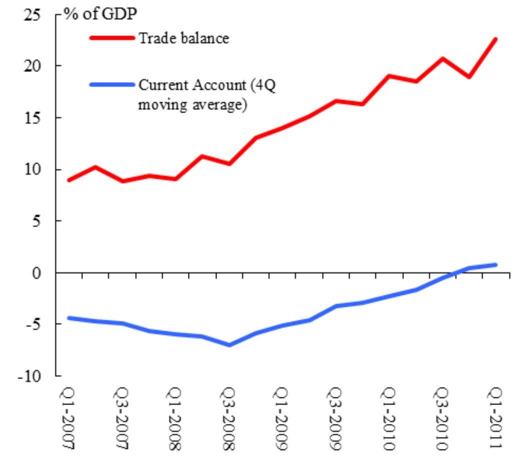
- *Hourly earnings* contracted by only 0.1% in the year to the first quarter, suggestive of some rigidities in the labour market, though the return of positive inflation, after falling prices in both 2009 and 2010, should bring about some decline in real earnings in 2011. Flexibility is still in evidence at the non-wage margin, with weekly *hours* *worked* falling by 1% year-on-year and average hourly labour costs falling by 2% (Graph 5).

Graph 5: Wage growth



Source: CSO

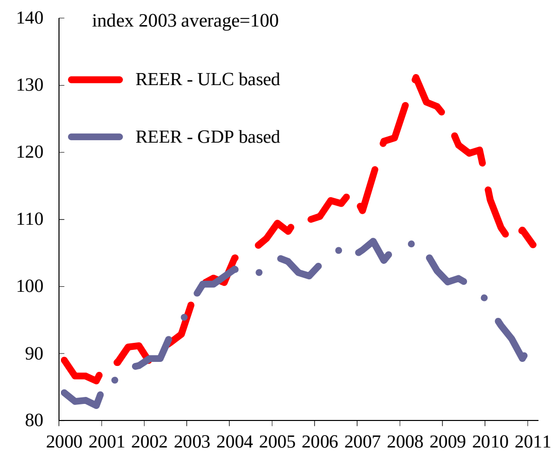
Graph 6: Current account



Source: CSO

Recent revisions showed that the current account actually returned to a slight surplus in 2010 (0.5% of GDP), up from a deficit of -2.9% of GDP in 2009 and the first full year surplus since 1999. The improvement in the balance of payments was due to a sharp increase in the trade balance (Graph 6), while factor flows such as repatriated profits and interest payments stayed roughly unchanged. Staff have revised upward their forecast to a surplus of 1.8% for 2011, up from 1.2% projected in April. In addition to the continuing contraction in domestic demand, the surplus results from robust export growth on the back of the substantial competitiveness improvements achieved in Ireland in recent years (see Graph 7). The latter have benefitted from productivity improvements stemming from the sharp fall in employment and the reductions in both hours worked and hourly labour costs. Economy-wide, prices have converged considerably toward

Graph 7: Competitiveness developments



Source: ECB

euro area norms, as seen by the fall in the GDP-based real effective exchange rate. The continuing improvements in competitiveness are expected to underpin the export-led nature of the recovery in the coming years.

Table 1 Macroeconomic framework

	July 2011 Forecast			April 2011 Forecast		
	2010	2011	2012	2010	2011	2012
	% change on previous year					
Real GDP growth	-0.4	0.6	1.9	-1.0	0.6	1.9
Private consumption	-0.9	-2.4	-1.0	-1.2	-1.9	-1.0
Public consumption	-3.1	-3.0	-1.5	-2.0	-4.4	-0.4
Fixed investment	-25.1	-10.7	1.6	-27.7	-13.5	2.0
Domestic demand (contribution)	-5.0	-3.0	-0.6	-5.3	-3.3	-0.4
Inventories (contribution)	0.9	0.2	0.1	0.6	0.2	0.1
Exports	6.3	6.0	5.2	9.3	6.0	5.2
Imports	2.7	3.2	3.8	6.5	3.2	4.0
Net trade (contribution)	3.7	3.4	2.4	3.6	3.8	2.2
Employment	-4.2	-1.9	-0.1	-4.1	-1.5	0.4
Unemployment rate (level)	13.6	14.3	13.8	13.6	14.5	13.9
GDP deflator	-2.4	0.5	0.9	-2.6	0.6	0.9
HICP inflation	-1.6	1.1	0.6	-1.6	1.0	0.7
Current account (% of GDP)	0.5	1.8	2.7	-0.7	1.2	1.8
Nominal GDP	156.0	157.7	162.1	153.9	155.9	160.3
	level as % of GDP					
General government						
General government balance	-32.0	-10.2	-8.6	-32.4	-10.5	-8.8
Primary government balance	-28.8	-6.3	-4.0	-29.2	-6.8	-4.2
Interest expenditure	-3.2	-3.9	-4.6	-3.3	-3.8	-4.6
General government debt	94.9	109.9	116.2	96.2	112.0	117.9

Source: Commission services

2. PROGRAMME IMPLEMENTATION

Fiscal performance is broadly in line with programme targets. Public finance cash data for January-June 2011 show a better-than-expected outturn. Tax revenue was 0.3% above the forecast of the programme's spring review (Table 2).[3] Of the main tax items, personal income and excise taxes were above program projections, while corporate income and value added taxes lagged somewhat, which bears close watching. Expenditure outturn was lower than expected by the authorities and the programme's assumptions (-1.5%), but this may reflect some slower-than-anticipated implementation of the capital budget, so that expenditure should be in line with the forecast for the year as a whole.

Table 2 Tax revenue outturn in January-June against the Spring 2011 updated programme projections (EC) and Department of Finance (DoF) forecast, cash

	Outturn EUR m	EC Forecast EUR m	Outturn vs. EC Forecast	Outturn vs. EC Forecast, %	DoF Forecast EUR m	Outturn vs. DoF Forecast	Outturn vs. DoF Forecast, %
Income Tax	6038	5967	71	1.2	6027	11	0.2
Value-Added-Tax	5075	5132	-58	-1.1	5209	-134	-2.6
Excise	2200	2160	40	1.8	2121	79	3.7
Corporation Tax	1424	1502	-78	-5.2	1540	-116	-7.6
Stamps	265	263	2	0.8	270	-5	-1.8
Capital Gains Tax	90	75	15	19.3	88	2	2.2
Capital Acquisitions Tax	48	35	13	38.0	33	15	46.6
Customs	117	105	12	11.6	106	11	10.4
Tax revenue	15279	15239	40	0.3	15394	-115	-0.7

Source: Department of Finance, Commission services.

For 2011 as a whole, Commission Services currently estimate the government deficit at 10.2% of GDP – below the EDP and programme target of 10.6%.[4,5] As compared to the

[3] Although relative to the authorities' more optimistic forecasts revenue fell somewhat short, by 0.7%.

[4] This excludes any one-off deficit-increasing effect in 2011 from the measures in support of domestic banks, for which no estimates are available at this point. Most of these measures are, however, already included in the debt and interest expenditure calculations.

[5] The fiscal forecasts mentioned in this document do not incorporate any savings which would arise from the improvements in the terms of EU financial assistance for Ireland announced following the meeting of the Heads of State and Government of the euro area and EU institutions on 21 July 2011 (see http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf).

spring 2011 larger deficit forecast of 10.5% of GDP, the current estimate includes the measures in the recently-launched Jobs Initiative and more recent public finance cash data until end-June 2011. The Jobs Initiative is designed to be budgetary neutral over the period 2011-2014, but it has a deficit-reducing effect of 0.1% of GDP in 2011, as the levy on pension funds more than offsets the cost of temporary reductions in some tourism-related VAT rates to 9% and reductions in social security contributions on low wages this year. Based on the performance through June, staff have revised upward 2011 tax revenue by about 0.1% of GDP. The upward revision to 2010 nominal GDP, which will carry through to following years, has a positive denominator effect of 0.1 pp. of GDP on the deficit ratio. On the expenditure side, there are no significant changes to the non-interest expenditure projections, while somewhat higher interest expenditure is due to marginally higher-than-programmed interest rates, which would amount to 0.1% of GDP annually if full programme financing is disbursed at this rate.

Deficit forecasts for outer years have also improved somewhat relative to the Spring 2011 forecast round, and are now closer in line with EDP targets:

- For 2012, the overall deficit is now projected to be just at the EDP target of 8.6% of GDP, down from 8.8% of GDP in the 2011 Spring Forecast, as the higher nominal GDP level and higher 2011 basis for tax revenue would each reduce the deficit ratio by 0.1% of GDP. After a positive contribution in 2011, the Jobs Initiative will have a net negative revenue effect in 2012, with a deficit-increasing effect of 0.2% of GDP as compared to 2011. However, this is fully compensated by a larger than previously assumed full-year effect of the 2011 budget measures (see Table 3, which assumes *new* measures for 2012 of at least EUR 3 billion as committed under the programme and in line with the assumptions used in the stability programme). Moreover, the Minister for Finance has publicly stated that the government may aim for a larger consolidation effort in the 2012 budget, without however being able to commit to specifics in advance of the conclusion of the ongoing expenditure review, which is expected for September.
- Looking forward, based on the authorities' existing commitments as confirmed in the stability programme submitted by the current government in April, the medium term

deficit path remains unchanged. Based on annual fiscal consolidation measures of 1.8% of GDP in 2013 and 2014, and 1.3% in 2015, the deficit is projected to be brought down to 7.5% of GDP in 2013, 4.6% of GDP in 2014 and 2.9% of GDP in 2015. Broad consolidation measures underpinning this consolidation path were originally specified by the previous government in the National Recovery Plan. The current government has indicated that the detailed composition of the adjustment might be modified following the results of the ongoing Comprehensive Review of Expenditure. The government will submit to parliament by end-October 2011 the Pre-Budget Outlook containing a medium term fiscal plan for 2012-2015 and outlining the overall composition of revenue and expenditure adjustments for each year. This plan will be specified in further detail on Budget Day, in early December.

Table 3 Annual consolidation measures, EUR billion

	2011	2012	2013	2014	2015
Annual consolidation measures	**6.2**	**3.9**	**2.9**	**3.4**	**2.3**
Permanent measures	5.3	4.1	3.1	3.1	2.3
Revenue	1.4	2.0	1.1	1.1	0.6
First year effect	*1.4*	*0.9*	*0.8*	*0.9*	*0.4*
Carry over from the previous year		*1.1*	*0.3*	*0.2*	*0.2*
Expenditure	3.9	2.1	2.0	2.0	1.7
Temporary measures	0.9	-0.2	-0.2	0.3	0.0
One-off measures	0.7				
Jobs Initiative	0.2	-0.2	-0.2	0.3	

Note: Table includes the measures of the budget for 2011 (with associated carry-overs for outer years), the jobs initiative, and the measures for 2012-14 as announced in the National Recovery Plan, which are however subject to revision following the Comprehensive Review of Expenditure. In 2015, additional measures are assumed to bring the deficit below 3% of GDP. Rounding may affect totals.
Source: Commission Services.

The authorities have begun implementing their financial sector strategy in earnest, securing significant progress towards the recapitalisation, restructuring and deleveraging objectives of the programme. In particular:

Recapitalisation

- Liability management exercises (LMEs) were launched as planned. In parallel, a Subordinated Liability Order (SLO) was obtained by the government based on the Credit Institutions (Stabilisation) Act to change the terms of AIB subordinated debt liabilities and incentivise a higher take up of the LMEs. A few legal challenges to the

SLO by AIB investors have been eventually settled out of court. The LMEs have generated some EUR 4.9 billion in capital by end-July.

- Agreement was reached on a term sheet for the contingent capital (in particular, the bonds would automatically become equity capital if the core tier-1 capital adequacy ratio of the relevant bank would fall below 8.25%). The contingent capital instruments were then injected into the respective banks on schedule.

- BlackRock Solutions assessed the methodology for loan loss estimation carried out for Anglo Irish Bank (Anglo) last year (outside of the recent Prudential Liquidity Assessment Review (PLAR) and Prudential Capital Assessment Review (PCAR)), and found it adequate. It also carried out a lifetime loan loss forecast for INBS, and concluded that INBS does not require any further capital. A joint restructuring plan foreseeing the resolution of the loan books of Anglo and INBS over a period of ten years was approved by the European Commission on 29 June 2011. The two banks were then merged on 1 July 2011 (ahead of schedule).

