VAKIFBANK GLOBAL ECONOMY WEEKLY

The Importance of Financial Stability:

The Case of Ireland

T. Vakıflar Bankası T.A.O

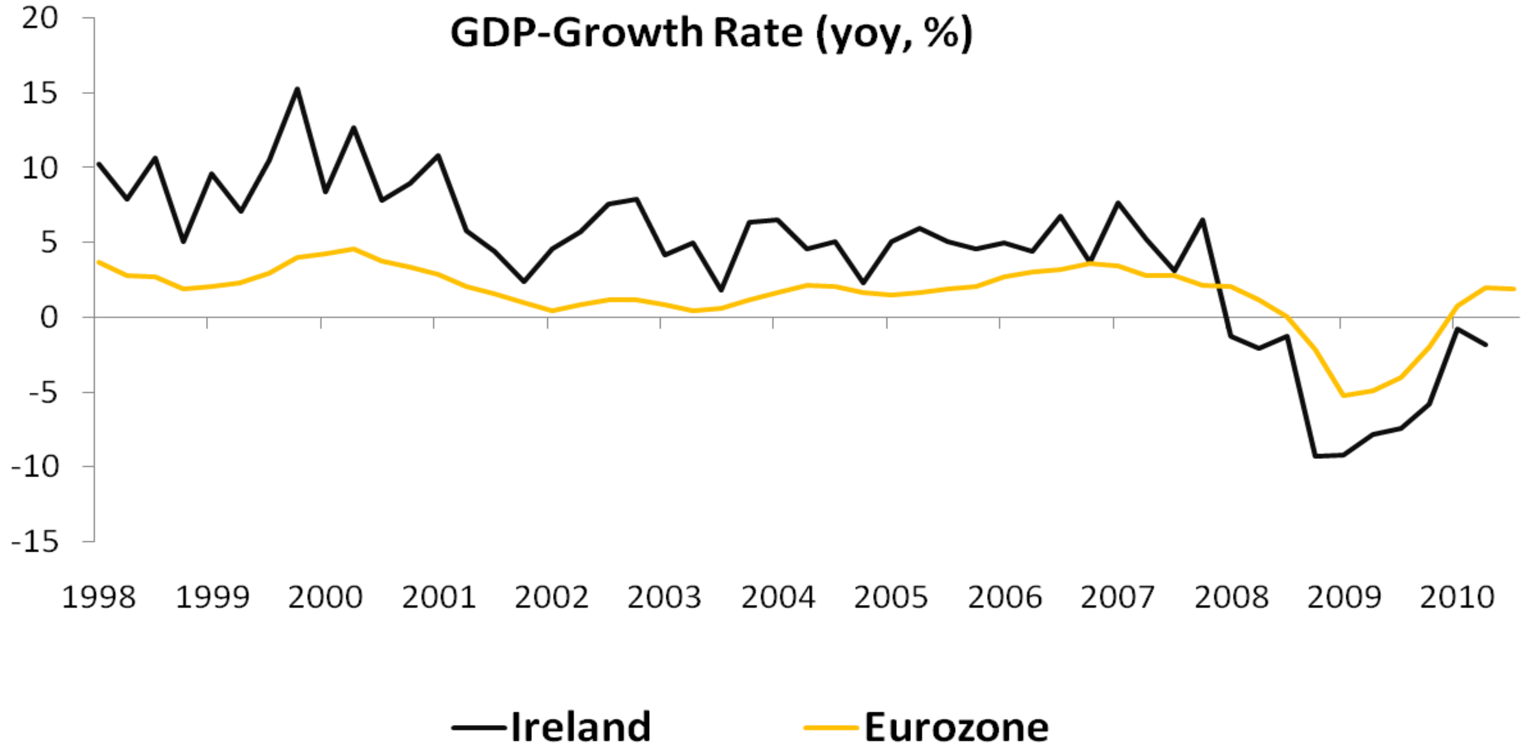
13 December 2010

No: 10

Vakıfbank Economic Research

Ireland, the so-called "Celtic Tiger"...

Ireland with positive macroeconomic indicators as high and sustained economic growth, low inflation and a growing budget surplus was called as "Celtic Tiger" between the years 1995 and 2007. In 2008 with the start of global financial crisis the Irish economy underwent a dramatic reversal.

