Learning from the Irish Crisis

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Prepared for the Central Bank of Iceland conference:

Looking back and looking forward: How do we preserve monetary and financial stability"

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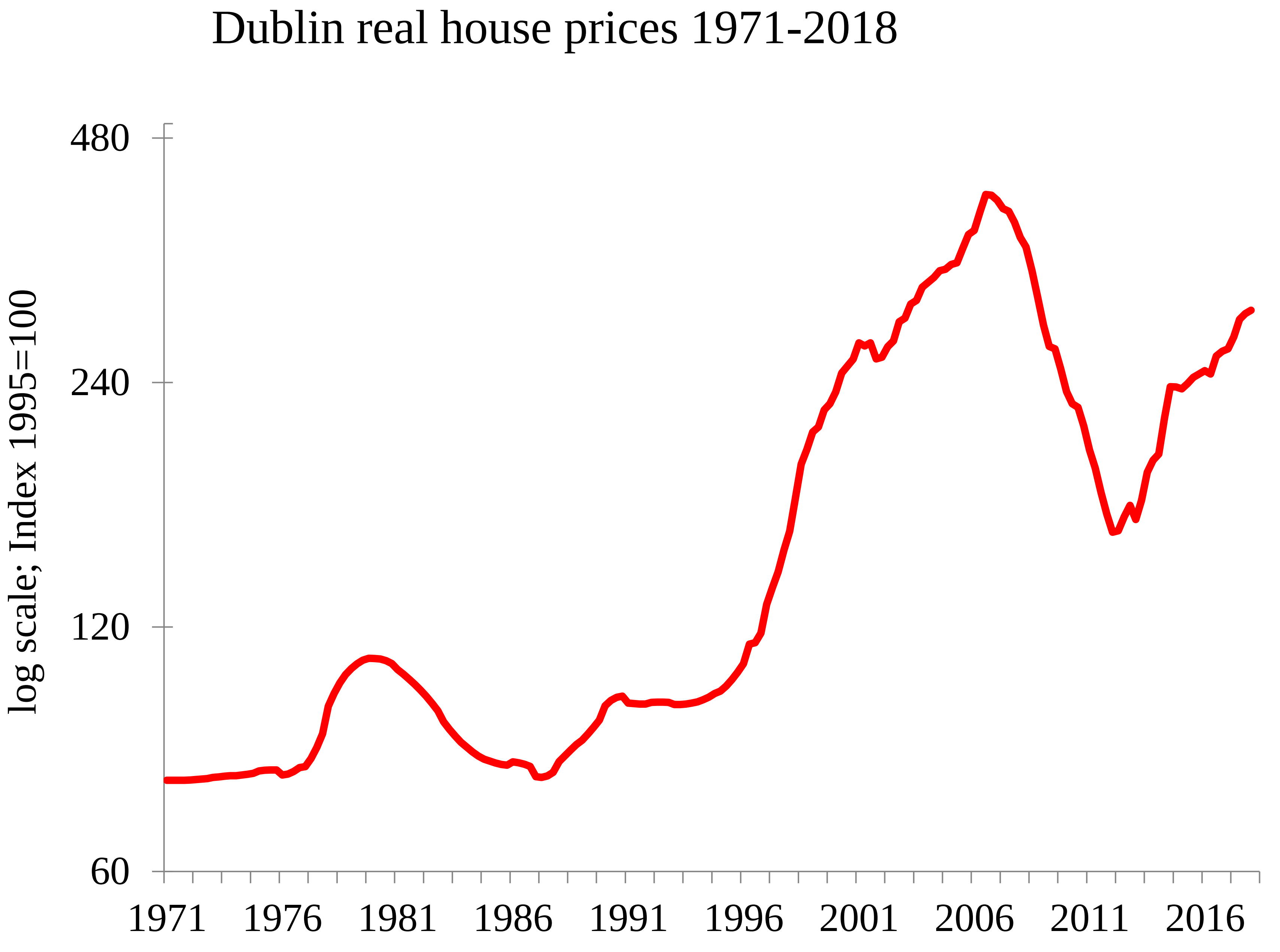
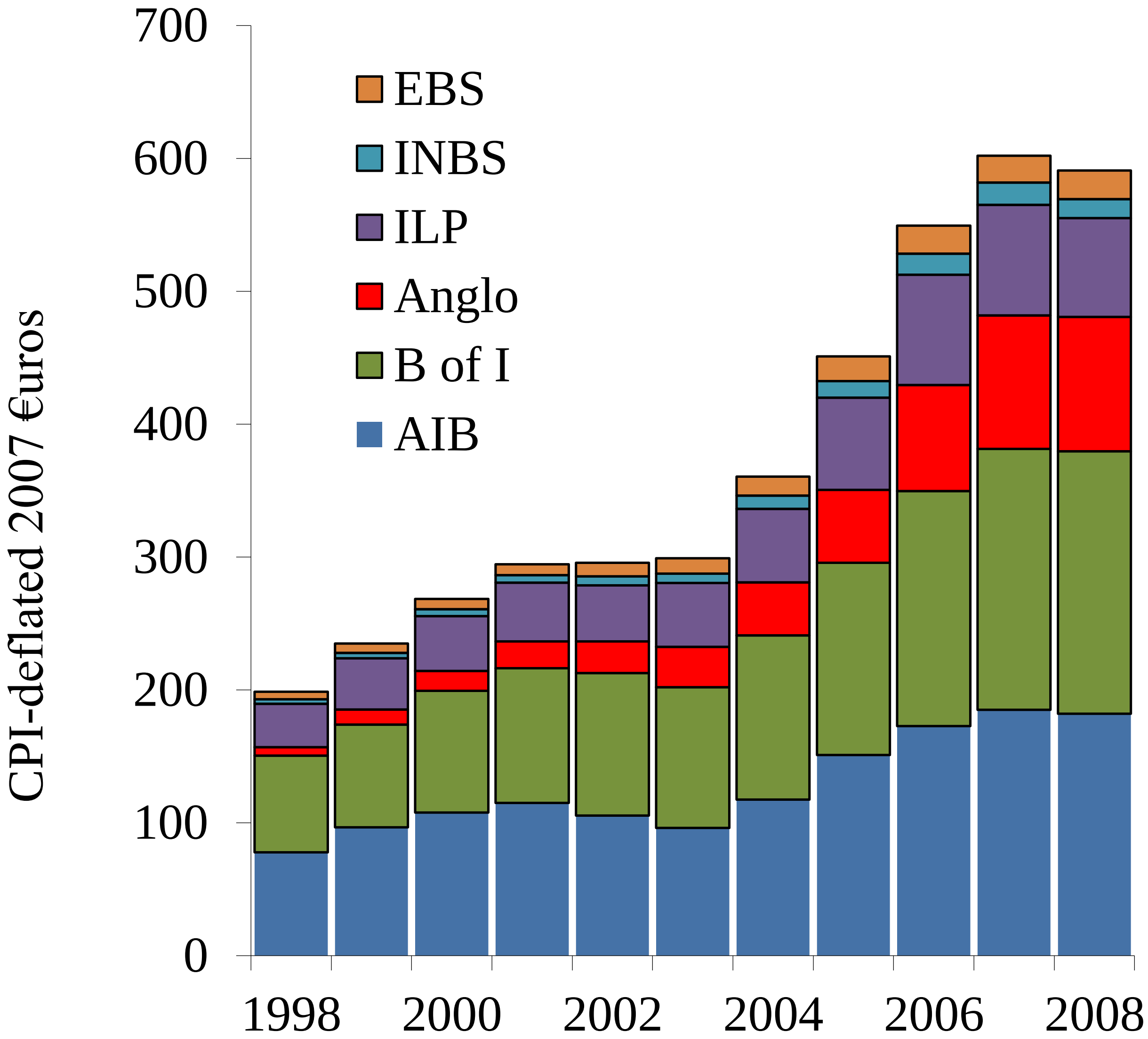
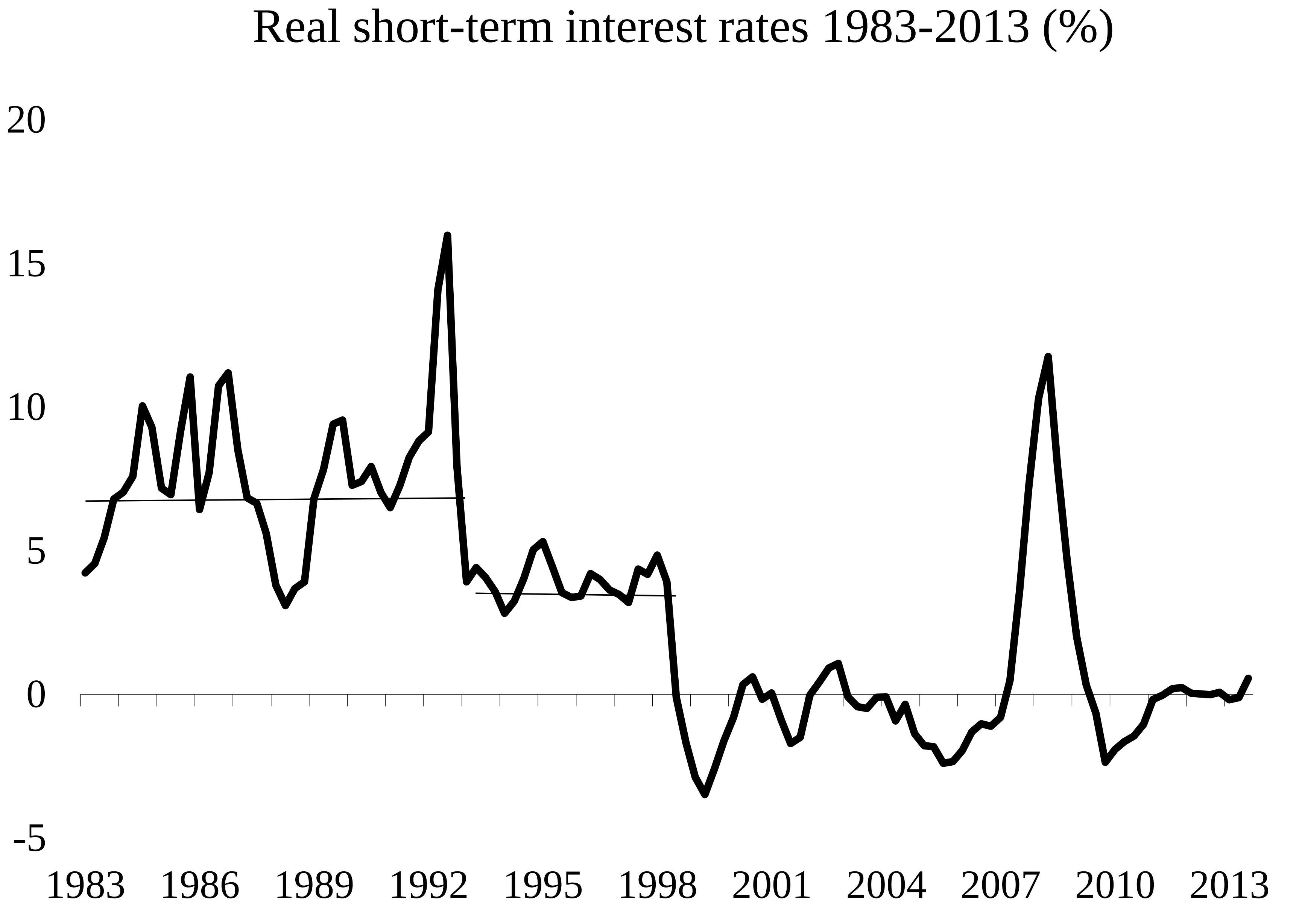
1. Sources