- The end-July recapitalisation of the domestic banks has been completed, apart from EUR 0.51 billion for Bank of Ireland (BoI) and EUR 1.1 billion for Irish Life & Permanent (ILP). To allow for the sale of its life insurance company, the May Council Implementing Decision and the MoU allowed an exception for ILP. For the remaining EUR 0.51 billion for BoI, the authorities have now requested an extension of the deadline to end-2011 in order to fully complete further private sector contributions. With no standing objections by the Central Bank of Ireland, programme partners saw the request as valid (see Section 4.2.2. below).

Deleveraging

- A governance framework for banks' deleveraging has been elaborated by the Department for Finance (see box 2), although it might need to be further fine-tuned as the process unfolds (see section 4.2.2 below).

- AIB and BOI have provided alternative deleveraging plans following the decision not to transfer sub-EUR 20 million land and development loans to the National Asset Management Agency (NAMA). Following inquiries from the Central Bank of Ireland

and programme partners, these banks have provided revised deleveraging plans, which will be assessed along with the restructuring plans banks submitted to the European Commission on July 29.

Upgrading the financial sector framework

- A Central Bank and Credit Institutions (Resolution) Bill was reintroduced to Parliament, while agreed amendments were presented to the Special Resolution Regime draft bill, broadly in line with the evolving EU principles on crisis resolution.

Restructuring of the credit union sector

- A strategy to underpin the solvency and viability of the credit union sector was presented to the European Commission, the ECB and the IMF. A Commission on Credit Unions has been set up, as envisaged, to review the future of the credit union movement and make recommendations in relation to the most effective regulatory structure for credit unions. This Commission will explore legislative changes to strengthen the sector in the medium-to-long run in a way that ensures ownership of the process by the sector. The Commission on Credit Unions is expected to publish an interim report to inform Government policy decisions at the end of September and issue a final report in March 2012. In the meantime, the Central Bank will continue to strictly monitor credit unions, especially with regard to their level of reserves and provisions and order the adoption of operational and lending restrictions as needed. Further discussion with the staff of the European Commission, the ECB and the IMF will be necessary to clarify some aspects of the restructuring of the credit unions.

Supervision

- The Central Bank produced an action plan to further strengthen its supervision capacity, based mainly on more pro-active supervision, more prudent loan loss provisions, enhanced disclosures by banks, publication of new guidelines for the valuation of bank collateral and the introduction of a central credit registry. Additionally, the new Central Bank (Supervision and Enforcement) Bill will strengthen the ability of the Central Bank to impose and supervise compliance with regulatory requirements and to undertake timely prudential interventions, including by entrusting the Central Bank with greater information gathering powers, authorisation to access credit institutions' premises and attend meetings, as well as the power to issue binding Regulations.

The authorities have also met the programme milestones in the area of structural reforms, in some cases ahead of schedule. In particular, legislation was passed to increase the state pension age (to 66 years in 2014, 67 in 2021 and 68 in 2028), and a 5-member Fiscal Advisory Council established. As agreed, the government included in the May Jobs Initiative a provision for temporarily reducing employers' social security contribution to offset the reversal of the cut in the national minimum wage. Finally, the voluntary 15-day prompt payment rule was extended to the health service executive, local authorities and state agencies. The authorities also enforced the elimination of the 50% mark-up paid for medicines under the State's Drugs Payment Scheme—an end-Q3 milestone).

Box 1: Deleveraging so far

Domestic banks deleveraged EUR 7.2 billion of non-core loans between end-2010 and May 2011 through EUR 4.4 billion of run-offs, EUR 1.8 billion of asset disposals and EUR 1 billion of foreign exchange and other adjustments. This represents about 10% of the total deleveraging planned by the end of 2013. Though disposals have been small until now, a significant pick-up in the amount of transactions is expected in H2 2011.

AIB/EBS have achieved disposals of EUR 1.1 billion since the end of 2010. Haircuts were below those assumed in the PLAR, except for the European commercial real estate category (actual haircut of 26% versus hypothetical haircut of 10%). Together with run-offs and adjustments, AIB/EBS has already deleveraged EUR 4.3 billion of non-core assets, i.e. 17.7% of the final 2013 target. Following the merger with EBS, the group may have to deleverage additional core loans while retaining non-core EBS portfolio, without prejudice to capital needs, given the small scale of EBS portfolio.

ILP has not disposed of any assets yet, and deleveraging until now amounts to EUR 0.4 billion, i.e. 2.5% only of the final 2013 target. EUR 10.4 billion of loan book disposals are to take place over the three-year horizon. There have been already a number of tentative expressions of interest with respect to ILP’s EUR 7 billion buy-to-let loan book, without pricing indications.

Anglo’s disposal of US assets is presently underway. A lot of interest has been expressed, within a market that has significantly revived recently. The transaction is expected to be completed in Q4 2011.

BoI deleveraged EUR 2.5 billion of non-core assets, i.e. 7.7 % of the final 2013 target, primarily through sales of EUR 0.7 billion and run-offs of EUR 1.6 billion. The bank has received offers for the whole or parts of its project finance loan book, EUR 2.7 billion of which are targeted for disposal by the end of 2011.

Box 2: Emerging governance structure of the domestic Irish banking sector

In light of the stepped up public ownership of domestic banks, responsibilities for the Irish banking sector have been reorganized. Overall, it is envisaged that Irish banks which have received taxpayer support will become more accountable to the government.

The Department of Finance's capacity in the area of banking policy has been significantly strengthened through the creation of a dedicated banking unit charged with advising the government on potential systemic threats and mitigation measures (the precise terms of reference and mission statement of this unit regarding financial oversight and management of the State shareholdings, as well as its organizational chart will be published by end- October 2011). This unit will be assigned staff from the National Treasury Management Agency with expertise in banking, to enable it to adopt a stricter hands-on approach to bank restructuring, and in particular a stronger control over the deleveraging processes. A separate Shareholding Management Unit will be dedicated to dealing with core and non-core bank issues, and with issues of system-wide relevance. Also, within the Financial Stability and Intervention Unit, specific resources will be dedicated to banks' management of their balance sheets and to broader issues of financial stability, also involving the non-covered banks operating in Ireland.

The key state governance structures comprise an Economic Management Council, a Bank Stability Committee and a Deleveraging Committee. The Economic Management Council (which meets weekly) includes the Taoiseach (Prime Minister), the Tánaiste (Deputy Prime Minister) and the Ministers for Finance and for Public Expenditure and Reform. The Bank Stability Committee, which also meets weekly, includes the Secretary General of the Department of Finance, the Governor of the Central Bank, the Central Bank Head of Financial Regulation and other state principals. The Deleveraging Committee, which will be reviewing banks' deleveraging actions and is composed of the Head of the Banking Unit of the Department of Finance, heads of other relevant Units and two independent non-executive directors, will meet monthly, or more frequently if needed.

At bank level, board members and senior managers are being renewed, where appropriate, drawing on a panel of 30 suitable candidates selected from for 480 applicants with the help of the Public Appointments Service and an outside expert.

In assessing the proposed governance framework, programme partners observed that the role of the Department for Finance in the proposed framework appeared to be more direct and hands-on than initially agreed, but the authorities considered that such a model was necessary, at least at the early stage of the process, to ensure that banks adapt quickly to the changed market conditions. The authorities strongly emphasized that they didn't intend to intervene in the banks' day-to-day operations (certainly not with the intention to direct lending to specific sectors or geographical areas). They however thought that close oversight might be necessary to progress with deleveraging, which is crucial to achieve broader programme goals, such as reducing the reliance of banks on central bank financing.

3. POLICY DISCUSSIONS

With financial markets unsettled by continued uncertainty about debt sustainability in some euro area Member States, the authorities concurred that steadfast policy implementation was of the essence. Programme partners commended the authorities for their resolve in pursuing an ambitious reform agenda despite difficult circumstances, including by securing some key programme objectives (such as the mergers of the AIB with EBS and Anglo with INBS) well ahead of schedule.

3.1. Fiscal Consolidation

The strong fiscal performance to-date, in the face of a challenging macroeconomic environment, speaks to the authorities' commitment. It bodes well for successful program implementation in this area. With financial markets sceptical of the prospects for some euro area Member States, there is however no room for complacency. Thus, staff welcomed the authorities' strong commitment to take all the necessary measures to achieve the agreed fiscal targets—if needed, by targeting larger-than-currently programmed savings in the forthcoming 2012 budget discussions. To this end, views on possible options for fiscal consolidations were the subject of a dedicated seminar. Staff stressed the benefits, in terms of enhancing credibility, from spelling out as soon as feasible the coalition's vision of the precise composition of the pledged consolidation efforts.

Staff noted that during the second half of the year challenging political decisions needed to be made. The authorities have indicated that they will outline a medium term fiscal plan for 2012-2015 by end-October 2011, when they would be able to avail themselves of the results of the comprehensive review of expenditure which is currently under way. The plan will present the overall composition of expenditure and revenue adjustments for each year, underpinning a path for the fiscal deficit in line with the Council Recommendations in the context of the Excessive Deficit Procedure. The policies underlying this path will be specified in more detail by Budget Day, early in December 2012.

3.2. Financial Sector Policies

3.2.1. RECAPITALISATION

The authorities have resolutely pursued burden-sharing with subordinated bondholders of the four viable domestic banks. They have secured some EUR4.9 billion contribution—at the higher end of expectations—through a series of well-executed liability management exercises (LMEs).[6] Yet they considered that up to EUR 500 million more can be achieved by BoI, which for implementation reasons could not however be completed before the 31 July 2011 programme deadline for the recapitalisation. The authorities proposed to allow until end-2011 to inject these funds, depending on the outcome of further burden sharing with BoI's outstanding subordinated bondholders, and reiterated their commitment to provide the envisaged capital in full, if necessary by topping up the proceeds from further burden sharing with BoI's outstanding subordinated bondholders with State funds.

Staff support the authorities' request. In light of the very cautious and conservative approach that was adopted in arriving at the recapitalisation needs of the domestic banks, staff agree that it is sensible to inject correspondingly less capital (i.e. EUR 0.5 billion) by the 31 July 2011 programme deadline and thus avoid that, after the completion of the further burden sharing, BoI would have capital in excess to the requirement established in the PCAR exercise.[7] The Central Bank of Ireland has also confirmed that they have no objections to this extension of deadline from a financial stability perspective, since even with a partial capitalization BoI's core tier-1 capital will be 15%, well above the 10.5% regulatory threshold.

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[6] Although these LMEs were backed by a Subordinated Liability Order, sought by the government on the basis of the Credit Institutions Stabilization Act, their almost complete take-up is seen to reflect the terms of the offer, which were close to the (discounted) market prices of the various securities.

[7] The principle here is the same that was agreed in the previous review with respect to the capital to be secured by the sale of the life insurance assets of ILP, for which an adjustment is explicitly foreseen in the MoU.

3.2.2. RESTRUCTURING AND GOVERNANCE OF DOMESTIC FINANCIAL SECTOR

The stepped-up ownership of the domestic banks by the State poses some governance challenges, about which the authorities are well aware. In general terms, it is important that publicly owned banks do not become a conduit for quasi-fiscal operations or directed lending. The deleveraging process, furthermore, presents issues of its own, since the interests of the individual banks with respect to the sale of a given non-core asset might not be completely aligned to wider interests of the sovereign.

The authorities intend to combine an "arms-length" approach to banks' *core* activities with a much more active and "hands-on" approach when it comes to their divestiture of non-core assets. The latter in practice means that Department of Finance (DoF)'s representatives on the banks' deleveraging committees will be authorised to refer material transactions to the DoF's Review Committee/Minister, which can in turn decide to either stop a given proposal of sale or, rather, to enforce it (as the case might be). While this approach is reasonable and pragmatic in principle, it might be hard to implement in practice. It was thus agreed to reassess this model in the context of future reviews. In this context, the significantly strengthened Banking Unit with the Department of Finance is expected to play a lead role (a Memorandum of Understanding between the Department of Finance and the Central Bank of Ireland in the area of banking is to be published by end-September), and it is envisaged to be subject to an appropriately frequent (i.e. quarterly) reporting requirement.