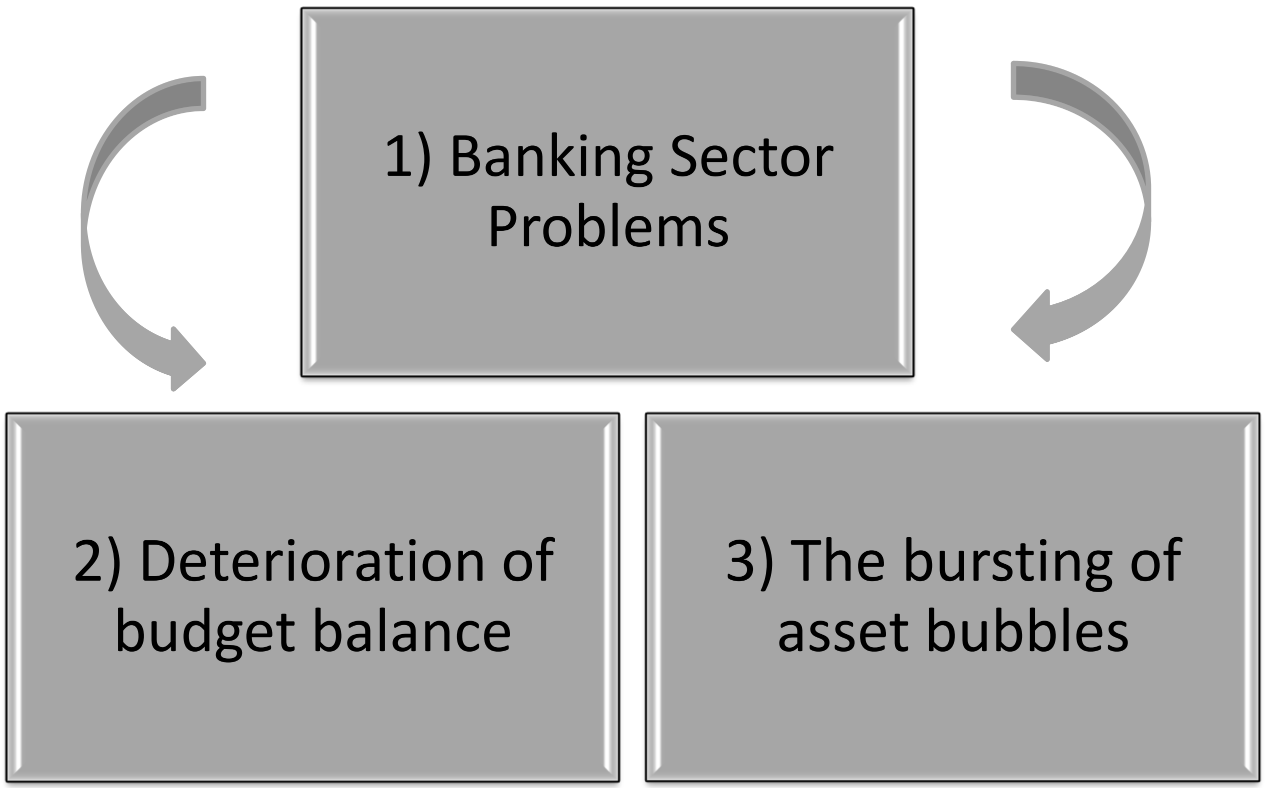


Source:Bloomberg

The causes of Irish financial crisis between the years 2008 and 2010...

