Support package for Ireland

Unease gradually increased on the financial markets during the autumn as a result of the weak of public finances in Ireland. This unease mainly related to the Irish state's costs for restructuring the nation's banking sector. Declining confidence in the Irish banks meant that they became increasingly dependent of the ECB for funding and that the Irish state's funding became increasingly expensive. Eventually, the Irish government decided to seek financial support from the EU and the IMF. The Swedish banks have limited exposures to Ireland, which indicates that any direct contagion effects would also be limited. On the other hand, Swedish banks may be indirectly affected if the events in Ireland have an impact on the global capital markets and the unease spreads.

Latest developments in countries with weak public finances

During the summer and early autumn, the situation for euro area countries with weak public finances stabilised. A contributing factor to this stabilisation was that most of the countries announced credible programmes for coming to terms with their public-finance problems. Spain and Portugal also managed to issue government bonds during the summer.

In the early autumn, signs of weaker macroeconomic development in the United States began to increase concern that lower global growth could affect the recovery in the euro area. Lower growth abroad could in turn undermine the chances of successful fiscal policy consolidation in the countries with weak public finances. At the same time, the attention of the financial markets began to turn to the problems in the Irish banking sector. As it became increasingly uncertain what it would cost the state to restructure the banking sector, yields on Irish government bonds increased. Proposals from Germany to make the euro areas' crisis mechanism permanent and to let private investors cover some of the costs in connection with future funding programmes also increased unease on the financial markets. On 20 November, the Irish prime minister confirmed that discussions had begun on a crisis package from the IMF and the euro area.

One difference compared to the unease that arose in May before Greece applied for support from the IMF and the EU is that unease over the situation in Ireland has not had such strong contagion effects on other sub-markets. Nor has the functioning of the markets been affected to the same extent.[B1] This is probably because all the components of a system for providing financial support are in place given the creation of the EFSF/EFSM during the spring of 2010. In addition, it can be noted that the crisis in Greece stemmed from public finance problems that then spread to the Greek banks, while the crisis in Ireland stems from problems in the banking sector that spilled over into the realm of public finances.

Background to the crisis in Ireland

Starting at the end of the 1990s, and particularly between 2005 and 2007, a generous provision of credit led to a dramatic increase in the prices of housing and commercial property in Ireland. In parallel with this, rapid wage increases also helped to undermine the competitiveness of the country. All in all, this led to the build-up of significant risks, particularly in the Irish banks. The banking system increased in size and in 2009 the banks' assets in relation to GDP amounted to over 300 per cent of GDP (see Chart 3:4). Consequently, Ireland was hit hard when the financial crisis began. GDP fell by over 7 per cent in 2009 as a result of reduced consumption and decreased investment. The crisis led to a fall in property and housing prices, which had serious negative effects on the Irish banks. The crisis also seriously undermined public finances in Ireland and the budget deficit for 2009 reached -14 per cent of GDP.[B2]

B1 Read more about the developments in Greece in Sveriges riksbank (2010), "Financial Stability Report 2010:1".