The authorities are continuing their diagnostic and efforts to strengthen the small, but important, credit union sector. The establishment of the Commission on Credit Unions (CCU), due to provide an interim report by end-September 2011, is welcome and will inform the submission by end-2011 of legislative proposals to strengthen the credit union's regulatory framework, including through more effective governance and regulatory requirements. Staff have stressed the importance to identify a proper funding mechanism that any restructuring process might require. The authorities indicated that they expected that any needed resources could be efficiently mobilized within the sector. Staff will continue closely monitoring the restructuring and possible need for public funding. Staff also underscored that intervention in this area should preserve the hard-won credibility of the overall financial sector strategy. The authorities confirmed that it is intended that the Special Resolution Regime for financial institutions will apply to credit unions.

The mission encouraged the authorities to review the restructuring plan of ILP and, if necessary, set out follow-on actions. The restructuring plan of ILP will be discussed during the next review.

3.2.3. OTHER FINANCIAL SECTOR OR FRAMEWORK REFORMS

The authorities are pursuing several other welcome improvements of the financial sector framework (these are listed in the attached MoU and MEFP). In particular:

- **A legislative bill to enhance the Central Bank's supervisory powers has been published.** Here as well, staff underscored that it is important to equip supervisors with the instruments they need, while avoiding provisions that might compromise banks' ability to conduct their business.
- **The Central Bank is currently analysing options to provide guidance to the banks on how to accelerate the recognition of accounting losses incurred in their loan book.** Such guidance is expected to be taken into account for the preparation of banks' 2011 financial statements. This guidance will aim at directing banks to recognise upfront existing losses on core and non-core assets, based on the underlying losses identified in the PCAR/PLAR while ensuring full compliance with International Financial Reporting Standards (IFRS) accounting practices. It should be noted that, while the Irish authorities have underscored their ambitious goals regarding provisioning levels, the specifics through which the individual bank guidance will translate into actual provisions remains unclear. Finally, although the new guidance on provisions will not be made public, the Central Bank has prepared new disclosure templates to enhance transparency on issues such as definition of impairment, timing of write-offs, and collective provisioning methodology.
- **A new centralised credit registry (CCR) will be established,** thus filling a major supervisory and information gap in the pre-crisis banking framework. The introduction of a mandate for the authorities to enforce the reporting to the existing CCR of credit

exposures above certain thresholds will assist both banks and the Supervisor in forming a correct assessment of the solvency of borrowers and the concentration of risk across the financial system. The next steps include the submission to the Minister for Finance by end-September of a proposal for setting up the legal underpinnings of a CCR, followed by the submission to parliament of draft legislation for the establishment of a statutory credit risk register in September 2012.

- **New guidelines for the valuation of collateral for bank loans will be published by end-December 2011.** Low values of collateral used to guarantee banks' risk exposures were identified as one of the main sources of bank losses in the PCAR exercise. The new measures put the emphasis on the banks' role in the valuation of collateral. To underpin more independent evaluation, staff suggested establishing a register of appraisal companies. The authorities however found such options to be excessively complex for the time being, but have committed to explore this and other possible options to strengthen banks' incentives to an accurate valuation in their future work.

3.3. Structural fiscal reforms

The mission commended the authorities for the establishment of the Fiscal Advisory Council. The five-member Council brings to the debate a host of skills and knowledge, as well as credibility. Looking ahead, it will be important to further underpin the Council's independence in the context of the Fiscal Responsibility Law for introduction by end-Q4 2011 (for example, by providing it with the explicit powers to use its budget, which should be adequately protected, e.g. by envisaging a specific multi-year appropriation in the budget framework).

The public wage bill and long term pension costs are being reduced as planned. The authorities confirmed that a minimum 10% reduction in pay for new entrants to the public service is in place, in addition to an effective 14% reduction to salaries of existing staff put in place between 2009 and 2010, as well as an effective pay freeze until 2014. Planned reductions in public service numbers are in line with targets and measures to reduce the overall public service wage bill have strong support from both government and unions. A reform of pension entitlements for new public service employees is set for legislative introduction before end-September 2011. It will link retirement benefits to average earnings and link pension payments to inflation, and is estimated to reduce the long term public pension burden by about 35%.

3.4. Other structural reforms

Sectoral wage-setting arrangements are being modernized. The government is working to develop a time-bound action plan by end September 2011 having regard to the views of the social partners and other stakeholders. This will take into consideration a recently completed review of sectoral wage-setting mechanisms and the implications of the 6 July 2011 High Court ruling which found that sections of legislation governing wage-setting mechanisms in employment regulation orders (EROs) are unconstitutional.

The mission encouraged the authorities to advance reforms to raise efficiency and increase the value of state-owned assets. This is important in its own right, as greater efficiency and lower costs would support recent competitiveness gains, but it can also contribute to alleviating the tight financial position of the state. The authorities have undertaken to identify assets for disposal, the required legislative and regulatory changes, and associated timelines by end-2011, based on the Programme for Government and building on the recently published review of State Assets and Liabilities.

Other structural reform measures are being advanced in line with programme commitments. A new Legal Services Bill is set to be introduced shortly, which should serve to increase transparency and competition in the sector. Government has returned to an independent process for recruiting members of the board of the Competition Authority, and will bring forward legislation to strengthen competition law enforcement and ensure the effective functioning of the Competition Authority. The draft of this legislation and of the Legal Services Bill will be discussed and assessed during the next review. A political commitment to introduce water charging on the basis of universal metering has been given and preparatory work is at an early stage. The authorities have also commenced discussions with Commission services towards an agreed time-bound action plan to ease planning caps on the size of retail premises.

4. PROGRAMME MODALITIES AND RISKS

The EU and the IMF have so far provided EUR 22.2 billion financial assistance (14.3% of GDP) under the programme. This corresponds to one third of total external financial assistance of EUR 67.5 billion envisaged under the program. Instalments amounted to EUR 17.8 billion in the first quarter of 2011 and EUR 4.4 billion in the second. The disbursed EU funds of EUR 15.0 billion were provided by the European Financial Stability Mechanism (EUR 11.4 billion) and the European Financial Stability Facility (EUR 3.6 billion).

The planned loan disbursement for the second half of 2011 was confirmed during the mission (Table 4)**.** Updated calculations by European Commission and IMF staff confirmed the financing needs, as set out in the April review mission. The planned instalments for the third and fourth quarter of this year amount to EUR 4.5 and EUR 11.5 billion, respectively. As explained in the introduction, part of the planned disbursement for Q4-2011 is pre-approved during this review. This allows spreading the disbursements more evenly across the fourth quarter and ensures a sufficiently large cash buffer, also in light of maturing bonds and the profile of tax yields. Disbursements for 2012 and 2013 are tentatively planned for EUR 19.0 and 10.3 billion, respectively. The financing need calculations are based on the assumption that only EUR 18 billion of the EUR 24 billion identified bank recapitalisation need will require budgetary resources, as the Liability Management Exercises have so far generated EUR 4.9 billion and private investors have committed to buy EUR 1.1 billion of BoI shares.

The programme remains well financed (Graphs 8 and 9)**.** The reduced budget cost of the banking support (some EUR 18 billion vis-à-vis EUR 35 billion as earmarked in the programme) as well as the decisions taken by the Heads of State or Government of the euro area and EU institutions on 21 July to lower interest rate and extend maturities of financial assistance will allow Ireland to stay away from the bond market for longer than initially envisaged. In addition, retail and short-term debt funding is expected to cover limited amounts of overall financing needs. There is no need for the Irish sovereign to tap the international bond market until the second half of 2013, but it is the stated intention of the authorities to re-enter the market sooner, also to keep a sufficiently large enough cash buffer for the post-programme period.

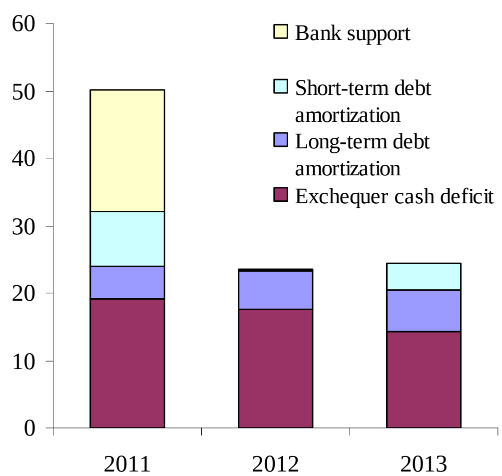
Table 4 Projected financing needs and sources, 2010-2013 (billion EUR) 1/

	2010 Dec	2011 Q1	Q2	Q3	Q4	Year	2012 Year	2013 Year	2010-2013 Total
FINANCING NEEDS									
A. Gross financing needs public sector 2/	7.9	12.8	5.3	4.4	9.6	32.1	23.5	24.5	87.9
B. Market financing (incl. retail funding)	0.5	0.7	0.4	0.3	0.3	1.7	4.5	14.2	20.9
C. Net financing needs public sector (A-B)	7.3	12.1	4.9	4.1	9.3	30.4	19.0	10.3	67.0
D. Bank recapitalisation	0.0	0.0	19.0	-1.0	0.0	18.0	0.0	0.0	18.0
TOTAL FINANCING NEEDS (C.+D.)	**7.3**	**12.1**	**23.9**	**3.1**	**9.3**	**48.4**	**19.0**	**10.3**	**85.0**
OFFICIAL FINANCING SOURCES									
E. Irish financial assets 3/	**7.3**	**-5.7**	**19.4**	**-1.4**	**-2.2**	**10.2**	**0.0**	**0.0**	**17.5**
F. EU-IMF loan disbursement	**0.0**	**17.8**	**4.4**	**4.5**	**11.5**	**38.2**	**19.0**	**10.3**	**67.5**
EU	0.0	12.0	3.0	3.0	7.7	25.6	12.7	6.6	45.0
EFSM/EFSF	0.0	12.0	3.0	2.5	7.2	24.7	10.4	5.1	40.2
Bilaterals 4/	0.0	0.0	0.0	0.5	0.5	0.9	2.3	1.5	4.8
IMF	0.0	5.8	1.4	1.5	3.8	12.5	6.3	3.6	22.5
TOTAL FINANCING SOURCES (E.+F.)	**7.3**	**12.1**	**23.9**	**3.1**	**9.3**	**48.4**	**19.0**	**10.3**	**85.0**

Notes:
1/ Table does not include decisions taken by the Heads of State or Government of the euro area and EU institutions on 21 July.
2/ Includes exchequer cash deficit, maturing long-term and short-term debt.
3/ Includes Treasury cash reserves and NPRF assets.
4/ Bilaterals include UK, Sweden and Denmark.

