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Central Bank Annual Report

Report of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2007

Notes

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Central Bank and Financial Services Authority of Ireland

30 June 2008

Dear Minister

I have the honour to enclose herewith the Activities and Annual Accounts of the Central Bank and Financial Services Authority of Ireland for the year ended 31 December 2007.

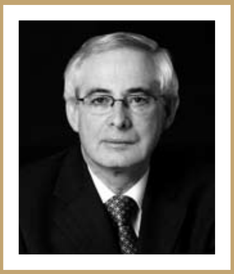
Yours faithfully

John Hurley
Governor

The Minister for Finance

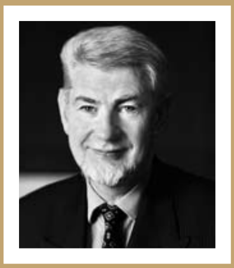
Organisation Chart

as at 1st May 2008



John Hurley, Governor

Tony Grimes



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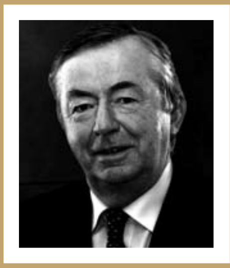
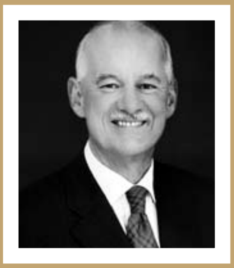


Jim Farrell

Alan Gray

Brian Hillery



Patrick Neary

Deirdre Purcell

Dermot O'Brien

Brian Halpin, Secretary

THE BOARD OF DIRECTORS

John Hurley, Governor	**Tony Grimes, Director General**	
David Begg	Gerard Danaher	David Doyle
John Dunne	Jim Farrell	Alan Gray
Dr. Brian Hillery	Patrick Neary	Deirdre Purcell
Dermot O'Brien		
Brian Halpin, Secretary		

MANAGEMENT AND ORGANISATION

	Head of Function	Deputy Head of Function
Director General - Tony Grimes		
General Secretariat	Neil Whoriskey	
Legal Unit		Joe Doherty
ESCB Support		Allan Kearns
Strategy and Planning		Bernie Keppel
Internal Audit	Donal Cahalane	John Fitzgerald
Deputy Director General & Secretary	**Brian Halpin**	
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Risk Unit		Peter Sinnott
Financial Markets	Robert O'Hara	Michael Maher
Payments and Securities Settlements	Dermot Maher	Michael Bushe
Assistant Director General	**Jim Cummins**	
Currency Issue	Brian Murphy	Frank Porter, Des Lane
Currency Production	Daragh Cronin	
Assistant Director General	**Tom O'Connell**	
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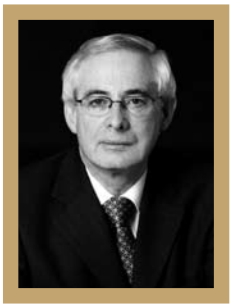
Financial Stability	Frank Browne	Mark Cassidy
Payments System		Paul O'Brien
Monetary Policy and International Relations	Maurice McGuire	Gerard O'Reilly
Statistics	John Kelly	Joe McNeill
Assistant Director General	**Mary Sheehy**	
Corporate Services	Michael Enright	Kay Mooney
Human Resources	Lucy O'Donoghue	Martin Langan
Information Systems	Vacancy	Clare Byrne, Declan Collins, Georgina O'Neill

Contents

Abbreviations

BIS	Bank for International Settlements
CBFSAI	Central Bank & Financial Services Authority of Ireland
CSO	Central Statistics Office
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EFC	Economic and Financial Committee
EMU	Economic and Monetary Union
EPC	Economic Policy Committee
EONIA	Euro Overnight Index Average
ESCB	European System of Central Banks
EU	European Union
FR	Financial Regulator
FSC	Financial Stability Committee
GDP	Gross Domestic Product
GNP	Gross National Product
HCIs	Harmonised Competitiveness Indicators
IBF	Irish Bankers Federation
IFSC	International Financial Services Centre
IMF	International Monetary Fund
IRIS	Irish Real-time Interbank Settlement
LTROs	Longer-Term Refinancing Operations
MFIs	Monetary Financial Institutions
MPC	Monetary Policy Committee
MROs	Main Refinancing Operations
NCBs	National Central Banks
OECD	Organisation for Economic Cooperation and Development
PSC	Private Sector Credit
Repos	Repurchase agreements
RTGS	Real-Time Gross Settlement
SEPA	Single Euro Payment Area
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer

Governor's Foreword



Very difficult challenges in world financial markets were the prominent feature of 2007. While global economic growth, at 4.9 per cent, remained strong in general terms, this performance masked a sharp slowdown in momentum in the final months of the year, marked by the financial markets turmoil and sharp increases in food and energy prices.

The euro area economy grew by 2.7 per cent in 2007, which is above its generally agreed sustainable growth rate. Growth was broad based, with contributions from both domestic and external demand, but there was a sharp decline in consumer sentiment towards the end of the year. This pattern appears to have continued into the first half of 2008 and, while exports have continued to hold up, for 2008 as a whole the euro area should see growth of about 1¾ per cent. The US economy experienced a more significant slowdown in the final months of 2007 and growth is expected to be somewhat weaker again in 2008. The risks to the growth outlook are on the downside in both the US and the euro area.

After a long period of extremely buoyant conditions, global financial markets experienced a substantial adjustment in the second half of 2007 and into 2008. The proximate cause for this correction was the downward valuation of securities linked to sub-prime mortgages in the US. Central Banks responded decisively to counteract this with the ECB in particular taking effective action in the light of the pre-existing arrangements that ensured banks had an extensive range of collateral that could be used to access central bank liquidity through the normal tender process.

The Irish financial sector was, of course, impacted like all others by these global developments. Medium- to long-term funding was not as readily available on wholesale markets as had been the case. However, Irish banks have negligible exposure to the sub-prime sector and they remain relatively healthy by the standard measures of capital, profitability and asset quality. This has been confirmed by the stress testing exercises we have carried out with the banks.

Although growth overall remained robust in 2007, increasing by 5.3 per cent GDP (4.5 per cent GNP), the Irish economy slowed towards the end of the year. A modest pick up in export performance was accompanied by a moderation in consumption growth in mid-year and a sharp slowdown in investment expenditure, which became more pronounced by year-end, particularly in the housing sector. There were sharp declines in both housing output and prices, which have continued into 2008.

The prospects for the Irish economy in 2008 are for a significant reduction in output growth, as many of the potential risks to growth that had been identified previously began to materialise. Developments in the construction sector constituted a significant drag on growth. Domestic demand is likely to contract and a sharp slowdown in the overall rate of job creation should see the unemployment rate at close to 6 per cent on average in 2008. Overall, it now seems likely that GNP growth will be less than 1 per cent in 2008. A recovery to about 2 per cent may be seen in 2009 as the domestic housing market bottoms out and some improvement occurs in the external environment, although considerable uncertainty attaches to this outcome.

Turning to the Bank's own activities, a strong focus on financial market issues was the dominant feature in the second half of the year. The institutional arrangements we have in place, where the Central Bank and Financial Regulator operate within the one single organisational structure, enabled us to meet the challenges we faced.

The Bank's profits for 2007 amounted to €228 million, compared with €110 million in 2006. Surplus income of €193 million will be paid to the Exchequer.

I would like to express my appreciation to the Board of Directors for all of their valuable input and support. In particular, I would like to thank Brian Patterson, Roy Donovan and Martin O'Donoghue who retired as members of the Board on 30 April 2008 for their major contribution to the work of the Bank. Brian Patterson also served as the first Chairman of the Financial Regulator and it was a huge pleasure to work alongside him over the past five years. I would like to welcome the new Board members, Jim Farrell, the newly appointed Chairman of the Financial Regulator, who is an ex-offcio member of the Board, Brian Hillery, Dermot O'Brien, and our new Director General, Tony Grimes.

I would like to thank Patrick Neary, Chief Executive of the Financial Regulator and all his team for their ongoing cooperation and support.

Finally, I pay special tribute to all the management and staff of the Central Bank and Financial Services Authority of Ireland for rising to, and meeting, the challenging times we faced in 2007.

John Hurley
Governor

Economic Overview

The International and Euro-Area Economy

Economic activity was relatively strong across the world during the greater part of 2007. However, signs of weaker growth began to appear in the latter half of the year, and this was reinforced by the turbulence experienced in international financial markets from early autumn. Economic activity in the US was particularly affected by this. The fallout from these developments has become more widespread with pressures on the liquidity of the banking sector being felt through reduced credit availability and tighter credit standards. The sharp increase in commodity prices also led to an acceleration in global inflationary pressures in the final months of 2007, pressures that have intensified in 2008 following further increases in oil prices.

The euro area economy continued to expand at an above its potential growth rate last year, with real GDP increasing by 2.7 per cent, a higher rate of growth than in both the US and Japan. Growth in the euro area was broad based with both domestic demand and the external sector contributing. Foreign demand for euro area goods and services remained robust as the strong pace of global growth more than compensated for an appreciating euro. Investment spending also accelerated against the backdrop of high capacity utilisation, strong order books and high profitability. Household spending, on the other hand, remained subdued despite further significant improvement in the euro area's labour market. The region's unemployment rate had declined to 7.2 per cent by the end of the year – the lowest on record – as almost 2½ million jobs were created in 2007. It appeared that these improvements were starting to filter through to private consumption until the final months of the year when sharp increases in oil and food prices weighed on the purchasing power of households, and, along with more general concerns about the global economy, led to a sharp decline in consumer sentiment.

Private consumption expenditure in the euro area appears to have remained weak in the first half of this year, but other growth components have shown more resilience in the face of higher commodity prices, tighter credit conditions and the slowdown in the US economy. In particular exports from the region have continued to expand strongly against the backdrop of sustained growth in emerging economies. For 2008 as a whole, the domestic and external sectors are expected to continue to support growth in real GDP of about 1 ¾ per cent. Given the potential for the turbulence in financial markets to have a more negative impact on activity, and with the prospect of a continued high level of commodity prices, the risks to the growth outlook are on the downside.

The US economy experienced a more significant slowdown in the final months of 2007, as the turbulence in financial markets and acceleration in commodity prices coincided with a sharp downturn in the housing market. US real GDP increased 2.2 per cent last year - the weakest annual expansion in five years – as a decline in residential investment weighed heavily on the growth rate. Furthermore, economic activity levels remained subdued in the first half of 2008, as weakness in the housing sector spread to the broader economy. The US authorities have been quick to respond – the Federal Reserve has cut interest rates by a cumulative 325 basis points since August, and temporary tax rebates have been introduced – but growth is still expected to be weaker this year, with the OECD projecting a real GDP increase of 1.2 per cent. As in the case of the euro area, the risks to the growth outlook are on the downside. These risks primarily relate to future household spending in an environment of falling house prices, an increase in unemployment and very low savings levels. Slower US economic growth combined with a stronger dollar resulted in a narrowing of the US current account deficit last year, although at 5.3 per cent of GDP it remained large. As a result, the possibility of a disorderly adjustment of global imbalances remains a downside risk to the global economic outlook.

Turning to euro area price developments, the headline HICP inflation rate moderated marginally to 2.1 per cent in 2007, although, as indicated, the sharp increase in commodity prices led to a significant acceleration in the annual rate in the final months of the year. Having averaged 1.9 per cent in the first three quarters of 2007, the headline rate picked up sharply in the final quarter, increasing to 3.3 per cent by December. It has subsequently remained well above 3 per cent in the first half of 2008 and is likely to stay above this threshold for some time, moderating only gradually over the course of 2009. While there has been a corresponding increase in the core inflation rate – the headline rate excluding energy and unprocessed foods – this has primarily reflected higher processed food prices rather than a more general increase in price pressures and, as yet, there is little evidence that second round effects have emerged. Moderate labour cost growth and relatively benign survey data of consumer price expectations provide further evidence of this. Nevertheless, the risks to the inflation outlook over the medium term are not only on the upside, but appear to have increased since the turn of the year, reflecting the potential for further food and energy price increases and more fundamentally the risk that price and wage setting behaviour could add to inflationary pressures. In light of this, the Governing Council of the ECB has stated that it is monitoring very closely all developments and is in a state of heightened alertness. The Governing Council's strong determination is to secure a firm anchor of medium and long-term expectations in line with price stability.

Financial Market Turbulence

After a long period when financial market conditions were extremely buoyant, global financial markets experienced a substantial adjustment last year and this has continued into 2008. This followed a prolonged period when asset prices were driven to exceptionally high and unsustainable levels in many parts of the world, and when inadequate attention was paid to risk. At a time of relatively low interest rates, the global supply of liquidity was a significant factor in the search for yield with limited attention paid to underlying risk. This led to strong demand for, and supply of, complex structured products that promised higher returns, and this was multiplied by large increases in leverage. The proximate cause of the correction was the downward valuation of such securities linked to sub-prime mortgages in the US. This in turn had its source in a notable increase in the rate of default of such sub-prime borrowers in more recent years. The unwinding of these excesses led to significant turbulence in financial markets. This was seen, in particular, in a decrease in confidence on the part of players in financial markets in dealing with counterparties that might have been exposed to large losses on these complex instruments with the result that there was a significant disruption in normal money market operations between banks.

Central banks responded decisively to counteract these adverse conditions in money markets. The ECB, in particular, was in a position to take effective action in the light of the pre-existing arrangements that ensured that banks had an extensive range of collateral that could be used to access central bank liquidity. These arrangements served to eliminate problems at the short end of the money market. However, with questions of credit quality and asset valuation remaining, term interest rates continued to be elevated with higher than normal spreads remaining between longer-term rates and official rates.

As a result of these developments, banks across the world have faced more difficult funding conditions. For many years, banks had come to increase their dependence on wholesale-type funding. This reflected a tendency for lending to outpace traditional deposit growth as well as a diffusion of the surplus funds of household and businesses over a broader range of assets beyond bank deposits. While central bank liquidity facilities have been used to fund bank assets to a greater extent than heretofore since the turbulence began last autumn, there are increasing signs that part of banks' response to the changed circumstances is to limit lending growth. If this were to become significant, it could hamper economic growth through limiting consumer and investment spending across the global economy.

The Irish financial sector is, of course, being affected by these global developments, and the share prices of Irish banks, as well as those of banks internationally, have declined significantly. Medium- to long-term funding is not as readily available on wholesale markets as heretofore and this has increased banks' focus on liquidity management. However, the exposure of Irish banks to US sub-prime mortgages, whether direct or indirect, is negligible. Irish banks remain strong by the usual metrics of capital, profitability and asset quality, and this is confirmed by stress tests on the banking sector. This is an essential prerequisite for the more challenging times that have arisen from the less benign international economic outlook and the significant effect on domestic economic growth of the substantial and rapid adjustment of housing output to a more sustainable level.

A number of factors contributed to the generation of the recent turbulence. These included a build-up of leverage, a weakening of credit discipline, excessive concentration of assets and a sense of complacency following a long period of low volatility. This led ultimately to an undue focus on prospective investment returns without adequate attention to risk. A careful assessment of the lessons to be learned from the turbulence must be made. At the EU level, Finance Ministers have set out a detailed roadmap of issues to be assessed with a view to strengthening arrangements for financial stability. At the same time, the Financial Stability Forum, working to G7 Finance Ministers and central bank Governors, has recently prepared a report directed to enhancing the resilience of markets and financial institutions.

The Domestic Economy

Growth in the domestic economy remained robust last year with real GDP and GNP increasing by 5.3 per cent and 4.5 per cent, respectively, in line with average output growth over the previous five years. In contrast to more recent years, however, when domestic demand was the dominant driver of activity, growth was more balanced between external and domestic sources. This reflected both a stronger rate of growth in exports and a slowdown in domestic demand. The divergence of developments in external and domestic demand widened as the year progressed with a modest pick up in export performance contrasting with a moderation in consumption growth from mid-year and a sharp slowdown in investment expenditure that became more pronounced by year-end. Housing investment, which was still recording a modest rate of increase in the first quarter of 2007 was declining at an annual rate of over 20 per cent by the final quarter of the year. The moderation in the pace of domestic demand last year contributed to an easing of domestic inflationary pressures, but this was more than offset by higher goods price inflation, particularly for energy and food products. The inflation rate, as measured by the Harmonised Index of Consumer Prices (HICP) increased to 2.9 per cent compared to a euro area average of 2.1 per cent. The labour market remained tight last year. Employment growth of 3.6 per cent was broadly in line with the increase in the labour force with the result that unemployment remained relatively stable at a rate of about 4½ per cent.

Growth in domestic demand moderated significantly during the course of last year. Consumption expenditure, which was boosted by the impact of maturing Special Savings Incentive Accounts (SSIAs) on disposable income, accelerated until mid-year but eased back significantly in the final quarter against a background of increasingly negative consumer sentiment and rising uncertainty about economic prospects, which was exacerbated by the emergence of financial market turbulence. Although maturing SSIA accounts boosted consumption, the impact was less pronounced than had been expected with more funds allocated to saving or debt reduction than had been indicated in ex-ante surveys of fund-holder intentions.

The housing market weakened significantly during 2007 with sharp declines in both output and prices. The permanent-tsb house price index declined continuously from March onwards with the monthly rate of decline increasing as the year progressed. The index has continued to decline in the early months of this year and was down by 9.2 per cent on an annual basis in April 2008. New house completions declined to 78,000 units last year from an underling total of about 88,000 units in the previous year. The pattern of activity saw significant weakening in house completions through the year. Strong activity in the home improvement sector served to mitigate the impact on overall housing investment, which nevertheless declined by 8.8 per cent last year.

An adjustment in the housing market had been envisaged by most economic commentators since housing output had, for a number of years, been well above the sustainable rate taking account of underlying housing needs. The value of spending on housing investment peaked at over 13.3 per cent of GDP in 2006, which was well in excess of international norms. This ratio declined to about 12 per cent in 2007 and a further sharp decline in house completions together with some moderation in activity in the home improvements sub-sector is likely to reduce it to about 7½ per cent of GDP in 2008. This would represent a very substantial scaling back of activity over the two years since 2006.

In a reversal of the trend of declining market share since 2003, export volume growth exceeded that in Ireland's export markets last year. Although merchandise exports performed well, particularly in the first half of the year, the main driver of export growth last year was services exports. The main contributors to this came from financial services, computer services and trade-related services such as merchanding and consulting. This strong performance followed the pattern of recent years, which has seen a shift in the composition of exports from goods to services with the share of services in overall exports increasing from 21.9 per cent in 2000 to 43 per cent in 2007. The services deficit has shrunk accordingly from a peak of 13.3 per cent of GDP in 2000 to 2.1 per cent last year. The decline in the services deficit last year from €7.4 billion to just under €4 billion was more than offset by an increase in net factor outflows and a decline in the merchandise balance due to a combination of strong import growth and adverse developments in the terms of trade associated mainly with energy and other commodity prices. Consequently, the deficit on the current account of the Balance of Payments increased last year to 5.9 per cent of GNP from 4.9 per cent in 2006.