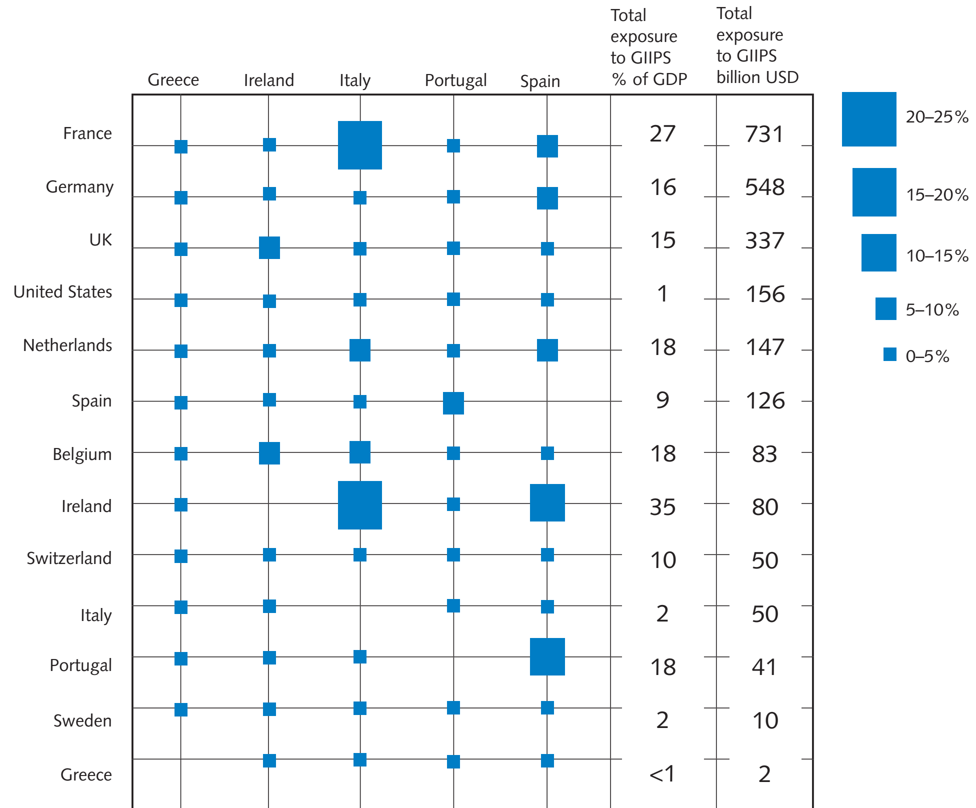
In the autumn of 2008, the Irish government responded by launching a major savings programme that aimed to achieve a budget deficit of under 3 per cent by 2014. At the same time, the government introduced a guarantee for depositors and creditors in the domestic banks. The guarantee, which covers approximately 260 per cent of GDP, is more extensive than in other countries.[B3] In addition, one of the domestic banks (Anglo Irish Bank) was completely taken over by the state in 2009 and the authorities set up the National Asset Management Agency (NAMA) to restructure the banking sector. The idea behind the NAMA was that it would purchase impaired property assets from the banks at reduced prices. The banks would then be recapitalised using either private or public funds. All of these measures helped to increase confidence in economic policy in Ireland. Unlike Greece, the country did not therefore need to apply for financial assistance from the IMF and the EU/euro area when the first wave of unease about public finances arose in the spring.

However, it became clear in the autumn of 2010 that the costs of restructuring the Irish banking sector would be much higher than expected. It was calculated that the budget deficit for 2010 would be over 30 per cent of GDP if the restructuring costs were included. In parallel with this, there was also increasing concern that the ongoing fiscal policy consolidation could threaten the weak recovery of the real economy in Ireland. All in all, this led to an increase in funding costs for the Irish state. Irish banks also faced increasing interest rates, which meant that they had problems funding their operations and that they became increasingly dependent on the ECB. Following the steady increase in the interest on the Irish national debt, the Irish government decided to seek support from the countries in the euro area (within the framework of the European Financial Stability Facility (EFSF)) and the International Monetary Fund (IMF). The aid package to Ireland will total 85 billion euros. Of this sum, Ireland contributes with 17.5 billion euros from its reserve funds. The remaining 67.5 billion euros will be received from the IMF, the euro area countries and through bilateral loans from the UK, Denmark and Sweden. Sweden will contribute with 600 million euros. The main terms of the program concern the banking sector restructuring and fiscal policy.

The Irish banking system is dominated by three banks (Bank of Ireland, Allied Irish and Anglo Irish Bank).[B4] In Europe, it is above all banks in the UK and Belgium that have substantial exposures to Irish banks (see Figure B1). Irish banks, on the other hand, have relatively large exposures to Italy and Spain. The direct exposures of Swedish banks to the Irish banking system are, however, very limited.

B2 See IMF (2010), "Staff Report for the 2010 Article IV Consultation".
B3 See IMF (2009), "Staff Report for the 2009 Article IV Consultation".
B4 Of these three banks, Anglo Irish is now wholly-owned by the state, while the Irish government has considerable holdings in the two other banks.

Figure B1. Banks' exposures to Greece, Ireland, Italy, Portugal and Spain (GIIPS), by country
Percentage of GDP, June 2010



Note. GDP relates to 2009.

Sources: Bank for International Settlements and IMF