Ireland’s Economic Crisis
The Good, the Bad and the Ugly

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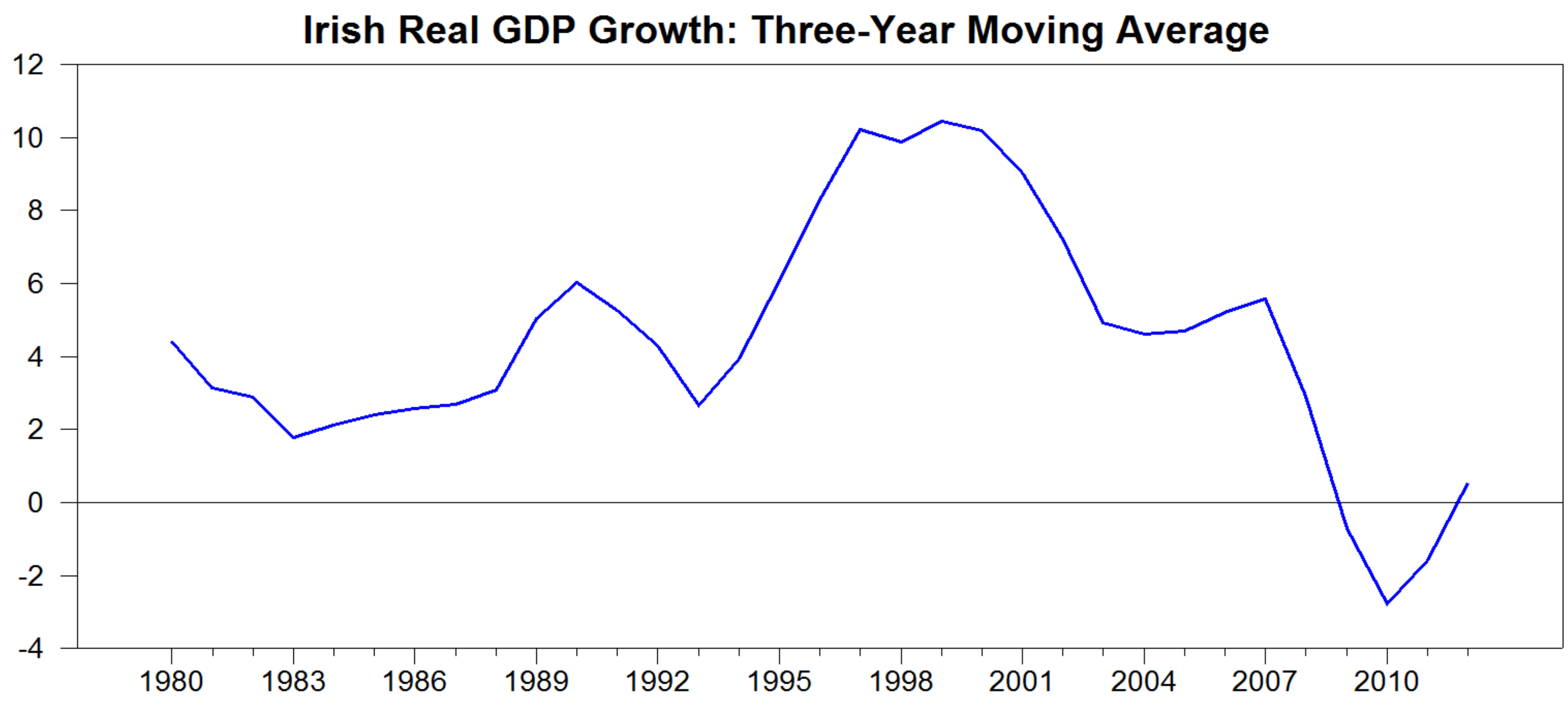
Plan for the Talk

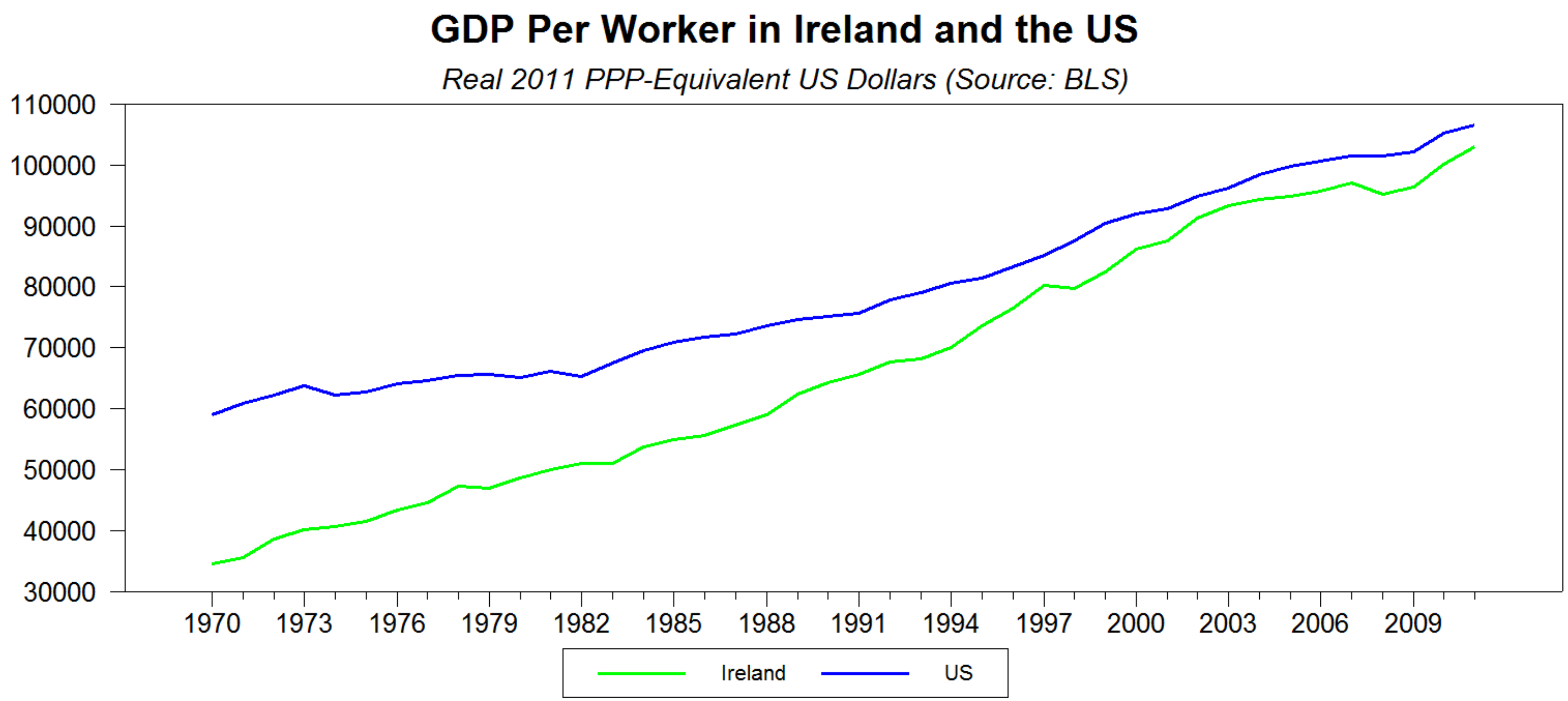
- Many aspects of Ireland's boom and bust are probably familiar to you.
- My talk focuses on shedding light on
  - Areas where international debate on Ireland sometimes misses some important facts.
  - Areas where Ireland serves as an example (both good and bad) for future euro area policy regimes.