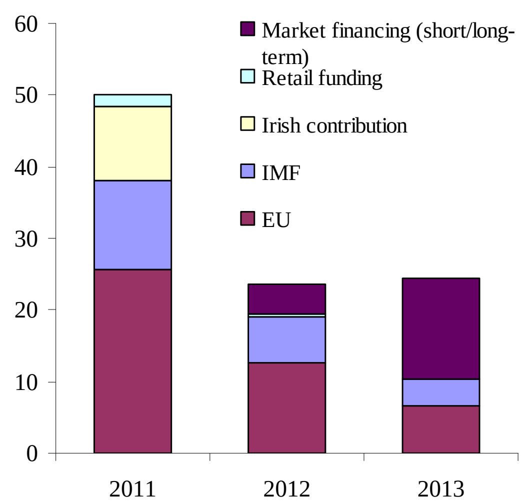
Source: Commission services

Graph 8: Financing needs (EUR billion)



Source: Commission services

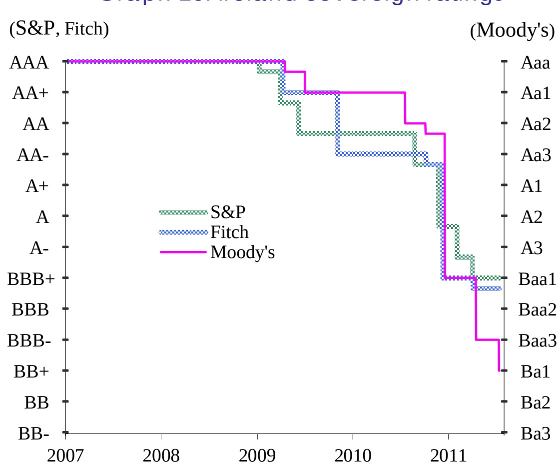
Graph 9: Financing sources (EUR billion)



Source: Commission services

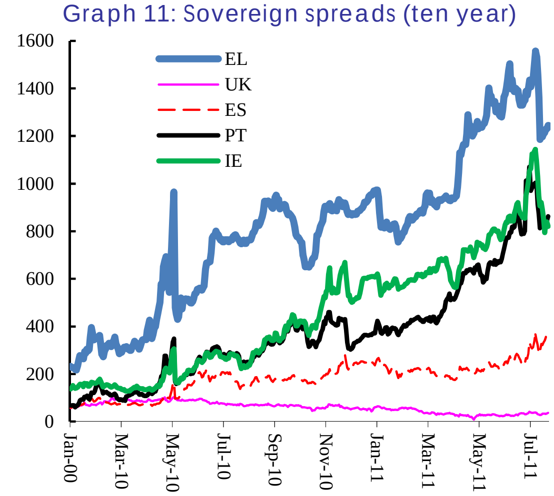
Secondary market yields remain highly volatile. Despite the comprehensive policy implementation, the adequate programme financing and the lack of negative macro-fiscal surprises, sovereign spreads continued to escalate in the first half of the year peaking in mid-July after Moody's downgraded Ireland to Ba1 (non-investment) status (Graph 10). Moody's specifically cited concerns about the common approach to the euro area debt crisis and confirmed that recent policy performance in Ireland was not a factor. Nevertheless, Ireland retains investment grade ratings from both Fitch and S&P. More recently, however, following the 21 July decisions by EU Heads of State or Government on strengthening the EU crisis management framework, Irish sovereign spreads have significantly declined (Graph 11), as Ireland stands to gain substantially from extended maturities, lower interest margins, and strong EU support until it regains market access.

Graph 10: Ireland Sovereign ratings



Source: Bloomberg

Graph 11: Sovereign spreads (ten year)



Source: Bloomberg

Risks to the programme remain significant, stemming mostly from the lingering uncertainty about the broader euro area sovereign debt market situation and the euro area/IMF strategy to deal with it. In addition, Ireland-specific macroeconomic risks may also emerge. Besides the anticipated drags on domestic demand (tight credit, expected ECB rate hikes further weighing on disposable income), Ireland's recovery is highly dependent on exports maintaining their momentum, which will be particularly challenging if the apparent soft patch in the global recovery becomes more pronounced. Finally, there are political risks associated with consolidation fatigue.

5. APPRAISAL

The authorities are to be commended for continued strong programme implementation. Despite strong headwinds at home (mostly reflecting the contractionary effects of a sizeable fiscal consolidation combined with the necessary balance sheet repairing and high unemployment) and large external shocks to confidence, programme objectives are being steadfastly advanced. Revenue performance has not suffered from weakening tax compliance, as is often the case in circumstances of economic distress, and effective expenditure control keeps outlays well in line with the budget. Despite formidable legal and technical challenges, the implementation of the banking sector strategy proceeds as scheduled, and its cost to the budget looks set to be significantly below both the original programme envelope (EUR 35 billion) and the gross recapitalisation need (EUR 24 billion) as calculated in the 2011 PCAR/PLAR. Most importantly, program ownership on the part of the government remains strong.

Fiscal consolidation is progressing well, but the task ahead is still very demanding. So far, effective measures have been introduced to meet the fiscal deficit limits set in the context of the excessive deficit procedure.[8] The fiscal consolidation strategy, which will set public debt on a downward path beginning from 2013-14, calls for additional sizeable efforts in the coming years. Policy credibility would benefit from combining the strong track record thus far with early clarity on the specific measures that the government wants to introduce to better reflect its priorities. Staff therefore looks forward to discussing the authorities' plans in this regard in the context of the next review mission. Important and difficult policy decisions will need to be taken detailing fiscal consolidation measures for the years ahead. Another

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[8] Documents on country-specific excessive deficit procedures are available at this link: http://ec.europa.eu/economy_finance/sgp/deficit/countries/index_en.htm

area where clarification of plans would be highly beneficial is the management of state assets, which could greatly contribute to the economy's overall competitiveness as well as to alleviating the State's financing needs including after the programme.

The implementation of the financial sector reform strategy will continue to be challenging in the near term. The deleveraging of non-core assets is expected to accelerate, helped by an apparently stronger than previously expected demand for assets held abroad by the Irish banks. The restructuring of the domestic banks, which is well underway, has to continue with the ultimate goal of restoring a viable banking sector capable of serving the Irish economy by providing a wide range of products at competitive conditions. The confidence built in this area with the transparent and prudent approach adopted in the 2011 PCAR/PLAR exercise needs to be further enhanced. From this perspective, the way in which the relationship between the State as a shareholder and the banks is shaped will have a significant bearing on the ultimate appeal these banks will have for private investors, once they are restructured and right-sized to the need of the economy. Therefore, it is important to strike the right balance between a more active role, which might be necessary in the early stages to ensure that the banks—whose management is new or being renewed—fully internalize the interests of their main shareholder, and the risks of portraying an excessive involvement in the banks' operations.

Structural reforms are also expected to accelerate. The finding by the High Court that some sectoral wage-setting arrangements are unconstitutional redoubles the urgency of reform in this area. The authorities' commitment to seek a radical reform, going even beyond what recommended by the recent independent review of the EROs/REAs, is welcome, as eliminating any impediments to job creation/reallocation, while safeguarding basic workers' rights, is essential to ensure that the emerging recovery benefits all.

Continued steadfast program implementation remains crucial. As Moody's 12 July downgrade to sub-investment grade shows, Ireland is strongly exposed to contagion. Only successful fiscal consolidation, improved competitiveness, and return to growth will over time convince currently highly sceptical investors that Ireland's public debt is sustainable. The best strategy for Ireland in this environment is to maintain its strong track record on program implementation.

LIST OF ABBREVIATIONS

ECB	European Central Bank
IMF	International Monetary Fund
EFC	Economic and Financial Committee
UK	The United Kingdom of Great Britain and Northern Ireland
EFSM	European Financial Stabilisation Mechanism
EFSF	European Financial Stability Facility
PMI	Purchasing Managers Index
GDP	Gross domestic product
HICP	Harmonised Index of Consumer Prices
HoSG	Heads of State or Government
EC	European Commission
EDP	Excessive deficit procedure
VAT	Value Added Tax
LME	Liability Management Exercise
SLO	Subordinated Liability Order
AIB	Allied Irish Bank
PLAR	Prudential Liquidity Assessment Review
PCAR	Prudential Capital Assessment Review
INBS	Irish Nationwide Building Society
ILP	Irish Life & Permanent
NAMA	National Asset Management Agency
BoI	Bank of Ireland
EBS	Educational Building Society
MoU	Memorandum of Understanding
DoF	Department of Finance
MEFP	Memorandum of Economic and Financial Policies
IFRS	International Financial Reporting Standards
CCR	Centralized Credit Registry
EROs	Employment Regulation Orders
REAs	Registered Employment Agreements

ANNEX 1: COMMISSION SERVICES' MACROECONOMIC PROJECTIONS

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

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	-1.4	-7.3	-0.9	-2.4	-1.0	0.5	1.8	1.7
2. Government consumption expenditure	1.2	-3.7	-3.1	-3.0	-1.5	-3.0	-4.8	-2.9
3. Gross fixed capital formation	-10.1	-28.8	-25.1	-10.7	1.6	4.8	5.1	5.5
4. Final domestic demand	**-3.4**	**-11.7**	**-5.8**	**-3.7**	**-0.8**	**0.3**	**0.8**	**1.4**
5. Change in inventories								
6. Domestic demand	**-4.0**	**-12.5**	**-4.9**	**-3.5**	**-0.7**	**0.3**	**0.8**	**1.4**
7. Exports of goods and services	-1.1	-4.2	6.3	6.0	5.2	4.9	4.9	4.9
7a. - of which goods	-0.3	-5.4	5.6	6.0	5.2	4.9	4.9	4.9
7b. - of which services	-2.0	-2.8	7.1	6.0	5.2	4.9	4.9	4.9
8. Final demand	**-2.6**	**-8.5**	**0.9**	**1.8**	**2.7**	**3.0**	**3.3**	**3.5**
9. Imports of goods and services	-3.3	-9.5	2.7	3.2	3.8	3.7	3.7	4.1
9a. - of which goods	-13.0	-17.3	-1.8	3.0	4.0	3.9	3.8	4.1
9b. - of which services	5.5	-3.8	5.4	3.3	3.6	3.6	3.6	4.1
10. Gross domestic product at market prices	**-3.0**	**-7.0**	**-0.4**	**0.6**	**1.9**	**2.4**	**3.0**	**3.0**
Contribution to change in GDP								
11. Final domestic demand	-3.0	-10.8	-5.0	-3.0	-0.6	0.2	0.6	1.0
12. Change in inventories + net acq. of valuables	-0.6	-0.7	0.9	0.2	0.1	0.0	0.0	0.0
13. External balance of goods and services	1.2	3.4	3.7	3.4	2.4	2.2	2.4	2.0

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

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	1.7	-11.3	-3.0	-1.1	-0.3	2.1	3.6	3.7
2. Government consumption expenditure	5.2	-4.4	-7.7	-2.5	-1.2	-2.2	-4.2	-2.0
3. Gross fixed capital formation	-18.6	-35.9	-28.7	-11.7	2.1	8.0	9.8	11.0
4. Final domestic demand	**-3.4**	**-15.8**	**-8.7**	**-2.9**	**-0.2**	**1.9**	**2.8**	**3.6**
5. Change in inventories	-156.2	275.7	-64.5	-37.9	-23.9	3.0	-11.0	0.0
6. Domestic demand	**-4.3**	**-16.9**	**-7.8**	**-2.7**	**-0.1**	**1.9**	**2.8**	**3.6**
7. Exports of goods and services	-1.4	-2.8	8.1	7.9	6.6	5.9	5.9	5.9
8. Final demand	**-3.0**	**-10.2**	**0.4**	**3.2**	**3.8**	**4.3**	**4.7**	**5.0**
9. Imports of goods and services	-1.1	-9.6	5.7	5.7	4.9	4.9	4.8	5.2
10. Gross national income at market prices	-5.5	-14.6	-4.8	0.2	1.1	2.5	4.0	4.5
11. Gross value added at basic prices	-3.9	-9.3	-3.9	2.1	3.2	3.6	4.3	5.1
12. Gross domestic product at market prices	**-5.2**	**-10.8**	**-2.9**	**1.1**	**2.8**	**3.8**	**4.6**	**4.9**

Table 3: Implicit price deflators

% change in implicit price deflator	2008	2009	2010	2011	2012	2013	2014	2015
1. Private consumption expenditure	3.1	-4.3	-2.1	1.3	0.7	1.6	1.8	1.9
2. Government consumption expenditure	4.0	-0.7	-4.7	0.6	0.3	0.9	0.7	0.9
3. Gross fixed capital formation	-9.4	-10.0	-4.8	-1.1	0.5	3.0	4.4	5.2
4. Domestic demand	**-0.3**	**-5.0**	**-3.1**	**0.8**	**0.6**	**1.7**	**2.0**	**2.2**
5. Exports of goods and services	-0.4	1.4	1.7	1.8	1.3	1.0	1.0	1.0
6. Final demand	**-0.4**	**-1.8**	**-0.5**	**1.4**	**1.0**	**1.2**	**1.4**	**1.5**
7. Imports of goods and services	2.3	0.0	2.9	2.5	1.1	1.1	1.1	1.1
8. Gross domestic product at market prices	**-2.3**	**-4.1**	**-2.4**	**0.5**	**0.9**	**1.4**	**1.6**	**1.8**
HICP	**3.1**	**-1.7**	**-1.6**	**1.1**	**0.6**	**1.4**	**1.6**	**1.8**