The emergence of a significant balance of payments deficit in recent years is a reflection of the dominance of domestic demand as the driver of growth in the economy as well as a gradual erosion of cost competitiveness. The cost base in Ireland is, by a number of measures, high by international standards. Eurostat data for 2006 indicate, for example, that the price level for goods was 18.3 per cent above the average while services prices were 28.8 per cent above the EU27 average, with particularly high prices for utilities, hotels and restaurants and some locally traded business services including industrial and commercial rents, energy costs, some legal and professional fees. Electricity prices for industrial users are now the third highest in the EU.

Wage inflation has also been higher in Ireland in recent years than in our main trading partners, averaging 5.9 per cent on an economy wide basis between 1999 and 2006 compared to an EU average of 3 per cent over the same period. Annual productivity increases of more than 4 per cent in the early part of this period ensured that unit labour cost increases were moderate. Since 2003, however, productivity increases have fallen back to 1.5 per cent with the result that there has been a significant increase in relative unit labour costs in Ireland.

Ireland's weaker competitiveness position has been associated with a loss of export market share – the share of world exports of goods and services fell from 1.45 per cent in 2003 to 1.23 per cent in 2006. Although this decline was arrested last year, a sustained recovery in export performance will require a concerted effort to improve competitiveness. While recognising that competitiveness in its broadest sense encompasses a wide range of factors including productivity, quality of output, innovation, sales and marketing expertise and the quality of infrastructure, a sensible approach to wage determination is nevertheless an essential element in ensuring competitiveness. In particular, wage settlements need to take account of the challenge to Ireland's competitive positions arising from the combination of exchange rate appreciation and the sharp rise in energy and other commodity prices.

The prospects for the Irish economy in 2008 are for a significant moderation in the pace of output growth as a result of the materialisation of a number of risks that had been signalled earlier. Domestic demand is likely to contract reflecting a strongly negative contribution from housing investment and a sharp decline in the rate of increase in consumption expenditure. Available indicators point to a decline in housing completions this year of over 40 per cent to about 45,000 units. The downturn in the housing market and the consequent reduced employment in that sector will contribute to a sharp slowdown in the overall rate of job

creation and a rise in the unemployment rate to about 6 per cent on average this year. This weakening in the labour market will contribute to greater caution on the part of consumers who are unlikely to increase expenditure in line with income growth. As a consequence, a rise in the household savings rate seems likely this year.

Export volume growth is expected to moderate this year against a less favourable external backdrop but, taking account of the impact of weak domestic demand on import growth, net exports should contribute positively to overall GDP growth. Overall output growth is now forecast to be less than 1 per cent on both a GDP and GNP basis.

The weakness of domestic demand should contribute to some easing of domestic inflationary pressures this year and this should lead to a convergence between inflation in Ireland and the euro area average. However, in common with trends throughout the developed world, rising energy and commodity prices are exerting upward pressure on inflation, which in the Irish case will more than offset the decline in domestic inflationary pressures. As a consequence, HICP inflation is likely to increase to about 3 ½ per cent in 2008 from 2.9 per cent last year. The rate of increase in the Consumer Price Index (CPI) is likely to decline this year to around 4 ½ per cent from 4.9 per cent last year, reflecting the fading of interest rate effects arising from increases in mortgage interest rates last year. Looking ahead to next year, with domestic inflationary pressure likely to remain contained, and assuming no additional adverse external developments, inflation should moderate.

Growth should recover next year on the basis of a bottoming out in the domestic housing market, and some improvement in the external environment. In the housing market, taking account of a negative carry-over from this year a further modest decline in output seems likely next year. However, this would represent a less significant drag on overall GDP growth than was the case this year and, since this level of output would be below underlying demand, there would be scope for some recovery in output from that point even allowing for the overhang of unsold stock in the market. On this basis, and assuming a recovery in world demand, growth in the Irish economy should recover towards its long run sustainable potential rate of about 4 per cent in 2010.

This outlook is subject to considerable uncertainty relating both to the timing and strength of recovery in world demand and the duration and depth of the downturn in Irish domestic demand. Clearly, the possibility of further increases in oil and other commodity prices or adverse exchange rate developments increases this uncertainty. Furthermore, financial market turbulence is beginning to affect the real economy in the form of tighter lending standards and a reduced supply of credit. This may restrain the recovery in effective demand both in Ireland and in our main trading partners.

The most likely outturn for the economy, namely a recovery in growth towards trend by 2010 will, nevertheless, pose major challenges for fiscal policy. The targets set out in Budget 2008 for public expenditure and revenue were predicated on a much more benign economic environment. Trends in tax revenue in the first half of the year point to significant overshooting in the targeted borrowing requirement of 0.9 per cent of GDP this year. While it is reasonable to allow for the operation of automatic stabilisers which tend to lower tax revenue and boost expenditure in periods of below potential growth, the terms of the Stability and Growth Pact have established clear limits on the acceptable deterioration in the General Government borrowing requirement. The medium-term needs of the economy warrant a continuing focus on the development of public infrastructure. This will require tight discipline to be exercised in regard to the development of current public spending.

Activities of the Central Bank and Financial Services Authority of Ireland

1. Monetary Policy and Price Stability

Since the inception of the euro on 1 January 1999 the Eurosystem, comprising the European Central Bank (ECB) and NCBs of the EU Member States that adopted the euro, has the task of formulating and implementing the single monetary policy for the euro area. The Treaty on European Union assigns to the Eurosystem the primary objective of maintaining price stability over the medium term, reflecting a broad consensus that maintaining stable prices is the best contribution that monetary policy can make to economic growth, job creation and social cohesion.

The ECB's Governing Council, which comprises the Governors of each of the fifteen NCBs (including Governor Hurley) and six members of the ECB's Executive Board, is responsible for the formulation of monetary policy. To ensure a consistent and systematic approach to determining the appropriate interest rate level to ensure price stability, the ECB has adopted and announced a coherent monetary policy strategy. This strategy comprises two main elements: the first is a definition of price stability; the second consists of an economic analysis to determine the short- to medium-term risks to price stability and a monetary analysis to identify the medium- to long-term influences on inflation.

The primary objective of price stability is defined as "a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below, but close to, 2 per cent". In pursuit of this objective, the ECB is focused on assuring price stability over a medium-term time horizon and does not attempt to fine-tune price developments in the short term.

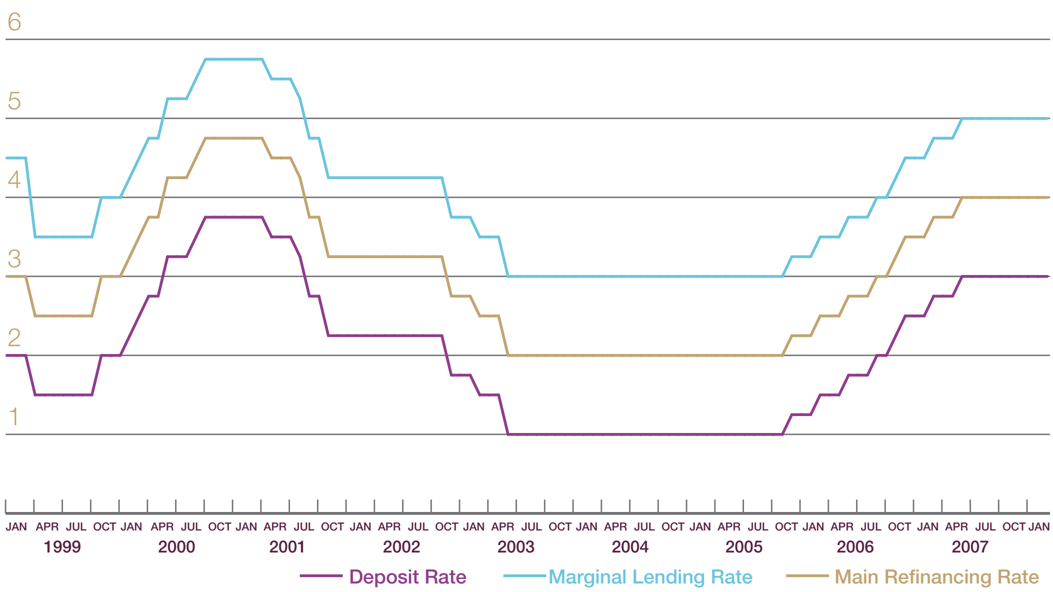
In the performance of their duties on the Governing Council, the Governors draw on the expertise residing in their own NCBs to inform their decision. Governor Hurley is advised and provided with a full brief on all issues arising at Governing Council meetings. For monetary policy discussions, the briefing includes a comprehensive analysis framed around both pillars of the monetary policy strategy. Analysis is also provided on other monetary policy related matters addressed by the Council, including issues concerning the implementation of monetary policy.

Monetary Policy Decisions

Following a series of interest rate increases in 2006, monetary policy in the euro area continued to tighten in the first half of 2007, albeit at a slower pace. The Governing Council decided to raise the minimum bid rate on the main refinancing operations of the Eurosystem by 25 basis points on two occasions. As a result, the minimum bid rate rose from 3.5 per cent in December 2006 to 4 per cent in June 2007[1]. The decisions to increase interest rates were taken in view of upside risks to price stability over the medium term, as indicated in the economic and monetary analyses. Subsequently, global economic developments and prospects were significantly affected by the turbulence in financial markets that unfolded since last August. Against this background, and notwithstanding the assessments that risks to price stability over the medium term continued to be on the upside, the Governing Council deemed it appropriate to assess incoming data and to monitor developments in financial markets before drawing further conclusions for monetary

1 The minimum bid rate of the main refinancing operations of the Eurosystem has remained unchanged since June 2007 to date (March 2008).

Chart 1: ECB Official Interest Rates



policy. Reflecting the heightened level of uncertainty, the Governing Council left key ECB interest rates unchanged in the second half of 2007 and into the first half of 2008.

Monetary Policy Implementation

The implementation of monetary policy in the euro area is conducted on a decentralised basis by the individual NCBs. Within this framework, the Bank provides liquidity to domestic financial institutions by means of various operations as described in Box A below. The amounts of liquidity provided, which are determined by the ECB, are reflected on the Bank's balance sheet. The Bank provides forecasts of the liquidity needs of the domestic market as an input to the ECB's liquidity management decisions.

Box A

The monetary policy operations of the Eurosystem comprise on the one hand open market operations, such as main refinancing operations (MROs), longer-term refinancing operations (LTROs) and fine-tuning operations, and on the other hand standing facilities.

Within the operational framework for the implementation of monetary policy, which also includes the system of minimum reserve requirements, these instruments are used to manage liquidity conditions in the interbank money market, first of all with a view to steering very short-term interest rates - in particular the overnight money market rate - close to the minimum bid rate in the MROs, which is the Eurosystem's key policy rate.

The most frequent liquidity-providing operations conducted by the Eurosystem are the *Main Refinancing Operations (MROs)*, which are weekly operations with a maturity of one week. The ECB signals the monetary policy stance by setting a minimum bid rate for these operations. MROs are conducted as variable rate tenders, meaning that participants bid for the amount of liquidity they require as well as the rate they are prepared to pay for funds (which cannot be lower than the minimum bid rate). The ECB allots funds to the highest bidders first, then to others in decreasing order of the rate bid, until the full pre-determined allotment

Box A (continued)

amount has been provided. The lowest rate at which funds are provided is called the marginal rate.

Longer-Term Refinancing Operations (LTROs) are liquidity-providing operations conducted on a monthly basis. They have a maturity normally of three months. In contrast to MROs, LTROs are not used to signal the Eurosystem's monetary policy stance. They are conducted as pure variable rate tenders with a pre-announced allotment volume, and the Eurosystem therefore acts as a rate taker.

Fine-Tuning Operations (FTOs) may either provide or absorb liquidity, and have a short maturity (typically overnight). They are used to smooth short-term liquidity imbalances in the market which might otherwise cause large spreads between short-term market rates and the policy/minimum-bid rate.

Overnight lending and deposit facilities, known as *standing facilities*, are available to financial institutions at their own initiative. The respective rates for these facilities are set currently at 1 percentage point above and below the minimum bid rate, in effect determining upper and lower bounds for the interbank overnight rate. Finally, credit institutions are required to hold deposits with NCBs called *minimum reserves*. These reserves help to smooth the effect on market rates of unexpected liquidity fluctuations since they can be drawn upon (or increased) temporarily as long as the required level is met on average over each maintenance period (approximately one month).

Monetary Policy Operations

The financial turmoil that broke out in August 2007 was triggered by problems in the US sub-prime mortgage market, but disruption quickly spread to other markets. By early August, the broad global financial system had become affected by the turbulence and a wide range of international financial markets became characterized by a significant lack of liquidity and heightened market volatility.

These developments spilled over into global money markets and had a strong impact on interbank lending. With banks becoming reluctant to lend, even at short maturities, overnight rates began to rise sharply. In response to these developments, the Eurosystem, followed by a number of other central banks, moved quickly to counteract disorderly money market conditions. In particular, the Eurosystem reacted by providing substantial extra liquidity to the market, initially by way of fine-tuning operations and thereafter through MRO allotments above the benchmark liquidity amount[2]. The amounts of additional liquidity provided fluctuated in line with market conditions (see Chart 2).

In addition, the Governing Council decided in November to introduce supplementary LTROs in order to increase the proportion of refinancing provided in the three-month sector, where market turnover was reported to be very low, and also to alleviate concerns about end-year factors. These operations increased by €120 billion the amount outstanding in three-month funding, bringing this funding to approximately 60 per cent of total funding, up from 26 per cent at end-2006.

Supplementary measures were announced in anticipation of an exacerbation of market tensions over the end of the year when, due to balance sheet concerns, banks usually are more reluctant to lend surplus funds. Thus, the MRO conducted on 18 December had a two-week maturity, allowing banks to cover their liquidity needs over Christmas and the year-end, and it was announced that all bids

2 The benchmark amount is the allotment amount normally required, on the basis of the ECB's liquidity forecast, to establish balanced conditions in the short-term money market.

Chart 2: MRO Allotments above Benchmark (€ billion)

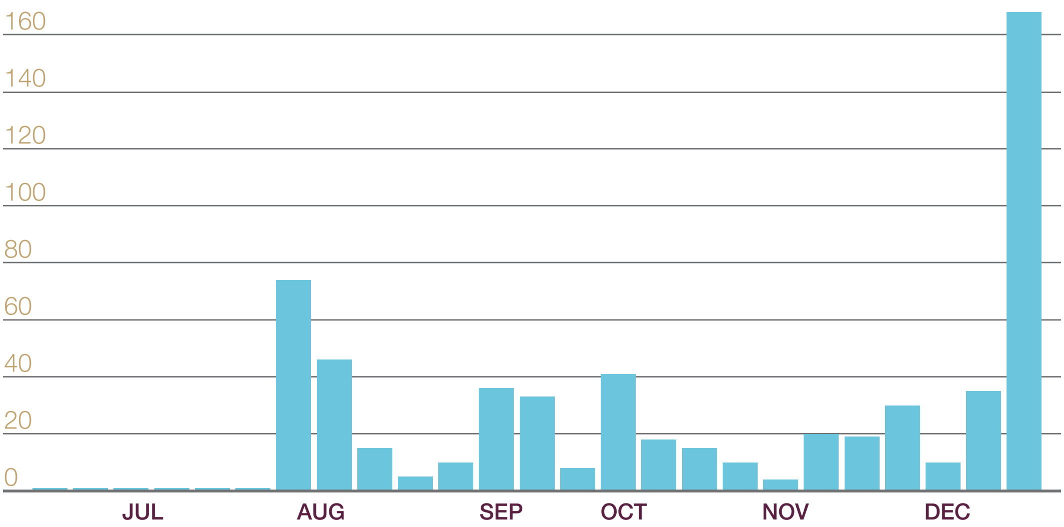
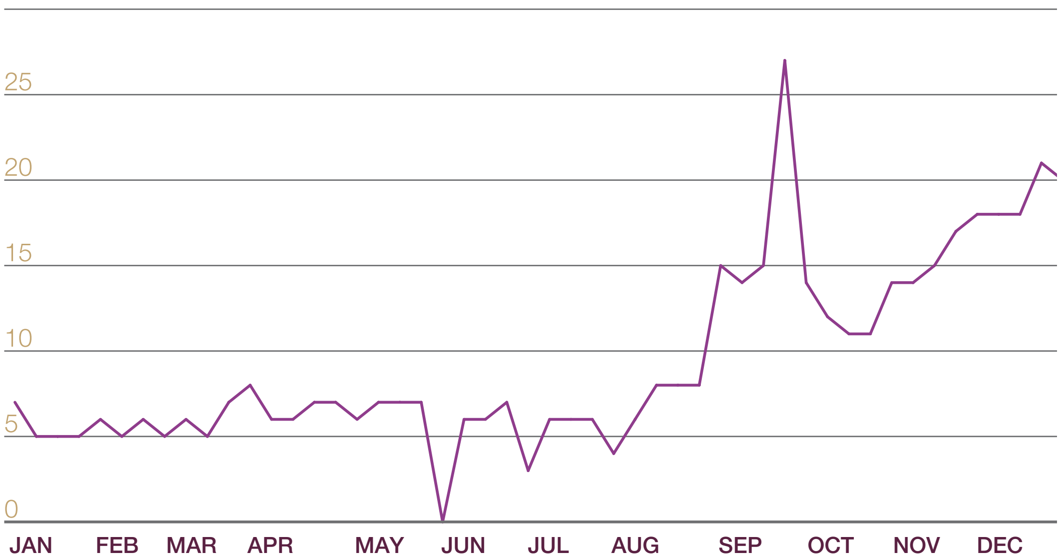


Chart 3: Spread between Marginal Rate and Minimum Bid Rate in 2007 (basis points)



at, or above, 4.21 per cent (the weighted average rate of the previous MRO) would be satisfied in full. In the event, an extra €168 billion above the benchmark liquidity amount was provided in this operation.

Also in December, in response to a concern among some euro area banks about the availability of US dollar funding, the ECB made US dollars available to its counterparties by way of a reciprocal currency arrangement with the US Federal Reserve System under the US dollar Term Auction Facility (TAF)[3]. The ECB conducted two operations towards the end of 2007 in which it lent a total of US$20 billion for one month (that is, US$10 billion on each occasion). These operations continued into 2008.

The disruption in the money markets is reflected in the spread between the ECB minimum bid rate and the marginal rate of the MROs (see Chart 3). This spread, which was between 5 and 8 basis points during the first half of 2007, increased markedly from August onward, ranging between 10 and 27 basis points.

3 Under the TAF program, the Federal Reserve auctions term funds to depository institutions against a wide variety of collateral that can be used to secure loans at the discount window.

Table 1: Total monetary policy lending outstanding at end-December 2007

	Eurosystem		Ireland		Ireland as percentage of Eurosystem	
	2007 €bn	2006 €bn	2007 €bn	2006 €bn	2007 %	2006 %
MRO	368.6	330.5	12.1	10.8	3.3	3.3
LTRO	268.5	120.0	27.3	16.2	10.2	13.5
Total	637.1	450.5	39.4	27.0	6.2	6.0

Table 1, above, shows the volumes of liquidity provided through MROs and LTROs during 2007 in Ireland and in the Eurosystem as a whole, with comparative figures for 2006. These figures reflect the additional €168 billion (above the benchmark amount) that was outstanding in the MRO at the end of the year, as well as the increase in the LTRO amount described above. The banking system in Ireland continued to take a relatively high share of Eurosystem monetary policy lending, reflecting Ireland's importance as a financial centre.