1. IRELAND’S BOOM: MERELY A CREDIT-FUELLED BUBBLE?

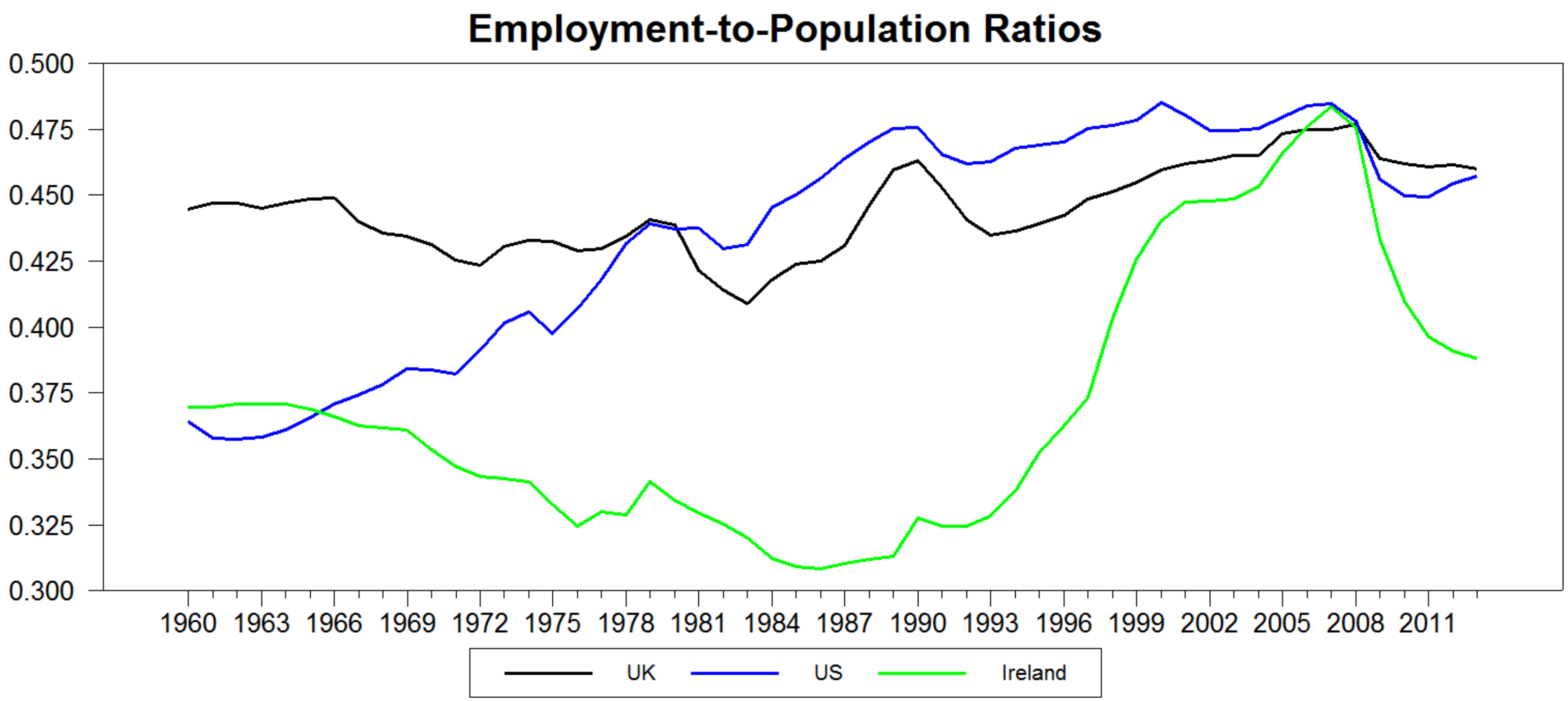
Crash Came After a Long Period of High Growth