Table 4: Labour market and cost

Annual % change	2008	2009	2010	2011	2012	2013	2014	2015
1. Labour productivity	-1.9	1.3	3.9	2.6	2.0	1.9	1.7	0.8
2. Compensation of employees per head	5.5	-1.2	-3.2	0.1	0.4	1.2	1.2	1.6
3. Unit labour costs	6.6	-4.6	-5.9	-3.3	-1.9	-0.5	-0.1	0.6
4. Total population	1.6	0.8	0.3	0.0	0.2	0.4	0.5	0.5
5. Population of working age (15-64 years)	1.0	-0.1	-0.8	-1.0	-0.8	-0.2	-0.1	0.1
6. Total employment	-1.1	-8.1	-4.2	-1.9	-0.1	0.5	1.3	2.2
7. Calculated unemployment rate - Eurostat definition (%)	6.3	11.8	13.6	14.3	13.8	13.3	12.6	11.5

Table 5: External balance

levels	2008	2009	2010	2011	2012	2013	2014	2015
1. Exports of goods (fob)	81.0	77.6	82.9	87.9	93.7	99.2	105.1	111.4
2. Imports of goods (fob)	57.2	45.2	46.4	49.7	52.1	54.8	57.6	60.6
3. Trade balance (goods, fob/fob) (1-2)	**23.8**	**32.5**	**36.5**	**38.3**	**41.6**	**44.5**	**47.5**	**50.7**
3a. p.m. (3) as % of GDP	*13.2*	*20.2*	*23.4*	*24.3*	*25.7*	*26.4*	*27.0*	*27.5*
4. Exports of services	69.1	68.3	74.7	82.2	87.6	92.8	98.4	104.2
5. Imports of services	76.7	75.9	81.5	85.6	89.8	94.0	98.4	103.5
6. Services balance (4-5)	**-7.5**	**-7.6**	**-6.7**	**-3.4**	**-2.2**	**-1.2**	**0.0**	**0.8**
6a. p.m. 6 as % of GDP	*-4.2*	*-4.7*	*-4.3*	*-2.1*	*-1.4*	*-0.7*	*0.0*	*0.4*
7. External balance of goods & services (3+6)	**16.3**	**24.9**	**29.8**	**34.9**	**39.4**	**43.3**	**47.5**	**51.5**
7a. p.m. 7 as % of GDP	*9.1*	*15.5*	*19.1*	*22.1*	*24.3*	*25.7*	*27.0*	*27.9*
8. Balance of primary incomes and current	-25.2	-29.1	-29.0	-32.1	-35.0	-38.0	-40.4	-42.8
8a. - of which, balance of primary income	*-22.7*	*-27.0*	*-26.7*	*-29.7*	*-32.6*	*-35.6*	*-38.0*	*-40.4*
8b. - of which, net current Transfers	*-2.5*	*-2.1*	*-2.3*	*-2.4*	*-2.4*	*-2.4*	*-2.4*	*-2.5*
8c. p.m. 8 as % of GDP	*-14.0*	*-18.1*	*-18.6*	*-20.3*	*-21.6*	*-22.6*	*-22.9*	*-23.2*
9. Current external balance (7+8)	**-8.9**	**-4.2**	**0.7**	**2.8**	**4.4**	**5.3**	**7.1**	**8.7**
9a. p.m. 9 as % of GDP	-4.9	-2.6	0.5	1.8	2.7	3.2	4.0	4.7
10. Net capital transactions	0.0	-1.3	-1.4	-0.4	-0.7	-0.4	-0.4	-0.4
11. Net lending (+)/ net borrowing (-) (9+10)	**-8.9**	**-5.5**	**-0.7**	**2.4**	**3.7**	**4.9**	**6.7**	**8.3**
11a. p.m. 11 as % of GDP	*-4.9*	*-3.4*	*-0.4*	*1.5*	*2.3*	*2.9*	*3.8*	*4.5*

Table 6: Fiscal accounts

	2008	2009	2010	2011	2012	2013	2014	2015
				% of GDP				
Indirect taxes	12.4	11.3	11.4	11.7	11.3	11.3	11.6	11.3
Direct taxes	11.5	10.6	10.5	12.1	12.9	13.2	13.4	13.3
Social contributions	7.0	7.2	7.3	6.3	6.2	6.0	6.0	6.1
Sales	1.7	2.1	2.3	2.2	1.9	1.8	1.8	1.8
Other current revenue	1.8	1.7	1.9	1.7	1.5	1.3	1.2	1.2
Total current revenue	**34.3**	**32.9**	**33.5**	**34.0**	**33.8**	**33.6**	**33.9**	**33.7**
Capital transfers received	1.2	0.8	0.7	0.9	0.9	0.9	0.8	0.8
Total revenue	**35.5**	**33.7**	**34.2**	**34.8**	**34.7**	**34.5**	**34.8**	**34.5**
Compensation of employees	11.3	12.2	11.6	11.4	10.8	10.2	9.5	9.1
Intermediate consumption	5.5	5.8	5.9	5.2	5.0	4.6	4.1	3.6
Social transfers in kind via market producers	2.0	2.1	2.2	2.0	1.8	1.6	1.4	1.2
Social transfers other than in kind	12.4	15.2	15.7	15.5	14.4	13.6	12.9	12.3
Interest paid	1.4	2.1	3.2	3.9	4.7	6.2	6.3	6.2
Subsidies	0.5	0.5	0.7	0.7	0.6	0.5	0.4	0.4
Other current expenditure	2.5	2.6	2.5	2.5	2.4	2.3	2.2	2.1
Total current expenditure	**35.6**	**40.5**	**41.8**	**41.2**	**39.8**	**39.0**	**36.8**	**34.9**
Gross fixed capital formation	5.3	4.1	3.8	2.9	2.5	2.2	1.9	1.8
Other capital expenditure	1.9	3.3	20.5	1.0	1.1	0.8	0.7	0.7
Total expenditure	**42.8**	**47.9**	**66.2**	**45.1**	**43.4**	**41.9**	**39.4**	**37.3**
General Government balance (EDP)	**-7.3**	**-14.2**	**-32.0**	**-10.2**	**-8.6**	**-7.5**	**-4.6**	**-2.9**
				% change				
Indirect taxes	-11.6	-18.8	-1.4	3.2	-0.9	4.2	7.2	2.7
Direct taxes	-13.9	-17.3	-4.0	16.2	10.0	5.8	6.1	4.4
Social contributions	2.5	-8.4	-1.6	-12.5	0.9	1.4	3.8	6.2
Sales	-1.0	10.4	9.3	-5.0	-9.9	-4.9	4.0	4.5
Other current revenue	38.1	-13.6	8.3	-7.6	-9.4	-9.9	-1.5	2.8
Total current revenue	**-7.7**	**-14.5**	**-1.1**	**2.7**	**2.3**	**3.2**	**5.6**	**4.1**
Capital transfers received	-26.4	-36.7	-18.6	24.7	7.0	-0.5	1.3	4.3
Total revenue	**-8.4**	**-15.2**	**-1.5**	**3.2**	**2.4**	**3.1**	**5.5**	**4.1**
Compensation of employees	6.8	-3.6	-7.3	-1.2	-2.5	-1.9	-2.4	0.3
Intermediate consumption	3.9	-6.2	-1.9	-9.9	-2.2	-3.7	-7.7	-7.0
Social transfers in kind via market producers	10.8	-5.7	-0.4	-4.9	-7.0	-11.1	-8.3	-6.4
Social transfers other than in kind	13.1	9.1	0.2	0.1	-4.5	-1.9	-1.1	-0.1
Interest paid	24.8	33.2	52.1	22.7	24.1	35.4	7.2	2.2
Subsidies	7.9	-8.9	33.5	-6.7	-5.1	-19.3	-5.3	-5.3
Other current expenditure	4.1	-7.9	-5.6	-0.6	0.0	0.0	0.0	0.0
Total current expenditure	**9.1**	**1.3**	**0.3**	**-0.3**	**-0.8**	**1.8**	**-1.2**	**-0.6**
Gross fixed capital formation	6.9	-30.1	-9.9	-24.6	-9.5	-9.8	-10.9	0.0
Other capital expenditure	77.2	55.1	507.8	-95.0	9.1	-23.5	-2.8	0.0
Total expenditure	**10.7**	**-0.2**	**34.2**	**-31.1**	**-1.1**	**0.5**	**-1.7**	**-0.6**
Nominal GDP, EUR bn	180.0	160.6	156.0	157.7	162.1	168.3	176.1	184.7

Note:

The general government projections include the measures announced in the National Recovery Plan and the budget for 2011. Measures for 2012-14 are subject to revision following the Comprehensive Review of Expenditure, with possible effect on GDP growth composition. In 2015, an additional consolidation effort of more than EUR 2 bn is assumed.

Table 7: Debt developments

	2008	2009	2010	2011	2012	2013	2014	2015
EDP deficit (% of GDP)	**-7.3**	**-14.2**	**-32.0**	**-10.2**	**-8.6**	**-7.5**	**-4.6**	**-2.9**
EDP gross debt (% of GDP)	44.4	65.2	94.9	109.9	116.2	119.4	117.6	113.9
				levels, EUR bn				
EDP deficit	**-13.2**	**-22.8**	**-49.9**	**-16.1**	**-14.0**	**-12.6**	**-8.2**	**-5.3**
Gross debt	79.8	104.8	148.1	173.4	188.4	201.0	207.1	210.4
Change in gross debt	32.5	24.9	43.3	25.4	15.0	12.5	6.1	3.3
Nominal GDP	180.0	160.6	156.0	157.7	162.1	168.3	176.1	184.7
Real GDP	144.7	134.6	134.0	134.9	137.4	140.7	144.9	149.3
Real GDP growth (% change)	**-3.0**	**-7.0**	**-0.4**	**0.6**	**1.9**	**2.4**	**3.0**	**3.0**
Change in gross debt (% of GDP)	18.0	15.5	27.8	16.1	9.2	7.4	3.5	1.8
Stock-flow adjustments (% of GDP)	10.7	1.3	-4.2	5.8	0.6	0.0	-1.2	-1.1
				% of GDP				
Gross debt ratio	**44.4**	**65.2**	**94.9**	**109.9**	**116.2**	**119.4**	**117.6**	**113.9**
Change in gross debt ratio	19.4	20.9	29.7	15.0	6.3	3.2	-1.8	-3.7
				Contribution to change in gross debt				
Primary balance	6.0	12.1	28.8	6.3	3.9	1.3	-1.7	-3.3
"Snow-ball" effect	2.8	7.6	5.2	2.9	1.8	1.9	1.1	0.7
of which								
Interest expenditure	*1.4*	*2.1*	*3.2*	*3.9*	*4.7*	*6.2*	*6.3*	*6.2*
Real growth effect	*0.8*	*3.5*	*0.3*	*-0.6*	*-2.0*	*-2.7*	*-3.4*	*-3.4*
Inflation effect	*0.6*	*2.0*	*1.6*	*-0.4*	*-1.0*	*-1.6*	*-1.8*	*-2.0*
Stock-flow adjustments	**10.7**	**1.3**	**-4.2**	**5.8**	**0.6**	**0.0**	**-1.2**	**-1.1**
Implicit interest rate	*5.2*	*4.1*	*4.8*	*4.2*	*4.4*	*5.5*	*5.5*	*5.5*

Notes:

Gross debt projections include injections of EUR 18 bn of fresh capital into the banking system in 2011. Cash balances remain at around EUR 13bn in 2010-15.