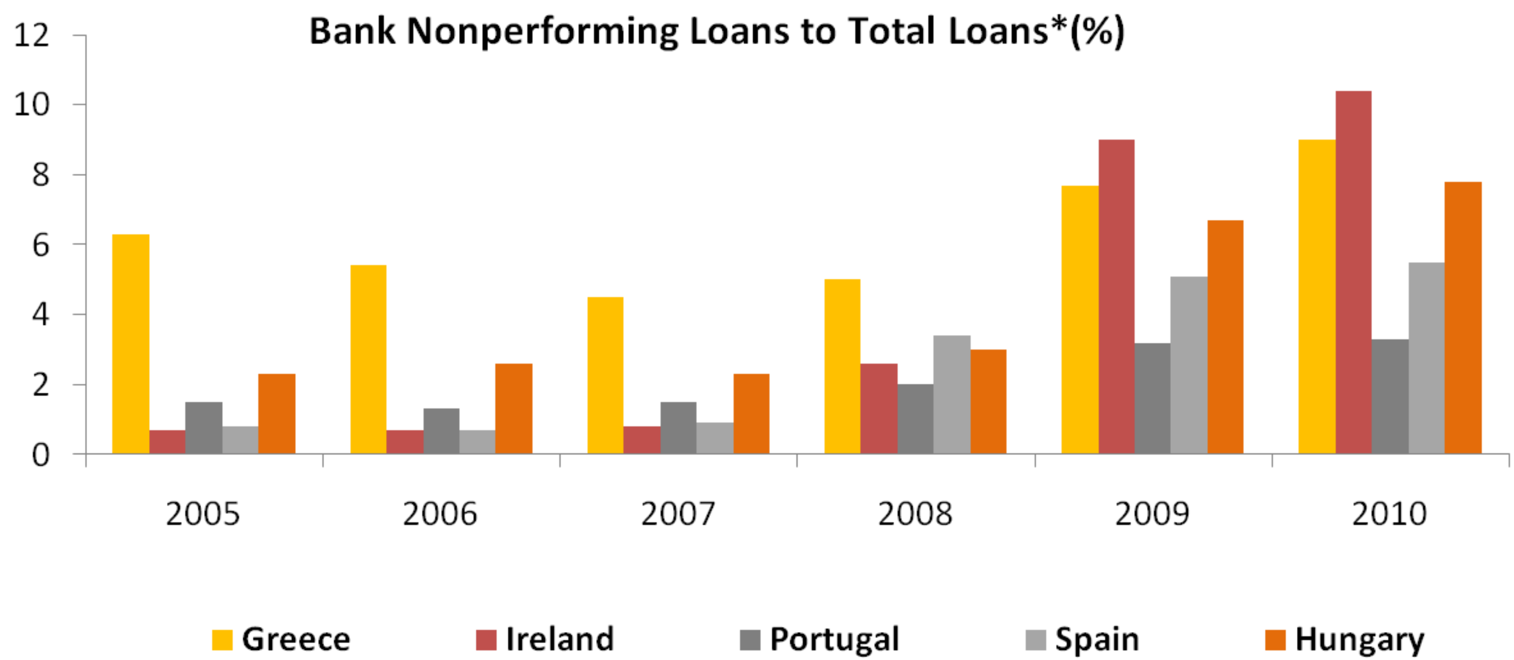
Ireland went into recession in 2008, with a sharp rise in unemployment rate and budget deficit. This report analyses the ***causes of the recession in Ireland, efficiency of rescue package and the importance of financial stability.***

3 main causes of Irish financial crisis



1) Banking sector problems...

Banks in Ireland had a large loan expansion in "Celtic Tiger" period. After the financial crisis, deterioration of banks' balance sheets together with the increasing ratio of nonperforming loans to total loans have made Irish banking sector fragile.



Source: IMF
*June 2010

Ireland has the largest assets/GDP ratio among PIIGS countries...

The size of Irish banks' balance sheets are approximately 8 times larger than the size of its GDP. As compared to the other countries' assets or assets/GDP ratios, it is remarkable that Irish banks would become problematic when they could not cope with debt burden.

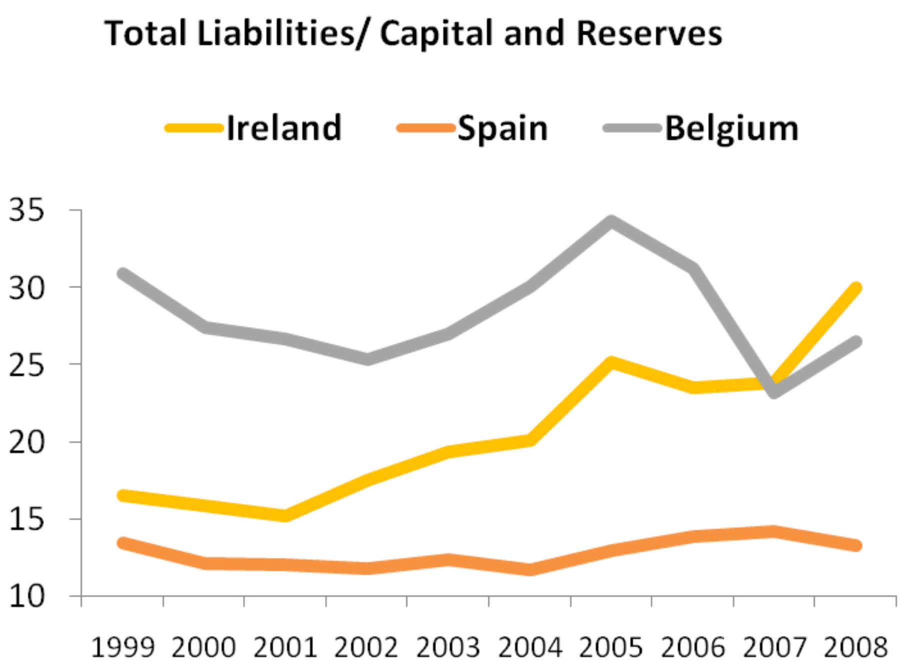
2009 (billion euro)

