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Ireland and the IMF

Press Release:
IMF Completes Twelfth and Final Review Under the Extended Fund Facility Arrangement for Ireland
December 13, 2013

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Ireland: Letter of Intent

November 29, 2013

An Roinn Airgeadais
Department of Finance

Oifig an Aire
Office of the Minister

Dublin, 29 November 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

1. **Our economic programme has achieved its main objectives and has underpinned Ireland's emergence from the crisis.** The key objectives of our programme were to address financial sector weaknesses, to put Ireland's economy on a path of sustainable growth, to strengthen our public finances, to boost job creation, and to fully regain international capital market access. Now, as we approach the conclusion of our programme we are beginning to reap the rewards of our sustained efforts. Economic growth has returned, albeit at a slower pace than was anticipated at the start of the programme. The public finances have been put on a sustainable footing and unemployment is declining slowly but steadily. Importantly, we have also successfully returned to financial market funding. The financial sector has undergone significant restructuring since the beginning of the crisis and we will continue to progress this agenda. All of this has been achieved by steadfast implementation and delivery of our commitments under the programme and complemented by European decisions that led to a reduction of the interest rates and an extension of the maturities of the EFSF and EFSM loans. This effort has encompassed the completion of over 260 actions to date. Looking ahead we intend to maintain our momentum and press on with our reform agenda. We are preparing a Medium-Term Economic Strategy (MTES), which will articulate the key principles that will underpin economic policy for the period to 2020. It will address the key policy areas such as education and training, labour market activation, industrial innovation, access to credit, competition and budgetary policy. Through this strategic, medium-term perspective, the MTES will not duplicate – but will complement – the necessarily more short-term focus of other related policy efforts such as the *Action Plan for Jobs*. Although the Extended Fund Facility arrangement is ending we will keep our close dialogue with the Fund and will consult with it semi-annually under the usual Post-Program Monitoring.

I. MACROECONOMIC OUTLOOK

2. **Economic growth has resumed and has supported programme objectives.** Real GDP is forecast to grow by a modest 0.2 per cent this year. The impact of the patent cliff is weighing on pharma-chem activity, given its large weight in Irish output and exports.

Developments in the domestic economy have been considerably more favourable though. So far this year the employment growth over the first three quarters is averaging 2.0 per cent, and unemployment, while still high, is continuing to fall. High-frequency indicators for the third and fourth quarters are also positive. Purchasing managers' indices have recorded some multi-annual highs, tourism numbers are up substantially and house prices have shown consistent growth since early in the year. 2014 GDP is forecast to grow by about 2 per cent. Net exports are expected to make a positive contribution to growth again, as the fast-growing service export sector offsets some drag from pharma-chem activity. Expectations for trading partner growth are also supportive as are continuing strong inflows of foreign direct investment. Domestic demand is expected to expand modestly, as increased employment and incomes spill over into real activity and construction output continues to rise from very low levels. The recovery is expected to strengthen with GDP growth set to average 2.5 per cent over 2015 and 2016.

II. FISCAL POLICY

3. **In each year of the programme we have met or exceeded the fiscal headline targets.** The level of adjustment has been significant with measures designed to yield €16.4 billion (9.6 per cent of 2013 GDP) announced for Budget 2011 to Budget 2014. This quantum of adjustment has ensured that fiscal targets were met or bettered against a background of much lower growth than was projected when the programme started. On the basis of present forecasts, the majority of the required adjustment has been delivered, with Budget 2015 expected to be the last of the consolidation Budgets. We have also introduced important structural changes to the management of our public finances with the enactment of the Fiscal Responsibility Act 2012, the establishment of the Irish Fiscal Advisory Council on a statutory basis, the introduction of regular wide-scale reviews of public spending (the next Comprehensive Review of Expenditure is to take place in advance of Budget 2015), and the implementation of multi-annual expenditure budgeting and Ministerial expenditure ceilings. The improved fiscal frameworks that have been put in place over recent years will assist in ensuring that the mistakes of the past will not be repeated.