- Property price and construction boom
- Propelled by “Celtic Tiger” myth/narrative
- Financialization: fuelled by bank foreign borrowing at low international interest rates
- Banks poorly managed and weakly supervised
- (Some criminal abuses by bankers--less than Iceland)
- Boom led to fiscal and wage/price relaxation
- Bust collapsed construction employment; and exposed underlying fiscal imbalances and bank insolvency

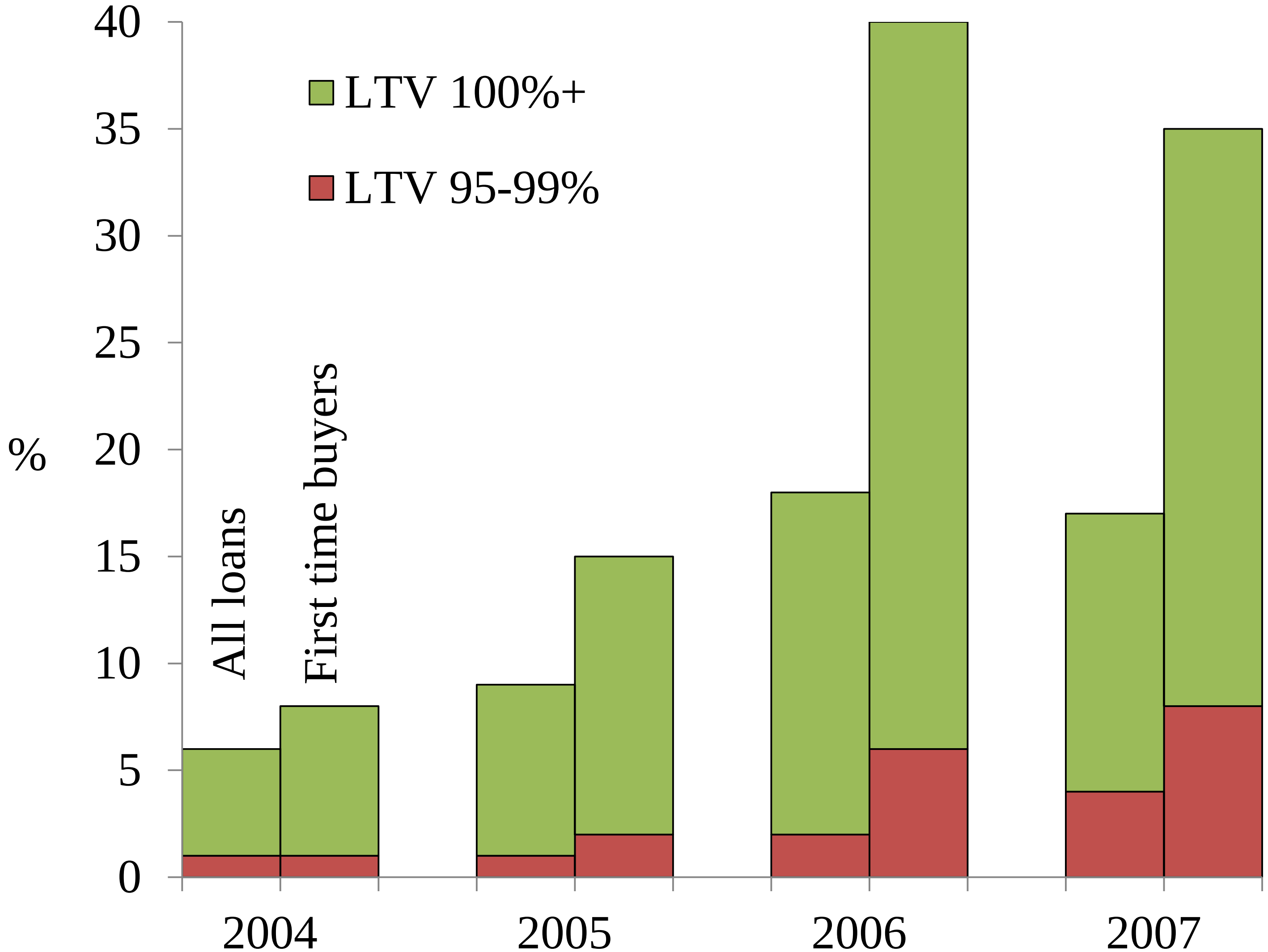

Dublin real house prices 1971-2018
log scale; Index 1995=100
480
240
120
60
1971
1976
1981
1986
1991
1996
2001
2006
2011
2016

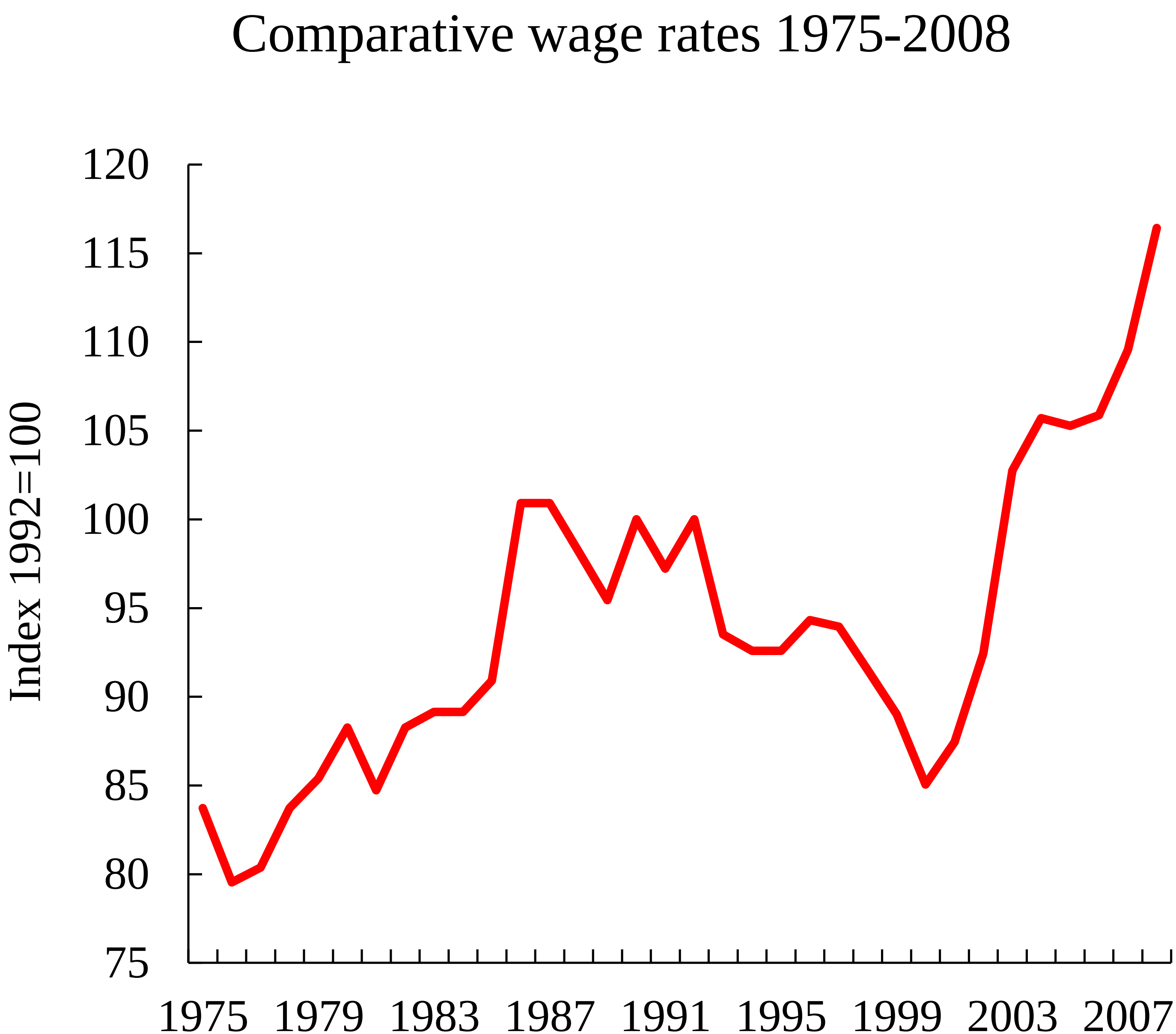
Size of Irish banks' balance sheets 1998-2008




Real short-term interest rates 1983-2013 (%)
20
15
10
5
0
-5
1983
1986
1989
1992
1995
1998
2001
2004
2007
2010
2013