	GDP	*Assets*	*Loans*	*Assets/GDP (%)*	*Loans/GDP (%)*
Ireland	**163.54**	**1306.69**	**590.86**	**799**	**361**
France	1907.15	7656.70	2127.80	401	112
Belgium	339.16	1217.80	450.60	359	133
Germany	2397.10	7436.10	3161.18	310	132
Spain	1051.15	3238.24	1837.04	308	175
Portugal	167.63	491.72	294.19	293	175
Greece	237.49	418.65	227.39	176	96

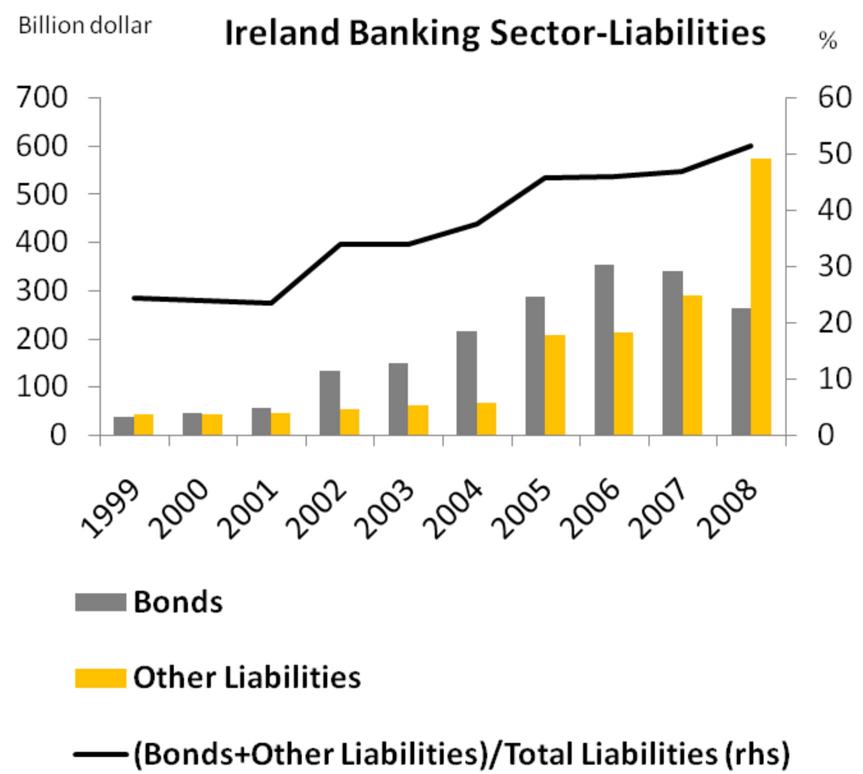
Source: EBF (European Banking Federation)

Banking sector still has problems…

Irish banks have an accelerated leverage ratio trend when leverage ratio is represented as total liabilities/capital and reserves. Relatively high leverage ratio has made Irish banking sector vulnerable to risks. The upward trend in 'liabilities to other banks and bonds/total liabilities' ratio indicates that there has been a credit expansion in banking sector's balance sheet.