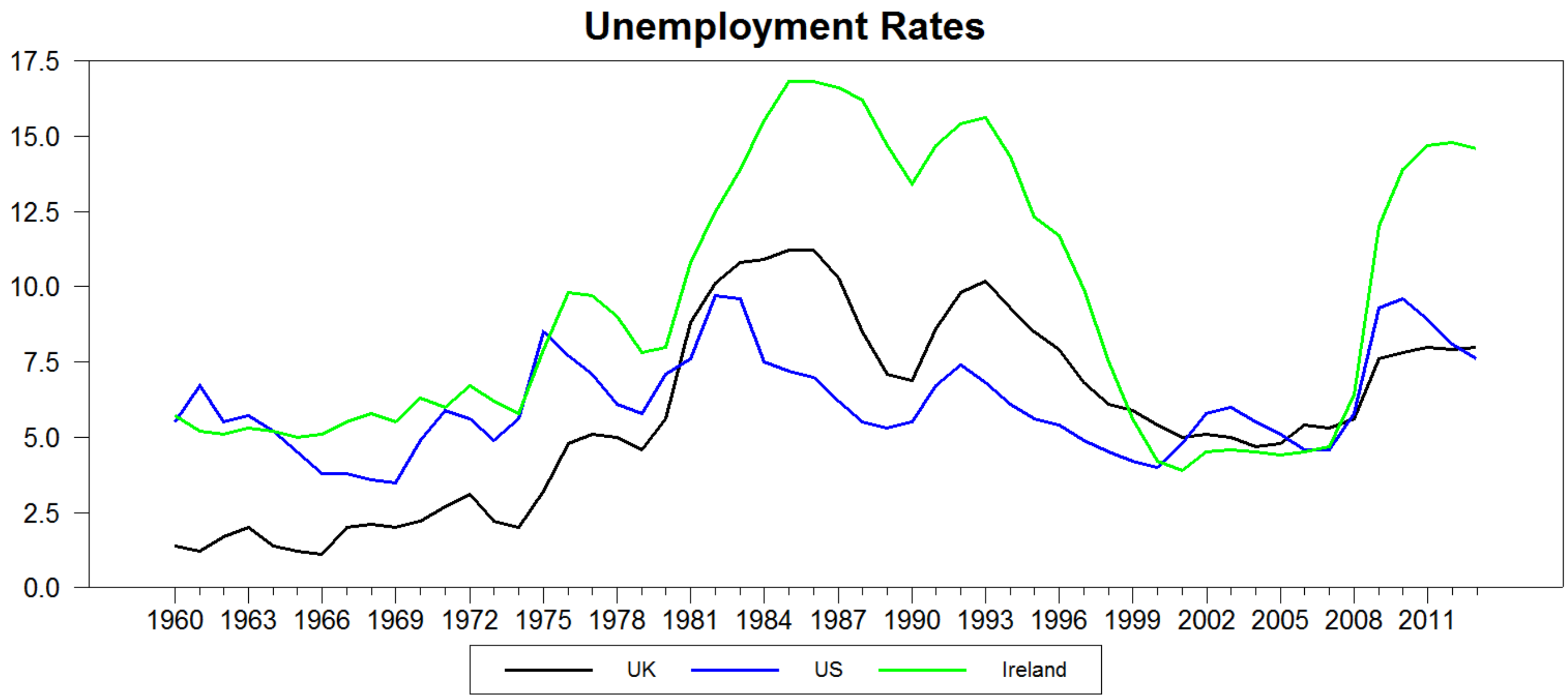
Driven by Rising Productivity



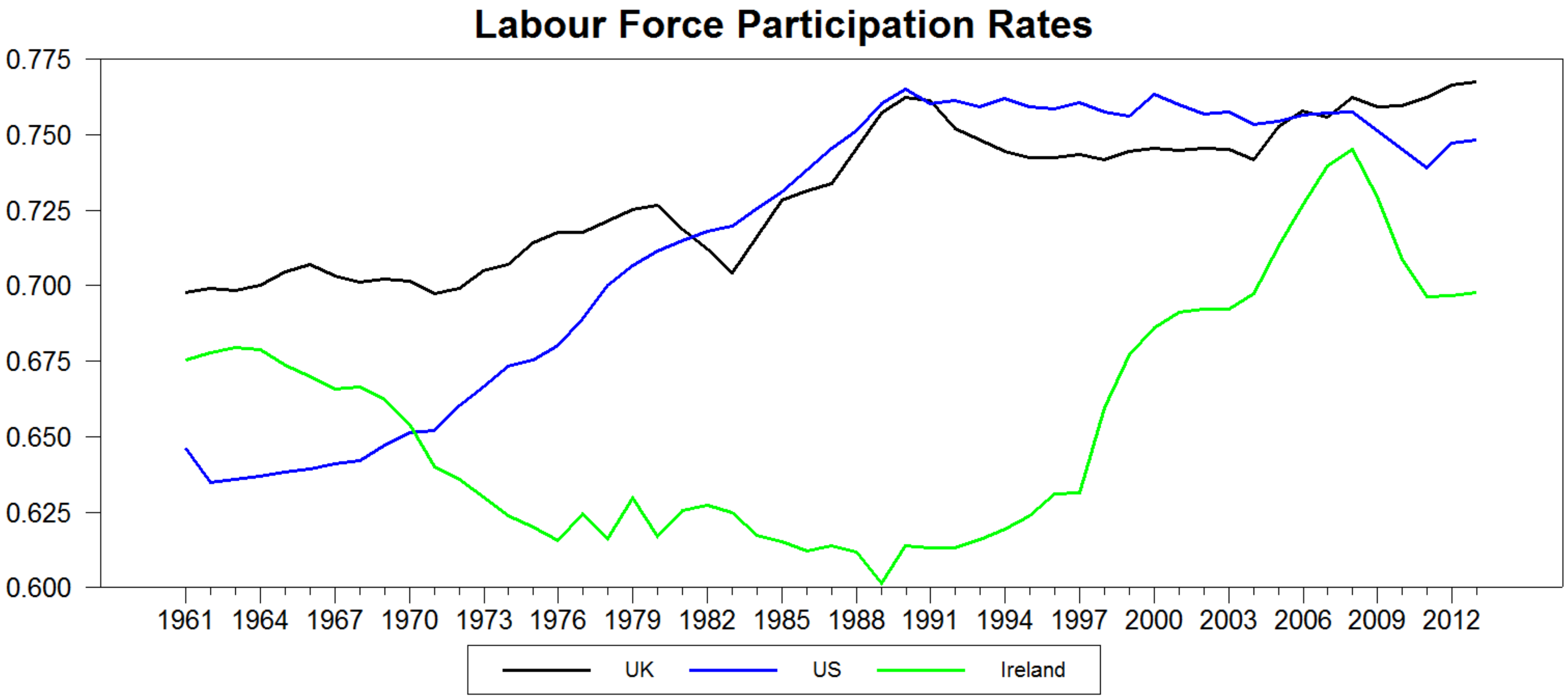
And an Employment Boom



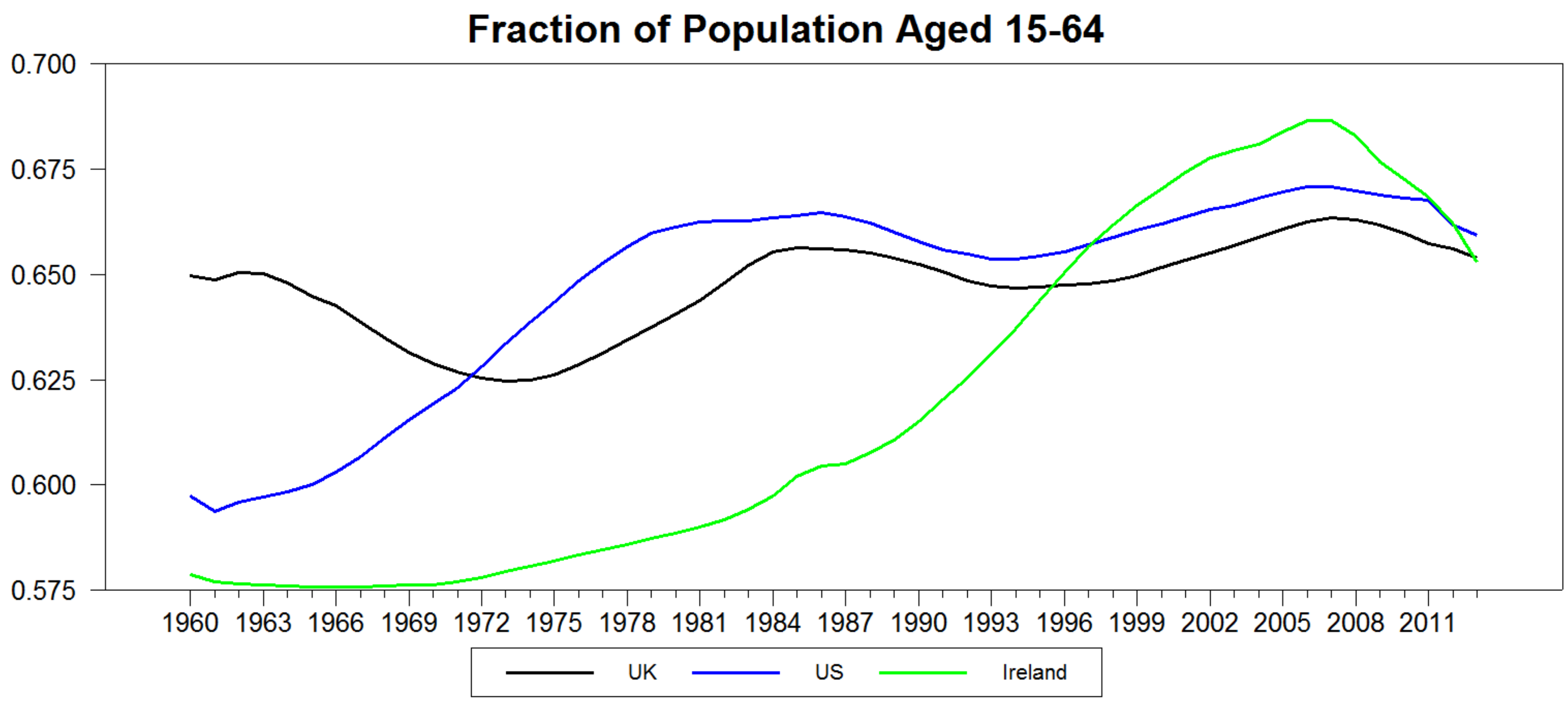
Driven by Falling Unemployment



Rising Labour Force Participation

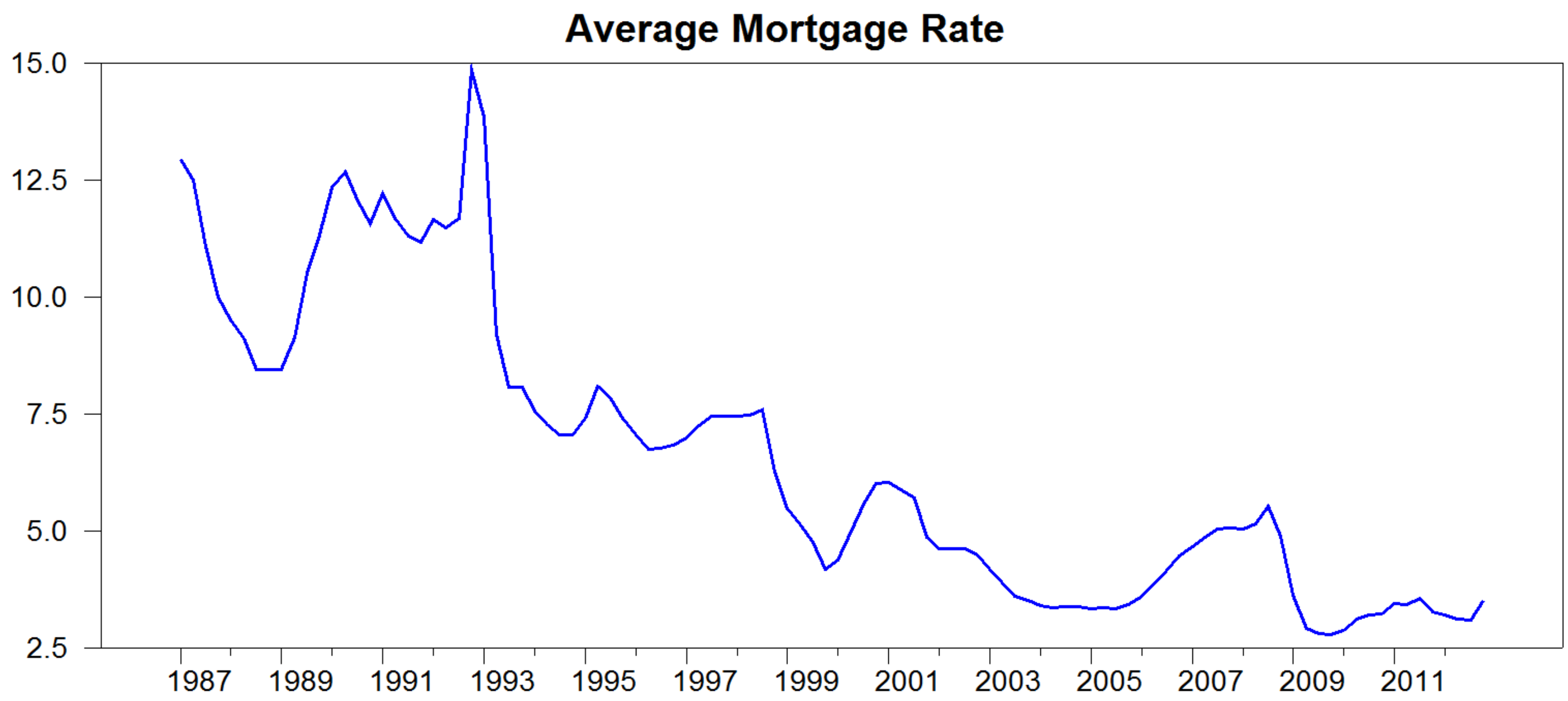


And Positive Demographics