ANNEX 2: PROGRAMME DOCUMENTS

LETTER OF INTENT

Dublin, 28 July 2011

Mr. Jean-Claude Juncker
Eurogroup President
Ministère des Finances
3, rue de la Congrégation
L-1352
Luxembourg

Mr. Olli Rehn
Commissioner for Economic and Financial Affairs
European Commission
BERL 10/299
B-1049 Brussels
Belgium

Mr. Jan Vincent Rostowski
Minister of Finance
Ul Swietokrzyska 12
PL-00-916 WARSZAWA
Poland

Mr. Jean-Claude Trichet
President
European Central Bank
Kaiserstrasse 29
60311 Frankfurt am Main
Germany

Dear Messrs. Juncker, Rehn, Rostowski and Trichet,

1. The Irish Government reaffirms its commitment to making this programme a success. Our track record to date is strong. We have met and in some important cases exceeded our commitments under the EU/IMF supported programme both in terms of policy reforms as well as quantitative targets. (MEFP Tables 1 and 2). This has been the case from the outset

of the programme. Furthermore we note that the commitments undertaken in Budget 2011 are on track and that after three years of decline economic growth has turned positive this year. Our ambitious financial sector reforms are also proceeding satisfactorily. However, despite this strong start financial market conditions for Irish Government paper have deteriorated. The widespread uncertainty surrounding the euro area has been a significant factor in this. In this regard, the recent moves to strengthen euro area financial assistance mechanisms are welcomed as a significant positive step which could lead to a much more favourable assessment of the medium term prospects for programme countries generally and Ireland specifically. These reflect the position that has been adopted by Government publicly on a number of occasions that the design changes now being proposed – particularly in the areas of pricing, flexibility for the funding instruments and greater use of guarantees – could form part of a redesigned European support arrangement. We would hope that further consideration will prove positive and look forward to your support for these initiatives.

2. Policy implementation since the review conducted last spring has been determined. We have met (and in some cases exceeded) all our commitments under the EU/IMF-supported programme, and are well on track to meet the programme's remaining quantitative and reform milestones:

- The cumulative deficit for the first six months of the year was well below the adjusted programme ceiling, and the net central government debt was below the programme's indicative ceiling. We are on track to observe, and indeed overachieve, the programme target on the overall deficit for 2011 as a whole of 10.6% of GDP.

- The recapitalisation of Allied Irish Banks, Bank of Ireland, Irish Life and Permanent and EBS Building Society will be completed (net of the remaining liability management exercises and disposal of ILP’s insurance arm).

- The Government has established the Irish Fiscal Advisory Council to provide an independent assessment of public finances.

- The credit unions were inspected between July 2010 and March 2011 to complete an assessment of their loan portfolios.

- The legal merger of Allied Irish Banks and EBS Building Society was completed on 1 July 2011, well ahead of the end September 2011 schedule.

- The merger of Anglo Irish Bank and Irish Nationwide Building Society to form the Irish Bank Resolution Company (IBRC) was completed on 1 July 2011, well ahead of its scheduled end December 2011 deadline.

- A joint restructuring plan for Anglo and INBS (now the IBRC) has been submitted to and approved by the European Commission

- A plan to recapitalise Irish Life & Permanent has been finalised, again ahead of schedule and the Irish Life subsidiary has been already offered for sale again in advance of the October 2011 deadline.

- The Central Bank (Supervision and Enforcement) Bill 2011 will be submitted to the Oireachtas by 31 July 2011.

3. In the attached Memorandum of Economic and Financial Policies (MEFP) and Memorandum of Understanding on Specific Economic Policy Conditionality (MoU), we set out our plans to further advance towards meeting the objectives laid out in our programme supported by the EU and the IMF. 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 third review. Overall financing needs have not changed. We request the release of the third EU instalment of EUR 5.5 billion. This would include planned disbursement of EUR 2.5 billion in the third quarter and enable EUR 3 billion to be disbursed during the first half of the fourth quarter before finalisation of the fourth review, allowing the disbursement of EUR 7.2 billion previously agreed to be spread over that quarter.

4. We are confident that the policies set forth in the Letters of Intent of 3 December 2010, on 28 April 2011, and in this letter are adequate to achieve the objectives of our programme. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. We will continue to consult with the Fund, the European Commission and the ECB on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum.

5. This letter is being copied to Ms 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

(SECOND UPDATE)

3 September 2011

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 second 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[9] 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. 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 tight supervision of expenditure commitments by the line departments, and effective tax collection, to ensure that the primary deficit target in cash (see Table 1 of

[9] 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.

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.

- 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 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.

1. Actions for the fourth review (actions to be completed by end Q3-2011)

i. Fiscal consolidation

- Government will review the achieved and projected savings arising from efficiency-enhancing administrative measures and from reductions in public service numbers and present appropriate adjustment measures, including to the overall public service wage bill, to ensure consistency with the fiscal adjustment targets over the programme horizon.

ii. Financial sector reforms

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

Recapitalisation

- The Irish authorities will ensure that the capital needs of Bank of Ireland (BoI), Allied Irish Banks (AIB), Educational Building Society (EBS) and Irish Life & Permanent (IL&P),

as identified in the 2011 Prudential Capital Assessment Review (PCAR) have been fully met by 31 July 2011, subject to appropriate adjustments for asset sales of IL&P and for pending Liability Management Exercises for BoI and IL&P. These adjustments reduce the amount to be injected by 31 July 2011 by EUR 1.1 billion for IL&P and EUR 0.5 billion for BoI.

Deleveraging

- The Irish authorities will ensure that the banks covered by the Prudential Liquidity Assessment Review (PLAR) will have identified the separation of their core and non-core assets and have implemented the appropriate governance structure for the deleveraging of non-core assets.

- In the area of asset disposal monitoring, in the near term focus will be on assessing bank targets for the quantum of asset disposal requirements, derived from their deleveraging programmes established to meet the PLAR target loan to deposit ratios (LDRs), which will be closely monitored. In line with the monitoring system set up, actual and forecast LDRs and asset disposals shall be reported by the banks to the Central Bank of Ireland every six months (first report by 31 July 2011). Such reports will include (i) progress achieved towards interim target; (ii) forecast of LDR for the end of the next period; (iii) a detailed plan of action to meet the next interim target; and (iv) actual and planned asset disposals. If actual or forecast asset disposals fail to meet the interim targets, the Irish authorities will inform the European Commission, IMF, and ECB within 14 days of becoming aware of such failure. The Central Bank will then oversee the remedial actions to be taken by any bank in question including a prompt timetable for their implementation. In addition to providing the six-monthly report, the Irish authorities will update the European Commission, the IMF and the ECB on progress in the intervening quarters.

- The Irish authorities, in consultation with the European Commission, IMF, and ECB, will monitor closely the evolution of Net Stable Funding Ratios (NSFR) and the Liquidity Coverage Ratios (LCR) of the banks in order to ensure convergence to Basel 3 standards by the relevant dates.

Financial Supervision

- The Irish 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 with the European Commission, the ECB and the IMF.

- Building on the restructuring undertaken to date, the Irish authorities will submit restructuring plans to the European Commission by 31 July 2011 in accordance with EU competition rules, taking into account the outcomes of the PCAR and PLAR and covering a period of 5 years. These plans will also be made available to the IMF and the ECB. Except where otherwise agreed with the European Commission, commitments already undertaken by the Irish authorities in the context of EU competition decisions will be maintained.

- Government will, by 31 July 2011, introduce legislation (titled "The Central Bank (Supervision and Enforcement) Bill 2011") strengthening the ability of the Central Bank of Ireland to impose and supervise compliance with regulatory requirements and to undertake timely prudential interventions. The Bill will provide the Central Bank of Ireland with greater access to information and analysis and will underpin the credible enforcement of Irish financial services legislation in line with international best practice.

- The Department of Finance will submit to the Minister for Finance proposals to enhance the quality and availability of credit information available to credit providers by 30 September 2011.

iii. Structural reforms

Labour market reforms

- Government will report on reforms to strengthen the labour market activation system and its links to unemployment support schemes in the fight against long-term unemployment.

- Government will discuss with European Commission Services the main findings of the independent reviews of Registered Employment Agreements (REAs) and Employment Regulations Orders (EROs) arrangements, and present a time-bound comprehensive action plan to follow up on its recommendations, taking into consideration the implications of the 6 July 2011 High Court ruling which found that sections of legislation governing wage-setting mechanisms in EROs are unconstitutional.

To increase competition

- Government will introduce legislative changes to remove restrictions to trade and competition in sheltered sectors including:
    - the legal profession, establishing an independent regulator for the profession and implementing the recommendations of the Legal Costs Working Group and outstanding Competition Authority recommendations to reduce legal costs.
    - medical services, eliminating restrictions on the number of general practitioners (GPs) qualifying and removing restrictions on GPs wishing to treat public patients as well as restrictions on advertising.

- Government will introduce legislation to strengthen competition law enforcement in Ireland 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 as well as ensuring the effective functioning of the Competition Authority, which will be merged with the National Consumer Agency

- The Irish authorities will agree with European Commission Services a time-bound action plan to implement the recommendations of the study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers.

- An independent assessment of the electricity and gas sectors will commence taking due account of the EU regulatory context for these sectors.

iv. Structural fiscal reforms

To underpin medium-term ceilings and identify savings and efficiencies

- The Irish authorities will complete a comprehensive review of expenditure (CRE) which will form the basis for the allocation of binding multi-year expenditure ceilings by expenditure vote group consistent with the aggregate expenditure envelope underpinning the government's fiscal targets under the EU/IMF financial assistance programme and the Stability and Growth Pact provisions.

To put the public service pension system on a more sustainable basis

- Pension entitlements for new entrants to the public service will be reformed with effect from 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New entrants' retirement age will also be linked to the Social Welfare pension retirement age.

To facilitate better government at a local level

- Government will ensure that effective measures are in place to cap the contribution of the local government sector to general government borrowing at an acceptable level. The mechanisms in place to underpin this position will be kept under close review, in consultation with the European Commission Services. The review will also consider how to provide data on the financial position including assets and liabilities of the sector on a timely basis.

2. Actions for the fifth review (actions to be completed by end Q4-2011)

v. Fiscal consolidation

- Following the conclusion of the CRE, government will, by end-October 2011, present the Pre-Budget Outlook to the Dáil, setting out a medium-term fiscal consolidation plan for 2012 – 2015 outlining the overall composition of revenue and expenditure adjustments for each year, consistent with the targets set out in the Council Recommendation in the context of the excessive deficit procedure. Moreover, by 2012 Budget day in early December 2011, Government will anchor this consolidation plan in binding medium-term expenditure cash ceilings and will set out revenue and expenditure measures to deliver the needed adjustment.

- Government will propose a budget for 2012 aiming to further reduce 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 amounting to at least €3.6bn. The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2012:

- Revenue measures to yield EUR1,500m[10] in a full year will be introduced, including:
  - A lowering of personal income tax bands and credits.
  - A reduction in private pension tax reliefs.
  - A reduction in general tax expenditures.
  - A property tax.
  - A reform of capital gains tax and acquisitions tax.
  - An increase in the carbon tax.
- Expenditure reduction of EUR 2,100m including:
  - Social expenditure reductions.
  - Reduction of public service numbers and public service pension adjustments.
  - Other programme expenditure, and reductions in capital expenditure.

The CRE will be completed in September 2011. The budgetary measures outlined above will be examined by the government in the light of the findings of the CRE and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, the government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral

vi. Financial sector reforms

- Government will ensure that the originally agreed recapitalisation of BoI is completed, including by providing public funds for any remaining capital needs net of the burden sharing in BoI. (See section 1.ii above). If the sale of IL&P's insurance arm is completed, any remaining capital needs in IL&P will be provided for (to be reviewed in October 2011).
- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.

[10] Inclusive of 2011 carryover

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 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 NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

Reorganisation

- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions on the basis of the restructuring plans and discuss it with staff of the European Commission, the ECB and the IMF.
- The Irish authorities, in consultation with the External Partners will review the restructuring plan for IL&P due by end July and, as necessary, set out by end October the relevant follow-on actions.

Credit unions

- The Irish authorities will implement the strategy to underpin the solvency and viability of the credit union sector. Steps will be taken to deal with weaknesses in the most troubled institutions, including restrictions on their operations where appropriate. Commencing in this quarter, the authorities will take all the necessary actions to restructure the sector and address difficulties in individual credit unions while minimising any fiscal cost, and will identify solutions within the sector, as well as specify additional funding arrangements in case they are needed to complete this process. This restructuring process will take account of the interim report of the Commission on Credit Unions.

