Patrick Honohan: Recent economic developments in Ireland and the outlook for the economy

Opening statement by Mr Patrick Honohan, Governor of the Central Bank & Financial Services Authority of Ireland, at the presentation of the Annual Report 2009, Dublin, 16 July 2010.

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We are today publishing the Central Bank's 2009 Annual Report. The new Central Bank Reform Bill will formally create a new single unitary organisation. To reflect the reality of our new structures, this is the first such report to incorporate the annual reports of both the Central Bank and Financial Regulator in one publication. We are today also publishing our Strategic Plan, which I expect will also form the basis for our operations going forward under the new legislation, subject to the views of the new Commission.

I am joined by Jim Farrell, Chairman of the Financial Regulator Authority; and Mary Sheehy, Assistant Director General and Secretary of the Bank. We will be happy to take your questions after our brief opening words.

As we state in the annual report, the failures of the banking system here have rocked the economy and the public finances, with severe impacts on all members of society. To address this, the country is faced with three key policy issues:

- stabilisation and normalisation of the banking sector;
- consolidation of the public finances; and
- restoration of the economy's competitiveness position.

For our part in the Central Bank, the focus remains on restoring the health of the banking system.

We have already taken action, in March of this year, to review and set new, higher capital requirements for our main banks. These new levels are based not just on expected loan losses but on potential losses in a stressed situation. We expect that the banks will meet the capital requirements set out by us, which we believe are sufficient to withstand future stress scenarios. A combination of capital raising and asset disposals, underpinned by government support, should ensure they meet those targets by December. We are also carrying out additional stress tests on AIB and Bank of Ireland, as part of the European wide methodology set out by the Committee of European Banking Supervisors (CEBS). Of course, we have already stress tested these banks in the earlier exercise I referred to. Indeed, the severity of the tests we conducted earlier on loan losses exceeds that of the CEBS version, although CEBS has extended the test to reflect events in the sovereign debt markets. We will be providing details of this latest exercise on this day week.

The new requirements we are imposing, along with some other measures, including the recent extension of the guarantee on banks' liabilities, place our banks in a stronger position to start lending again and to support economic recovery.

As for the public finances, it remains critical that the government sticks firmly to the fiscal adjustment programme that it has embarked on. This path, difficult as it may be, is the surest route to supporting the recovery in confidence in the Irish economy both domestically and internationally. The budgetary arithmetic is so far broadly on track and in this context I'd like to emphasise how important it is to interpret correctly the overall government borrowing figures as they are published. In addition to the normal government borrowing requirement, these figures now include the additional net costs of financial restructuring of the banks. The €4 billion injected in 2009 into Anglo Irish Bank already lifted the general government deficit from 11.7% to 14.3% of GDP. This year again, the remaining sizeable net injections into

Anglo and Irish Nationwide Building Society add an even larger sum. So looking at the general government deficit net of bank restructuring costs gives a clearer picture of whether the underlying trend in the public finances is still on track, as it is so far.

The focus internationally on the sustainability of public finances has been at the centre of renewed pressures in financial markets generally in Europe. Here too, it is important to interpret data correctly. What might broadly be described as IFSC institutions represent a large and growing part of the borrowing by Irish resident banks from the Eurosystem. For this reason we are enhancing our statistical presentations to include a new table covering retail banking institutions in Ireland and that table, to be published in our monthly statistics, will give the best indication of Irish bank liquidity conditions.

The other key element is competitiveness. Again, this is improving but we need to maintain the momentum in order to maximise the economy's growth prospects over the medium term. We will be publishing our next economic commentary and forecasts in a couple of weeks when we will address these issues in some more detail.

Today we also publish our Strategic Plan for the period 2010–2012. It sets out our medium term objectives and the actions we will take to achieve them. This again reflects the reforms we have already implemented in our own organisation. We have made a number of new senior appointments and have reformed our internal structures to fully merge the functions of the Central Bank and Financial Regulator. In doing so we have taken account of the lessons that we have learnt to date about the financial crisis, including those I set out in my recent report to the Minister for Finance.

The Strategy covers all our main functions, including our requirement to contribute to price stability, to fulfil our responsibilities generally as a member of the Eurosystem, to ensure the financial services infrastructure delivers the necessary efficiencies to the economy, to provide authoritative economic advice and to help consumers through our consumer protection mandate.

The major new measures and initiatives featured in the Plan include:

- A refocused approach to strengthening the financial system including a new approach to financial stability assessment;
- The development of a new regulatory model with an enhanced supervisory capacity for the detection and correction of problems with an active and challenging approach;
- Interacting with new EU supervisory bodies, such as the European Systemic Risk Board and the European System of Financial Supervisors;
- Building on consumer protection including a review of the Consumer Protection Code;
- Greater attention in our economic research on the functioning of the financial system and fuller collaboration with the universities, ESRI and the wider public service;
- Moving towards a 100% charge back arrangement on the costs to industry to reduce the cost to the taxpayer.

We are also today publishing a Payments Oversight Report which explains how we discharge our various responsibilities in this area in order to ensure that the economy has reliable and effective payments systems to allow for the smooth functioning and delivery of everyday financial transactions.

Finally, the annual report details the Central Bank's accounts. The Bank's profits for 2009 amounted to €933.8 million. After transfers to reserves, surplus income of €745.5 million will be paid to the Exchequer. The Bank's balance sheet assets at the end of 2009 amounted to just under €125 billion reflecting the continuing high levels of liquidity support by the Bank through the Eurosystem to banks located in Ireland.