Numbers of Participants in MROs and LTROs in 2007

The average number of financial institutions participating in MROs in the Eurosystem in 2007 fell to 337, compared with 377 in 2006. Participation also declined in Ireland, to an average of 12 counterparties from 16 in 2006. LTRO participation in the euro area as a whole fell to 145 banks, on average, compared with 162 in 2006. The average number of counterparties participating in LTROs in Ireland also fell slightly, from 13 to 12.

Box B

Collateral Management

Under the terms of Article 18.1 of the ESCB statute, all credit operations conducted by counterparties with the Bank must be based on adequate collateral provided to the Bank by its counterparties.

Risk control measures are applied to collateral underlying monetary policy and intra-day operations in order to protect the Eurosystem against the risk of financial loss if such collateral has to be realised in the event of default of a counterparty. The risk control measures entail the application to individual assets of a "valuation haircut" which varies on the basis of the nature of the asset concerned and the liquidity category into which it falls. Application of the "valuation haircut" entails the value of the underlying asset being calculated as the market value of the asset less a certain percentage (i.e., the haircut).

The Bank values assets put forward by its counterparties, both at the time of nomination of assets as collateral for a particular credit operation and subsequently on a daily basis until maturity of that operation. If the value of the underlying assets falls below a certain level, the Bank requires the counterparty to pledge additional assets (i.e., a margin call). Similarly, if the value of the underlying assets, following their revaluation, exceeds a certain level, the Bank releases excess assets to the counterparty on request.

Cross-Border Use of Eligible Assets

Counterparties may use eligible assets on a cross-border basis, i.e., they may obtain funds from the Bank by making use of eligible assets located in another Member State. All Irish Government Bonds provided to the Bank as collateral are delivered into its account in the Euroclear system. The Bank also uses its account in the Euroclear system to hold other securities issued into Euroclear and which are provided to the Bank as collateral. The other mechanisms available to counterparties to mobilise assets on a cross-border basis are the Correspondent Central Banking Model and Links between Securities Settlements Systems.

Collateral Usage

During 2007, the Bank's counterparties continued to make extensive use of assets on a cross-border basis as collateral for monetary policy and intraday credit operations conducted with the Bank. At end-December 2007, assets delivered on a cross-border basis accounted for 86 per cent of the total collateral used by the Bank's counterparties for such credit operations, down marginally from 90 per cent in 2006. The majority of these cross-border assets (51 per cent) were corporate issues (bonds, medium-term notes and asset-backed/mortgage-backed securities) while credit institution issues (bonds and medium-term notes) accounted for 31 per cent. The establishment of the Single List of assets[4] on 1 January 2007 (replacing the previous two-tier system) had the effect of allowing counterparties across the euro area to mobilise non-marketable assets – that is, credit claims (bank loans) and mortgage-backed promissory notes (MBPNs)[5] – that heretofore were permissible for collateral purposes in only a limited number of jurisdictions.

4 In order to be useable as collateral in Eurosystem credit operations, assets must satisfy the general eligibility criteria specified in the Bank's Documentation on Monetary Policy Instruments and Procedures 2007 – http://www.centralbank.ie/data/site/monpol.pdf

5 Included in the new asset category: "non marketable retail mortgage backed debt instruments".

Table 2: Assets included on the EADB as submitted by the Bank

	2006		2007	
	No.	€bn	No.	€bn
Short-term paper	32	0.1	84	2.1
Govt/Corp bonds	14	34.6	19	39.6
MTNs	216	44.7	347	72.9
Jumbo Pfandbriefe-Style	10	21.0	10	21.0
Traditional Pfandbriefe-Style	10	0.8	28	2.2
Asset-backed securities	126	71.4	269	174.0
Total	**408**	**172.5**	**757**	**311.7**

Marketable Assets

The Bank is responsible for assessing the eligibility of assets listed on the Irish Stock Exchange and for the subsequent reporting of these to the ECB for inclusion on the eligible assets database (EADB). Over the course of 2007, the Bank assessed a wide range of debt instruments for eligibility. At end-December, the ECB had included on its EADB a total of 757 assets submitted by the Bank. In value terms these assets amounted to €312 billion, an increase of some 85 per cent on 2006 (see Table 2 above). This increase reflects an increase in assets listed by the Irish Stock Exchange, particularly the asset classes of medium-term notes (MTNs) and asset backed securities (ABS).

Non-Marketable Assets

The Bank is responsible for assessing the suitability of institutions to issue Mortgage-Backed Promissory Notes (MBPNs) and credit claims. In 2007 the number of institutions approved for the issue of MBPNs rose from five to seven. However, few institutions were in a position to use credit claims as collateral during the year, as most had not yet put in place an approved credit assessment framework.

The Bank validates the underlying mortgage pools that back potential issues of MBPNs, as well as the individual credit claims put forward as collateral, against the respective set of eligibility criteria.

Modifications to Collateral Framework during the Year

During the course of the year, the Governing Council adopted a number of relatively minor adjustments to the collateral framework, including providing further details on the residence criteria; amending the calendar for the phasing-out of marketable tier two assets; the extension of the minimum rating (by an external rating agency) requirement to covered bonds issued from 1 January 2008; and the addition of DBRS as an approved rating agency.

2. Economic Analysis

Work in the Economic Services area during 2007 included the monitoring, analysis and projection of short-term developments in Ireland, the euro area and the wider world. High-level economic research was undertaken on a range of longer-term structural issues including macroeconomic, microeconomic and financial stability issues. In addition, a wide range of statistics were produced and analysed including monetary, financial, balance-of-payments and prudential data. Much of this work was carried out in co-operation with other national central banks and the ECB through a system of committees and working groups. This work supported the Governor of the Bank and other members of the ECB Governing Council in formulating policy. In addition, it contributed to effective prudential supervision and consumer protection by the Financial Regulator.

In addition to the extensive commentary and analysis produced in our core publications, ten articles on specific topics were published in the Quarterly Bulletin with a similar number of research papers being published in the Bank's technical paper series and in leading economic journals internationally. The topics covered included:

- Job turnover in the Irish labour market;
- The links between monetary growth, commodity prices and inflation
- Modelling house prices; and
- The behaviour of Irish exporters and the geography of trade.

The main issues of concern internationally in 2007 were the emergence of financial market turbulence, high energy and non-energy commodity prices and the persistence of global imbalances. In the domestic economy, the implications of the decline in house prices and housing output was a particular focus. In this context, work was undertaken and presented to the Board and senior management on a number of relevant topics including the determination of house prices in Ireland and internationally, the usefulness of leading indicators for forecasting housing output, the determinants of exports and labour market turnover in the traded sector. In addition, the Board and senior management received regular briefing material on developments internationally and in the domestic economy.

Six forecasting exercises were completed during the year, with two of these conducted within the context of the Eurosystem's Broad Macroeconomic Projection Exercises and the other four for publication in the Bank's Quarterly Bulletin.

The more formal approaches to economic analysis were supplemented by assessments of business sentiment based on contacts with key firms in various sectors across the economy. This included an annual broadly-based postal survey of business conditions. The results of these contacts were reported to the Board of the Bank on a number of occasions during the year.

Inflation and Competitiveness

The Bank continued to monitor developments in inflation and competitiveness during the year. Forecasts and assessments were published in the Quarterly Bulletins while four detailed inflation projection exercises were produced and submitted to the ECB as part of co-ordinated Eurosystem exercises (the Broad Macroeconomic Projection Exercises and Narrow Inflation Projection Exercises). A number of reports on various aspects of competitiveness were prepared, including an assessment of geographical and currency dimensions of external trade, recent developments in the current account for Ireland and the likely impact of a US slowdown on Ireland's economic performance. Work on competitiveness indicators continued throughout the year and included the introduction of the harmonised competitiveness indicators (HCIs) for Ireland and euro area countries developed by the ESCB. Further research on the development of new competitiveness indicators for Ireland carried into 2008.

The Bank's research on domestic inflation was largely focused on the computation and assessment of core inflation indicators. A paper focusing on the forecasting ability of these core measures was published.

The Bank continued its participation in the Eurosystem Research Network on wage dynamics. A survey of Irish firms was launched to gather information on wage setting arrangements and wage flexibility. Similar surveys were undertaken by other euro area members with the aim of facilitating consistent comparisons across countries as the project continues. Also as part of this network, a paper examining the link between inflation and the wage share of national income was completed.

In an international context, a review paper on modelling inflation dynamics was completed along with a study which forecasts US inflation using global liquidity.

Monetary Issues

Research work at the Bank also focused on a number of important monetary policy issues during the year. These include a study examining how uncertainty can affect money demand. The role of uncertainty has been stressed by the ECB as an important explanatory factor in euro area money demand particularly between 2001 and 2003. This paper contributed to this literature by assessing the influence of uncertainty using complex time-series methods. Two papers on monetary topics were published in the Quarterly Bulletin. The first examined recent puzzles in monetary dynamics while the second article assessed the impact of commodity prices in the transmission of monetary policy.

The Bank hosted an ESCB-sponsored conference in Dublin in October entitled *Asset Management, Private Equity Firms and International Capital Flows: Their Role for Financial Integration and Efficiency.*[6] The conference brought together academics, central bankers and industry participants and was also addressed by Governor Hurley and Executive Board Member of the ECB, Gertrude Tumpell-Gugurell. This was the ninth such conference held by the ECB and the Center for Financial Studies (Frankfurt) as part of their research network examining capital market integration in Europe.

6 The complete conference program and downloadable papers, including names and affiliations of conference paper co-authors, can be found at: http://www.eu-financial-system.org./index.php?id=82

Econometric Modelling

The Bank continued to use a macroeconomic model for forecasting and scenario analysis in both a domestic context and as part of a linked system of country models for analysis of the euro area economy. This model is underpinned by a quarterly dataset, which is consistent with the quarterly ESA95 National Income and Expenditure Statistics. The model underwent extensive revisions during the year with a view to assessing and improving its effectiveness and it remains under review on an ongoing basis. Maintenance and development of the model is a continuous process towards improving its forecasting capabilities and incorporating information as new data become available.

Public Finances

Public finance developments continued to be monitored as part of the Bank's role in assessing overall economic developments. The Bank actively participated in various ESCB working groups on public finance related issues, which included the ESCB's assessment and projection of public finances in the euro area and the EU27. The Bank also participated in a number of other projects relating to issues regarding tax forecasting in Ireland and tax revenue windfalls in the euro area.

Statistics - Monetary, Financial, Balance of Payments and Prudential Data

The Bank continued to make significant progress in meeting its expanding reporting obligations during the year. The large and growing volume of ECB requirements for money and banking, balance of payments and financial accounts data was fully addressed.

In addition to the 'Monthly Statistics' release, a note on sectoral developments in private-sector credit is published quarterly and has included since April a breakdown of outstanding mortgages into borrowing for residential and investment purposes.

Work continued on updating ECB requirements for the collection of balance sheet data from Monetary Financial Institutions (MFIs) and Other Financial Intermediaries (OFIs). The new data collected will help fill existing gaps in euro area statistics for the purposes of economic and monetary analysis. The ECB Regulation concerning statistics on assets and liabilities of investment funds, a sub-category of the OFI sector, was published in July.[7] Preparations also continued on the development of a statistical reporting regime for another OFI sub-category, namely financial vehicle corporations (FVCs).

The Bank continues to work closely with the Central Statistics Office (CSO). As part of this cooperation, a joint survey form was launched to combine Balance of Payments/ International Investment Position statistics and the new requirements under the ECB Investment Fund Regulation in a single return. This combined return has helped to alleviate the reporting burden on a large proportion of the financial sector. Some 4,000 Irish resident funds and sub-funds now report to the Bank as part of this arrangement.

The Bank, also in cooperation with the CSO, continued to extend its data delivery to the ECB in the area of financial accounts under the Monetary Union Financial Accounts (MUFA) Guideline.[8] These data now serve as an input to the quarterly euro area Integrated Economic Accounts (financial and non-financial). In April, the Bank also assisted the CSO in the first publication of annual Institutional Sectoral Accounts for Ireland (2001-2005) through the provision of data on the financial sector.

Work also continued on the analysis of motor insurance statistics on behalf of the Financial Regulator. A report on private motor insurance statistics,[9] based on the most recent data available, was published. It examined trends in premium income, accident frequency and claims costs, and presented analysis of market share and pricing.

7 Regulation (EC) No 958/2007 of the ECB of 27 July 2007 concerning statistics on the assets and liabilities of investment funds (ECB/2007/8)

8 Guideline of the ECB of 17 November 2005 amending Guideline ECB/2002/7 on the statistical reporting requirements of the ECB in the field of quarterly financial accounts (ECB/2007/13).

9 2005 Private Motor Insurance Statistics.

3. Financial Stability and Payment Systems Oversight

Financial Stability

The Bank has legal mandates to contribute both to the overall stability of the Irish financial system and also financial stability in the euro area. Financial stability is a joint responsibility of the two constituent parts of the Central Bank and Financial Services Authority of Ireland and consequently, the Bank works in close co-operation with the Financial Regulator on these issues. While the Bank has overall responsibility for financial stability, the Financial Regulator has a mandate to foster sound and solvent financial institutions and to help consumers make informed financial decisions. Both approaches are necessary for a comprehensive approach to financial stability issues and the advantage of the institutional arrangements in Ireland is the seamless sharing of expertise and information between both parties within the organisation.

Financial Stability Report

The Bank published its annual assessment of the stability of Ireland's financial system in the *Financial Stability Report 2007.* The aim of the report was to update financial market participants and the wider public on developments in the economic and financial environment, with particular attention to the key risks. A press briefing was held to convey the key messages of the report to the wider public. In addition to the financial stability assessment, the report also contained a number of research articles which aimed to provide a more in-depth analysis of some specific financial stability issues. The articles covered topics such as an assessment of developments in commercial property and the significant role of residential property investors, the results of a survey of banks' exposures to sub-prime lending, private equity and hedge funds, the international dimension of banks' foreign activities, and the issue of concentration in banks' loan portfolios.

The overall assessment of the Report noted that financial stability risks had, on balance, increased during 2007. This was due in large part to the disruption to international financial markets that emerged at mid-year. Nevertheless, the overall conclusion was that the Irish financial system remained well placed to cope with emerging issues.

During the year, as the environment in international markets became more challenging, the dialogue intensified between the Bank and the major domestic credit institutions in order to review issues affecting the domestic financial system. As a matter of routine, the Bank also met with a number of international organisations such as the International Monetary Fund and the Organisation for Economic Development, as well as with ratings agencies to outline its assessment of, and exchange views about, financial stability in Ireland.

The Bank contributed to the assessment of financial stability across the euro area through its involvement in international committees and by contributing to financial stability discussions of the European Central Bank's Governing Council.

Stress-Tests of the Domestic Banking Sector

A key tool used to inform our assessment of the strength of the banking system is stress testing, whereby banks assess their resilience to plausible, but extreme, economic scenarios. During the year, the Bank continued to develop its stress-testing procedures and participated in two Eurosystem task forces on stress testing. This afforded an opportunity to benchmark our approach in this area against methodologies used internationally. The results of a 'top-down' stress test were published in the *Financial Stability Report 2007.* The results of that exercise, notwithstanding some important caveats, suggested that the banking sector's shock absorption capacity remains strong. Preparations were begun with a view to launching the next bi-annual 'bottom-up' exercise (i.e., with the participation of the retail banks) in mid-2008.

Planning for the next stress tests with domestic financial institutions commenced in late 2007 and, in line with our commitment to conduct these exercises every two years, the next stress test will be carried out in mid-2008.

Crisis Management Procedures

The Bank continued to develop procedures to deal with potential disruptive events and to facilitate an orderly resolution in the case of any such events materialising. There was continuing co-operation between the Central Bank, the Financial Regulator and the Department of Finance on these issues. A crisis management exercise was also carried out involving these three parties. The Bank continued to contribute to international efforts in this area through its participation in international fora.

Oversight of Payment and Securities Settlement Systems

The principal aim of oversight (or regulation) of payment and securities settlement systems is to ensure that they function at all times in an orderly manner, thereby minimising systemic risk. In carrying out this role, the Bank's primary focus is to promote payment and securities settlement systems that are safe, effective and efficient, and to ensure that all credit institutions with a requirement to do so can access these systems on a fair and equitable basis. The Bank also aims to ensure that payment and securities settlement systems do not operate in such a way as to cause, or add to, instability in the operation of financial markets. The proper functioning of these systems is a core requirement for maintaining financial stability, and for meeting both the business needs of the economy generally and the personal banking requirements of the public at large. Moreover, payment systems provide the means by which the Eurosystem implements its monetary policy, making the oversight of payment systems a key task for the ECB and all euro-area NCBs.

Payment Systems Oversight

In carrying out its oversight function, regular review meetings were held with the Irish Payment Services Organisation (IPSO), the representative body for the payments industry in Ireland. Bank staff also participated, from a payment systems oversight perspective, in board meetings of IPSO. In addition, Bank staff also attended board meetings of the Irish Paper Clearing Company Limited (IPCC), the Irish Retail Electronic Payments Clearing Company Limited (IRECC), LASER and the Irish Real-time Interbank Settlement Company Limited (IRIS). IPCC handles all retail paper payment instruments (e.g., cheques and credit transfers), IRECC has overall responsibility for the clearing and settlement of all retail electronic payments, LASER is responsible for the Irish debit card scheme, and the fourth company, IRIS, was responsible for the Irish RTGS system, prior to the successful migration of this system to the Eurosystem's new TARGET2 single shared platform in February 2008.

Securities Settlement Systems Regulation

The Bank continued to co-operate with the National Bank of Belgium in relation to the oversight of Euroclear Bank, in accordance with the provisions of a Memorandum of Understanding (MoU) agreed in this regard in 2002. The Bank's role in this area stems from the fact that settlement of transactions in Irish Government bonds take place in Euroclear Bank.

The Bank also monitored developments in CREST, the UK-based system operated by Euroclear UK and Ireland Limited, that provides settlement services for Irish securities other than government bonds. The Bank also developed, in conjunction with the UK FSA and the Bank of England, an MoU on a cooperative framework for the regulation/oversight of the securities settlement system operated by Euroclear UK and Ireland, as it relates to the settlement of Irish securities. The parties signed this MoU in early 2008.

The Bank also continued to participate in the Irish Market Advisory Committee of Euroclear and in its Payments Working Group, which is a new working group established by Euroclear.

RTGS System and Retail Payments

Over the course of the year, the Bank, in its capacity as payment systems overseer, continued to monitor the operations of IPCC and IRECC and the retail payment systems for which these companies are responsible. The Bank also continued to administer the daily interbank settlement process for these two companies, which took place via the IRIS system across the participating banks' settlement accounts at the Bank.

In 2007, the Bank extended its oversight regime to cover the Irish banks' LASER debit card scheme; this development is in line with the Eurosystem's Oversight Framework for card payment schemes as approved by the ECB's Governing Council. The Bank's oversight role in relation to the LASER scheme is similar to that already applied to IRECC and the IPCC, and includes attendance at LASER board meetings in an oversight capacity.