- The Irish authorities will submit legislation to the Dáil to strengthen the regulatory framework for credit unions including more effective governance and regulatory requirements.

Financial supervision

- The Irish 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 with the European Commission, the ECB and the IMF.
- The Central Bank of Ireland will issue guidance to banks for the recognition of accounting losses incurred in their loan book. Specifically, the Central Bank of Ireland will begin requiring the banks: (i) on core assets, to increase the consistency and conservatism in their impairment triggers and provisioning model inputs including *inter alia*: period of arrears, emergence periods, cure rates and collateral value, and treatment of restructured loans and forbearance; (ii) on non-core assets (assets under deleveraging) to provision to reflect losses arising from their planned disposal, taking account as appropriate of the

PLAR/PCAR analysis. The Central Bank of Ireland will develop these new requirements with assistance of an internationally recognised auditing firm to ensure consistency with International Financial Reporting Standards (IFRS).

- The Central Bank of Ireland will publish new guidelines for the valuation of collateral for bank loans by end December 2011.

vii. Structural reforms

To prepare for the introduction of water charges

- Government will prepare proposals for implementation of the recommendations of the independent assessment of transfer of responsibility for water service provision from local authorities to a water utility in consultation with European Commission Services with a view to starting charging during the EU/IMF Programme period.

To better target social support expenditure

- The Department of Social Protection will build on their recent studies on working age payments, child income support and disability allowance with a view to producing, after consultation with stakeholders, a comprehensive programme of reforms that can help better target social support to those on lower incomes, and ensure that work pays for welfare recipients. To this end, the Department will submit a progress report by end-December 2011.

viii. Structural fiscal reforms

To reinforce the credibility of the budgetary process

- 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, fiscal rules and the Fiscal Advisory Council. This will give a statutory basis to the Council and ensure its independence with due regard to the role that nomination and appointment/dismissal procedures can play and to medium-term budget allocations.

To further reform key sectors of the economy

- Government will consider options for an ambitious programme of asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. Government will prepare a draft programme of asset disposals in this context and discuss it with the staff of the European Commission, the IMF and the ECB by end-December 2011 in advance of taking final decisions on the programme to be pursued. The draft programme will include the identification of the potential assets to be disposed, any necessary regulatory changes and a timetable for implementation.

- Finance Bill 2012 will contain necessary provisions to bring into effect the already signalled VAT increases in 2013 and 2014.

x. Financial sector reforms

- The Irish authorities will agree the terms of reference for the PCAR 2012.
- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).
- The Irish authorities, in consultation with 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 Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish 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 European Commission, the ECB and the IMF.

xi. Structural reforms

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

To better target 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.

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

xii. Financial sector reforms

- The PCAR for 2012 will be completed. Before publication, the results of the PCAR for 2012 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by

30 June 2012. Based on these results, the authorities will ensure that banks are adequately capitalised.

- 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 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 NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

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

- The Irish 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.

xiii. Structural reforms

To assist in covering financing needs and to increase competition

- 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 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.

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

xiv. Financial sector reforms

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4^{th} Review (Q3 – 2011).

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

- The Irish 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.

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

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

xv. 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 amounting to at least EUR 3,100m. The EU/IMF Programme of Financial Support for Ireland agreed in December 2010 provides for the following commitments in relation to measures for 2013:
  - Revenue measures to raise at least EUR 1,100m[11] in the full year will be introduced, including:
    - A lowering of personal income tax bands and credits
    - A reduction in private pension tax relief.
    - A reduction in general tax expenditures.
    - An increase in property tax.
  - Expenditure reductions of no less than EUR 2,000m, including:
    - Social expenditure reductions.
    - Reduction of public service numbers and public service pension adjustments.
    - Other programme expenditure, and reductions in capital expenditure.

The budgetary measures outlined above will be examined by the government in the light of the findings of the CRE and the Programme for Government. Based on the CRE and in consultation with the European Commission, the IMF and the ECB, government will introduce budgetary changes which will aim to fully realise efficiencies identified, while remaining fiscally neutral.

xvi. Financial sector reforms

- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.

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[11] Inclusive of carryover from 2012.

- 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 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 NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.
- The Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish 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.

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

xvii. Financial sector reforms

- The Irish authorities will agree the terms of reference for the PCAR 2013.
- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).
- The Irish authorities, in consultation with 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 Irish authorities will report on progress in implementing the strategy for the reorganisation of Irish credit institutions and discuss it together with the European Commission, the ECB and the IMF.
- The Irish 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.

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

xviii. Financial sector reforms

- The PCAR for 2013 will be completed. Before publication, the results of the PCAR for 2013 will be assessed, together with European Commission, the ECB and the IMF. The results and methodology used will then be published in detail and on a bank-by-bank basis by 30 June 2013. Based on these results, the Irish authorities will ensure that banks are adequately capitalised.
- 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 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 NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

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

- The Irish 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.

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

xix. Financial sector reforms

- Asset disposal monitoring – as per requirement under Financial Sector Reforms in 4th Review (Q3 – 2011).

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

- The Irish 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.

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

xx. Financial sector reforms

- The Irish authorities will report on the evolution of the capital within the banks covered by the PCAR.

- A final report of the banks' implementation of their deleveraging plans under the PLAR 2011 and their compliance with the LDR target 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 NSFR and the LCR in order to ensure convergence to Basel 3 standards by the relevant dates.

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

- The Irish 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.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF staffs by the 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 enterprises (interest and amortisation)	Quarterly, 30 working days after the end of each 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.
F11	Report on progress achieved towards interim PLAR targets and actual and planned asset disposals.	Quarterly, 10 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, next working day

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 central government.	Monthly , 30 working days after the end of each month
N.5	Updated estimates of financial sources (bonds issuance, other financing sources) for the banking and government sectors 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	The Central Bank will provide details on the aggregate monetary balance sheet of all Irish authorised credit institutions, EEA and non-EEA branches on a monthly basis.	Monthly, on the last working day of the following month
C.3	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.4	Consolidated balance sheet information for the domestic banks (collected through the FINREP reporting system)	Monthly, 30 working days after each month end.
C.5	Balance sheet information, based on products rather than categories (as in FINREP).	Quarterly, 30 working days after the end of each quarter
C.6	Detailed information on deposits for the last Friday of each month.	Monthly, 30 working days after each month end.
C.7	Data on liabilities covered under the ELG Scheme for each of the Covered Institutions.	Monthly, 30 working days after each month end.
C.8	Certain financial stability indicators on a monthly basis, including capital adequacy ratios, liquidity ratios, loan to deposit ratios and sectoral distribution of loans	Monthly, 30 working days after each month end.
C.9	Additional financial stability indicators including details on non performing loans, provisions, return on assets, return on equity, interest margin and income.	Quarterly, 30 working days after the end of each quarter.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

Recent Economic Developments and Outlook

1. **The economy is on track to return to positive growth this year.** GDP stabilised on an annual basis in the first quarter of 2011. Strong exports, aided by progress in recovering lost competitiveness, are expected to continue driving the recovery, as domestic demand, especially consumption, contracts. The export-led recovery will lead to a further strengthening of the current account, which turned into surplus in 2010. Annual inflation of 1.1 percent in June is primarily due to higher international energy prices, with core inflation turning slightly positive in recent months. Economic activity is expected to strengthen next year and beyond as the recovery broadens out and spills over to the labour market.

Financial Sector Policies

2. **We are continuing to restore the healthy functioning of our domestic financial system so it can contribute to the recovery**. Accordingly, we are taking decisive steps to (i) recapitalise, restructure, and deleverage the domestically owned banks; (ii) reform the business model and strengthen the financial health of the credit union sector; (iii) enhance the existing institutional and regulatory framework, and strengthen the transparency and quality of bank balance sheets.

The Domestically-Owned Banks

3. **Recapitalising the domestic banks by end July, with contributions from the private sector, will represent a key milestone** (structural benchmark)**.** Of the €24 billion required, €4.9 billion has been obtained to date through liability management exercises (LMEs). To allow further burden sharing, the final €0.5 billion step in recapitalising Bank of Ireland will be completed by end 2011 and any further recapitalisation of ILP will be completed following the disposal of the insurance arm. We will review the restructuring plan for ILP due by end July and, as necessary, set out by end October the relevant follow-on actions.

4. **We are strengthening the governance framework for banks.** Our ultimate goal is a robust, profitable, and privately owned banking system, which can support the Irish economy. In the meantime, we are:

- **Renewing the boards and senior management of banks based on fit and proper standards.** Already a number of Board members of credit institutions that have received financial support have departed voluntarily. The Minister has asked the institutions to submit board and management renewal plans. In addition the Central Bank will review any remaining incumbent directors’ and senior managers’ roles in the lead up to the crisis against the new fitness and probity standards following those standards coming into force.

- **Enshrining arms length governance of pillar banks' core activities.** In order to properly exercise the ownership rights of the state in banks we have strengthened the Banking Unit of the Department of Finance, and the legislation for the delegation to NTMA of these rights has been rescinded. By end October we shall:

    - Publish the mission statement for the new Banking Unit, as well as its lines of responsibility and organisational structure.

    - Develop and publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight to ensure clarity of responsibility in this area (proposed structural benchmark).

    - Initiate public reporting on the activities of the Banking Unit on a regular basis.

- **Establishing relationship frameworks.** By December 2011 the Minister for Finance shall prepare relationship frameworks with each bank to establish the commercial basis for each bank's operations under Government ownership and a template will be developed for discussion with the External Partners in October 2011. In order to achieve the objectives of the deleveraging process, we will as an exception, exercise more active oversight of banks' activities relating to the non-core assets (as further described below).

5. **We will ensure that the deleveraging process proceeds in a well coordinated and effective manner.** The non-core assets are being deleveraged through a combination of run offs from amortisation or prepayments and a carefully coordinated programme of phased asset disposals. While avoiding fire sales, this will deliver a smaller more robust banking system, with a target loan to deposit ratio of 122.5 percent by end 2013. In the near term, the focus will be on assessing bank targets for the quantum of asset disposal requirements, derived from their deleveraging programmes established to meet the PLAR target loan to deposit ratios, which will be closely monitored. As set out below, we have developed a framework for the governance of deleveraging, which will be kept under review based on experience.

- **Banks have established a framework for asset disposals.** Following the identification of the non-core assets, the banks, with the assistance of international consulting firms, are completing due diligence on their inventories to establish the phasing and pricing of non-core assets identified for sale. Banks have also established deleveraging committees (chaired by a non-executive Director) to make decisions on larger transactions, and will report to the authorities on progress towards the semi-annual interim targets for key liquidity indicators on a quarterly basis.

- **The Banking Unit of the Department of Finance (DoF) will play an active role in driving and overseeing the deleveraging process**. A representative of the DoF will participate in a non-voting capacity in each bank's Deleveraging Committee to promote the observance of agreed goals, report regularly to the DoF Review Committee, and have the authority to refer material transactions to the DoF Review Committee. Any such transactions would automatically be reviewed if the price falls below a certain threshold based on the PCAR/PLAR exercise. The Minister for Finance would use his powers to either enforce or veto transactions with a view to advancing deleveraging while avoiding fire sales.

- **The Central Bank will monitor the process from a financial stability perspective.** The Central Bank has defined the semi-annual interim targets for key liquidity indicators, and will monitor progress against those metrics. Upon receipt of a report from an institution forecasting a breach of an interim target or based on its own assessment the Central Bank will request a remediation plan and may at the same time convert the interim target into a mandatory target. Appropriate application of enforcement actions will be considered if due wholly or partly to the non execution of a deleverage plan transaction.

Strengthening the Credit Union Sector

6. **We are implementing the strategy to underpin the solvency and viability of the credit union sector.** Immediate steps are being taken to deal with weaknesses in the most troubled institutions, including restrictions on their operations where appropriate. Commencing in the fourth quarter we will take all measures necessary to restructure the sector and address difficulties in individual credit unions while minimising any fiscal cost, and will identify solutions within the sector, as well as specify additional funding arrangements in case they are needed to complete this process. This restructuring process will take account of the interim report of the Commission on Credit Unions.