Share of loans made at high loan-to-value ratios 2004-8




Comparative wage rates 1975-2008
Index 1992=100
120
115
110
105
100
95
90
85
80
75
1975
1979
1983
1987
1991
1995
1999
2003
2007

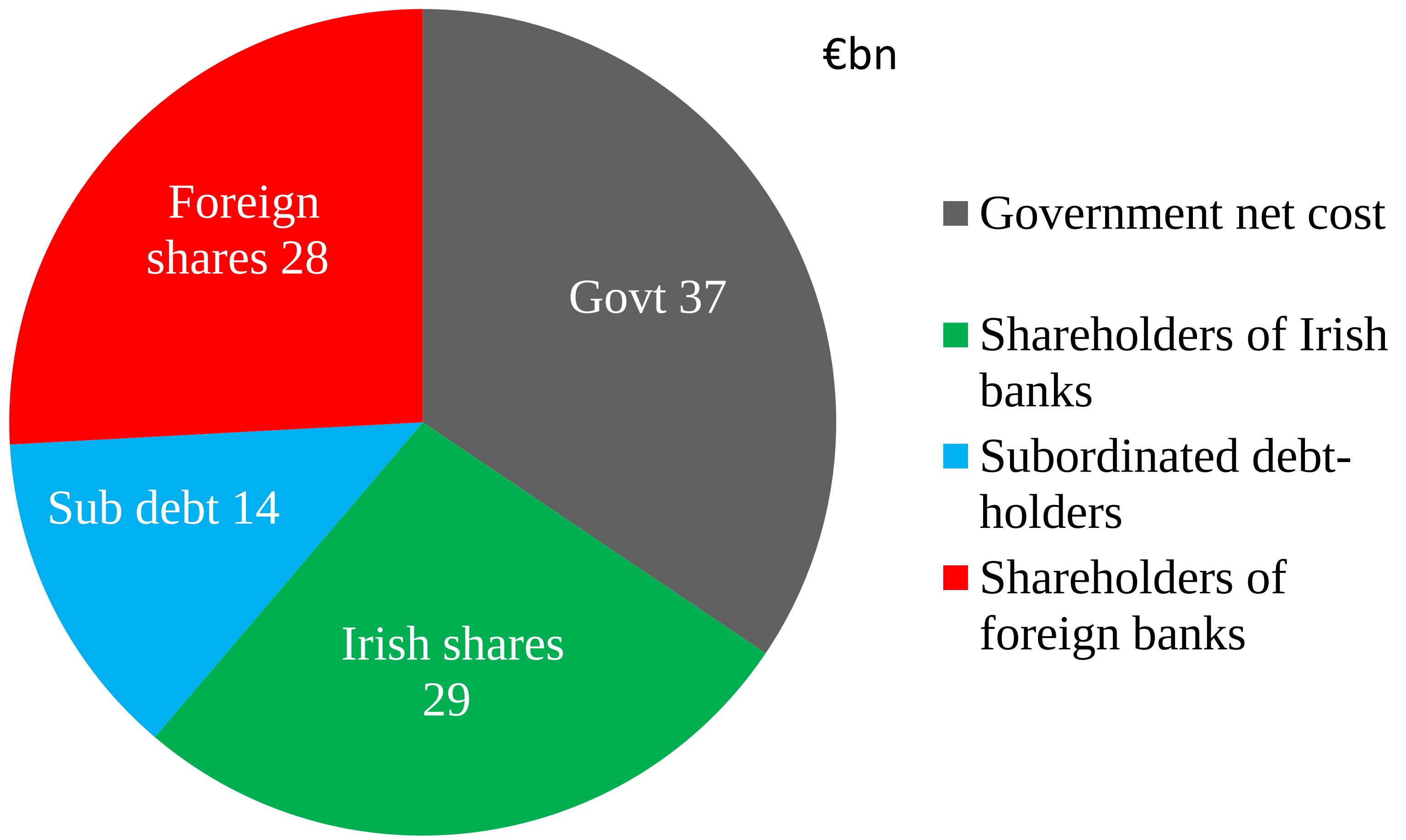
2. Tailor-made policies

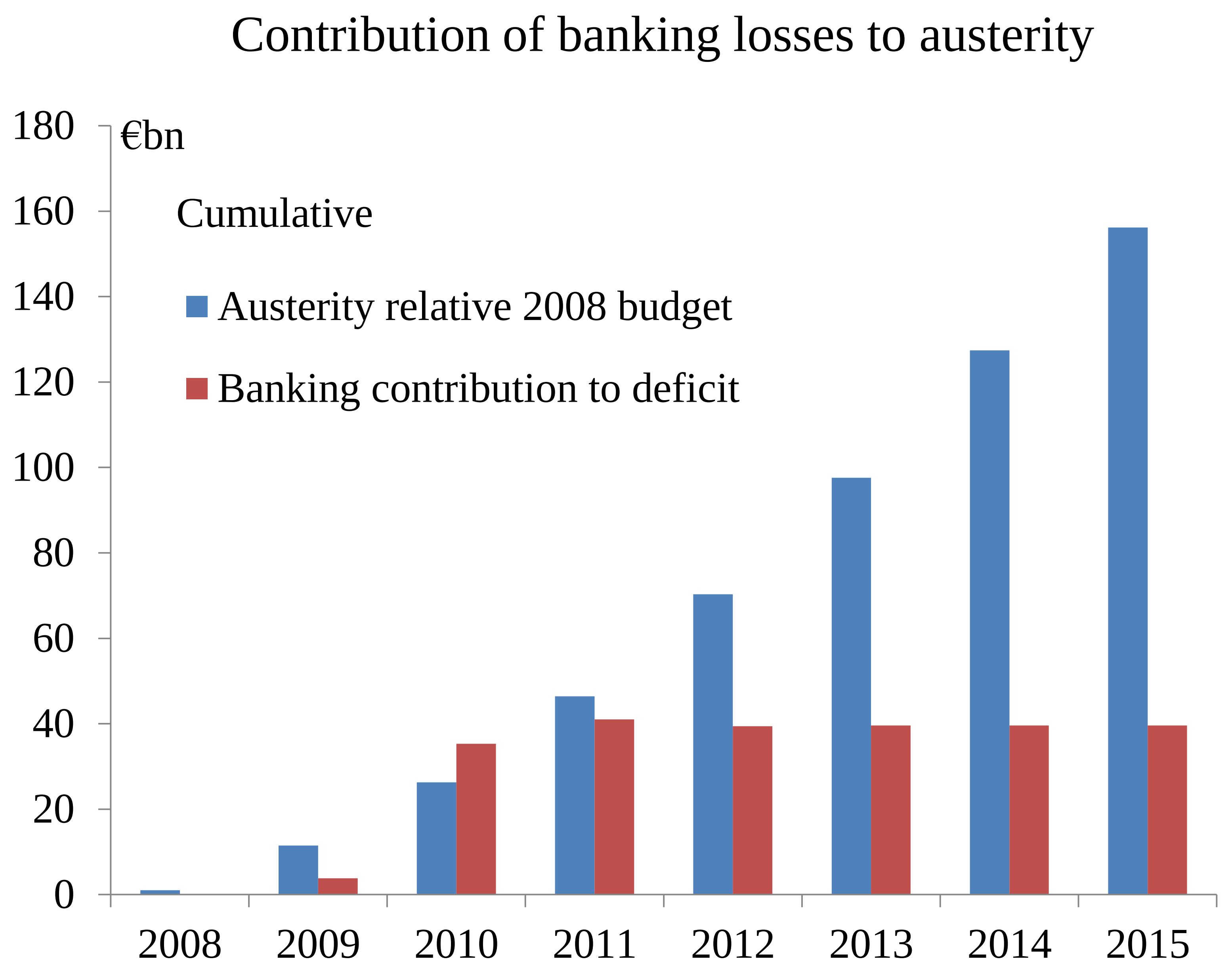
- Blanket guarantee (Sept 2008) socialized about 1/3 of banking losses
- Big property loans transferred from banks to asset management agency NAMA
- Calculating losses and recap needs with granular asset quality reviews and stress tests
- Banks recapitalized with Government and foreign shareholders (plus sub debt holders)
- Worst banks (Anglo and INBS) liquidated