The Bank also continues to be involved in the National Payments Implementation Programme (NPIP), a joint IPSO/Department of the Taoiseach initiative aimed at improving Ireland's payment systems infrastructure, for example, by encouraging consumers to move away from using cash and paper payment instruments to electronic alternatives and improving access to payment systems for all groups in Irish society. The NPIP Advisory Group, which was initially made up of representatives of IPSO, the Departments of the Taoiseach and Finance, the Bank and the Financial Regulator, has now been enlarged to involve as many interested parties as possible in the process of payment systems development (for example, bodies such as the Consumers Association of Ireland, the Combat Poverty Agency and RGDATA are now represented).

SEPA (Single Euro Payment Area)

Since euro notes and coins were introduced in 2002, the ECB and the Eurosystem NCB's (together with the EU Commission and the European Payments Council) have been working to make non-cash, euro-denominated retail payments throughout the EU as easy and efficient as their domestic equivalents. This initiative is known as SEPA (i.e., the Single Euro Payments Area).

Work on implementing SEPA in Ireland progressed satisfactorily in 2007, with all banks involved reporting their SEPA projects as 'on schedule' at year-end. it was expected that all would be in a position to offer their customers SEPA Credit Transfer Scheme services in early 2008 in keeping with the agreed deadline in this regard. With regard to the SEPA Direct Debit Scheme, the Irish banks report that they expect to meet the November 2009 deadline mandated for the introduction of this service.

The Irish authorities currently do not envisage any difficulty in meeting the required timeframe for transposition of the EU Commission's Payments Services Directive (adopted in March 2007) into national law by the required date of 1 November 2009. It is expected that the Directive will be transposed into Irish law by means of a Statutory Instrument, and work in this regard is currently being progressed by the Department of Finance.

4. Payments and Securities Settlement Systems

TARGET2

A key focus in the area of payments systems in 2007 was the successful preparations for the introduction of TARGET2 for Irish financial institutions. User testing, which commenced in June and involved detailed test scenarios, was carried out with the Irish banking community. The migration of national banking communities to the TARGET2 Single Shared Platform (SSP) was scheduled in three stages. The TARGET2 system was introduced on 19 November when the first group of countries (Germany, Cyprus, Latvia, Lithuania, Luxembourg, Malta, Austria and Slovenia) migrated to the SSP. This was to be followed on 18 February 2008 by the migration of a second 'wave' of countries including Ireland (along with Belgium, Finland, France, the Netherlands, Portugal and Spain) with the final migration group on 19 May 2008.

Processing of Payments

As indicated in Table 3, in 2007, TARGET as a whole processed a total of 93.4 million payments, with a total value of €617 trillion. This corresponds to a daily average of 366,000 payments with a value of €2.4 trillion. The growth of 12.3 per cent in the volume of transactions is in line with the Eurosystem's policy objective of promoting settlement in central bank money as a uniquely safe means of payment.

In excess of 1.4 million payments were processed in 2007 through IRIS, the Irish element of TARGET, with the value of those payments amounting to approximately €7.4 trillion. The average daily number of transactions initiated by IRIS participants was 5,334, up 11.2 per cent on the 2006 figure, with an average daily value of €29.2 billion. Transactions processed by IRIS represented 1.2 per cent by value and 1.5 per cent by volume of the total transactions processed by TARGET.

The overall availability of TARGET was 99.90 per cent, compared with the minimum availability requirement of 99.44 per cent. Availability of the IRIS system was 99.99 per cent.

Table 3: TARGET Traffic

	2007	2006
Volume of transactions for year (million)	93.4	83.2
Volume of transactions per day	366,000	326,000
Value of transactions (trillion)	617	534
Value of transactions per day (€ trillion)	2.4	2.1
Average Daily transactions via IRIS		
Volume of transactions per day		
Domestic	3,181	2,070
Cross-border (TARGET)	2,153	1,905
Total	5,334	4,775
Value of transactions per day		
Domestic	16.9	13.9
Crosss-border (TARGET)	12.3	12.2
Total	29.2	26.1
TARGET Availability and Service Level		
Overall availability of TARGET (per cent)	99.90[10]	99.87
Minimum availability requirement	99.44	99.44
IRIS availability	99.99	99.78

10 This availability figure incorporates the migration of 8 countries to the TARGET2 platform on 19 November.

TARGET2-Securities

In July 2006, the Governing Council of the ECB announced its intention to explore, in co-operation with central securities depositories (CSDs) and other market participants, the setting up of a new service — TARGET2-Securities (T2S) — for the settlement of securities transactions of multiple CSDs on a single platform.

The concept behind the T2S project is that CSDs would use T2S as a common technical service for settlement of securities transactions, with the securities accounts of such CSDs being maintained on the T2S technical platform alongside central bank cash accounts. The CSDs would maintain their relationships with intermediaries, investors and issuers, as well as their asset servicing function. It is intended that T2S would be developed and operated within the Eurosystem on the TARGET2 platform in order to exploit synergies to the fullest extent. Four Eurosystem national central banks (Deutsche Bundesbank, Banco de Espana, Banque de France and Banca d'Italia) are ready to develop and operate T2S.

Following an informal consultation with market participants, a detailed feasibility study on the project was prepared in early 2007. Following consideration of this study, the Governing Council concluded that the T2S project was feasible and decided to launch the next phase of the project. The objective of this phase was to prepare, in co-operation with CSDs and market participants, user requirements that the Eurosystem regards as deliverable within a reasonable cost and time scale. A public consultation was launched in April 2007 in order to obtain input regarding the user requirements.

The publication of a progress report on TARGET2-Securites in October by the ECB was followed, in December, by the launch of a public consultation on the T2S user requirements and on the methodology for the assessment of the economic impact of T2S, which is intended to facilitate the calculation of the costs, benefits and macroeconomic impact of T2S. In May 2008 the T2S Advisory Group assessed the comments received during the public consultation, with a proposal for the final T2S user requirements expected to be submitted to the Governing Council shortly thereafter. At that stage, the Governing Council will decide on whether or not to move to the next phase of the T2S project.

Provision of Settlement Services to UK Institutions

Settlement of Irish equities - in euro - within CREST, the UK-based securities settlement system, on the basis of real-time Delivery-versus-Payment (DVP) in central bank money, has been facilitated by the Bank of England currently acting as cash settlement agent. Following the decision by the Bank of England not to participate as a member NCB in the Single Shared Platform of TARGET2, the Bank has agreed to replace the Bank of England as CREST settlement agent for euro-denominated transactions. Legal, technical and operational preparations were undertaken for the Bank's replacement of the Bank of England as the provider of central bank money for the settlement of euro securities (including Irish equities) which went live in April 2008 and will cover the period until the introduction of the settlement phase of Euroclear's Single Platform.

Since end-October, the Bank has been providing euro settlement services for the retail clearing companies in the UK. In this regard, the Bank provides settlement facilities to the Cheque and Credit Clearing Company Ltd. for its euro cheque clearing service and to BACs Payment Schemes Ltd. for its euro automated clearing service.

Collateral Central Bank Management (CCBM2)

In March 2007, the Governing Council of the ECB decided to review the current Eurosystem collateral management handling procedures and to develop a single platform, allowing the Eurosystem to manage collateral both for domestic and cross-border operations. It also agreed that such a platform would be based on existing systems.

Following the first consultation on CCBM2, draft User Requirements were drawn up and a second public consultation on these requirements was announced in February 2008. To maximise synergies and to minimise overlap, it is intended that work on this project *(Collateral Central Bank Management or CCBM2)* will be conducted in parallel with the TARGET2-Securities (T2S) project.

Bond Register

The Bank maintains the register of bonds issued by the National Treasury Management Agency, the Housing Finance Agency and the European Investment Bank, while Irish Government Bonds (and other bonds for which the Bank acts as registrar) are settled in Euroclear Bank, which is based in Belgium. The Bank, in its role as registrar, effects dividend and redemption payments to account holders, including Euroclear (on behalf of relevant participants in the Euroclear system).

At the end of 2007, the nominal value of NTMA-issued bonds on the Register amounted to €31.3 billion, a small decrease over the value outstanding at end-2006. The combined nominal value of bonds issued by the Housing Finance Agency and the European Investment Bank totalled €330.1 million at end-2007, mirroring the end-2006 figure. In October, a new bond (4.5% Treasury Bond 2018) with a nominal value of €6 billion was issued by the NTMA while a further bond (4.25% Treasury Bond 2007) matured, resulting in redemption payments of €6,041 billion. At end-year there were 1,708 accounts on the Register, down from 1,950 at end-2006.

In order to fulfil its legal obligations, during the course of 2007 the Bank notified the Revenue Commissioners of interest payments that were made by the Bank during 2006 on bond-holdings recorded on the Bank's register to individuals resident in other EU Member States and other relevant territories.

5. Currency Production and Issue

In the currency area, the Bank aims to provide the public with banknotes and coins in the quantities and denominations that best suit their needs. The Bank is also responsible for the receipt and processing of used banknotes, the re-issue of good quality banknotes and for the destruction of banknotes unfit for circulation.

Banknote Production and Processing

Under the pooled production arrangements of the ECB in 2007, the Bank produced a total of 55 million banknotes, in the €20 and €5 denominations. In addition, banknotes were received from other euro area NCBs. The Bank supplied retail banks with 235 million new banknotes and 228 million re-issuable banknotes in 2007.

Retail banks lodged 399 million banknotes. A total of 459 million banknotes were sorted during the year and, of these, 203 million were sorted as reissuable.

Coin Production

In 2007, the Bank's Currency Production Department produced 294 million coins. Demand for coin amounted to 446 million pieces compared to 393 million pieces in 2006.

The details of the coins issued in 2007 were as follows:

Collector Coins

The Bank issued a 2007-dated circulating coin set in January. In keeping with the concept of featuring national heritage sites, this set featured images of Dún Aonghasa and other monuments on the Aran Islands.

In February the Bank issued a €15 Silver Proof Coin celebrating the Croatian sculptor Ivan Mestrovic, who designed the image used on the coin. The Croatian National Bank issued a 150 Kuna coin of the same reverse design.

To mark the 50th anniversary of the signing of the Treaty of Rome in 1957, the Bank issued a commemorative €2 coin in March. The traditional harp was replaced by a design featuring the Treaty signed by the six founding countries on a background based

Table 4: Banknote Issues

	€5	€10	€20	€50	€100	€200	€500	Total
No.of Banknotes (m)	52	45	143	222	2	-	-	463
Value €m	258	446	2,869	11,082	158	8	59	14,880

Figures may not sum due to rounding

Table 5: Coin Issues

	1c	2c	5c	10c	20c	50c	€1	€2	Total
No. of Coins (m)	118	95	85	64	44	16	11	12	446
Value €m	1	2	4	6	9	8	11	23	65

Figures may not sum due to rounding

on the paving (designed by Michelangelo) of the Piazza del Campidoglio in Rome, where the Treaty was signed on 25 March 1957. The Bank issued over 4.6 million of these coins into circulation and also produced a variety of collector and proof coin items.

In September, a €10 silver proof collector coin and a €20 gold proof collector coin were issued to celebrate the influence of Ireland in the spread of Celtic culture throughout Europe.

Finally, in December the sixth and final set in the heritage series of Annual Mint Sets was issued. This is the Annual Mint Set for 2008 and featured images of the national heritage site at Newgrange, Co Meath.

Counterfeits

The number of counterfeits received by the National Analysis Centre, located in the Bank, increased slightly compared with 2006. Within the Eurozone, as a whole, there was a marginal decrease. All of the counterfeits discovered could be detected using the recommended “feel-look-tilt” test.

Measures put in place during 2007 to minimise the risk of counterfeit currency circulating in Ireland include the provision of training on counterfeit identification for cash handlers. A report on proposals to authenticate coin in Ireland was completed in consultation with stakeholders. Major commercial coin processors will carry out the authentication process as part of their normal operation.

Withdrawal of Irish Banknotes and Coin

The Bank continued to accept Irish banknotes and coin and these were withdrawn from circulation. At 31 December, the value of Irish banknotes in circulation was IR£195 million (€248 million) and the value of Irish coin in circulation was IR£100 million (€127 million).

6. European and International Relations

Niche Areas

As a strategic objective, the Bank has sought to focus on economic areas where it already has a distinctive expertise in the Eurosystem and where we can exploit synergies with its domestic role. Further progress on research in the niche area of growth and productivity was made during the year. A number of papers documenting research work carried out in the Bank in this area were presented at academic conferences both in Ireland and abroad and published or accepted for publication by leading Irish and international journals. The high quality of Bank research in 2007 was recognised both in Ireland, by the award of the Barrington Medal to one of the Bank's research economists, and internationally at the annual conference of the European Economic Association. A paper documenting work on export dynamics received an award from the European Economic Association as one of the five best papers produced by young economists.

The development of a conceptual framework for a research programme on the niche area of interaction between monetary policy and financial stability was completed. Research projects are ongoing and a conference on this niche area is being organised for early 2009.

In addition to our work in these areas, the Bank carried out a pre-test of a possible new euro-area-wide household survey of consumption and wealth at the request of the Eurosystem. The results were presented at the ECB and provided a valuable input into the design of further test surveys to be carried out in 2008.

Other EU Fora

The Governor, together with the Minister for Finance, participated in the biannual Informal meetings of the ECOFIN Council, which were held in Berlin in April, and in Porto in September. The Bank is also represented on a number of high-level EU committees, namely, the Economic and Financial Committee, the Economic Policy Committee and the Eurostat Committee on Monetary, Financial and Balance of Payments Statistics.

IMF Meetings and Article IV Review

The Governor and Director General of the Bank attended the IMF/World Bank Annual Meetings in October in Washington, and the Bank was also represented at the spring meetings.

At the spring IMF Meetings, the Fund's role and operations were reviewed as part of the Fund's medium-term strategy (MTS), which was undertaken by the then Managing Director, Rodrigo de Rato. At the Annual Meetings, discussions continued on the package of governance reforms, and the mechanisms to put Fund finances on a more sustainable footing was also assessed.

The IMF conducted its annual Article IV review of the Irish economy in May. The Bank provided analysis on statistics and the economic and financial issues raised by the IMF mission teams.

Other International Activities

During the year, the Governor also participated in a high level seminar between the Eurosystem and the central banks of Western and Central Africa. The seminar was hosted by the Banque de France and the ECB in Paris and was attended by the President of the ECB and the governors from the Western and Central African central banks and the euro area. The issues discussed included regional economic integration and monetary co-operation, fluctuations in commodity process and their impact on exchange rate and monetary policies and central bank governance and the implementation of monetary policy.

The Governor also participated in the Annual Symposium of the Federal Reserve Bank of Kansas City in Jackson Hole and attended a meeting of Governors jointly hosted by the South African Reserve Bank and the Bank for International Settlements in Cape Town, while the Director General participated in the Fourth Joint High Level, Eurosystem – Bank of Russia, Seminar in Moscow.

International Events hosted in Ireland

The ECB Governing Council meets in a euro area location, other than Frankfurt, twice per year and, in May 2007, the Bank hosted a meeting of the Governing Council, held in Dublin Castle.

In June, the Bank also co-hosted an International Conference with US organisations, the Global Interdependence Centre and the Irish American Business Chamber and Network. The Conference was addressed by a number of eminent speakers on issues such as "Monetary Policy Perspectives", "Global Investment Strategies" and "Ireland's Economic Development and Convergence".

In October, the Bank hosted the 9th conference of the ECB and Centre for Financial Studies Research Network on "Asset management, private equity firms and international flows: Their role for financial integration and efficiency". The conference featured a number of high-level speakers from academia, international financial institutions and policy authorities.

7. Asset Management and Risk Management

Management of Investment Assets

As at end-December, the Bank's investment portfolios comprised euro-denominated assets of €12.1 billion and US dollar holdings of €0.4 billion, together amounting to €12.5 billion. This total represents an increase of €0.4 billion on the comparable figure at end-December 2006. Most of the increase is accounted for by the accumulation of dividends and interest. The Bank's euro portfolio derives mainly from sales of foreign currency assets in the context of portfolio restructuring since 2002 and also from its holdings prior to January 1999 of EMU legacy currencies.

Under the Statute of the ESCB, one of the basic tasks of the System is to hold and manage the official reserves of Member States. Thus, the Bank's foreign currency holdings form part of the foreign reserves of the Eurosystem.

Portfolio Restructuring

Over the years, the Bank has converted most of its foreign currency holdings into euro, and since 2005 only a small proportion (some 4 per cent) of non-euro assets remains (Table 6). Furthermore, the exchange rate risk on the small non-euro portion (held in US dollars) is hedged. This ensures that the Bank has virtually no exposure to volatility of returns arising from the impact of exchange-rate movements on the euro value of its investments.

Box C

The Board of the Bank determines the overall parameters of the Bank's investment portfolio. These include the currency composition of the non-euro reserves, the choice of investment instruments, and the overall degree of risk that the Bank considers appropriate for its investment activities. A separate Investments Committee of the Board reviews investment policy and performance.

This is supported by the Bank's Investment Assets Committee, which is chaired by the Management Board member responsible for Financial Operations, and includes senior staff of the Financial Markets Department, the Financial Control Department and the Risk Monitoring Function. A Standing Investments Committee, comprising management, senior dealers and senior analysts of the Financial Markets Department, together with a representative from the Risk Unit, meets weekly to formulate short-term policy.

Finally, the Financial Markets Department's Investment Desk carries out the day-to-day dealing activities that are required to implement decisions and to ensure that the Bank's investment assets are fully invested.

The risks inherent in managing the Bank's investment portfolio are managed by a comprehensive system of controls, limits and procedures. Risk monitoring and performance measurement are carried out independently of the Financial Markets Department.

The investment portfolio is invested in a wide range of instruments — deposits, other money market instruments, government bonds and other high-quality fixed-income securities. The objective is to maximise return within pre-defined risk parameters. Within this framework, the Bank employs a number of strategic and tactical investment methodologies and techniques. On a day-to-day basis, the investment strategy involves positioning the portfolio to take advantage of opportunities to enhance returns in the international money and capital markets.

Table 6: Currency composition (%) of the investment portfolio since EMU

	Dec 98	Dec 99	Dec 00	Dec 01	Dec 02	Dec 03	Dec 04	Dec 05	Dec 06	Dec 07
Euro	29	28	27	28	43	68	80	95.5	96.2	96.5
Non-euro	71	72	73	72	57	32	20	4.5	3.8	3.5

During 2007, the duration of the US dollar portfolio was maintained at the upper end of the Bank's risk tolerance range in order to be positioned to avail of the capital gains that would be associated with falling bond yields (higher bond prices). The duration of the euro portfolio was gradually increased amid market perception that euro area bond yields were near their cyclical highs and therefore also likely to decline in the future and thereby deliver capital gains. The Bank's Held-to-Maturity (HTM) portfolio[11] increased to €3.3 billion at the end of 2007, mainly as a result of transfers from the managed portion of the investment assets.

Return on Investment Assets

Total earnings (income and capital gains) on the Bank's investment portfolios amounted to €472.3 million in 2007 compared with €274.5 million in 2006. In rate of return terms, earnings on the investment portfolios were 3.97 per cent compared with 2.55 per cent in 2006. The higher return in 2007 is primarily due to higher interest returns on cash holdings.

Over the year, the Bank managed its investment assets (both foreign currency and euro denominated) by reference to benchmark portfolios created by Merrill Lynch on behalf of the Bank. These benchmark portfolios incorporate the Bank's preferences for liquidity, risk and return. The active management of the Bank's assets produced results in excess of the return on the benchmark portfolios.