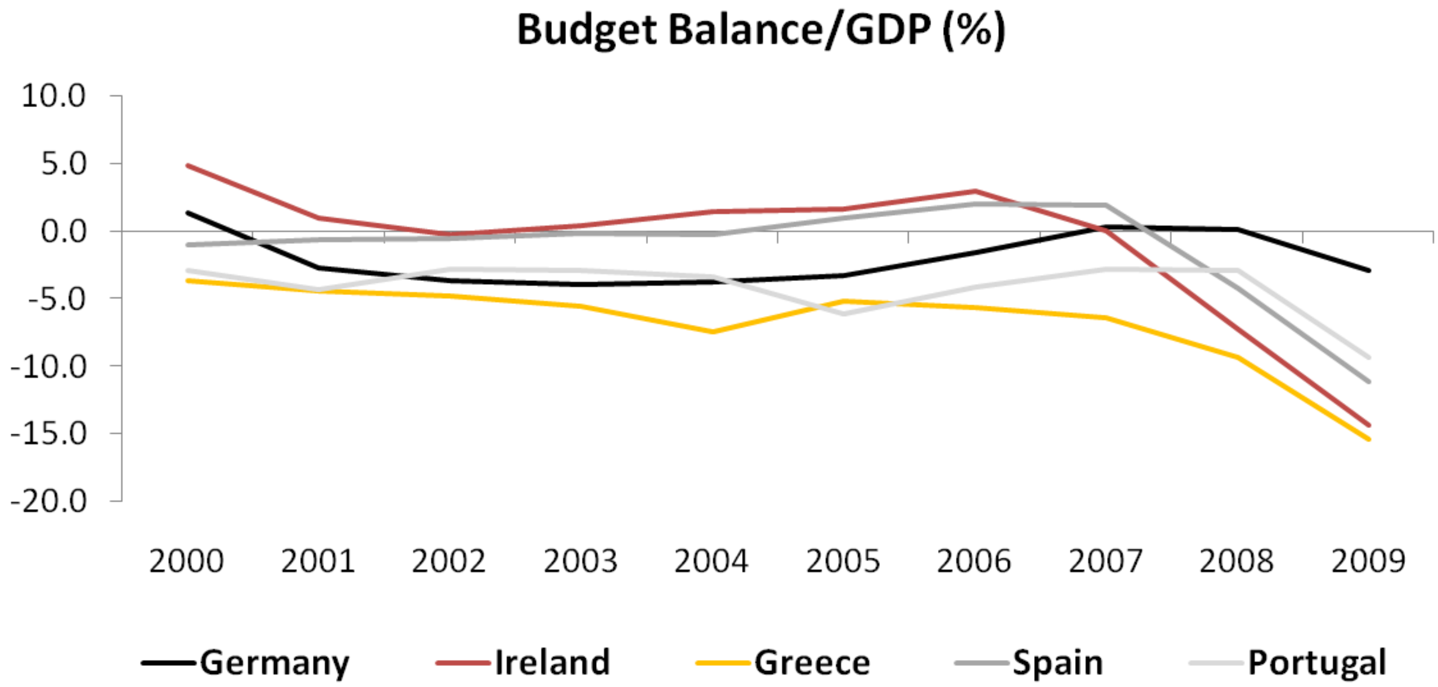


Source: OECD



Source: OECD

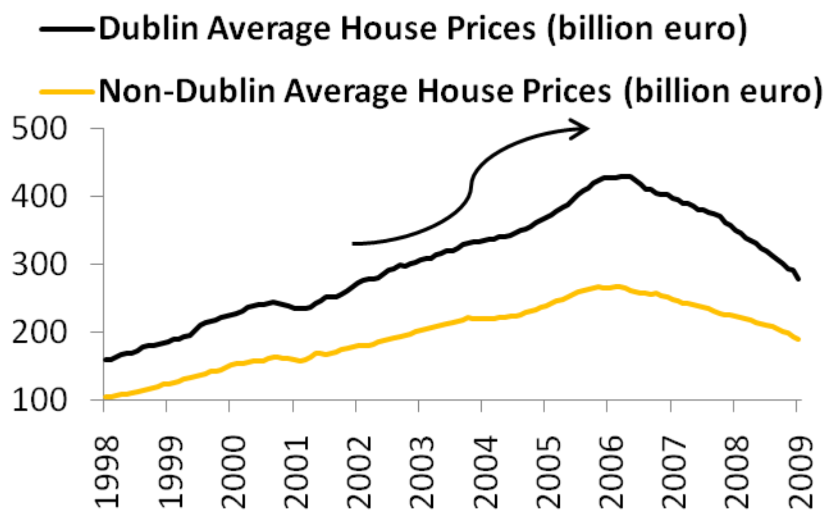
2) Deterioration of budget balance...