4. **The 2013 Budget position remains on track and we will ensure the 2013 fiscal deficit target of 7.5 per cent of GDP is met.** Building on the actions taken since mid-2008, which were designed to yield savings around €28 billion, *Budget 2014* introduced a set of adjustment measures aimed at reducing the deficit next year to 4.8 per cent of GDP, below the 5.1 per cent of GDP ceiling under the Excessive Deficit Procedure (EDP). The measures are also intended to achieve a primary balance or a small surplus next year. Broadening the revenue base, reforming the health sector, and targeting social supports towards the most vulnerable will help achieve the further fiscal consolidation needed in a durable and growth-friendly manner.

5. **A clear focus on reducing the deficit below 3 per cent of GDP in 2015 has been the cornerstone on which budgetary planning over recent years has been anchored.** The Government remains steadfast in its commitment to meet this deficit target and will do whatever is necessary to achieve this. Beyond 2015, Ireland will be subject to all the conditions of the preventive arm of the Stability and Growth Pact which necessitates continued fiscal prudence and structural improvement over the medium term.

III. FINANCIAL SECTOR

6. **Confidence in the Irish banks is beginning to return and has helped reduce their reliance on Eurosystem funding, which is now a fraction of what it was at the beginning of the programme.** As part of the 2011 Financial Measures Programme Irish banks were recapitalised to meet a capital requirement identified at €24 billion which was sourced from the private market, burden sharing with subordinated bondholders and from the State. The banking system has been restructured including deleveraging undertaken as part of the Financial Measures Programme and the merger of Allied Irish Banks with EBS. Exceptional Liquidity Assistance (ELA) has been removed from the system following the liquidation of IBRC. NAMA has maintained a strong financial position, generating considerable cash, leaving it on track to redeem €7.5 billion of bonds by the end of this year. Private capital has been introduced to the banking system including the sale of equity (in 2011) and contingent capital notes in Bank of Ireland in 2013 and the sale of Irish Life (in 2013).

7. **We will press ahead with further restructuring of the banking sector.** We have prepared a preliminary assessment of the balance sheets of the PCAR banks. A rigorous review is being performed incorporating an assessment of impairment provisions and a review of the appropriateness of risk weights for regulatory capital purposes. The review has the benefit of extensive sampling of loan files by independent third parties and engagement with staff of the EC, ECB and IMF on an ongoing basis on progress, methodology, inputs, outputs and findings. The review will inform the continuing supervisory dialogue with each of the banks on the adequate level of provisioning at year end, in line with the Central Bank's guidelines. We will agree restructuring plans for AIB and PTSB with the European Commission and these plans will be implemented along with the already agreed restructuring plan for Bank of Ireland. Returning the banks to profitability will continue to be a key focus. The legacy banking assets now housed in NAMA will be run down over time together with assets that will be transferred to it from the liquidated IBRC. We will continue our policy of exiting our banking investments in a manner that maximises the proceeds to be returned to taxpayers. The main Irish banks will undergo a comprehensive risk assessment, including a stress test in 2014, in the context of the upcoming euro area-wide exercise prior to the establishment of the SSM.

8. **Building on the recommendations of the 2011 Inter-Departmental Mortgage Arrears Working Group, we have put in place a broad suite of measures to address the problem of mortgage arrears in a way that seeks to maintain credit discipline while**

providing appropriate relief to borrowers who are experiencing genuine repayment difficulty. We have significantly reformed and updated our personal insolvency law and practice and also made changes to vindicate the legitimate rights of creditors. The Personal Insolvency Act 2012 introduced new insolvency resolution frameworks and also modernised the judicial bankruptcy system. The Land and Conveyancing Law Reform Act 2013 removed an uncertainty regarding the rights of some secured creditors. We have also put in place a process to require mortgage lenders to resolve, on a sustainable basis, cases of mortgage arrears. In particular, performance targets have been set for six credit institutions requiring them to propose and conclude sustainable mortgage solutions for their mortgages which are more than 90 days in arrears.