Upgrading the Financial Sector Framework

7. **We are continuing our efforts to strengthen the institutional and regulatory framework underpinning the financial system.** We are making progress in several fronts:

- **A new prudential risk assessment framework is being adopted.** The Central Bank is currently engaged in ongoing development of its new risk framework, Prudential Risk and Impact System (PRISM), which will be implemented by end 2012. By the start of 2012 phase one will be implemented for banks and by March 2012 we expect to have completed our first assessment of the pillar banks' risk profile on the basis of PRISM, and identified a set of mitigating recommendations. We also plan to issue new credit risk standards, including collateral valuations and credit limits by end December 2011. During 2013 we will request the IMF to undertake an independent assessment under a stand-alone Report on the Observance of Standards and Codes (ROSC) against Basel Core Principles for Effective Banking Supervision.

- **Strengthened banking supervision and enforcement powers.** We plan to publish the Central Bank (Supervision and Enforcement) Bill by end July (structural benchmark). This bill strengthens the ability of the Central Bank to impose and supervise compliance with regulatory requirements and to undertake timely prudential interventions. The bill will provide the Central Bank with greater access to information and analysis and will underpin the credible enforcement of Irish financial services legislation in line with international best practice.

- **Enhanced supervisory transparency.** The Central Bank will over time further increase the level of supervisory disclosure by publishing information concerning the supervisory actions undertaken during the previous year.

- **Steps to establish a credit risk register are being taken**. A proposal to enhance the quality and availability of credit information will be sent to the Minister by end September 2011. Legislation for the establishment of a statutory credit register will be drafted and submitted to the Oireachtas by September 2012.

- **Special resolution regime.** The Central Bank and Credit Institutions (No. 2) (Resolution) Bill is expected to complete Second Stage before the end of the current Dáil session and will proceed to Committee Stage in September 2011 for further discussion and refinement.

8. **We are strengthening the transparency and quality of bank balance sheets:**

- **By December 2011, the Central Bank will issue guidance to banks for the recognition of accounting losses incurred in their loan book (proposed structural benchmark).** Specifically, the Central Bank will begin requiring the banks: (i) on core assets, to increase the consistency and conservatism in their impairment triggers and provisioning model inputs including *inter alia*: period of arrears, emergence periods, cure rates and collateral value, and treatment of restructured loans and forbearance; (ii) on non-core assets (assets under deleveraging) to provision to reflect losses arising from their planned disposal, taking account as appropriate of the PLAR/PCAR analysis. We will develop these new requirements with assistance of an internationally recognised auditing firm to ensure consistency with IFRS.

- **Introduction of new disclosure practices by end 2011.** We will ensure that banks adopt a best practice template that enhance transparency in definition of impairment, measurement process for loan and receivable financial assets, timing of write-offs, collective provisioning methodology, and risk management and portfolio quality disclosure.

- **We will continue to facilitate improvements in the quality of banks' loan books.** In particular, we will review the requirements of the Code of Conduct for Business Lending to SME Enterprises (SME Code) relating to the treatment of SMEs in financial difficulties and facing arrears. By end September 2011 revisions to the existing procedural guidelines (especially relating to those in financial difficulties) will be approved. These are being drafted through a consultative process and will be designed to avoid introducing incentives for strategic defaulting. The Government will continue to review implementation and experience under the Code of Conduct on Mortgage Arrears to encourage early and effective engagement between borrowers and banks and report by the end of October 2011.

- **Reform the personal insolvency regime.** We will continue to facilitate efforts by individuals and lenders to address issues of significant over-indebtedness. We intend to have in place by end December 2011 a strategy covering the key policy issues and parameters for the development of broader legal reforms, including significant amendments to the Bankruptcy Act 1998 and creation of a new structured non-judicial debt settlement and enforcement system (proposed structural benchmark). The objective is to permit efficient and effective insolvency proceedings while minimising moral hazard.

Fiscal Policies

9. **On the back of a €6 billion consolidation effort, we are on track to achieve the programmed deficit reduction in 2011.** The end June 2011 primary exchequer balance target was met with a margin and the end year programme targets remain within reach. The end June central government net debt target was also met, as was the non-accumulation of external arrears requirement. Our strong performance, despite challenging macroeconomic conditions, reflects the government's unwavering commitment to fiscal consolidation, and Ireland's strong institutional capacity in revenue administration and public finance management. Our robust implementation record credibly positions us to deliver the programmed fiscal adjustment of at least €3.6 billion in 2012, and the additional measures in outer years needed to bring the general government deficit below 3 percent of GDP by 2015.

10. **The ongoing comprehensive review of expenditure (CRE) is expected to identify significant scope for sharpening public service delivery.** Instead of cutting around the edges, we are adopting a "programme review" approach to help focus spending on the most effective and high-priority programmes. By end October 2011, following the conclusion of the CRE, we will present the Pre Budget Outlook to the Dáil setting out a medium-term fiscal consolidation plan for 2012–2015 outlining the overall composition of revenue and expenditure adjustments for each year, consistent with the targets set out in the Council Recommendation in the context of the excessive deficit procedure. Moreover, by 2012 Budget day in early December 2011, we will anchor this consolidation plan in binding medium-term expenditure cash ceilings (structural benchmark) and will set out revenue and

expenditure measures to deliver the needed adjustment while protecting the poor and vulnerable.

11. **We are implementing significant pension reforms to help secure Ireland's long-term public finances in the face of high projected increases in ageing-related costs.** Signed into law on June 29, 2011, the reforms provide for step increases in the retirement age for social welfare pensions from 65 to 68 years over 2014-2028. Supplementing this is a package of public service pension reforms for new entrants, to be submitted for Parliamentary approval by end September-2011. Notably, these necessary reforms, which will help brace Ireland against population ageing, are being implemented in a socially-cohesive manner.

12. **As part of our institutional fiscal reform commitments, we have established the Irish Fiscal Advisory Council.** The Council comprises five distinguished economics professionals with strong international expertise, and has received an initial funding provision for the remainder of 2011. The Council will have the mandate to assess and comment on official macroeconomic forecasts and budgetary projections, compliance with fiscal rules, and the appropriateness of the fiscal stance. A Fiscal Responsibility bill, to be submitted to the Houses of the Oireachtas by end December 2011, will give statutory basis to the Council and ensure its independence with due regard to the role that nomination, appointment, and dismissal procedures can play, and medium-term budget allocations (proposed structural benchmark). The bill will also give legal backing to the aforementioned expenditure ceilings, and establish a set of fiscal rules to underpin sound fiscal policy.

13. **We are committed to an ambitious programme of state asset disposals.** We will consider options for asset disposals, based on the Programme for Government and the report of the Review Group on State Assets and Liabilities. We will prepare a draft programme of asset disposals in this context and discuss it with the staff of the European Commission, the IMF and the ECB by end December 2011 in advance of taking final decisions on the programme to be pursued. The draft programme will include the identification of the potential assets for disposal, any necessary regulatory changes, and a timetable for implementation.

Product and Labour Market Reforms

14. **To reform the framework for sectoral wage agreements, the Government is working to develop a time-bound plan of action by end September 2011 having regard to the views of the social partners and other stakeholders.** The reforms aim at increasing employers' willingness to hire, in particular in sectors hard hit by the crisis and to facilitate the necessary cross sector adjustment. They will take into consideration the implications of the 6 July 2011 High Court ruling which found that sections of legislation governing wage-setting mechanisms in EROs are unconstitutional.

15. **We are advancing policies to lower costs in sheltered sectors to boost purchasing power and underpin competiveness improvements.** We have taken steps to reduce margins on pharmaceuticals, and intend to submit legislative changes to Parliament by end September 2011 to reform regulation of the legal profession to promote greater transparency and efficiency, and to reduce barriers to entry to the medical profession. To enhance the enforcement of Irish and EU competition law, we will consider how the effectiveness of the Competition Authority will be strengthened; we will also merge the Competition Authority and National Consumer Agency. Requests for exemptions to the competition law framework will not be accepted unless they are consistent with the goals of the EU / IMF supported programme for Ireland and the needs of the economy.

Programme Financing

16. **The programme remains adequately financed.** Progress is ongoing in finalising loan documentation with our EU bilateral partners. The bilateral agreement with the United Kingdom is in place, with the first of 8 quarterly disbursements due to be made in the context of completion of this review. Loan arrangements with Sweden and Denmark are being finalised and envisage semi-annual disbursements, also linked to future programme reviews.

Programme Monitoring

17. Progress in the 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 the Letters of Intent of December 3rd, 2010, April 28, 2011 and 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).

18. 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-June 2011	Observed
Indicative Target		
Ceiling on the stock of central government net debt	End-June 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[12]
Submit to Dáil Éireann the draft legislation on a special resolution regime.	End-February 2011	Observed [13]
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	Ongoing
Submit the Supervision and Enforcement Bill to Oireachtas.	End-July 2011	Ongoing
Complete the legal merger procedures of Allied Irish Bank and EBS Building Society.	End-September 2011	Observed
The merger of Irish Nationwide Building Society and Anglo-Irish bank.	End-December 2011	Observed

[12] 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.

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

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

	March 31, 2011		June 30, 2011		September 30 2011	December 31, 2011	March 31, 2012	June 30, 2012
	Target 1/	Outcome	Target 1/	Outcome	Target	Target	Target	Target
	(In billions of Euros)							
	Performance Criterion		Performance Criterion		Performance Criterion	Performance Criterion	Indicative Target	Indicative Target
1. Cumulative exchequer primary balance 2/	-7.9	-6.3	-10.1	-8.4	-14.2	-15.0	-5.7	-7.4
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
	Indicative Target		Indicative Target		Indicative Target	Indicative Target	Indicative Target	Indicative Target
3. Ceiling on the stock of central government net debt	92.1	88.5	94.6	91.7	98.6	100.4	107.9	112.0

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.

Table 3. Upcoming Structural Benchmarks under the Programme for 2011

Measure	Date	Status
Financial sector policies		
Publish a memorandum of understanding governing the relationship of the Department of Finance and the Central Bank in relation to banking sector oversight (MEFP, ¶4).	End-October 2011	Proposed structural benchmark
Central Bank to issue guidance to banks for the recognition of accounting losses incurred in their loan book (MEFP, ¶8).	End-December 2011	Proposed structural benchmark
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 (MEFP, ¶8).	End-December 2011	Proposed structural benchmark
Fiscal policies		
Introduce a medium-term expenditure framework with binding multi-annual expenditure ceilings with broad coverage and consistent with the fiscal consolidation targets (MEFP, ¶10).	2012 Budget day in early December 2011[14]	Structural benchmark
Submit to parliament, as part of the Fiscal Responsibility Bill, a legal framework for the Fiscal Advisory Council ensuring its independence (MEFP, ¶12).	End-December 2011	Proposed structural benchmark

[14] Timing advanced from end December 2011.

TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

28 July 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 1 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 November 24, 2010 as shown on the European Central bank web-page, in particular, €1 = 1.3339 U.S. dollar and €1 = 0.86547 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.[15] The Exchequer balance is the difference 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

[15] 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.

(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).[16]

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. 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.

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, 2011:	
End-September 2011 (performance criterion)	-14.2
End-December 2011 (performance criterion)	-15.0
From January 1, 2012:	
End-March 2012 (indicative target)	-5.7
End-June 2012 (indicative target)	-7.4

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: [17]

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

[17] 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.

Cumulative Exchequer tax revenue & other receipts (as outlined in 7. above)	(In billions of Euros)
From January 1, 2011:	
End-September 2011 (projection)	28.6
End-December 2011 (projection)	42.4
From January 1, 2012:	
End-March 2012 (projection)	9.9
End-June 2012 (projection)	19.6

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 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 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-June 2011 central government net debt.

Central government net debt	(In billions of Euros)
Outstanding stock:	
End-June 2011 (provisional)	91.7
End-September 2011 (indicative target)	98.6
End-December 2011 (indicative target)	100.4
End-March 2012 (indicative target)	107.9
End-June 2012 (indicative target)	112.0

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 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.