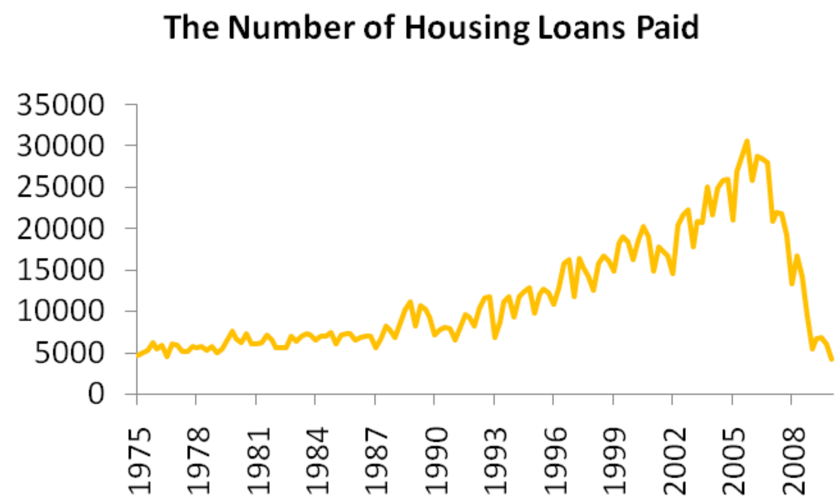
Source: Eurostat

In recent years Ireland experienced deterioration in deficit outlook and rapid increase in government deficits. The banking system supports, bank rescues and recapitalization of banks caused Ireland government budget widen sharply. According to IMF's forecasts, Ireland public debt/GDP ratio is expected to be 71% in the next few years.

3) The bursting of asset bubbles…



Source: Bloomberg



Source: CEIC

House price in Ireland went on to triple between the years 1995 and 2007. With a combination of increased speculative construction and rapidly rising prices the property bubble had built up. After the financial crisis, the housing crash followed by credit crash. Hence, banks faced huge losses and the bank rescues pushed costs higher for the Irish government.

The budgetary measures taken in Ireland…

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1) 4-year budget plan of Ireland Government

4-year Budget Plan

It is targeting €15 billion savings to decrease the budget deficit from 14.4% of GDP to 3% of GDP by 2014

€10 bn of €15 bn budget plan will be achieved through expenditure cuts while the remainder will rely on revenue-boosting measures. €6 bn of this will be achieved in the first year of the plan.

Expenditure cuts include a reduction in the minimum wage and public sector salaries.

Revenue-boosting measures include an inrease in the VAT rate from 21% to 23% altough the corporate tax rate will remain at 12.5%.

Key Budget Projections	2010	2011	2012	2013	2014
GDP Growth Rate (%)	**0.3**	**1.7**	**3.2**	**3.0**	**2.8**
BudgetDeficit/GDP (%)	**31.9**	**9.4**	**7.3**	**5.8**	**2.8**
Debt Stock/GDP (%)	**94.2**	**98.6**	**102.0**	**102.5**	**100**
Source: Ireland Finance Department					

- The government forecasts GDP growth of 2.75% between 2012-2014. The government also expects a peak in the debt-to-GDP ratio. National debt is expected to be 102% of GDP by 2013 and 100% of GDP by 2014.

2) EU-IMF rescue package

- Both IMF and EU called that budget plan is positive for the solution of crisis in Ireland.
- After the government had approved the budget programme, the €85 bn Irish financial rescue package was announced.

€85 bn rescue package		
€22.5 bn from IMF, €45 bn from EU, €17.5 bn from Ireland domestic sources	€35 bn will be used for the banking system, of which €10 bn are to be used for immediate sources	€50 bn will be used to cover the budget financing needs.

Financial stability is important!...

Banking sector crisis in Ireland is the main reason of recent debt crisis. This reflects the importance of the effectiveness of financial stability in the country's economy.

The bailout of Ireland is important for global financial system, as German and British banks combined for over half of the exposure. The US followed Germany as the third.

This National Plan with Rescue Package will enable Ireland to build upon many positive aspects of the economy. However, its sustainability depends on the other EU countries performance.

Serkan Özcan
Chief Economist
+ 90 312 455 7087
serkan.ozcan@vakifbank.com.tr

Seda Meyveci
Economist
+ 90 312 455 8485
seda.meyveci@vakifbank.com.tr

Selin Düz
Researcher
+ 90 312 455 8493
selin.duz@vakifbank.com.tr

Fatma Özlem Kanbur
Researcher
+ 90 312 455 8482
fatmaozlem.kanbur@vakifbank.com.tr

T. Vakiflar Bankasi T.A.O
Ataturk Bulvari No: 207
Kavaklidere 06683 Ankara, Turkey
www.vakifbank.com.tr

Vakifbank Economic Research
ekonomik.arastirmalar@vakifbank.com.tr