Gold Holdings

The Bank holds a small portion of its assets in gold. Gold holdings were valued at €110 million at year-end. The gold is held in physical form and, with the exception of coin stocks held in the Bank, may be placed on deposit in the London gold market depending on market conditions. The Bank did not purchase or sell any gold during the year, in accordance with the Central Bank Gold Agreement.

ECB Pooled Reserves

The Treaty on European Union provided for the initial transfer by NCBs of up to €50 billion of foreign-reserve assets to the ECB. At the commencement of EMU in January 1999 the Governing Council of the ECB decided that €39.5 billion - that is, €50 billion adjusted downwards for the shares of the countries not participating in the euro area - should be transferred to the ECB. Each NCB's contribution to the ECB reserves was in proportion to its shareholding in the ECB. Further reserves have been transferred to the ECB as other countries have joined EMU. At the end of 2007, the ECB's net foreign reserve assets amounted to €42.8 billion compared with €42.3 billion at the end of 2006. The change in the value of the portfolio reflects primarily the appreciation of gold and positive net returns from portfolio management over the year, which was partly offset by the depreciation of the US dollar and Japanese yen vis-à-vis the euro. The size of the portfolio managed by the Bank on behalf of the ECB was €0.4 billion equivalent at year-end.

11 A HTM portfolio, because it is not traded during its life, is not subject to mark-to-market accounting rules; rather the return is spread evenly over the life of the assets included in the portfolio.

Box D

The foreign reserves transferred to the ECB are managed in a decentralised manner by the NCBs. The ECB determines the investment parameters, makes policy decisions, including setting performance benchmarks, approving counterparties and setting permitted risk levels, and performs control and monitoring functions. The benchmarking framework is set at both strategic and tactical levels and each NCB's performance is measured against the tactical benchmark and against the other NCBs. Within this framework, each NCB undertakes management and settlement functions associated with their portion of the ECB reserves. NCBs act on behalf of the ECB on a disclosed agency basis so that market participants can differentiate between operations carried out on behalf of the ECB and those undertaken on NCBs' own reserves. The Bank enters trades onto the ECB reserve management system, which permits the ECB to monitor positions and exposures and to carry out performance measurement.

The basic objectives of ECB investment policy are to protect the value of the ECB's reserves and to ensure that the assets are sufficiently secure and liquid to support the ECB's monetary policy. When foreign exchange intervention takes place, the foreign reserve assets of the ECB are used.

Under the framework introduced in 2006 to increase efficiency as more countries join the single currency, new members have the option of requesting an existing Member State to enter into a "pooling" arrangement whereby the existing member, in consultation with the new member, manages their combined ECB portfolios. During 2007 the Bank agreed to such a request from the Central Bank of Malta. Accordingly, the Bank has managed the combined reserve portions of Ireland and Malta since 1 January 2008 when Malta adopted the euro.

Work continued on extending the list of eligible instruments in which foreign reserves can be invested. Interest-rate swaps were put in place while an automated securities lending programme for the USD portfolio is expected to be implemented during 2008.

Risk Management

The risk control policy framework governing the Bank's asset management and monetary policy operations is established by the Board of the Bank and is reviewed regularly. The framework consists of various risk policies, procedures and limits. The Bank's code of conduct for dealers, settlement staff and decision makers covers potential conflicts of interest, private financial accounts, insider trading, dealing limits and related issues. A high-level committee, chaired by the Deputy Director General, oversees the management of operational risk in the Bank. The operations of each function are reviewed regularly to ensure that potential exposures are identified and that appropriate controls are implemented. A full review of operational risk is furnished to the Board on an annual basis.

The Risk Management Unit, which is operationally independent of the dealing function, presents regular reports to the relevant decision-making bodies of the Bank including the Board, the Audit Committee, the Investment Committee and the Management Board. In addition to the work performed by the Risk Unit, the Bank's asset management and monetary policy operations are audited by the Bank's Internal Audit Department, by the Bank's external auditors – the Comptroller and Auditor General and Deloitte and Touche and by the ECB's external auditors – KPMG.

The main risks associated with managing the investment portfolio during 2007 continued to be currency risk, market risk, credit risk,

Table 7: Value at Risk Analysis of Investment Portfolio

€m	Interest Rate Risk	Foreign Exchange Risk	Total Risk*
31 December 2007	168.0	2.5	168.0
31 December 2006	128.1	1.8	127.8

** VaR measures the potential loss at a specific confidence level (e.g. 99 per cent) over a certain period of time (e.g. 1 year). Thus, the figure of €168.0 million (total risk) implies that at 31 December 2007 there is a 1 per cent chance that the portfolio's value would be €168.0 million or more below its current value at 31 December 2008.*

Table 8: Exposure of Investment Portfolio by Credit Rating

% of investment portfolio	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Total
End-December 2007	73	7	16	4	0	0	0	100
End-December 2006	62	12	12	13	1	0	0	100

liquidity risk and operational risk (including settlement risk). Estimates of the value at risk (VAR) analysis of the investment portfolio and the exposure by credit rating are shown in Tables 7 and 8 above.

A number of projects commenced in 2007 with the aim of ensuring a more resilient and integrated risk management framework in the Bank. Firstly, a major IT project commenced to develop further the front, middle and back office systems for the Bank's investment function. Secondly, in the area of business continuity, a detailed work plan was established and a number of initiatives undertaken, including the provision of off-site facilities for staff (directly involved in the investment function as well as from other areas of the Bank) and a planned upgrade of the IT network to provide synchronous back up of data in Currency Centre.

These projects, when complete, will reduce operational risk within the organisation and significantly increase organisation-wide resilience and enable the CBFSAI to better survive the loss of part or all of its normal operational capability or significant losses of resources such as staff, systems or accommodation.

Internal Audit

In the area of internal audit, the objectives remained to assure that systems of risk assessment and internal control are adequate, and to assist in the pursuit of efficiency and effectiveness.

Domestic audits sought to achieve a balance in coverage of risks and controls across key parts of the organisation. Audits completed focused, inter alia, on reviews of Information Security, Mint Operations, Bond Register System, Credit Union Supervision and FIFA Authorisations. A Value for Money (VfM) review of printing and publication costs was also performed. The Internal Audit function within the Bank reported formally to the Audit Committee of the Bank on the outcome of these audits and on other relevant issues three times during the year.

As mandated by the Institute of Internal Auditors and the Internal Auditors Committee of the ESCB, an external review of the operations of the internal audit function was undertaken in the latter part of the year. The outcome of the review was broadly positive, and concluded that the function is predominantly delivering on stakeholder expectations. However, recommendations were made for improvement in a range of current practices.

Steps were taken to further strengthen the effectiveness of the internal audit team through external recruitment and ongoing skills development.

8. Resource Management and Communication

Remuneration, Resource Management and Value for Money

To improve effective resource management, a new budget compilation, monitoring and management information system (MAS), based on the common cost methodology used in the ECB, has been put in place. The development of organisation-wide guidelines on Value for Money (VfM) issues commenced and a VfM audit of printing/publishing was completed in 2007.

A review of the operational arrangements for shared services to ensure that the resources and systems of the organisation are being sourced and used efficiently also commenced. Discussions are being held both domestically and with some other NCB's with a view to identifying comparators and meaningful benchmarks for the Bank's HR processes; this will be completed by mid-2008. It is intended to undertake similar exercises for the other main resource areas during 2008.

The ongoing growth of the organisation has placed a significant strain on the utilisation of premises. During 2007, the Board approved a medium-term accommodation strategy that resulted in lease arrangements being negotiated for premises in Spencer Dock. This arrangement will allow for an increase in staff numbers and will also allow progress on refurbishment work in the Dame Street complex.

Management and Support Services

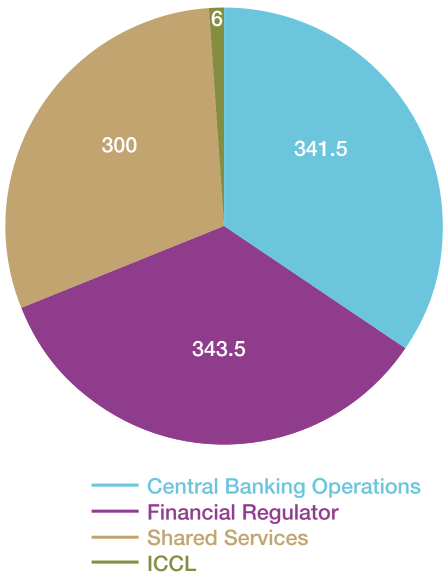
Staffing

There were 991 permanent staff serving at 31 December from an approved staff complement for 2007 of 1,036.5. Recruitment is ongoing to fill the outstanding vacancies across the organisation. Turnover of permanent staff decreased to 4.9 per cent from 5.4 per cent in 2006.

Of the permanent staff employed at year-end, 341.5 were assigned to Central Banking Operations, 343.5 to the Financial Regulator and 300 to Shared Services. A further 6 staff were assigned to the Investor Compensation Company Limited (ICCL). Staff employed comprised 752.5 clerical, professional and management staff and 238.5 industrial, technical and service staff.

The breakdown of staff numbers over the divisions within the organisation is set out in Figure 1.

Figure 1: Staff Breakdown by Division



In July, the Director General introduced changes in the organisation structure and reporting lines of the Bank, to achieve a more optimal alignment of functions across the Bank's four Directorates – Finance and Operations, Economic Policy, Currency Operations and Services and Resources. These changes took effect from 1 January 2008.

Staff numbers continue to reflect the Bank's commitment to provide services such as human resources, information technology, security, engineering, catering and cleaning on an in-house basis. The majority of staff are permanent full-time employees on open contracts.

Permanent Staff Serving At Year End (Fte)

	Department		2006	2007
Central Bank				
		Governor & Management Board	6	7[12]
	Financial Operations	Payments and Securities Settlements	39.5	43
		Financial Markets	27	26
	Economic Services	European Monetary Affairs & International Relations	12.5	12.5
		Economic Analysis, Research and Publications	24.5	24.5
		Statistics	32	30.5
		Monetary Policy and Financial Stability	19	19
	Currency Services	Currency Issue	102	102.5
		Currency Production	60.5	76.5
	Central Bank Operations Total		**323**	**341.5**
	Shared Services	General Secretariat	22	23.5
		Human Resources	41.5	38
		Information Systems	52.5	51.5
		Financial Control	39	37
		Corporate Services	127	139
		Engineering Services	24	0[13]
		Internal Audit	11	11
	Shared Services Total		**317**	**300**
Central Bank Total			**640**	**641.5**
Financial Regulator				
	CEO's Office	CEO and Executive Board	3	3
		Legal and Enforcement	13	11
		Planning and Finance	15	18.5
		Registrar of Credit Unions	19	21
	Prudential Division	Banking Supervision	49.5	48
		Financial Institutions & Funds Authorisation	64	67.5
		Investment Services Providers Supervision	37	46
		Markets Supervision	16.5	15.5
		Insurance Supervision	30	33
	Consumer Division	Consumer Protection	50	48
		Consumer Information	32	32
Financial Regulator Total			**329**	**343.5**
ICCL			<u>8</u>	<u>6</u>
TOTAL CBFSAI			**977**	**991**

12 This figure reverted to 6 following the retirement of a member of the Management Board in early 2008.

13 The Engineering Services function was divided between the Currency Production Department and the Corporate Services Department.

Employment Policies

The Bank is an equal opportunities employer with the majority of staff being permanent full-time employees. Remuneration policy is based on appropriate comparators in the Public Sector and/or by reference to the relevant industry norms. The terms of National Pay Agreements are applied to all categories of staff.

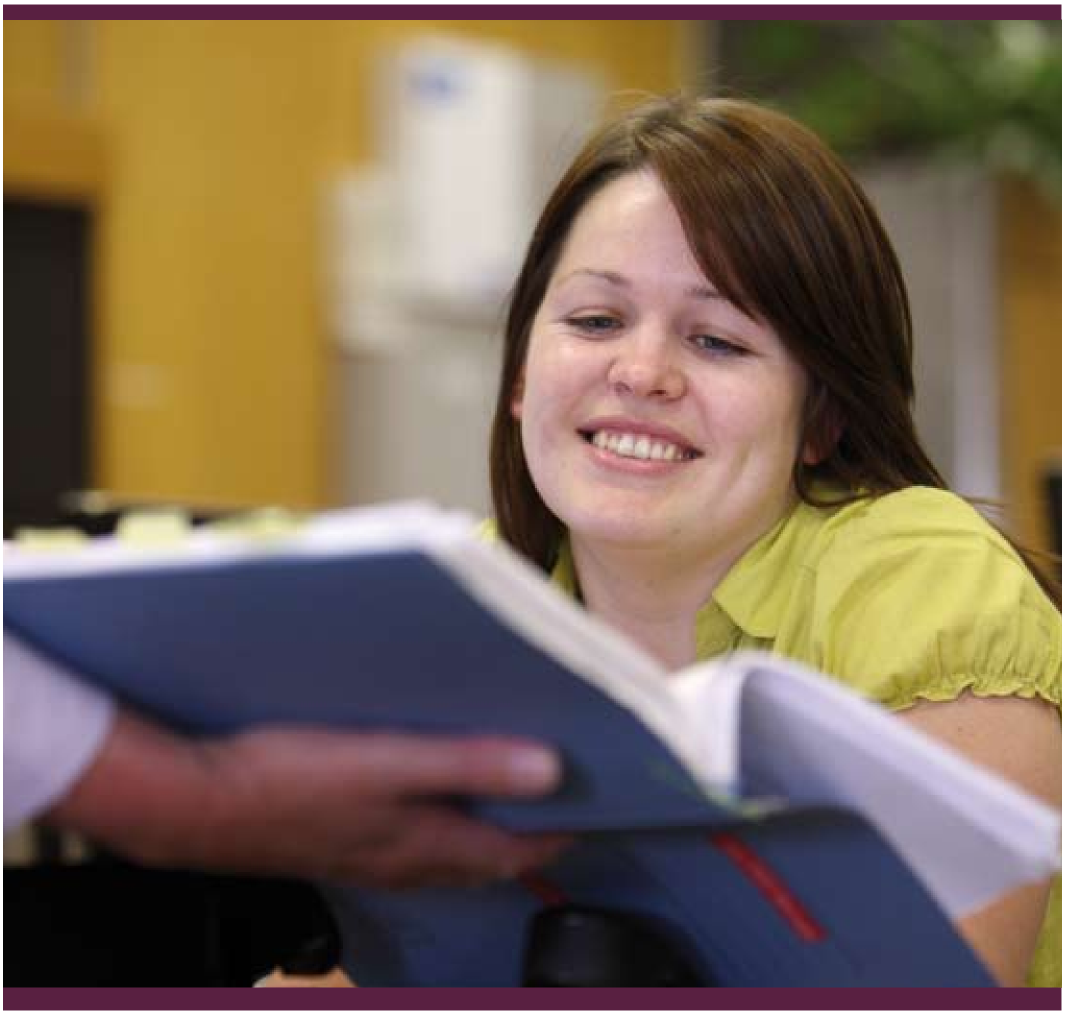
In 2007, the Bank appointed an independent Benchmarking Body to undertake a pay benchmarking exercise of remuneration rates with other organisations in the private and public sectors. This work, which included a job evaluation exercise by external independent consultants, was completed in May 2008.

Training and Development

As part of training and development, staff continued to be provided with both internal and external programmes covering all aspects of the organisation including leadership, management and relationship development skills.

Acquisition of technical skills continued to be a major focus of the training programme throughout the organisation and the Academic and Professional Training Scheme continued to provide staff with the opportunity to gain these skills, enhancing the professional profile of the staff. The range of courses supported through the Scheme continues to be updated to meet the needs of the organisation and the staff.

This includes a range of Executive Master's courses introduced in 2007.



In addition, staff participated in a number of Common ESCB training programmes. These programmes were run by various national central banks across the Eurosystem. Staff also attended courses hosted by the Federal Reserve Bank in New York and other regulatory bodies such as the Financial Services Authority in the UK and the Australian Securities & Investment Commission. The organisation also hosted a phase of the ESCB Heading for Leadership programme.

A comprehensive management development programme was implemented in the second half of the year. The programme commenced in late 2007 and will continue throughout 2008.

The existing Performance Management System for Administrative and Professional staff groups has been reviewed. It is intended that an enhanced system will be rolled out in 2008.

Information Technology

A major strategic priority for IT is advancing the Electronic Reporting infrastructure for the organistion. The first two phases to meet Capital Requirements Directive (CRD) and Markets in Financial Instruments Directive (MiFID) requirements were successfully delivered in 2007. In addition, work continued on developing new systems for business areas in the Central Bank and Financial Regulator. The main priorities were systems for Financial Operations including Portfolio Management and Collateral Management and Enterprise Resource Planning projects including an enhanced Budgets Management Accounting system.

Another major priority was the redevelopment of the Financial Regulator websites. The Financial Regulator Consumer website 'It's your Money' was successfully implemented in 2007 and the redevelopment of the Financial Regulator industry website commenced with the requirements gathering and planning phase.

Projects to provide an enhanced network infrastructure giving greater capacity, resilience and connectivity commenced during the year and will continue into 2008.

Over the last number of years there has been an increase in workload in relation to ESCB common systems and this trend continued. In addition to ongoing support for local components of existing systems, projects to review and refresh the ESCB's network and to implement local components of an ESCB-wide Enterprise Content Management system were undertaken. The first phase of a new centralised securities database system incorporating securities reporting which involves significant local components for collection and processing of statistical data from the Banking and Other Financial Intermediary populations continued. These projects will all continue into 2008.

External Communications

Our primary formal sources of communication are the Annual Report, Quarterly Bulletins, Financial Stability Report, statistical publications and Governor's speeches and interviews. The Bank's commentary, projections and policy advice received widespread media coverage during 2007. During 2007, the Governor delivered a number of speeches and interviews to domestic and international audiences and media. These included:

- Speeches to the Finance Dublin Securitisation Conference; Bloomberg Business Lunch; ACI Ireland; ECB-CFS Research Network and the Global Interdependence Centre Conference.
- Press Conferences for the Annual Report and Financial Stability Report.
- Press Conference of the European Central Bank Governing Council, following the hosting of the meeting in Dublin in May.
- Interviews with various domestic and international media.

Media Activity	Total
Press Conferences	6
Media Queries Handled	946
Press Releases Issued	42

In addition, a review of the design and presentation of our publications was completed and implemented. The Quarterly Bulletin No. 1 2008 was the first publication using the new design. The obligations under the Official Languages Act Scheme were met and a report was submitted on progress on the provision of services in Irish to An Comisinéir Teanga.

Media communications on behalf of both the Central Bank and the Financial Regulator is handled by a dedicated Press Office. In 2007 a total of 946 media queries were handled, 131 interviews took place, 42 press releases were issued and six press conferences were held.

Two major economic conferences were hosted - the ECB-CFS Research Network on Asset Management, Private Equity Firms and International Capital Flows and the Global Interdependence Conference. A number of commemorative and collector coin sets were launched. These included a collector coin celebrating Celtic Culture and a Heritage Set celebrating the Newgrange heritage site. There was significant interest in a new €2 coin that went into circulation during the year to commemorate the 50th Anniversary of the Treaty of Rome.

In addition to domestic issues, the level of interest in ECB and ESCB-related activity remained high with media and financial analysts focusing on issues related to monetary policy, financial stability, banknote issues and payments systems. A number of media visits to the ECB premises and Governing Council press briefings in Frankfurt were also facilitated.