2. Tailor-made policies (continued)

- Sharp fiscal adjustment from 2008 (unwinding earlier tax cuts and public servant salary increases)
- Adjustment supported from end-2010 by EU-IMF loan
- Lenders vetoed haircuts on unguaranteed bank debt, despite doubts about fiscal debt sustainability
- Lowering of interest rates and lengthening of maturities on the EU loans helped remove those doubts
- Financing arrangements through CB for liquidated banks also helped

Who paid? Allocation of net banking losses

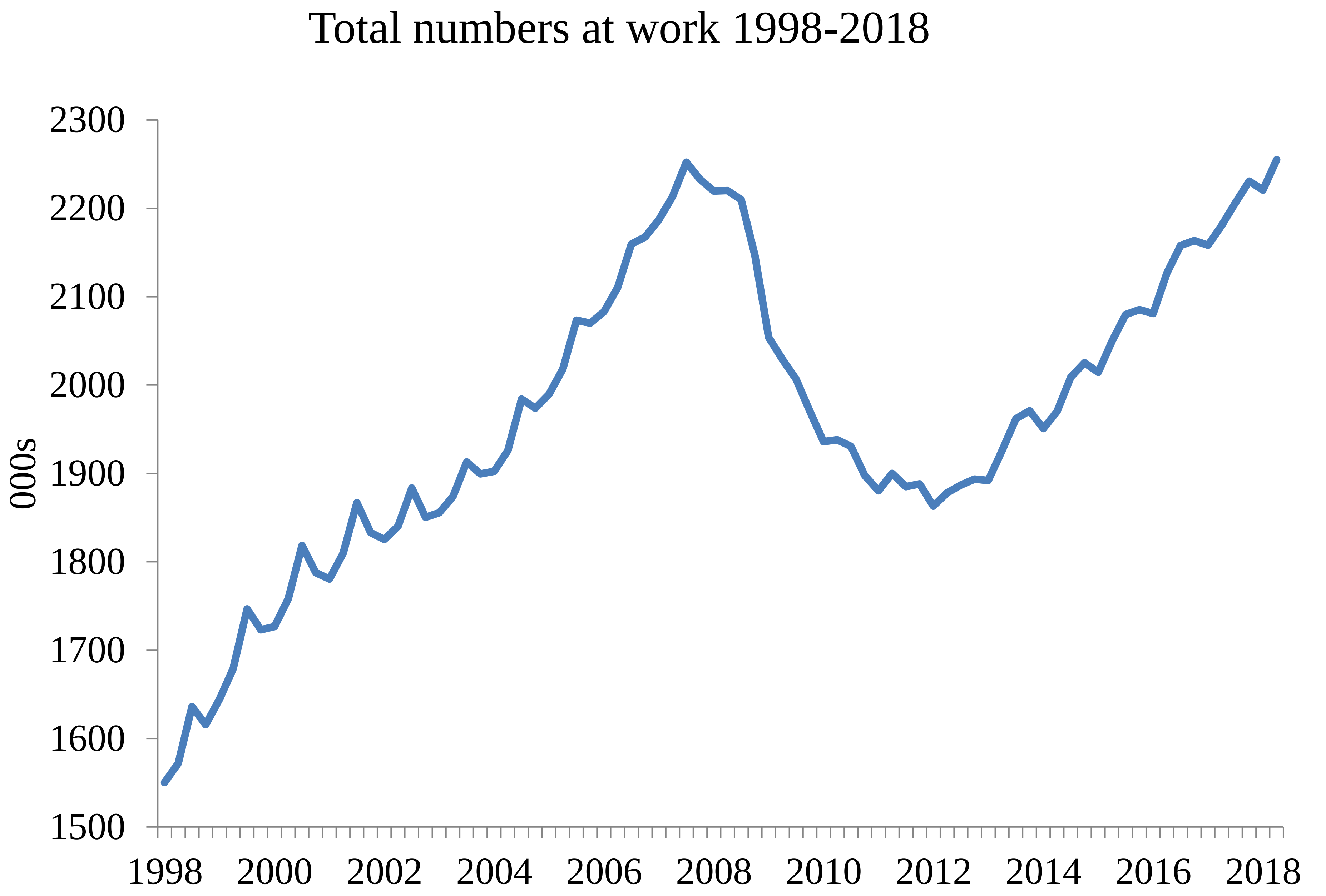


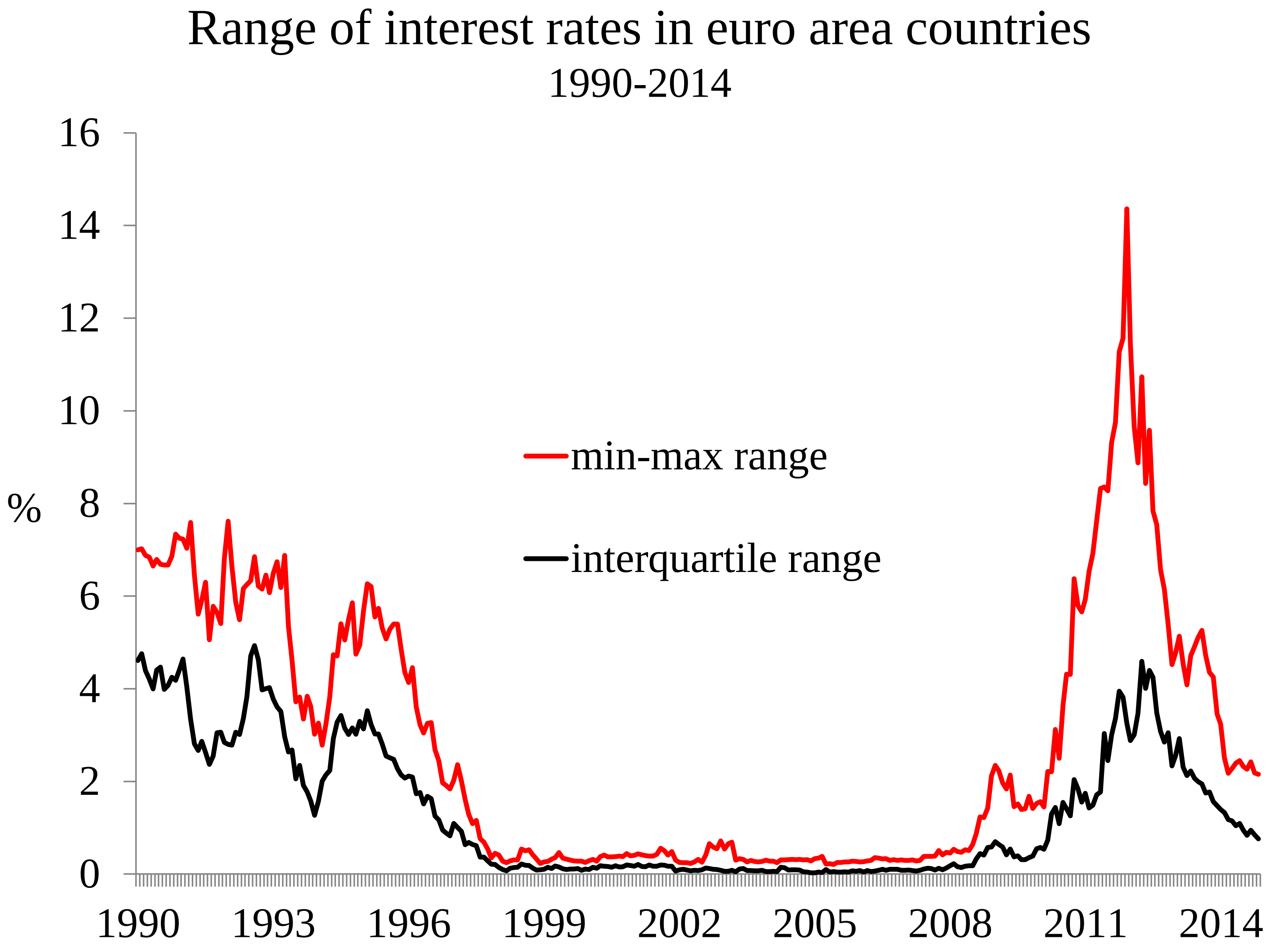


Contribution of banking losses to austerity