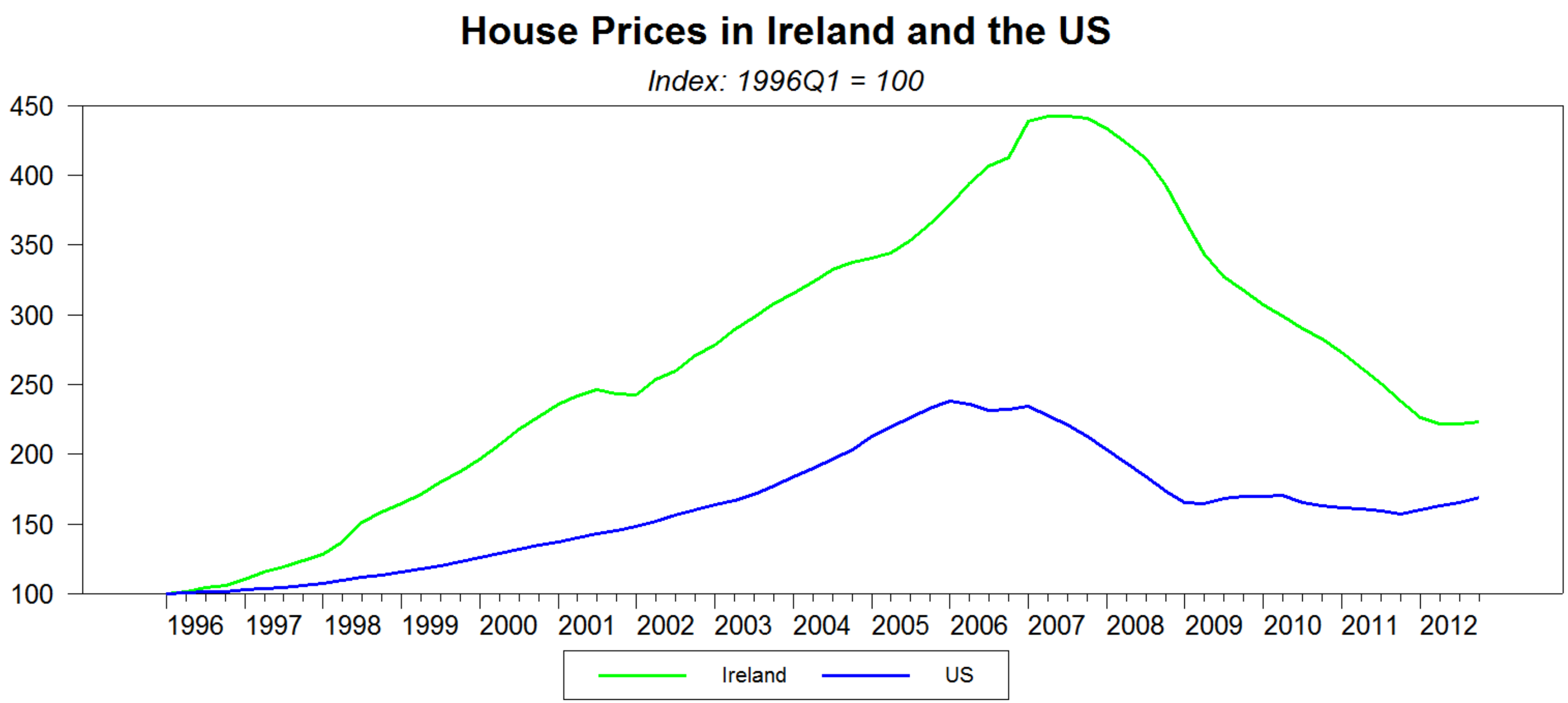


2. BUT ECONOMY BECAME INCREASINGLY UNBALANCED: BROADER MACRO SURVEILLANCE REQUIRED

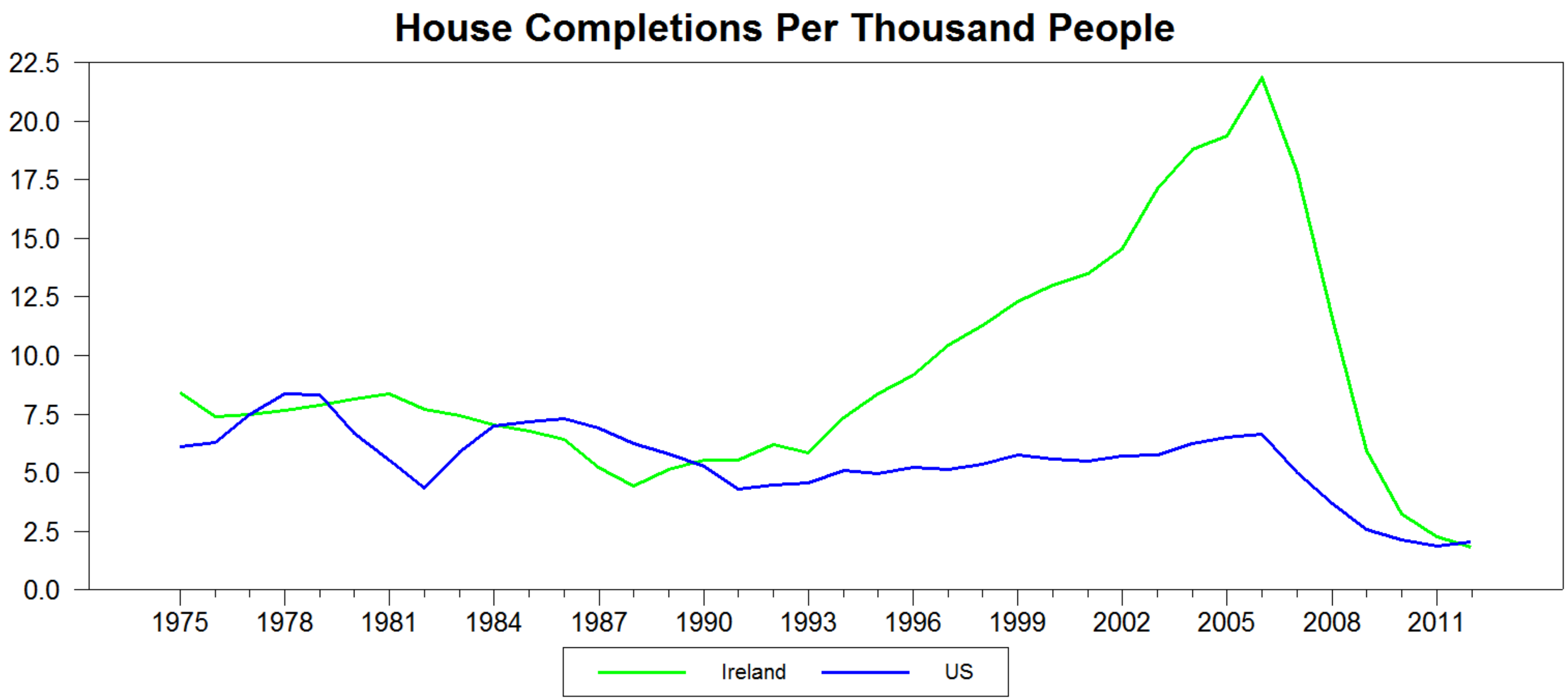
Low Cost of Mortgage Credit Due to Euro



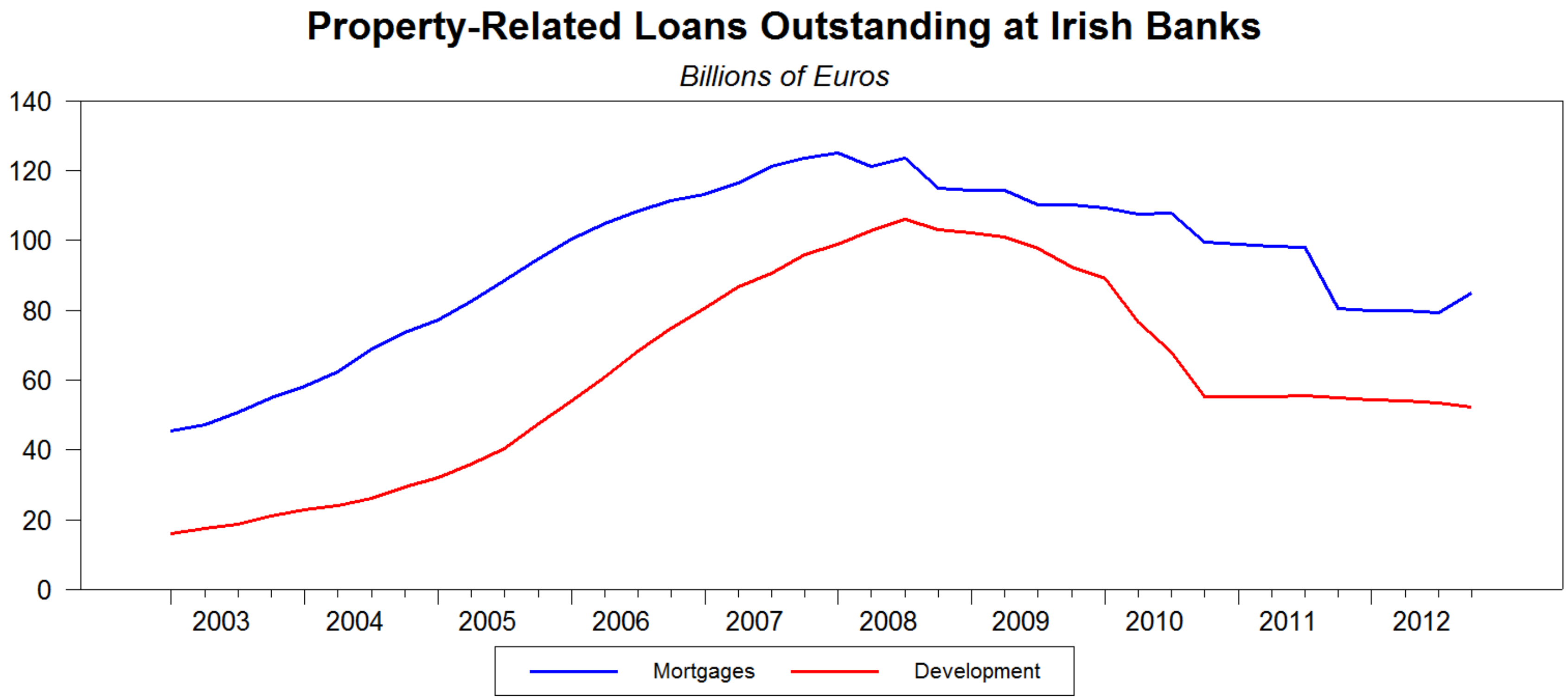
Combined with Strong Growth to Produce a Huge Rise in House Prices