Internal Communications

A review of internal communications processes was completed in 2007 and a report issued to all staff. A number of recommendations from the report were implemented in 2007 including the appointment of a full-time internal Communications Officer, the establishment of a cross-organisational Communications Committee to oversee implementation of the recommendations in the Report; the establishment of a Communications Team comprising a communications liaison officer nominated by each department and the re-introduction and on-line publication of an internal staff bulletin, in addition to the existing staff magazine. Various presentations were also made to staff on issues of common interest during the year.

Strategy and Planning

The Board approved the Central Bank Strategic Plan covering the period 2007-2009 in March. This plan sets out the high level goals for the organisation and also identifies some key performance indicators, which are being used to monitor the impact of implementing the objectives in the plan. Since the approval of the Strategic Plan and following the appointment of the new Director General, a re-structuring of some departments and a re-assignment of responsibilities and portfolios was effected. This resulted in improved alignment of responsibility for the implementation of our strategic intents. A detailed report on progress in 2007 under each of the high-level goals was presented to the Board in February 2008.

Work continued on the implementation of the long-term programme of organisational development and change throughout the Bank. The main areas of work included: improving the alignment and efficiency of planning processes; continuing to embed the organisational values in the organisation; continuing the programme of business process reviews; and progressing organisational issues arising from workshops with management and professional grades.

This is given under the seal of the Central Bank and Financial Services Authority of Ireland.

John Hurley, Governor

Brian Halpin, Secretary

The 30th day of June, 2008

Governance and Organisation

Statutory Background

The Central Bank and Financial Services Authority of Ireland (the Bank), formerly called The Central Bank of Ireland, was established under the *Central Bank and Financial Services Authority of Ireland Act, 2003*, (the Act). The Act also established the Irish Financial Services Regulatory Authority (Financial Regulator) as a constituent part of the organisation with statutory responsibilities for financial sector regulation and consumer protection.

Members of the Board

The Members of the Board as at 30 April 2008, were:

Name	Occupation	Date first Appointed	Date Last Appointed
John Hurley	Governor	11.03.02	11.03.02
Tony Grimes	Director General	17.08.07	17.08.07
David Begg	General Secretary, Irish Congress of Trade Unions	12.05.95	01.05.03
Gerard Danaher	Senior Counsel	15.10.98	01.05.03
Roy Donovan	Former Member of the Economic & Social Comm. of the EU	01.12.89	01.05.03
David Doyle	Secretary General, Department of Finance	01.07.06	01.07.06
John Dunne	Chairman, IDA	01.05.03	01.05.03
Alan Gray	Managing Partner, Indecon International Economic Consultants	21.12.06	21.12.06
Martin O'Donoghue	Emeritus University Professor	01.07.98	01.05.03
Patrick Neary	Chief Executive, Financial Regulator	01.02.06	01.02.06
Brian Patterson	Chairman, Regulatory Authority	01.05.03	01.05.03
Deirdre Purcell	Author	01.05.03	01.05.03

Total fees due to Directors in respect of membership of the CBFSAI Board in 2007 amounted to €140,000.

In August 2007, Mr. Liam Barron retired from his position as Director General and was replaced on the Board by Mr. Tony Grimes.

Mr. Brian Patterson, Mr. Roy Donovan and Dr. Martin O'Donoghue retired as members of the Board on 30 April 2008. The Minister for Finance announced the appointment of Mr. Jim Farrell, Chairman of the Financial Regulator, Mr. Dermot O'Brien and Dr. Brian Hillery to the Board for a five year term with effect from 1 May 2008. The Minister also renewed the term of office of the other non-executive Board members for a further five years.

Board Structure

Responsibility for the management of the Bank is vested in the Board of the CBFSAI, which comprises the Governor, the Director General of the Central Bank, the Secretary General of the Department of Finance, the Chairperson of the Regulatory Authority, the Chief Executive of the Financial Regulator and seven non-executive Directors appointed by the Minister for Finance. Four of these non-executive Directors are appointed by virtue of their membership of the Regulatory Authority. Ex-officio Directors are members of the Board for as long as they hold the office by virtue of which they are appointed to the Board. Non-executive Directors are appointed by the Minister for renewable fixed terms of five years. The sole shareholder of the Bank is the Minister for Finance.

Board Procedures

The Board holds eleven regular meetings each year. A quorum of seven normally applies for all meetings. The Governor approves the agenda and papers, which are circulated to the Directors one week in advance of meetings. Additional Board meetings may be called by the Governor at short notice either on his own initiative or at the request of any two Directors. The Secretary of the Bank keeps minutes of all Board meetings.

The agenda for meetings typically includes:

- Reports on monetary and financial developments;
- Reports on various issues relating to the Irish economy, the European economy and the international economy;
- Management of the investment assets of the Bank;
- Substantial financial contracts to be placed by the Bank for the procurement of goods and services;
- General management, planning and budgetary issues;
- Quarterly and annual financial statements and results.

The Board also considers regulatory issues that require a decision or which are circulated for the purpose of keeping the Board fully informed of developments at a general policy level or relating to specific institutions.

Governor

The Governor is appointed by the President, on the advice of the Government, for a term of seven years. Mr. John Hurley, the current Governor, was appointed with effect from 11 March 2002. The Governor is the Chairman of the Board of the CBFSAI and is also an ex-officio member of the Governing Council of the European Central Bank (ECB). He was appointed first Chairman of the ECB Audit Committee in 2007. He has sole responsibility for the performance of the functions imposed, and the exercise of powers conferred, on the Bank by or under the EU Treaties or the ESCB Statute.

The total remuneration paid to the Governor for service during the year was €368,703. Superannuation benefits attaching to the Governor's salary are in accordance with the terms of the Civil Service Superannuation Scheme. The Governor was also provided with the use of a car.

Powers Delegated to Governor

The Governor, the Director General and the Chief Executive of the Financial Regulator are executive members of the Board. As provided for in the Central Bank Act, 1942, it is the Board's practice generally to delegate powers to the Governor for the exercise and performance of all functions, powers and duties of the Bank with the exception of those powers which it would either not be possible or appropriate to delegate. These include provisions relating to the Governor's position or that are specified to be Board responsibilities or which require the formulation of an opinion by the Board.

Board Sub-Committees

The Board established three sub-committees on 30 June 1994 as follows:

- The Audit Committee
- The Remuneration and Budget Committee
- The Investments Committee

Board regulations detail the terms of reference of each sub-committee and membership in each case is comprised of Directors - one of whom is appointed as Chairman - and a further member of the Regulatory Authority with observer status. The Secretary of the Bank, or a nominee, minutes all meetings of the sub-committees and, when approved, these minutes are circulated to the Board.

The members of the sub-committees, as at 30 April 2008, were as follows:

Audit Committee	David Begg (Chair), Martin O'Donoghue, Deirdre Purcell*, Alan Ashe**
Remuneration and Budget Committee[1]	Roy Donovan (Chair), John Dunne*, Martin O'Donoghue, Dermot Quigley**, Tony Grimes (Director General), Patrick Neary* (Chief Executive, Financial Regulator)
Investments Committee	Gerard Danaher (Chair), Tony Grimes, Jim Farrell**

* Members of both the Board and the Regulatory Authority.

** Members of the Regulatory Authority who are not also members of the Board but who participate at meetings of the above CBFSAI Board committees with observer status.

1. The Director General and the Chief Executive are members of this Committee when meeting on budgetary matters only.

Code of Practice for Directors and Staff

The Governor is prohibited by law from holding shares in, or being a Director of, any bank or other credit institution, financial institution or insurance undertaking.

A Code of Practice for disclosure of interest by members of the Board has been in operation since 23 April 1992. This Code was updated during 2002, in accordance with the Government's 2001 Code of Practice for the Governance of State Bodies, and was adopted by the Board on 19 September 2002.

Ethics in Public Office Act, 1995 and Standards in Public Office Act, 2001

The Ethics in Public Office Regulations, 1997, have prescribed membership of the Board of the Bank as a designated directorship for purposes of the Ethics in Public Office Act, 1995 and the Standards in Public Office Act, 2001. In accordance with this, members of the Board submit annual statements of interests to the Public Offices Commission and to the Secretary of the Bank.

The Ethics in Public Office Regulations also prescribe executive positions in the Bank at or above the Professional 1 level as designated positions. The Secretary of the Bank submits annual statements of interests to the Governor, and the other holders of designated positions submit annual statements of interests to the Secretary of the Bank.

All members of the Board and staff of the Bank are subject to the provisions of the Prevention of Corruption Acts, 1906 and 1916. The Bank has a written code of conduct for staff.

On 28 November 2002, the Board of Directors adopted a Code of Conduct for Board Members which sets out the standards of conduct and integrity expected of each member in the performance of his or her functions as a member of the Board of the Bank. The Code of Conduct contains a wide range of requirements with which Directors are obliged to comply.

Management Boards

The Central Bank Management Board, which is chaired by the Director General, and includes the Deputy Director General and three Assistant Director Generals, manages the performance of the Central Bank on behalf of the Governor and Board. The Financial Regulator Executive Board, which is chaired by the Chief Executive, and includes the Consumer Director, the Prudential Director the Registrar of Credit Unions and all the Heads of Function in the Financial Regulator, manages the performance of the Financial Regulator on behalf of the Regulatory Authority. A Joint Management Board, comprising the senior executives of both the Central Bank and the Financial Regulator, co-ordinate the development and implementation of management policies in respect of all organisational matters of common interest. These include planning, budgeting, and utilisation of shared services and corporate resources including staffing, information technology, physical infrastructure and corporate services.

Accountability

As required by Section 61 of the *Central Bank Act, 1942,* the Bank prepares a report of its activities during the year and presents this report to the Minister for Finance within six months after the end of each financial year. Copies of this report are laid before each House of the Oireachtas. Section 6H of the *Central Bank Act, 1942* requires the Bank to prepare and transmit to the Comptroller and Auditor General a Statement of Accounts for the year concerned. The Comptroller

and Auditor General audits, certifies and reports on the Statement of Accounts and remits both his/her report and the Statement of Accounts to the Minister. Copies of both of these documents are also laid before each House of the Oireachtas. The Bank's accounts are also audited by independent external auditors as required by Article 27 of the ESCB/ECB Statute.

Within the terms of the *Central Bank Act, 1998,* the Governor meets with the Minister from time to time to keep him informed regarding the Bank's performance of its statutory duties.

Subject to the requirements of the Maastricht Treaty and the confidentiality provisions imposed by law, the Governor appears before Joint Committees of the Oireachtas on request. This practice was put on a statutory basis in the Central Bank Acts, 1997 and 1998.

Objectives

As a member of the European System of Central Banks (ESCB), the statutory objectives of the Bank are laid out in Section 6 of the Act as follows:

"6. – (1) The Bank shall perform all functions imposed, and exercise all powers conferred, on the Bank by or under the Rome Treaty or the ESCB Statute.

6A – (1) In discharging its functions and exercising its powers as part of the European System of Central Banks, the primary objective of the Bank is to maintain price stability.

(2) The Bank also has the following objectives:

(a) contributing to the stability of the financial system;

(b) promoting the efficient and effective operation of payment and settlement systems; and

(c) discharging such other functions, duties and powers as are conferred or imposed on it by the Rome Treaty, the ESCB Statute or any enactment.

The legislation empowers the Minister to request the Governor, the Board or the Financial Regulator to consult with him, in relation to their respective functions, and also to request the Governor to consult the Minister with respect to the price stability objective. The Governor and the Board are required to comply with this, insofar as the request is consistent with the Rome Treaty, the ESCB Statute or any law of the State.

Internal Audit

The Internal Audit function is an independent and objective appraisal function, which is required to provide audit assurance that the system of risk management and internal control is adequate to manage and control those risks to which the Bank is exposed. It also assists the Bank in its pursuit of efficiency and effectiveness.

The Head of Internal Audit reports directly to the Governor and the Chairman of the Financial Regulator and has unrestricted access to the Audit Committee and members of the Joint Management Board. The Internal Audit function submits four-monthly written reports to the Governor, the Chairman of the Financial Regulator, the Audit Committee and the Joint Management Board giving an assessment of how effectively the Bank's objectives are being met. The Internal Audit function also reports to the Internal Audit Committee of the ECB on the outcome of ESCB audits and other audit issues.

ESCB Governance

The Eurosystem and European System of Central Banks

The Eurosystem consists of the European Central Bank and the national central banks of the euro-area Member States. Responsibility for monetary policy, the primary objective of which is price stability, resides within the Eurosystem. Other tasks of the Eurosystem relate to foreign exchange operations, reserves management, the operation of payments systems, prudential supervision and financial stability.

The European System of Central Banks consists of the ECB and the national central banks of all EU Member States.

ECB Decision-Making Bodies

The Governing Council comprises the six members of the Executive Board of the ECB and the Governors of the national central banks of the euro area countries. As the primary decision-making body of the ECB, it is responsible for the formulation of the single monetary policy for the euro area and the setting of guidelines for its implementation. Meetings take place twice a month in Frankfurt with two away meetings a year, hosted by one of the Eurosystem central banks – the Bank hosted a meeting on 10 May 2007 in Dublin Castle. The first monthly meeting is generally reserved for monetary policy discussions and interest rate decisions. Other issues discussed include foreign exchange operations; external reserves management and payment systems; currency production and issue; and operational areas, such as budgetary and legal matters. (The roles of the ESCB committees are described in Appendix 1 of the Activities chapter.).

The Executive Board (the second decision-making body of the ECB) is responsible for the current business of the ECB. Its tasks include preparing meetings of the Governing Council and implementing monetary policy in accordance with the guidelines and decisions laid down by the Governing Council. It consists of the ECB's President, Vice-President and four other members.

The General Council (the third decision-making body of the ECB) comprises the President and the Vice-President of the ECB and the Governors of the national central banks of all EU Member States. Its work includes contributing to the advisory and coordinating functions of the ECB and tasks relating to the national central banks of non euro area Member States.

The Governor and the Director General of the Bank attend meetings of both the Governing and General Councils. The President of the ECB chairs the meetings of all three bodies.

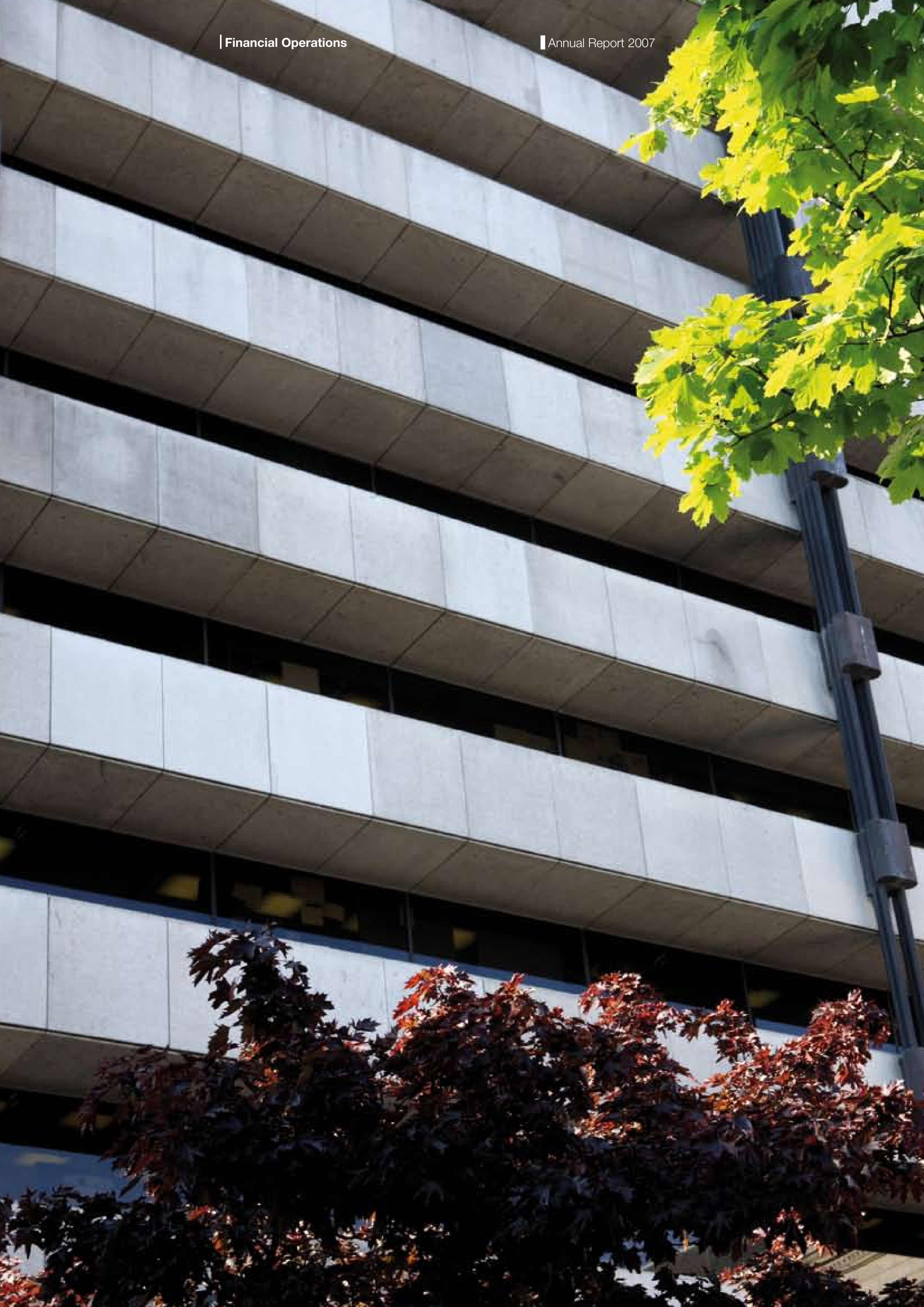
Representing Ireland at the IMF

Ireland's relations with the IMF are handled by the Bank in association with the Department of Finance. The *Board of Governors of the IMF*[1] is the highest decision-making body of the organisation, consisting of one Governor and one Alternate Governor for each member country. The Board of Governors meet once a year at the IMF/World Bank Annual meetings. Twenty-four Governors, representing the 184 member countries, sit on the International Monetary and Finance Committee (IMFC)[2], which meets twice a year to discuss IMF policy issues. In Ireland's case, the Minister for Finance is a Governor and the Governor of the CBFSAI is an Alternate Governor of the IMF. The day-to-day management and operation of the IMF is entrusted by Governors to the Executive Board and the senior management of the IMF. The Executive Board consists of 24 Executive Directors which each represent a constituency. Ireland is a member of the Canadian constituency. The Bank, the Department of Finance and our Alternate Executive Director work closely together to coordinate policy advice on IMF issues and Ireland's operational interests at the Fund[3].

1 The governor is appointed by the member country and is usually the minister of finance or the governor of the central bank. All powers of the IMF are vested in the Board of Governors which normally meets once a year. The Board of Governors may delegate to the Executive Board all except certain reserved powers.

2 The IMFC acts as an advisory committee to the Board of Governors on matters relating to the Board of Governors' functions in supervising the management and adaptation of the international monetary and financial system. This includes reviewing developments in global liquidity and transferring resources to developing countries.