9. **Financial sector repair will continue with a view to ensuring that significant progress is made in the resolution of mortgage and SME difficulties in 2014.** The ongoing work on durable resolution of mortgages in arrears will reduce uncertainties that weigh on economic recovery. The Mortgage Arrears Resolution Targets process will be implemented in a resolute manner with a view to addressing most mortgages in arrears by the end of next year. The Insolvency Service of Ireland is now fully operational and will process insolvency applications from insolvent debtors in a fair and efficient way. In addition, we are continuing to address the SME distressed portfolios (which include considerable property-related exposures) through targets which require the banks to implement sustainable long-term debt resolution strategies for all distressed SME loans. Overall, we will continue to monitor and assign a high priority to the resolution of the arrears problem. Ensuring an adequate flow of credit for SMEs remains a priority and active consideration is being given to alternative provision of non-bank financing for the enterprise sector.

IV. STRUCTURAL REFORM

10. **Structural reform focusing on improved competitiveness has also been progressed.** This included the enactment of the Competition (Amendment) Act (2012) (to support the Competition Authority in the investigation and prosecution of anti-competitive practices) and the implementation of Sectoral Wage Reforms. As a result, over the last three years, we have won back much of the competitiveness we lost during the boom. Having seen significant erosion in competitiveness during the boom years, the European Commission is now estimating a 22 per cent improvement in unit labour costs in Ireland vis-à-vis the euro area over the period 2008-2014. The economic path for the years ahead will be directed by the Medium Term Economic Strategy 2014-2020 which we are preparing (see paragraph 1 also).

11. **There has been significant reform in the Health Sector, with substantial reduction in the cost of drugs to the State.** The implementation of generic substitution and reference pricing has been prioritised by the Department, the Health Service Executive and the Irish

Medicines Board. Reference pricing is expected to deliver at least €50 million savings in 2014. The Health (Pricing and Supply of Medical Goods) Act 2013 also includes a process for the review of existing prices outside of reference pricing. Each medicinal product, which was on the Reimbursement List when the legislation was commenced, must be reviewed by the HSE within three years to determine whether it should remain on the List and, if so, the price that should apply.

12. **Structural reform in other areas including labour market activation is well underway and will be continued.** The labour activation effort will prioritise the reduction and prevention of long-term unemployment, combatting youth unemployment and helping to reduce the number of jobless households; this will involve greater engagement on job seeking activity and appropriate referral to activation or further education and training programmes. We also intend to deliver a Strategic Implementation Plan for Further Education and Training that will draw on the analysis and recommendations of the FET Strategic Review carried out under the Programme this year. Legal services reform is also being advanced. The Legal Services Regulation Bill has completed Second Stage and commenced Committee Stage in July 2013. The resumption of Committee Stage is expected early 2014 with a view to the Bill's earliest enactment and the expedited establishment of the new Legal Services Regulatory Authority. Water sector reforms are also continuing at pace and the definitive time-plan for the introduction of domestic charges will be announced by the end of the year. The Water Services (No. 2) Bill has been approved by Government and is expected to be published shortly.

V. FUNDING

13. **Strong policy implementation of the programme has improved funding conditions even as domestic challenges and external uncertainties remain.** Ireland remains on course to end the year with a cash buffer sufficient to cover more than 12 months of Exchequer financing needs. The 7-year extension in EFSM/EFSF maximum average maturities and the February IBRC Promissory Note transaction significantly reduce funding needs in the coming years. These positive developments strengthen Ireland's ability to access long-term market funding on sustainable terms. The NTMA is guiding for €6 billion to €10 billion of market issuance in 2014 by way of pre-funding for 2015. In the context of euro area sovereign issuance requirements this is relatively modest. The NTMA looks forward to normalised engagement with the debt markets, following exit from the EU-IMF programme, through 2014 and beyond using the standard issuance mechanisms, such as bond auctions and syndications.

14. **In light of our strong performance and the policies outlined in this letter, we request the completion of the twelfth review under the Extended Arrangement.** We request the drawdown of the remaining programme funding in an amount equivalent to SDR 579 million at the time of the completion of the review. This would complete the disbursements of IMF assistance under the programme.

15. **We authorise the IMF to publish this Letter of Intent and the related staff report.**

This letter is being copied to Messrs. Draghi, Dijsselbloem, Rehn, and Šadžius.

Sincerely,

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