€bn
Cumulative
Austerity relative 2008 budget
Banking contribution to deficit
180
160
140
120
100
80
60
40
20
0
2008
2009
2010
2011
2012
2013
2014
2015

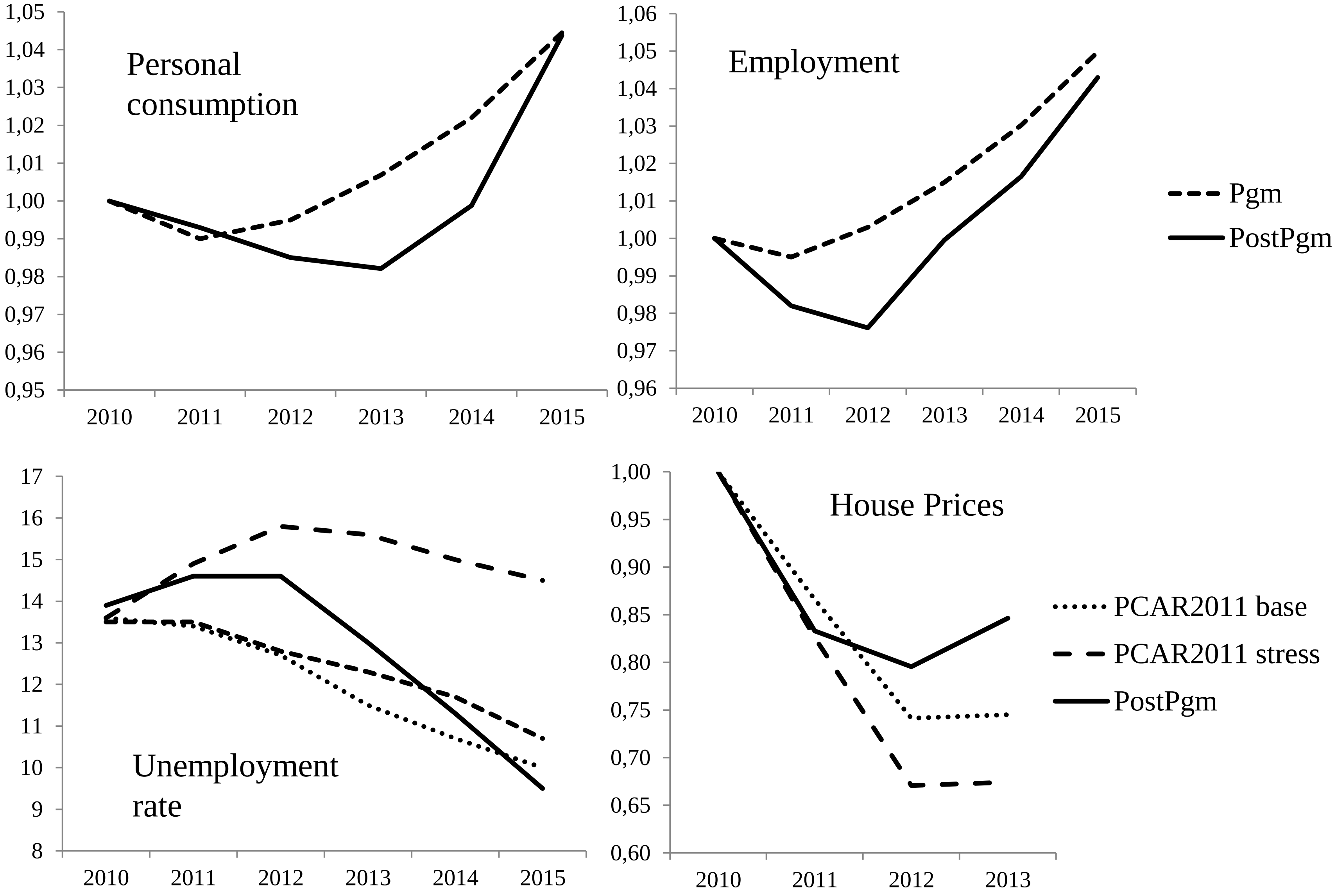
3. Recession and recovery

- Global recession on top of construction collapse meant soaring unemployment and emigration 2009-10
- Progressive recognition of banking losses and fiscal imbalance resulted in loss of market access September 2010
- Credible macro forecasts and banking stress test achieved by early 2011
- Easing of Program's financial conditions put turnaround in prospect
- Sustained and solid recovery from mid-2012