Housing Completions Per Thousand People



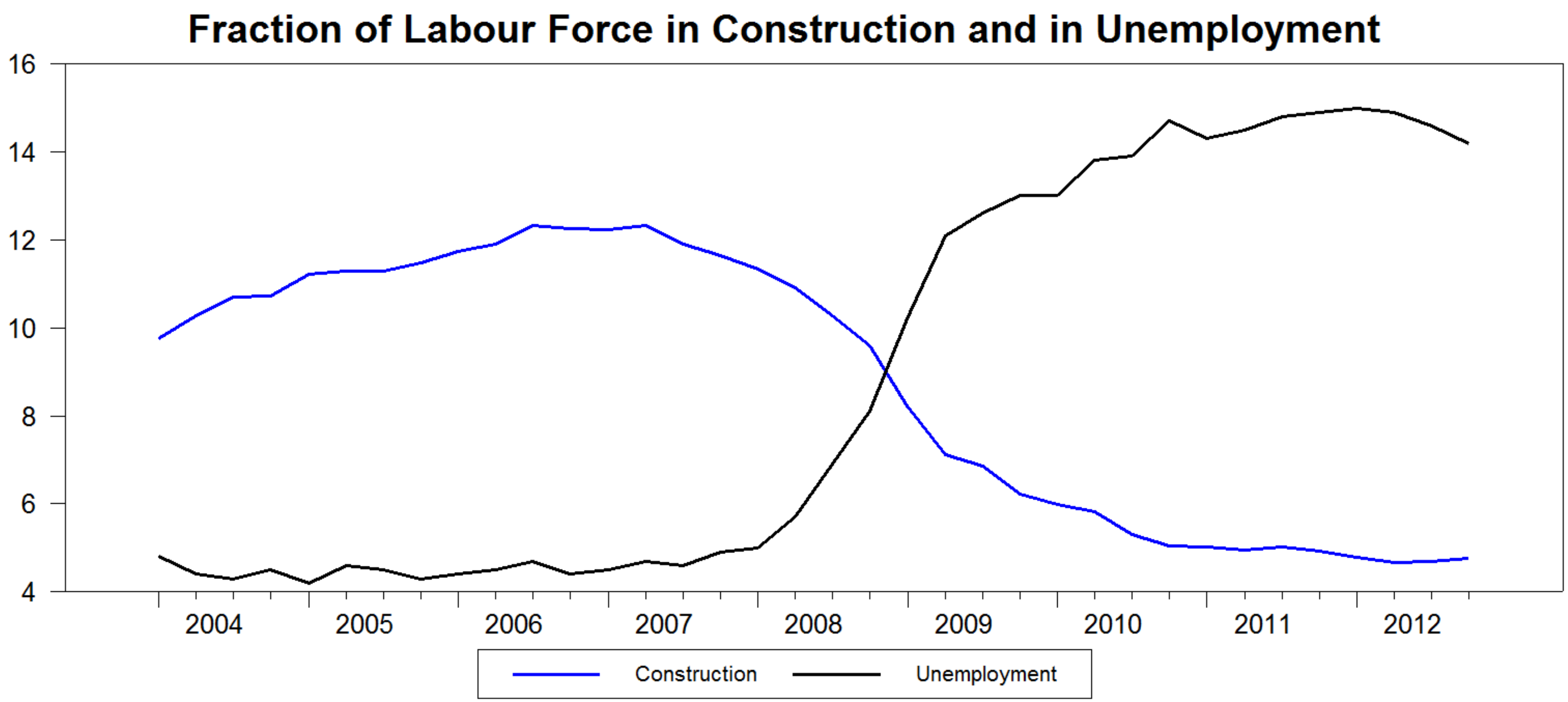
Huge Increase in Property-Related Lending (Much of it Speculative)



Huge Bank Exposure to Property

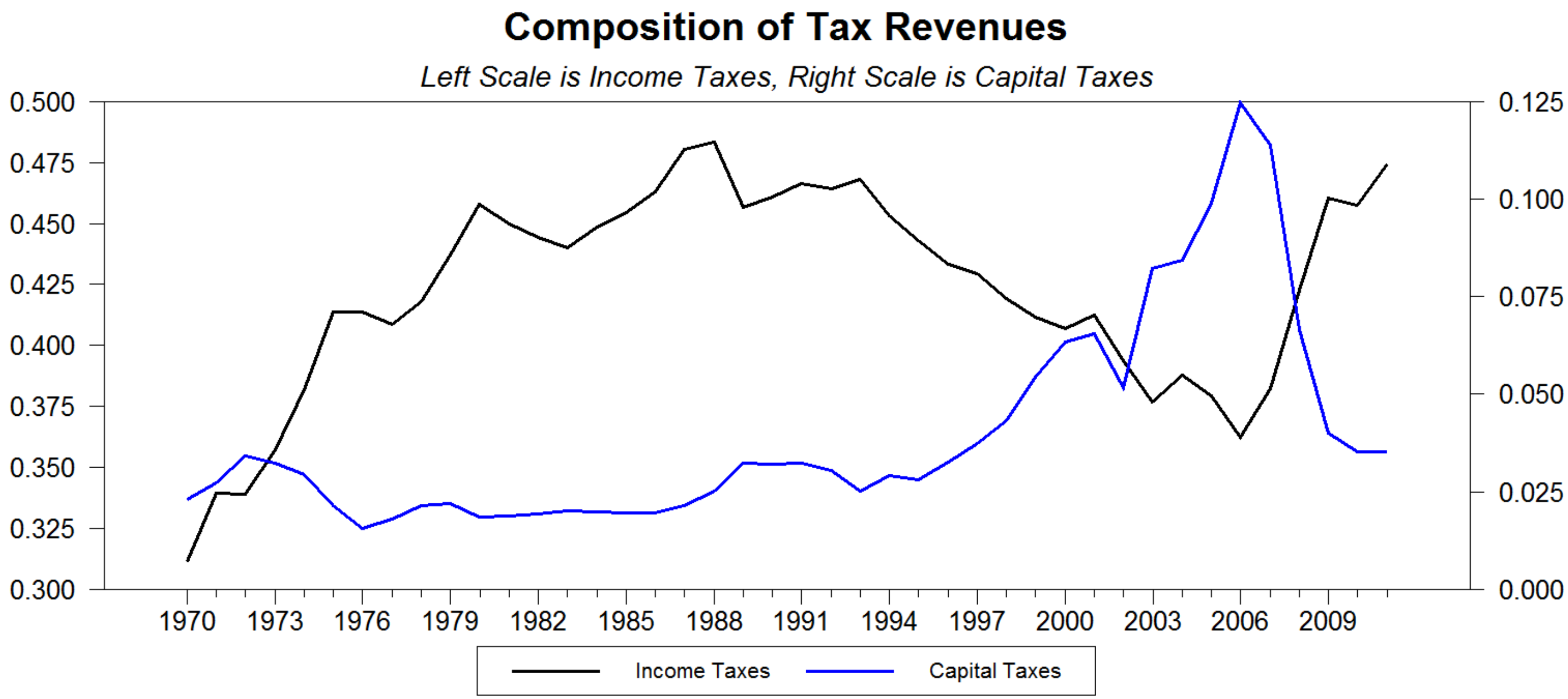
- Domestic banks built up huge exposure to property.
  - Anglo Irish Bank, a property development specialist, grew from assets of €26 billion in 2003 to €97 billion in 2007.
  - Allied Irish Bank, a retail bank, increased property development loans from €16 billion in 2004 to €47 billion in 2007
- Mainly funded in international bond markets: Grew from less than €15 billion in 2003 to almost €100 billion by 2007