3 The CBFSAI acts as Ireland's fiscal agent within the framework of operations with the IMF, holding the IMF accounts through which Ireland's quota payment is passed.



Financial Operations

Accounting Policies

It is the Bank's policy in preparing its financial statements to follow, as far as possible, generally accepted accounting principles (GAAP). However, because of the unique nature of some of its operations as a central bank, and as a member of the Eurosystem, certain deviations from GAAP are necessary. All such deviations from GAAP are clearly identified in the statement of the Bank's Accounting Policies, which is provided as part of the Statement of Accounts.

Auditing and Reporting Standards

Under the *Central Bank and Financial Services Authority of Ireland Act, 2003,* the Bank is required to prepare and submit its Statement of Accounts to the Comptroller and Auditor General within six months of every year-end. The Comptroller and Auditor General must in turn audit and report on the Statement of Accounts to the Minister for Finance who is required to lay them before both houses of the Oireachtas.

Under Article 27 of the Statute of the European System of Central Banks (ESCB), the Accounts of the Bank must be audited by an independent external auditor recommended by the Governing Council of the ECB and approved by the European Council. Deloitte & Touche were appointed as independent external auditor of the Bank for 2007.

As a member of the Eurosystem, the Bank complied with regular extensive reporting requirements to the ECB, comprising both statistical and financial data during 2007.

Sharing of Monetary Income

The income the Bank earns from the assets backing banknotes in circulation and from net monetary operations on behalf of the Eurosystem forms part of the total income of the Eurosystem. Under Article 32 of the Statute of the ESCB, this income, described as “monetary income”, is to be pooled by all the National Central Banks (NCBs) and then redistributed according to each NCB's share in the capital of the ECB, which is based on national population and Gross Domestic Product.

Financial Results for 2007

Profit for the year to 31 December 2007 amounted to €228 million compared with a corresponding amount of €110.2 million in 2006.

International interest rates rose in line with increases in official ECB rates in the early part of 2007 and uncertainty in financial markets in the second half of the year. The higher interest rate environment impacted on both the interest income earned on the Bank's assets and the interest paid on liabilities. Interest income increased by €441.1 million to €1,518.8 million, mainly attributable to increases in the interest receivable on higher levels of monetary policy-related lending to credit institutions (€297.0 million) and larger holdings of securities (€124.5million).

Interest payable rose by €318.1 million to €1,135.7 million and primarily related to an increase in the interest payable on credit institutions deposits (€212.7 million), Government deposits (€135.8 million) and remuneration on the Bank's euro banknote issue over and above its capital key share of total circulation (€189.6 million). These were offset somewhat by a decrease of €223.0 million on interest payable on Intra-Eurosystem liabilities. In summary, net interest income was €123.0 million greater than in 2006.

There was a net loss from financial operations of €15.3 million in 2007 compared to an equivalent loss of €48.0 million for the previous year. The 2007 outcome is comprised of net realised exchange rate and capital losses of €0.3 million (€4.5 million in 2006), and unrealised exchange rate and capital losses of €15.0 million (€43.6 million in 2006). Unrealised gains which are not carried to profit under ECB accounting rules, were €30.0 million in 2007.

The result of pooling of Monetary Income gave rise to a net payment of €41.0 million compared to €11.7 million in 2006.

Total operating costs of €106.5 million, comprising pay, non-pay, banknote raw materials and depreciation, which are charged against profit increased by €7 million, or 7 per cent in 2007. Staff costs including pay increased by €4.8 million (6.8 per cent), while other operating costs increased by €2.2 million (7.7 per cent). A detailed analysis of the Bank's operating costs is given in Note 8 to the Statement of Accounts.

After transfers to reserves and adjustments related to the recognition of the Bank's superannuation liability as required under Financial Reporting Standard 17, the Bank's Surplus Income amounted to €192.8 million, which will be paid to the Exchequer.

Balance Sheet Developments

Total balance sheet assets as at 31 December 2007 were €53.5 billion, which is €13.3 billion greater than the corresponding figure for 31 December 2006. Monetary policy-related lending to credit institutions increased by €12.4 billion which was primarily due to the active liquidity management of the ECB during the latter half of 2007.

At end year, the Bank's proportional share of euro banknotes in circulation amounted to €7,957 million, which represented an increase of €503 million on the previous year and reflects a general increase of 6.7 per cent in the value of euro banknotes outstanding worldwide. Liabilities to euro area credit institutions (commercial banks) increased by €8,924 million and include end-year fine tuning operations conducted by the ECB. Liabilities to other euro area residents denominated in euro, essentially Government deposits, increased by €2,563 million to €8,025 million while Intra-Eurosystem net liabilities to the ECB increased by €963 million. This includes an increase of €2,913 million in the value of the net issue by the Bank of euro banknotes over and above its capital key share of the total issue. This was partly offset by a decrease of €1,950 million in the Bank's liability to other central banks of the Eurosystem in respect of cross-border payments in euro through the ESCB's large-value payment system – TARGET[1]. As at 31 December 2007, the net present value of the Bank's superannuation liability was €425 million, a decrease of €3.5 million over the previous year.

Redemption of Irish Banknotes

Irish banknotes ceased to be legal tender with effect from 9 February 2002. As at 31 December 2002, notes to the value of €299.7 million were outstanding, at which point the proceeds were transferred to the exchequer less a provision of €60 million to meet obligations in respect of unredeemed Irish notes. During 2007, an amount of €4.3 million was redeemed (compared to €5.4 million in 2006) leaving €247 million in Irish banknotes still outstanding and a balance on the provision account of €7.3 million at end-December 2007.

Proceeds of Coin

During 2007, the value of euro coin issued was €65.0 million (€47.8 million in 2006). After deduction of expenses, seigniorage of €59.1 million was paid to the Exchequer. The Bank continues to redeem Irish coin issued prior to the introduction of the euro in January 2002. In 2007, Irish coin redeemed totalled €0.6 million (compared with €0.8 million in the previous year). Full details are incorporated in Note 32 of the Statement of Accounts.

1 Trans-European Automated Real-time Gross settlement Express Transfer system

Prompt Payment of Accounts 2007

The Bank is obliged to comply with the provisions of the European Communities (Late Payment in Commercial Transactions) Regulations, 2002, which provides that penalty interest will become payable if payments for commercial transactions are not met within 30 days, unless otherwise specified in a contract or agreement. The regulations do not apply where the interest penalty is less than €5. The rate of interest applicable to late payments is the ECB minimum main refinancing rate plus 7 percentage points, with the relevant rate at 1 January and 1 July each year applying for the six-month period after these dates. In 2007, interest was payable at a rate of 11 per cent per annum.

The following is a summary of interest payments made to suppliers during 2007 in accordance with the provisions of the Regulations referred to above.

Total number of late payments	37
Total value of all late payments (A)	€264,609.74
Total value of all payments (B)	€33,336,017.36
A as % of B	0.79%
Total amount of interest paid on late payments	€2,139.16

Statement of Directors' Responsibilities

The main statutory provisions relating to the role and duties of the Directors are covered in Sections 5, 5A and 6 of the *Central Bank Act*, 1942, (as inserted by Sections 4, 5 and 6 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003) and Section 22A of the *Central Bank Act*, 1942 (as inserted by Section 18 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003). Moreover, under Section 6 of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003), the Bank is responsible for the maintenance of proper accounting records. This responsibility also extends to the preparation and presentation to the Comptroller and Auditor General of a Statement of Accounts within six months of the end of each financial year and the appointment of external auditors as required by Article 27 of the Statute of the European System of Central Banks and of the European Central Bank.

The Board has overall responsibility for the system of internal financial control in the Bank, which is designed to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities. To discharge this responsibility, the Board has established an appropriate organisational structure. In this regard, the Audit Committee of the Board meets periodically with the Internal and External Auditors and members of the Management of the Bank to discuss control issues, financial reporting and related matters. The Internal and External Auditors have full access to the Audit Committee.

The Board is satisfied that generally accepted accounting principles and standards, adapted to suit the nature of central banking activity and both domestic and European System of Central Banks' statutory provisions which apply to the Bank, have been consistently applied and are supported by reasonable and prudent judgements and estimates.

John Hurley, Governor

David Begg, Director

17 June 2008

Statement on Internal Financial Controls

On behalf of the Board, I acknowledge the Board's responsibility for ensuring that the Bank maintains effective systems of internal financial control and reviewing their effectiveness on an ongoing basis. The Board has formally adopted a code of conduct, which requires each Director to ensure that the Bank has in place an effective system of internal controls including financial controls, operational controls, risk management and fraud prevention.

The systems of control in place provide reasonable but not absolute assurance of the safeguarding of assets against unauthorised use or disposition, the maintenance of proper financial records and the reliability of the financial information provided and published. In essence, these systems are designed to manage rather than eliminate inherent financial risks.

The systems of control include:

- A clearly defined organisation structure with specified authorisation limits and reporting requirements to senior management and the Board;
- Appropriate terms of reference for the Board and management committees with responsibility for core policy areas;
- A comprehensive financial and budgeting management information system which incorporates:
    - Approval of annual plan and detailed expenditure budgets by the Board
    - Quarterly reporting to the Board on financial and budgetary performance
    - Regular reporting to the Board on capital expenditure;
- Detailed policies and procedures relating to financial controls.

An operational risk framework has been developed for the whole organisation. Each business area is responsible for the management of risk and the implementation of appropriate controls and procedures aimed at minimising and monitoring such risks. An Operational Risk Committee, which comprises senior management, has responsibility for the oversight of the management of operational risk. A full review of operational risk is furnished by the Bank Audit Committee to the Board on an annual basis. To assist departments in the ongoing assessment of risk, an operational risk database has been developed.

Details of the risk controls deployed in respect of the management of investment assets are outlined in the Activities Chapter under Risk Management and in Note 35 to the Statement of Accounts.

The Internal Audit Department independently and systematically reviews the controls in place and reports to the Board Audit Committee on a regular basis. The Audit Committee approves the Internal Audit Plan and work programme. In addition, the Audit Committee meets with and receives reports from both external auditors. The Chairman of the Audit Committee reports to the Board on all significant issues considered by the Committee and the minutes of meetings of the Audit Committee are circulated to the Board for consideration at subsequent meetings of the Board.

The Board-level Committee structures have been designed so that the Board and the Irish Financial Services Regulatory Authority work closely together to ensure that their respective obligations in relation to the control of expenditure and the management of operational risk are managed within a consistent and complete framework.

I can confirm that the Board reviewed the effectiveness of the system of internal financial controls during the year ended 31 December 2007.

John Hurley, Governor

17 June 2008

Accounting Policies

(a) Form of Presentation of Accounts

In preparing the accounts, the Bank, as a participating member of the ESCB[1], has a policy of following the accounting policies, which the Governing Council of the ECB considers to be appropriate to the nature of central banking activity, and the statutory provisions[2], which apply, to the Bank.

The accounts have been prepared (i) on the historical cost basis of accounting, modified to include market valuations of securities, unmatured contracts and gold and all assets and liabilities denominated in foreign currency and (ii) in accordance with accounting standards generally accepted in Ireland in as far as it is considered applicable to a participating member of the ESCB. Accounting standards generally accepted in Ireland in preparing accounts giving a true and fair view are those recognised by the Institute of Chartered Accountants in Ireland and issued by the Accounting Standards Board.

The accounting unit is the euro.

Having regard to the role and activities of a central bank, the Bank is of the opinion that a cash flow statement would not provide any additional or useful information to users of the accounts. Therefore, such a statement is not included as part of these accounts.

The accounts have been prepared pursuant to Section 6H of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003).

Throughout the Statement of Accounts the term 'Bank,' where used, refers to the Central Bank and Financial Services Authority of Ireland (CBFSAI).

(b) Income Recognition

The accruals concept in accounting for income has been adopted.

(c) Fixed Assets

(i) Measurement

Fixed assets are stated at cost and are not revalued.

(ii) Depreciation

All fixed assets are depreciated on a straight-line basis over their anticipated useful lives as follows:

Freehold Premises (excluding site costs)	–	50 years
Plant and Machinery	–	5 to 15 years
Other	–	5 years

(d) Superannuation

Under the Bank's superannuation scheme permanent Bank staff obtain the same superannuation benefits as established civil servants. The Bank pays these benefits out of current income as they fall due. The Bank discloses the cost of providing benefits in accordance with Financial Reporting Standard ('FRS') 17 'Retirement Benefits'.

1 Throughout this document the use of the term the European System of Central Banks (ESCB) refers to the twenty-seven National Central Banks (NCBs) of the Member States of the European Union on 31 December 2007 plus the European Central Bank (ECB). The term 'Eurosystem' refers to the thirteen NCBs of the Member States participating in the Monetary Union, plus the ECB on the same date.

2 The principal statutory provisions are: *Treaty on European Union*, 1992, *Central Bank Acts* 1942-1998, *Central Bank of Ireland (Surplus Income) Regulations*, 1943, *Coinage Act*, 1950, *Decimal Currency Acts* 1969-1990, the *Economic and Monetary Union Act*, 1998 and the *Central Bank and Financial Services Authority of Ireland Act*, 2003.

Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. The current service cost and any past service costs for the general body of staff are charged to the Profit and Loss account and to the Currency Reserve in respect of Mint staff. Actuarial gains and losses are recognised in the appropriation account.

In determining the value of scheme liabilities, assumptions are made as to price inflation, pension increases, earnings growth and employees. The assumptions underlying the 2007 liabilities and pension cost are set out in Note 34.

(e) Coin Provision and Issue

Proceeds and expenses relating to the provision and issue of coin are transferred directly to the Currency Reserve under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts*, 1969-1990 and the *Economic and Monetary Union Act*, 1998. The cost of production of coin is charged to the Currency Reserve in the year in which it is incurred. Proceeds from the issue of coin are credited to the Currency Reserve in the year they are received (Note 32). Section 14A of the *Economic and Monetary Union Act*, 1998 (as inserted by Section 137 of the *Finance Act*, 2002) which came into operation on 25 March 2002 provides for the net proceeds from the issue of coin, from 1 January 2002, to be passed directly to the Exchequer as directed by the Minister.

(f) Foreign Currency Transactions

Accounting transactions denominated in foreign currency are converted to euro equivalents at exchange rates prevailing at the date of settlement unless the year end falls between the trade date and settlement date, in which case they have to be recognised at the trade date (Accounting Policy (k)(i)).

(g) Amortised Income

Premiums and/or discounts arising on securities are treated as net interest income and amortised on a straight-line basis over the period to their maturity and accounted for through the Profit and Loss account.

(h) Valuation Policy

Assets and liabilities denominated in foreign currency, unmatured investment and foreign currency contracts outstanding and shares in the Bank for International Settlements are valued at mid-market closing exchange rates at year-end (Note 31). The exchange rate valuation of assets and liabilities is performed on a currency-by-currency basis.

Gold is valued at the closing market price and securities at mid-market closing prices at year-end. The valuation of securities is performed on a security-by-security basis.

Securities held in long term investment portfolios are not valued but are held at cost until maturity.

(i) Recognition of Gains and Losses

Realised gains and losses arising from sales of foreign exchange, gold and securities are accounted for through the Profit and Loss account. Foreign exchange realised gains and losses are calculated by reference to average cost.

Unrealised gains identified at the end of every financial year in accordance with the Bank's valuation policy (Accounting Policy (h)) are accounted for through the Profit and Loss and Appropriation account and transferred therefrom to the Revaluation Accounts.

Unrealised losses are accounted for through the Profit and Loss account to the extent that they exceed revaluation gains. Unrealised losses accounted for through the Profit and Loss account in this manner may not be reversed in subsequent years against future unrealised gains.

As all gains and losses are recognised through the Profit and Loss and Appropriation account it is not considered necessary to include a separate Statement of Total Recognised Gains and Losses.

(j) Repurchase Agreements

Under a Sale and Repurchase Agreement the Bank sells securities from its portfolio for cash and simultaneously agrees to repurchase them at an agreed price on a set date. These agreements to repurchase are reflected on the liability side of the Bank's balance sheet and also lead to an interest expense in the Profit and Loss account (Note 2). At all times the Bank remains the beneficial owner of the securities which remain on its balance sheet.

Under a Reverse Repurchase Agreement the Bank buys securities for cash and simultaneously agrees to sell them back to the counterparty at an agreed price on a set date. These agreements to sell are recorded on the asset side of the balance sheet (Notes 13 and 15), but are not included in the Bank's holdings of securities. At no time during the term of the agreement does the Bank acquire beneficial ownership of the underlying securities. These agreements give rise to interest income in the Profit and Loss account (Note 1).

Repurchase agreements may be transacted in both euro and other currencies.

(k) Euro System Accounting Guidelines

(i) Trade Date Accounting

Transactions in assets and liabilities are generally recorded on the settlement date. However, since 1 January 2007 the CBFSAI has applied trade date accounting[3]. Under this method, transactions in foreign currencies are booked at the settlement date (usually the trade date plus two days), unless a year end falls between the trade date and the settlement date, in which case they have to be recognised at the trade date i.e., all gains and losses arising from these transactions are booked in the current year. The effect on the Bank's income is not material and therefore no adjustment is required to the prior year results in respect of this change.

(ii) Intra-ESCB balances

All NCBs of the Eurosystem maintain accounts with each other for the purpose of making bilateral payments including cross-border payments through the TARGET[4] system. All bilateral balances at the close of business each day are netted by means of a multilateral netting process and replaced by a single outstanding debt-obligation to the ECB by each NCB or vice versa as appropriate.

3 Defined in the Accounting Guideline of the European Central Bank 5 December 2002 on the legal framework for accounting and financial reporting in the ESCB (ECB/2002/10), as amended. With effect from 1 January 2007, this Guideline has been revoked and replaced by Guideline ECB/2006/16.
4 Trans-European Automated Real-time Gross settlement Express Transfer system.

At end-2007, two of the non-participating countries (U.K., Denmark) were included in the multilateral netting process.

Intra-Eurosystem balances arising from the allocation of euro banknotes within the Eurosystem are included as a liability under Intra-Eurosystem liabilities (net): 'Liabilities related to the allocation of euro banknotes within the Eurosystem'. (See Accounting Policy (k)(iv) and Note 27).

(iii) ESCB Capital Key

The capital key is the percentage of each NCB's share capital in the ECB. The capital key is a measure of the relative national size of member countries and is a 50:50 composite of GDP and population size and must be adjusted at least every five years under ESCB statute.

On 1 January 2004, the Bank's Capital key was 1.0254 per cent. Following the accession of ten countries to the European Union on 1 May 2004, the key changed to 0.9219 per cent and remained so until end December 2006. The capital key changed to 0.8885 per cent on 1 January 2007 following the entry of Slovenia into the Eurosystem.

The Bank's share of the total key held by Eurosystem members was 1.2895 per cent at 31 December 2005 and 2006. At 31 December 2007 the Bank's key was 1.2782 per cent and this is used as the basis of allocation for a series of important items including monetary income, banknotes in circulation and the sharing of the ECB's profit/loss.

(iv) Banknotes in Circulation

The ECB and the 13 participating NCBs, which together comprise the Eurosystem, have issued euro banknotes as from 1 January 2002[5]. The total value of euro banknotes in circulation is allocated on the last working day of each month in accordance with the banknote allocation key[6].