Total numbers at work 1998-2018
000s
2300
2200
2100
2000
1900
1800
1700
1600
1500
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018

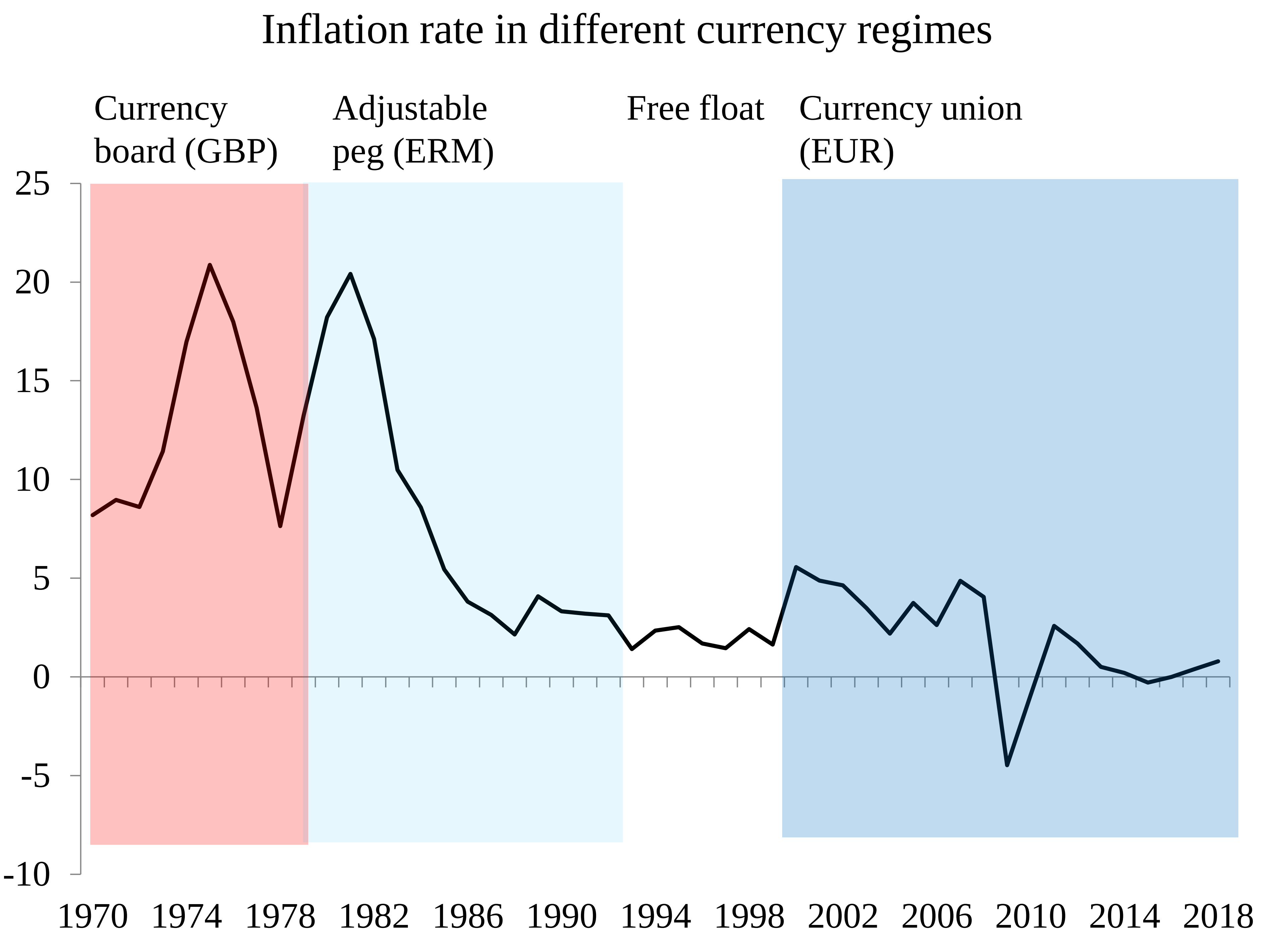

Range of interest rates in euro area countries
1990-2014
%
16
14
12
10
8
6
4
2
0
1990
1993
1996
1999
2002
2005
2008
2011
2014
min-max range
interquartile range