Construction Collapse Drove Unemployment



3. WAS IRELAND'S FISCAL CRISIS DUE TO ITS BANK BAILOUT? WHAT WAS THE ROLE OF THE ECB?

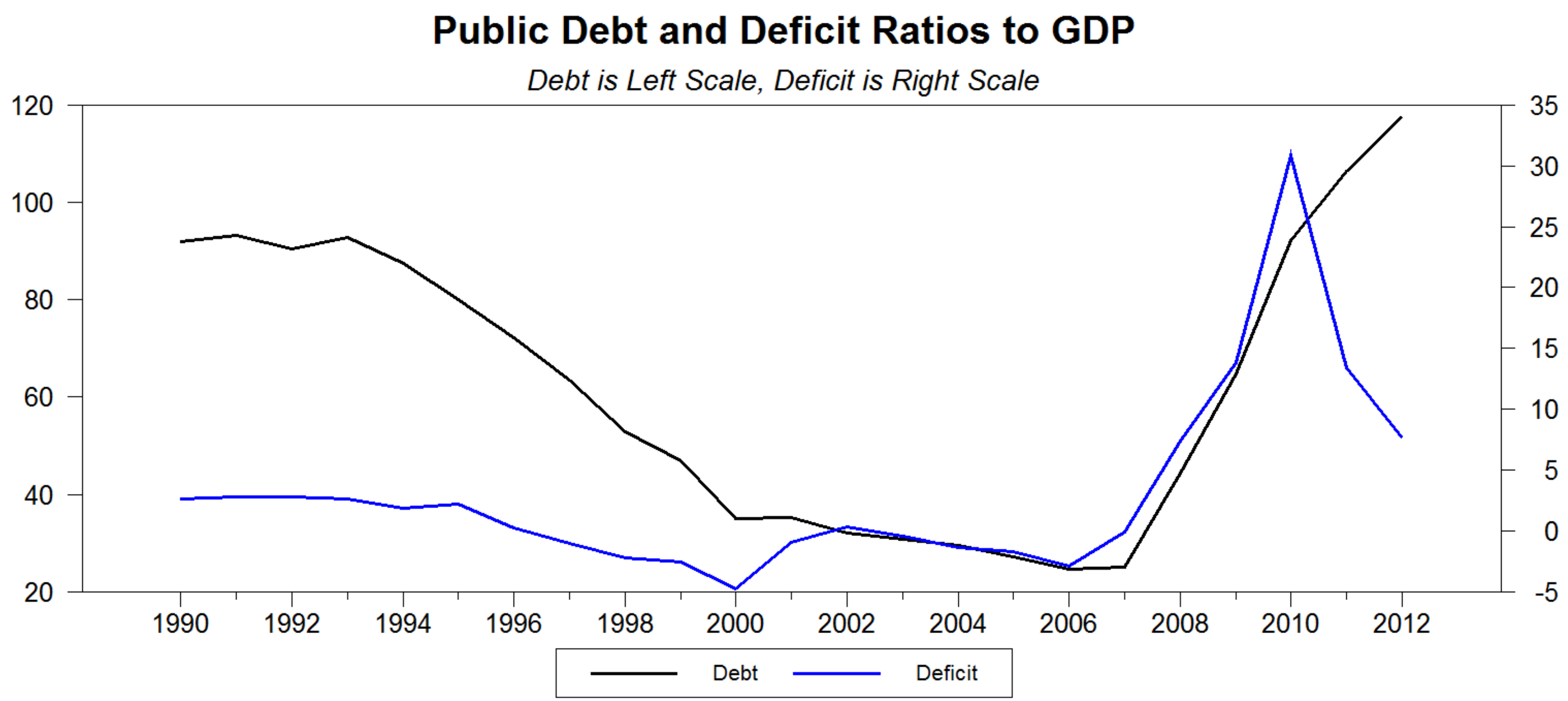
Tax Base Increasingly Relied on the Housing Market



The Bank Bailout

- Irish government passed a near-blanket guarantee in September 2008. ECB not responsible for this policy.
- However, ECB made repayment of senior bondholders an implicit condition of their co-operation with EU-IMF bailout.
- Final cost of about €64 billion or 40% of GDP but most was incurred prior to EU-IMF program.
- In light of Cyprus, worth noting that Anglo (which cost about €35 billion) had relatively few domestic retail depositors.

Debt Crisis Only Partly Due to Bank Bailout

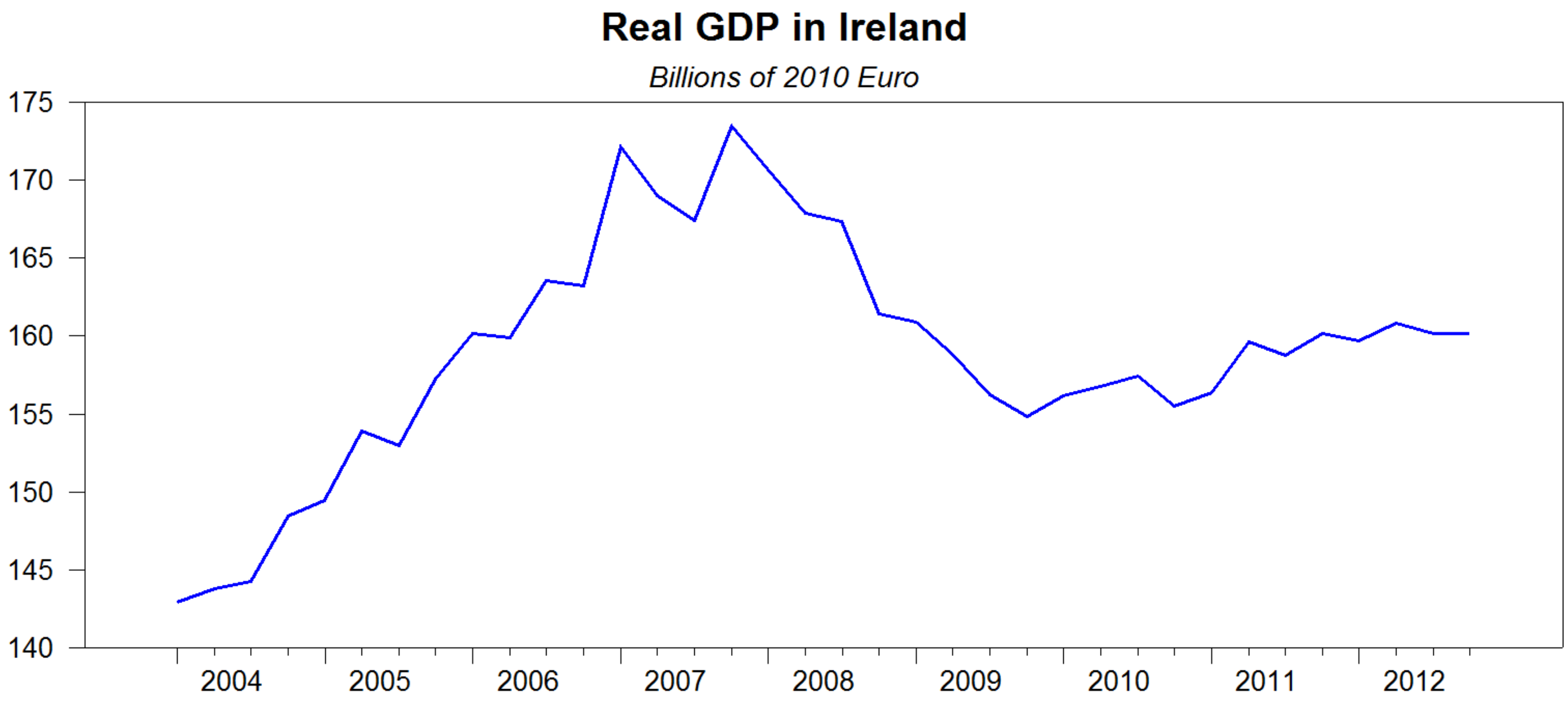


Did Euro Membership Help or Hurt?

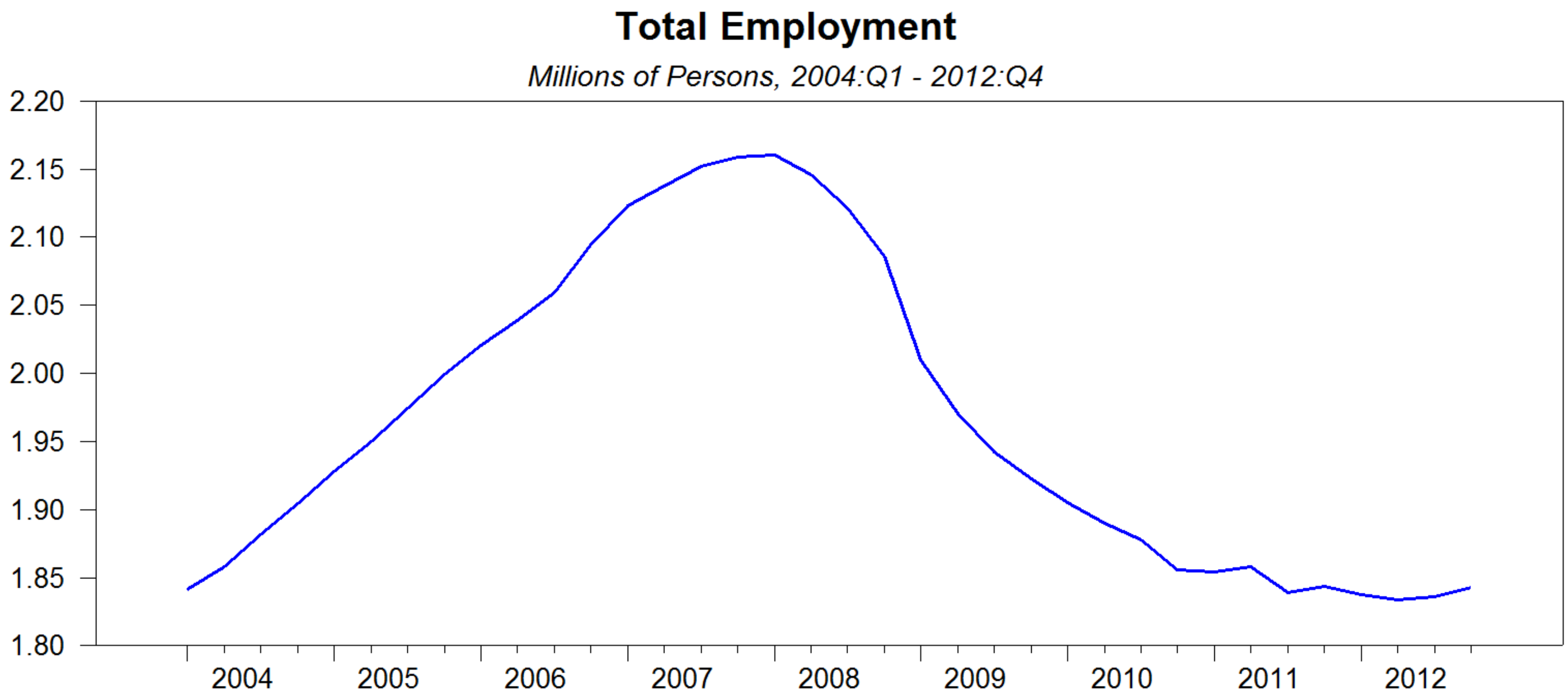
- Euro membership proved a mixed blessing. It helped prevented a liquidity crisis in 2008 and kept the money flowing from the ATM machines.
- However, there were severe negatives:
  - Enabled a denial-driven policy on bank losses.
  - LOLR function had limits: By Autumn 2010, much of the liquidity support (the ELA) required Irish fiscal guarantees.
  - Bondholders being paid back in full became an explicit condition of ECB funding.
  - Relative to Iceland, for example, can argue that euro membership offered Ireland more than enough rope to hang itself.
- Without a clear policy on bank resolution, the Eurozone was not a good place to have a systemic banking crisis.