Programme projections and outcome

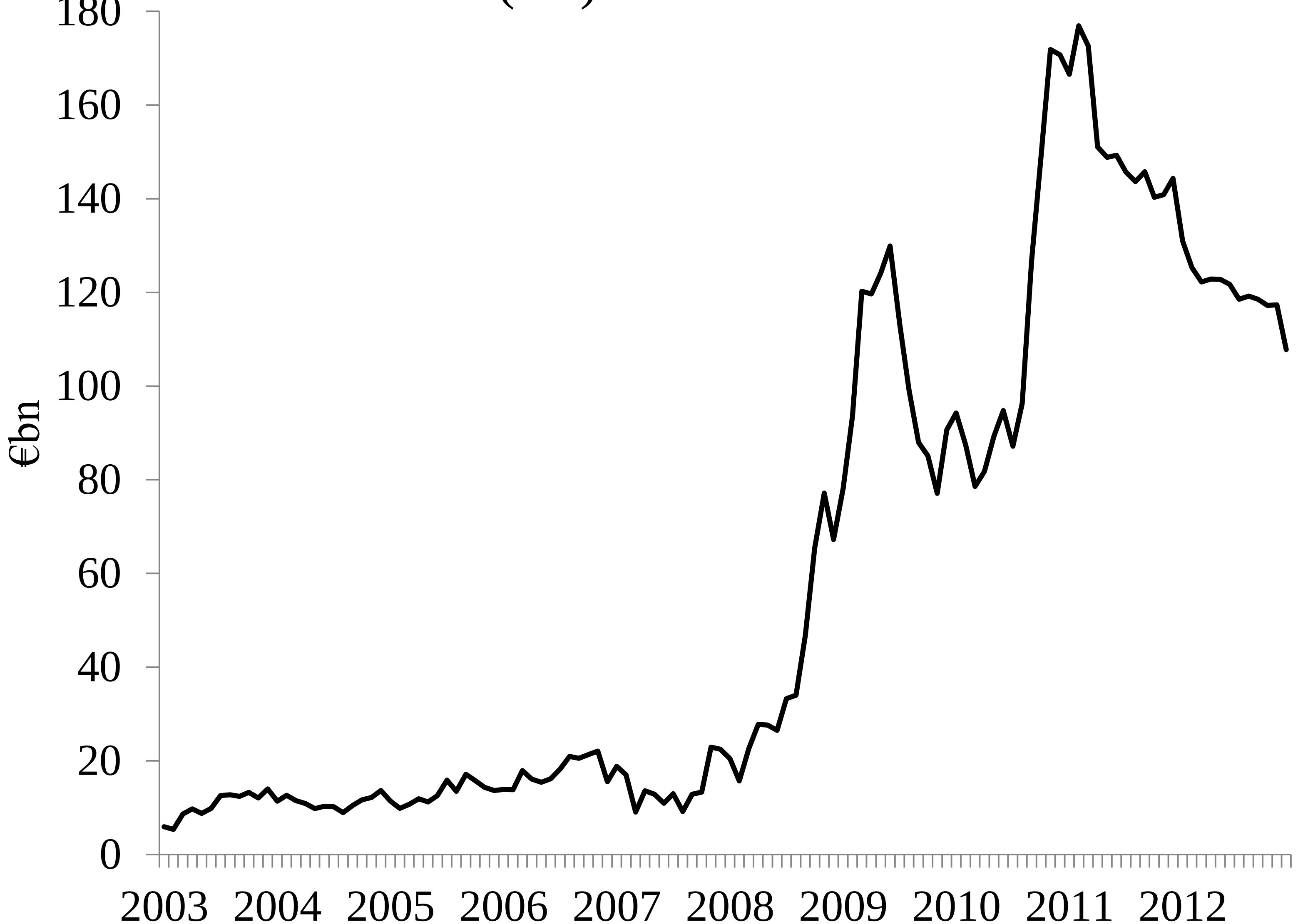


4. Impact of monetary regime

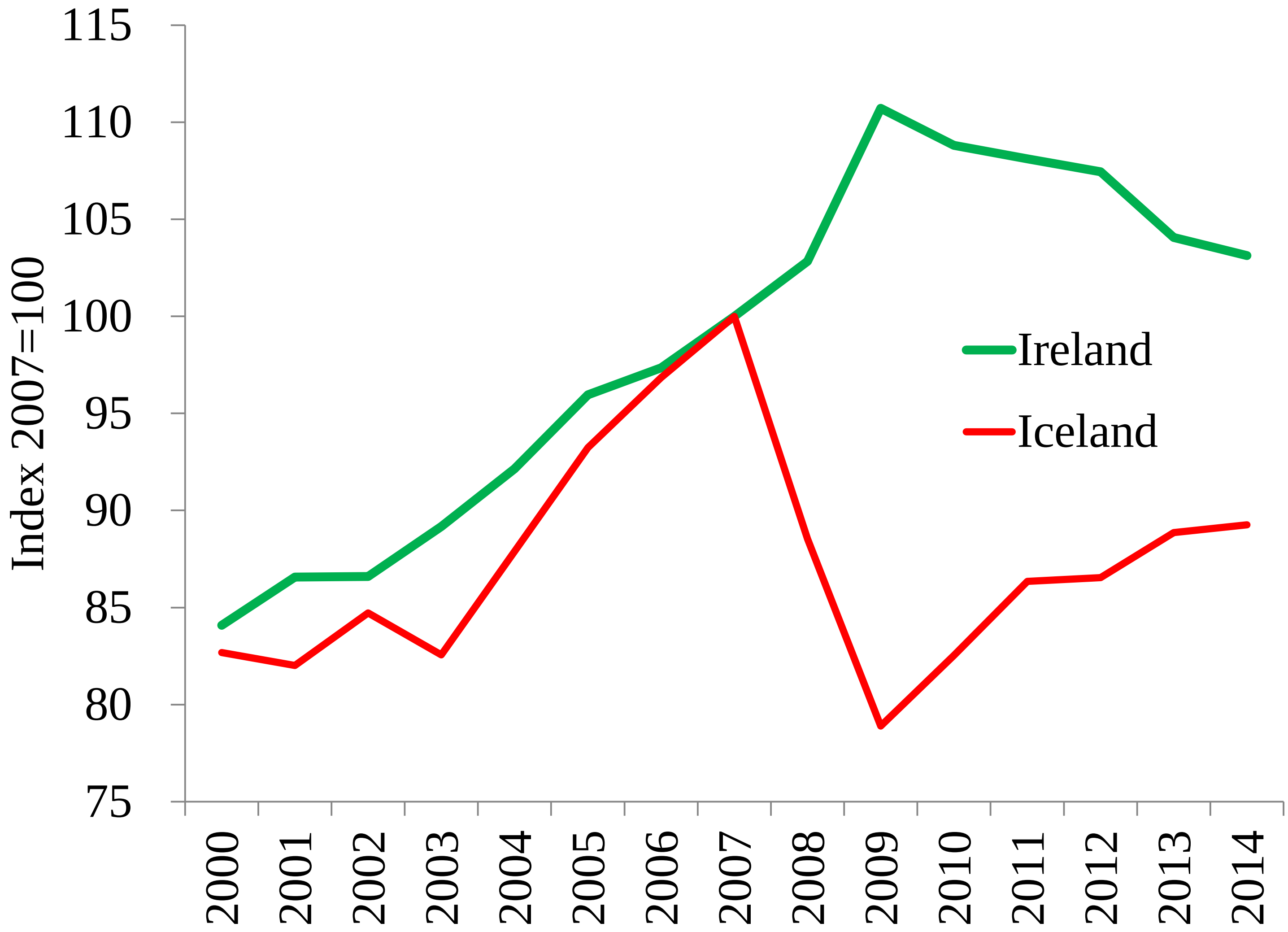
- Almost no effect on inflation
- Liquidity available throughout from ECB (despite threats)
- **Contrast with Iceland: real wages slow to fall in Ireland so employment fall is greater than in Iceland.**
- Prolonged Central Bank financing of deposit outflow from failed banks avoids crippling interest costs on this element


Inflation rate in different currency regimes
Currency board (GBP)
Adjustable peg (ERM)
Free float
Currency union (EUR)
25
20
15
10
5
0
-5
-10
1970
1974
1978
1982
1986
1990
1994
1998
2002
2006
2010
2014
2018

Central bank financing of Irish banking system (net) 2003-12



Real wages: Ireland and Iceland



5. Preventing a recurrence

- A regulatory push to improve quality of banking (operations; loan appraisal; culture)
- Macroprudential instruments (including limits on high LTV, LTI mortgages) introduced to avoid recurrence of price-credit-price boom
- SSM distances bank supervision; CRD increases capital; BRRD provides for bail-in
- Fiscal Advisory Council strengthens analytical debate on fiscal balance

After the crisis

- Sizable debt-related legacy issues remain.
- Still, despite the crisis, employment in Ireland has grown substantially in the 20 years of the euro
- But its close ties to the UK make Ireland exceptionally vulnerable to a no-deal Brexit (EW trade of more economic importance than the Irish border)