4. LESSONS FROM IRELAND’S RECOVERY

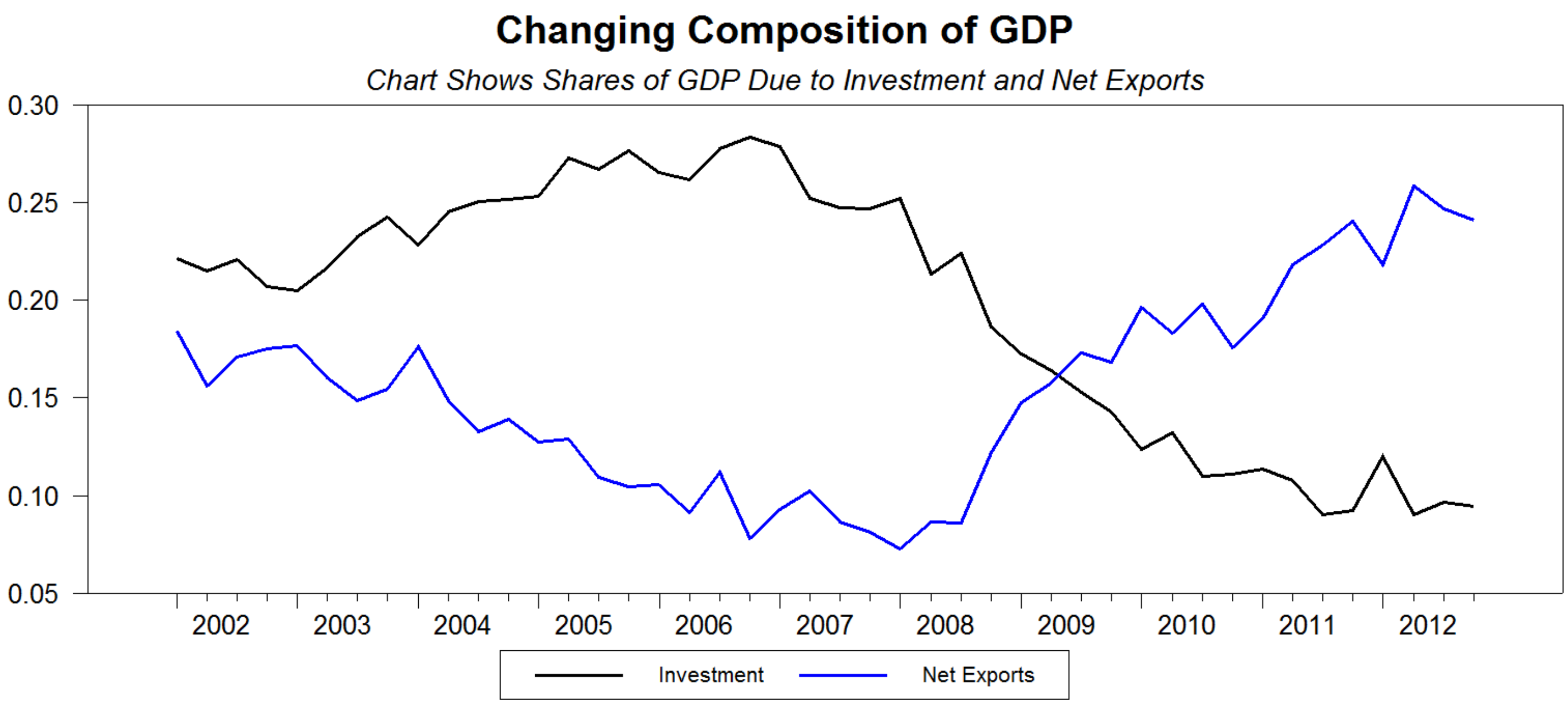
Economy Tentatively Returning to Growth



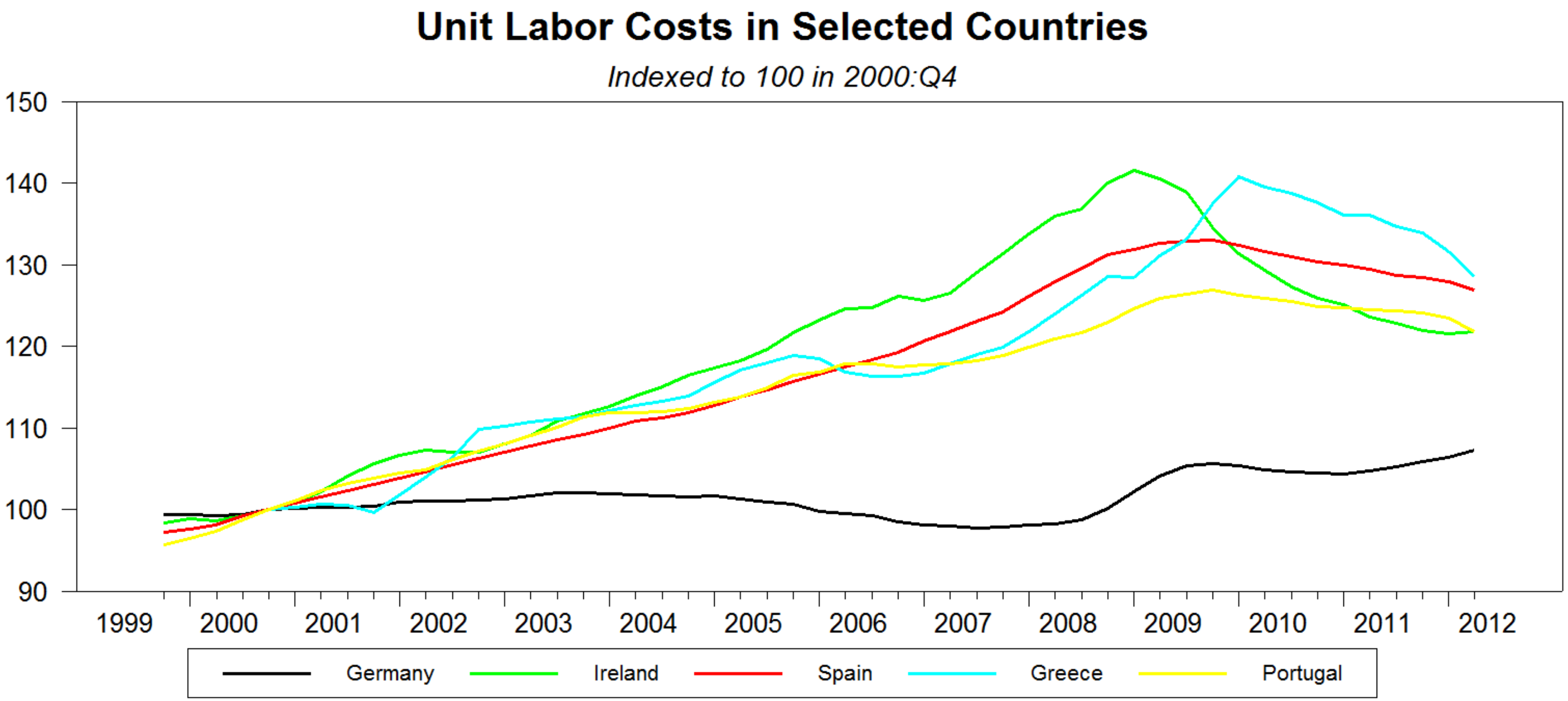
Employment Stabilizing



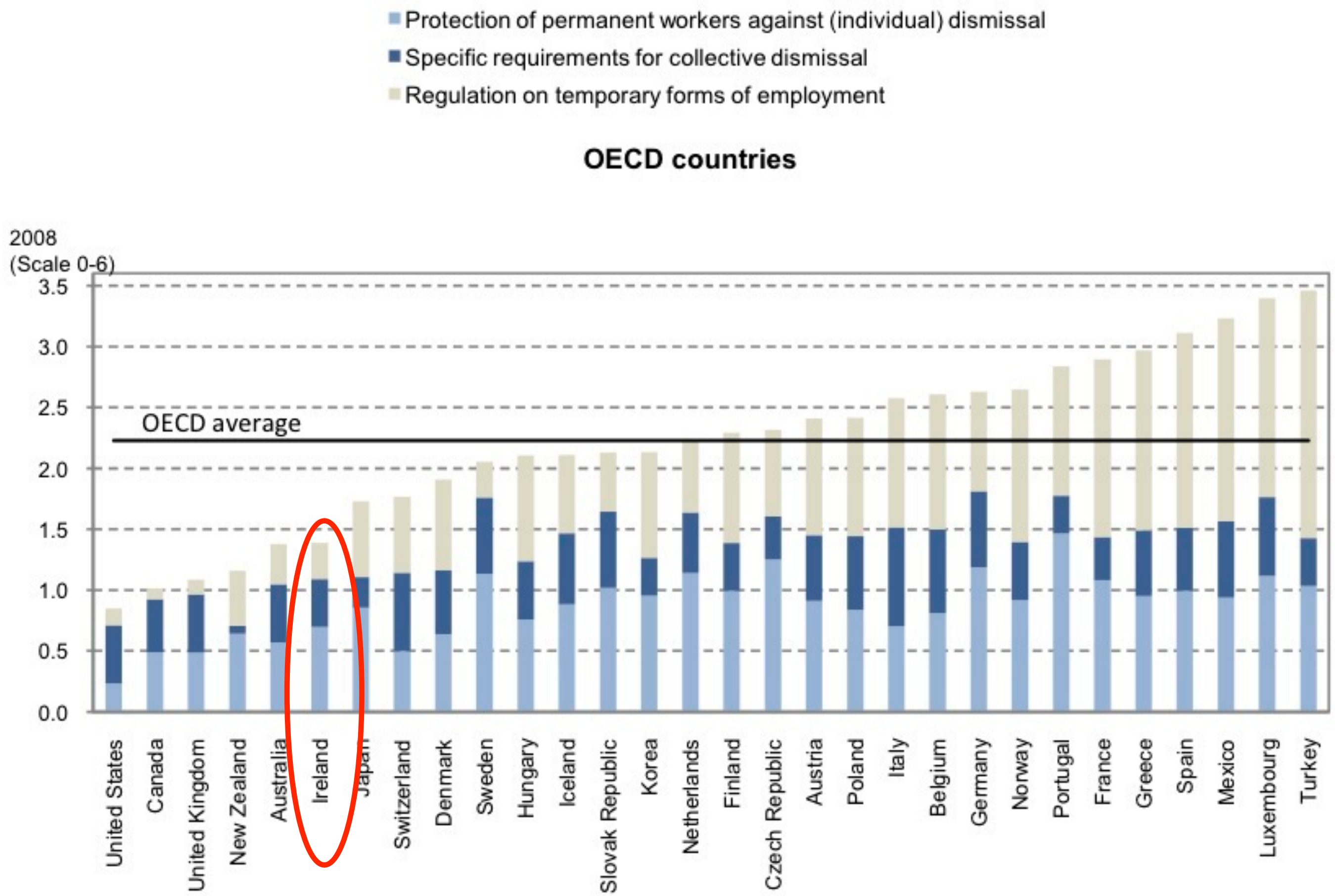
Economy is Re-Balancing



Relatively Flexible Labour Markets Mean Improving Competitiveness



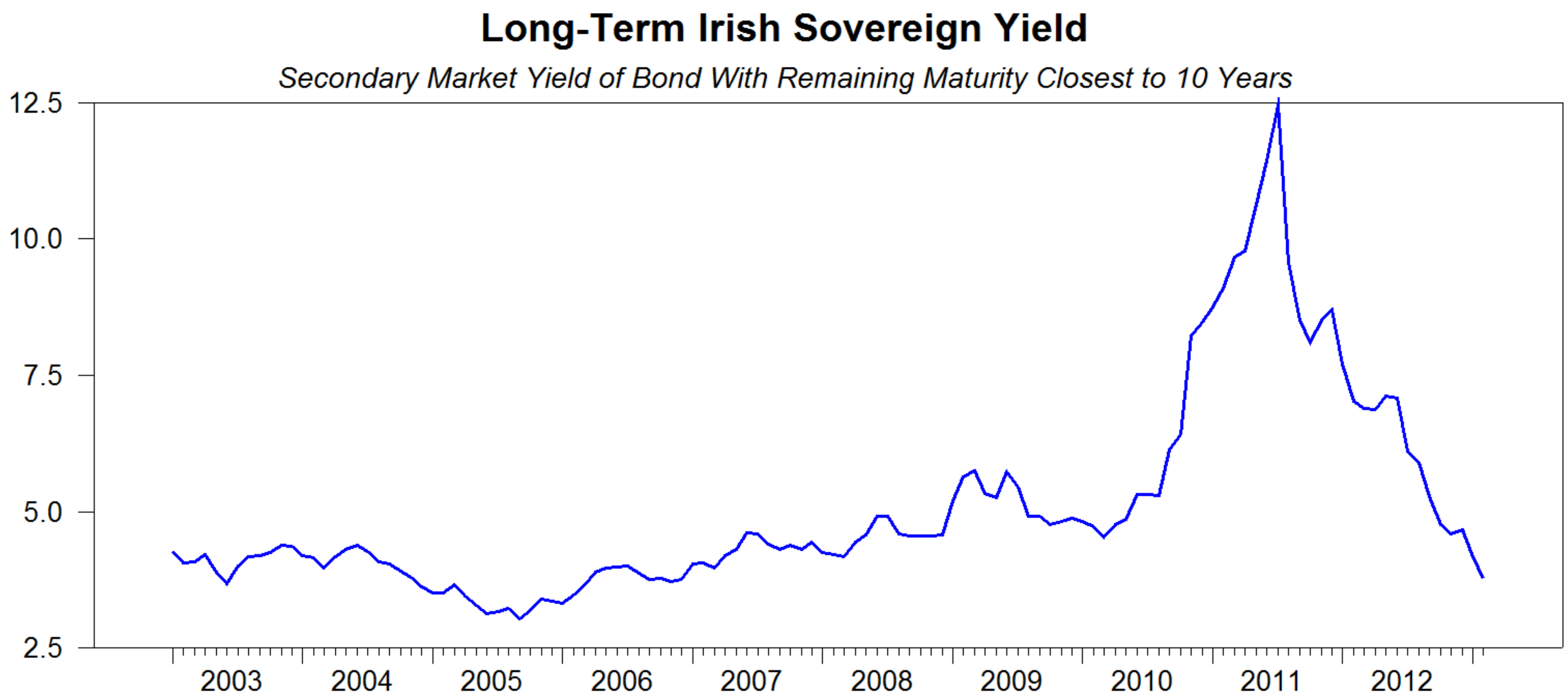
Ireland Has Low Level of Employment Protection



Reflecting Historical Approach, Not New Reforms

- One narrative suggests "Ireland shows how structural reforms in product and labour markets can boost growth while an economy undergoes fiscal austerity."
- In reality, there have been very few structural reforms (Minimum wage was cut in EU-IMF programme and the raised again by new government.)
- Different message is correct: Flexible labour markets facilitate adjustment.
- But difficult to reform in recession and positive results are slow while negative impact of austerity is immediate.

Falling Sovereign Yields and a Return to the Bond Market



The Negatives

- Many previous sources of fast growth are played out.
- Factors constraining domestic demand
  - More fiscal adjustment to come.
  - Banks still overly reliant on central bank funding and reducing credit.
  - Overhang of personal and business debt.
  - Mortgage arrears rising to critical levels.
  - Uncertainty about the health of banks.
- Reliant on exports from growth but Euro Area and UK economies are in a slump.
- Hard to see return to projected rates of growth (and significant downward movement in debt-GDP ratio) without a general EU recovery.