From the beginning of 2002, the ECB has been allocated a share of 8 per cent of the total value of euro banknotes in circulation, whereas the remaining 92 per cent has been allocated to NCBs in the Eurosystem according to their weightings in the ESCB key (Accounting Policy (k)(iii)). The share of banknotes allocated to each NCB is disclosed under the balance sheet liability item 'Banknotes in circulation' (Note 22).

The difference between the value of euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. These claims or liabilities, which incur interest[7], are disclosed in the Balance Sheet under 'Intra-Eurosystem: Liabilities (net)'. (See Accounting Policy (k)(ii) and Note 27).

From 2002 until 2007 the intra-system balances arising from the allocation of euro banknotes are adjusted in order to avoid significant changes in NCBs' relative income positions as compared to previous years for those countries who participated in the Euro from its inception[8]. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the period from July 1999 to June 2001 and the average value of banknotes that would have been allocated to them during that period under the ESCB capital key. The adjustments are progressively reduced in annual stages. A similar transition arrangement was set up for the NCBs joining the Euro at a later date

5 Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20.12.2001, pp. 52-54.
6 The banknote allocation key refers to the percentages that result from taking into account the ECB's share of the total euro banknote issue and applying the ESCB capital key to the NCBs' share of such total.
7 Decision of the European Central Bank of 6 December 2001 on the allocation of monetary income of the National Central Banks of participating Member States from the financial year 2002 (ECB/2001/16), OJ L 337, 20.12.2001, pp. 55-61.
8 Decision of the European Central Bank of 6 December 2001 on the issue of euro banknotes (ECB/2001/15), OJ L 337, 20. 12.2001, pp. 52-54.

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under 'Net interest income' (Note 2).

The Governing Council of the ECB has decided that the seigniorage income of the ECB arising from the 8 per cent share of euro banknotes allocated to the ECB shall be distributed separately to the NCBs in the form of an interim distribution of profits[9] (Note 5). From 2006 onwards, the Governing Council has decided that this income is due to the NCBs in the financial year in which it accrues, but is to be distributed on the second working day of the following year[10]. It is distributed in full unless the ECB's net profit for the year is less than its income earned on euro banknotes in circulation and subject to any decisions by the Governing Council to make transfers to a provision for foreign exchange rate, interest rate and gold price risks and to charge costs incurred by the ECB in connection with the issue and handling of euro banknotes against this income.

(v) Net Result of Pooling of Monetary Income

The amount of each Eurosystem NCB's monetary income is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base.

The liability base consists of the following items: banknotes in circulation; liabilities to credit institutions related to monetary policy operations denominated in euro; intra-Eurosystem liabilities resulting from TARGET transactions; intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem. Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The earmarkable assets consist of the following items: lending to euro area credit institutions related to monetary policy operations denominated in euro; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; intra-Eurosystem claims resulting from TARGET transactions; intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; a limited amount of each NCB's gold holdings in proportion to each NCB's capital key. Gold is considered to generate no income. Where the value of a NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference shall be offset by applying to the value of the difference the average rate of return on the earmarkable assets of all NCBs taken together.

The monetary income pooled by the Eurosystem is allocated between NCBs according to the subscribed capital key. The difference between the monetary income pooled by the Bank and that reallocated to the Bank constitutes the net result arising from the calculation of monetary income recorded in the Profit and Loss (Note 6).

In the event of the ECB incurring a loss, the loss can be offset against the ECB's general reserve fund, and if necessary, by a decision of the Governing Council, against the monetary income of the relevant financial year in proportion and up to the amount allocated to the NCBs.

(vi) Claims Equivalent to the Transfer of Foreign Reserves

The *Treaty on European Union*, 1992 and Section 5A of the *Central Bank Act*, 1942, (as inserted by Section 4 of the *Central Bank Act*, 1998) as substituted by Section 5B(o) of the *Central Bank and Financial Services Authority of Ireland Act*, 2003 provides that the Bank has the power to 'transfer assets, income or liabilities to the European Central Bank where required under the ESCB Statute'. Accordingly the Bank transferred an amount equivalent to €424.8 million to the ECB in January 1999 and received in turn a corresponding claim on the ECB equivalent to this amount. As a result

9 Decision of the European Central Bank of 21 November 2001 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the National Central Banks of the participating Member States (ECB/2002/9) the *Official Journal of the European Union* L 323, pp. 49-50.
10 Decision ECB/2005/11 of 17 November 2005 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the National Central Banks of the participating Member States, OJ L 311, 26.11.2005, p.41. This Decision repealed Decision ECB/ 2002/9.

of Capital Key changes an additional €87.9 million was transferred on 1 January 2004 and €0.3 million on 1 May 2004. In 2007, the change in the capital key lead to a reduction in the level of reserves transferred of €1.2 million. The resulting claim on the ECB is remunerated at rates based on euro short-term market rates (Note 1 and Accounting Policy (k)(iii)).

(vii) Off-Balance Sheet Items

Profits and losses arising from off-balance sheet instruments are recognised and treated in a similar manner to on-balance sheet instruments. Unrealised (valuation) gains are not recognised as income but are accounted for through the Profit and Loss account and transferred therefrom to a Revaluation Account. Unrealised (valuation) losses are taken to the Profit and Loss account when exceeding previous revaluation gains registered in the Revaluation Account. Unrealised trade date gains/losses on foreign exchange forward contracts are recorded under 'other assets/liabilities' in accordance with ESCB guidelines having been accounted for through the Profit and Loss account as outlined above. This method is used for foreign exchange forwards and these techniques cover the most significant off-balance sheet financial instruments which have been identified for possible use by the ESCB, i.e. foreign exchange forwards, foreign exchange swaps, interest rate futures, interest rate swaps and forward rate agreements.

Profit and Loss and Appropriation Account for year ended 31 December 2007

	Note	2007 €000	2006 €000
Interest income	1	1,518,859	1,077,729
Interest expense	2	(1,135,739)	(817,616)
NET INTEREST INCOME		**383,120**	**260,113**
Net realised (losses)/gains arising from financial operations	3	(324)	(4,473)
Write-downs on financial assets and positions	3	(14,972)	(43,576)
Net result of financial operations, write-downs and risk provisions		**(15,296)**	**(48,049)**
Income from fees and commissions	4	**2,414**	**1,743**
Income from equity shares and participating interests	5	**2,459**	**2,432**
Net result of pooling of Monetary Income	6	**(41,070)**	**(11,744)**
Other income	7,41	**2,904**	**5,190**
TOTAL NET INCOME		**334,531**	**209,685**
Staff expenses	8	**(75,824)**	**(71,013)**
Other operating expenses	8	**(22,543)**	**(20,279)**
Depreciation	8	**(6,568)**	**(6,442)**
Banknote raw materials	8	**(1,595)**	**(1,796)**
PROFIT FOR THE YEAR BEFORE UNREALISED GAINS		**228,001**	**110,155**
Net movement in Unrealised Gains	31	30,031	(6,861)
Transfers (to)/from Revaluation Accounts	31	(30,031)	6,861
Transfers (to)/from Reserves	32	**(33,880)**	**15,156**
Transfer to Reserves	32	**(35,185)**	**(11,659)**
Transfer from/(to) Pension Liability	34	**33,880**	**(15,156)**
SURPLUS INCOME	9	**192,816**	**98,496**

The accounting policies together with Notes 1 to 42 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann

17 June 2008

John Hurley, Governor

Brian Halpin, Deputy Director General

Balance Sheet as at 31 December 2007

ASSETS	Note	2007 €000	2006 €000
Gold and gold receivables	10	109,721	93,203
Claims on non-euro area residents in foreign currency	11	521,987	566,114
Claims on euro area residents in foreign currency	12	445,504	58,636
Claims on non-euro area residents in euro	13	1,552,502	3,243,335
Lending to euro area credit institutions related to monetary policy operations in euro	14	39,449,415	27,043,763
Other claims on euro area credit institutions in euro	15	428,913	1,060,477
Securities of euro area residents in euro	16	9,883,885	7,137,455
Intra-Eurosystem claims		568,564	570,283
Participating interest in ECB	17	*56,730*	*57,276*
Claims equivalent to the transfer of foreign reserves	18	*511,834*	*513,007*
Items in course of settlement	19	7,481	47,204
Other assets	20	560,586	432,588
Total Assets		53,528,558	40,253,058

The accounting policies together with Notes 1 to 42 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann — **John Hurley, Governor**

17 June 2008 — **Brian Halpin, Deputy Director General**

Balance Sheet as at 31 December 2007

LIABILITIES	Note	2007 €000	2006 €000
Banknotes in circulation	22	7,957,251	7,454,068
Liabilities to euro area credit institutions related to monetary policy operations in euro	23	21,839,389	12,915,313
Liabilities to other euro area residents in euro	24	8,025,289	5,462,612
Liabilities to non-euro area residents in euro	25	2,282	9,387
Counterpart of special drawing rights allocated by the IMF	26	93,720	99,615
Intra-Eurosystem liabilities (net)		12,896,178	11,933,408
Liabilities related to the allocation of euro banknotes within the Eurosystem	27	*12,300,943*	*9,388,407*
Other Liabilities within the Eurosystem (net)	28	*595,235*	*2,545,001*
Other liabilities	29	1,029,289	783,588
Pension liability	34	424,950	428,447
Provision	30	7,326	11,580
Revaluation accounts	31	88,237	58,206
Capital and reserves	32	1,164,647	1,096,834
Total Liabilities		53,528,558	40,253,058

The accounting policies together with Notes 1 to 42 form part of these accounts.

Banc Ceannais agus Údarás Seirbhísí Airgeadais na hÉireann

17 June 2008

John Hurley, Governor

Brian Halpin, Deputy Director General

Notes to the Accounts

Note 1: Interest Income

	2007	2006
	€000	€000
Deposit Income	73,832	83,036
Coupons on Securities	367,518	243,008
Reverse Repurchase Agreements (i)	9,257	4,030
(Premiums)/Discounts on Securities (ii)	26,490	12,051
Monetary Policy Operations (iii)	1,029,486	732,498
Income from Transfer of Foreign Reserve Assets to ECB (iv)	17,340	12,448
Other	(5,064)	(9,342)
Total	**1,518,859**	**1,077,729**

(i) As at 31 December 2007 there were no Reverse Repurchase Agreements outstanding. See Accounting Policy (j).

(ii) See Accounting Policy (g).

(iii) This relates to lending to credit institutions by the Bank as part of the Eurosystem's monetary policy operations (Note 14).

(iv) This relates to the remuneration of Foreign Reserve Assets transferred to the ECB. See Accounting Policy (k)(vi) and Note 18.

Note 2: Interest Expense

	2007	2006
	€000	€000
Government	313,575	177,774
Credit Institutions	447,160	234,466
Intra-Eurosystem Balances (i)	(39,606)	183,372
Remuneration of Liability in respect of Euro Banknotes in circulation (ii)	411,449	221,854
Repurchase Agreements (iii)	3,161	150
Total	**1,135,739**	**817,616**

(i) The interest income/expense on these balances, which are remunerated at the short-term refinancing rates of the Eurosystem, is calculated by the ECB at the end of each day.

(ii) See Accounting Policies (k)(ii) and (k)(iv).

(iii) As at 31 December 2007 there were no Sale and Repurchase Agreements outstanding. See Accounting Policy (j).

Note 3: Net Result of Financial Operations, Write Downs and Risk Provisions

Net Realised Gains (Losses) Arising From Financial Operations	2007	2006
	€000	€000
Net Realised Price (Losses) on Securities	(654)	(4,251)
Net Realised Exchange Rate Gains/(Losses)	330	(222)
Total	**(324)**	**(4,473)**

Write Downs on Financial Assets and Positions	2007	2006
	€000	€000
Unrealised Price (Losses) on Securities	(12,337)	(42,980)
Unrealised Exchange Rate (Losses)	(2,635)	(596)
Total	**(14,972)**	**(43,576)**

Note 4: Income from Fees and Commissions

	2007	2006
	€000	€000
Service Fees and Charges	829	864
Securities Lending	1,463	771
Other	122	108
Total	**2,414**	**1,743**

Note 5: Income from Equity Shares and Participating Interests

This item represents any dividends received on shares in the Bank for International Settlements (Note 20(i)) and from the Bank's participating interest in the ECB.

In 2007 and 2006 no dividends were received from the ECB (Note 17).

Note 6: Net Result of Pooling of Monetary Income

This item represents the difference between the monetary income pooled by the Bank (€337.1 million) and that reallocated to the Bank (€296.0 million). See Accounting Policy (k)(v).

Note 7: Other Income

	2007	2006
	€000	€000
Financial Regulator Net Industry Funding (Note 41(i))	22,309	21,394
Interest on pension scheme liabilities (Note 34(d))	(20,777)	(16,835)
Other	1,372	631
Total	**2,904**	**5,190**

Note 8: Expenses

€000	Head Office*		Printworks		Total Head Office and Printworks		Mint (i)		Total	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Salaries/Allowances (ii)	47,971	45,098	10,021	9,576	57,992	54,674	618	578	58,610	55,252
PRSI	3,170	2,888	641	590	3,811	3,478	41	36	3,852	3,514
Pensions (Note 34(d))	12,327	11,097	1,694	1,764	14,021	12,861	107	98	14,128	12,959
Staff Expenses	**63,468**	**59,083**	**12,356**	**11,930**	**75,824**	**71,013**	**766**	**712**	**76,590**	**71,725**
Training, Recruitment & Other Staff Costs	2,555	2,132	432	398	2,987	2,530	11	9	2,998	2,539
Maintenance of Premises	1,265	1,162	1,188	1,018	2,453	2,180	8	3	2,461	2,183
Energy	702	599	571	572	1,273	1,171	–	–	1,273	1,171
Rent & Rates	1,126	908	452	460	1,578	1,368	–	–	1,578	1,368
Equipment, Stationery & Requisites	1,417	1,398	137	155	1,554	1,553	4	2	1,558	1,555
Post and Telecommunications	548	513	169	156	717	669	3	2	720	671
Investment Services and Bank Charges	1,494	1,356	25	19	1,519	1,375	–	–	1,519	1,375
Business Travel	1,836	1,606	238	209	2,074	1,815	17	30	2,091	1,845
Publishing & Media Relations	3,225	3,316	15	45	3,240	3,361	1	1	3,241	3,362
Professional Fees (iii)	2,893	2,613	26	21	2,919	2,634	5	9	2,924	2,643
Works Machine Maintenance	–	–	984	711	984	711	289	172	1,273	883
RTGS System Costs	518	407	–	–	518	407	–	–	518	407
Miscellaneous (iv)	675	430	52	75	727	505	–	–	727	505
Other Operating Expenses	**18,254**	**16,440**	**4,289**	**3,839**	**22,543**	**20,279**	**338**	**228**	**22,881**	**20,507**
Depreciation	**3,394**	**3,145**	**3,174**	**3,297**	**6,568**	**6,442**	**145**	**156**	**6,713**	**6,598**
Raw Materials	**–**	**–**	**1,595**	**1,796**	**1,595**	**1,796**	**7,960**	**7,546**	**9,555**	**9,342**
Total Expenses	**85,116**	**78,668**	**21,414**	**20,862**	**106,530**	**99,530**	**9,209**	**8,642**	**115,739**	**108,172**

*Head Office expenses include all expenses (including Financial Regulator) other than those of the Printworks and Mint. Details of the Financial Regulator's income and expenditure in 2007 are shown in Note 41.

Note 8: Expenses (continued)

(i) Expenses incurred at the Mint relating to the provision and issue of coin are charged directly to the Currency Reserve under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts*, 1969-1990 and the *Economic and Monetary Union Act*, 1998 and not to the Profit and Loss account. See Accounting Policy (e).

(ii) Total fees paid to Directors of CBFSAI and Members of the Financial Regulator in respect of 2007 were €315,000 (2006: €309,166). This is allocated as follows:

	2007 (€)	2006 (€)
CBFSAI	140,000	137,083
Financial Regulator	175,000	172,083

(iii) Auditors fees for 2007 in respect of both the Comptroller and Auditor General and Deloitte & Touche amounted to €264,078 (2006: €283,494), of which €27,578 were for non-audit services by Deloitte & Touche.

(iv) Included here are the expenses of the Financial Services Appeals Tribunal which the Bank pays, in accordance with the provisions of Section 57AX(4) of the *Central Bank Act*, 1942, (the Act), as amended.

Note 9: Surplus Income

Surplus Income of €192.8 million was payable to the Exchequer in respect of the year ended 31 December 2007 (2006: €98.5 million).

A payment on account of €40.6 million (2006: €40.6 million) of Surplus Income was made during 2007 leaving a balance of €152.2 million (2006: €57.9 million) (Note 29(i)). These arrangements are in accordance with Section 6G of the *Central Bank Act*, 1942 (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003), which provides that the Bank may at any time pay into the Exchequer such sums on account of Surplus Income as may be agreed upon by the Minister for Finance and the Bank.

Under Section 6J of the *Central Bank Act*, 1942, (as inserted by Section 7 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003) the Bank is exempt from Corporation Tax, Income Tax and Capital Gains Tax.

Note 10: Gold and Gold Receivables

With the exception of coin stocks held in the Bank, gold holdings consist of deposits with foreign banks. The change in value is due mainly to the change in the market value of gold during the year.

Note 11: Claims on Non-Euro Area Residents in Foreign Currency

	2007	2006
	€000	€000
Receivables from the IMF (i)	127,730	171,665
Balances with banks and security investments, external loans and other external assets (iv)	394,257	394,449
Total	**521,987**	**566,114**

(i) Receivables from the International Monetary Fund (IMF)

	2007	2006
	€000	€000
Quota	900,440	957,077
Less IMF Holdings of euro	(841,019)	(857,450)
Reserve Position in IMF (ii)	**59,421**	**99,627**
SDR Holdings (iii)	**68,309**	**72,038**
Total	**127,730**	**171,665**

(ii) Reserve Position in IMF:

This asset represents the difference between Ireland's Quota in the IMF and IMF holdings of euro. Ireland's Quota is its membership subscription, twenty five per cent of which was paid for in foreign currencies and the balance in euro. The holdings of euro by the IMF, which initially were equal to seventy five per cent of the Quota, have changed from time to time as a result of instructions received from the IMF regarding its lendings to member countries.

(iii) Special Drawing Rights (SDRs):

The SDR is an international reserve asset, which was created by the IMF and allocated to member countries in the early 1970s and the early 1980s in order to increase international liquidity. The SDR is defined in terms of a basket of currencies. Its value is determined as the weighted sum of exchange rates of four currencies (US dollar, sterling, yen and euro).

(iv) Balances with Banks and Security Investments, External Loans and Other External Assets

	2007	2006
	€000	€000
Balances with Banks	41,325	24,470
Security Investments	352,932	369,979
Total	**394,257**	**394,449**

Note 11: Claims on Non-Euro Area Residents in Foreign Currency (continued)

Maturity Profile	2007	2006
	€000	€000
0 – 3 months	46,623	40,387
3 months – 1 year	16,077	10,833
1 – 5 years	331,557	343,229
Total	**394,257**	**394,449**

Note 12: Claims on Euro Area Residents in Foreign Currency

	2007	2006
	€000	€000
Balances with Banks (i)	412,840	24,202
Security Investments	32,664	34,434
Total	**445,504**	**58,636**

Maturity Profile	2007	2006
	€000	€000
0 – 3 months (i)	414,200	24,205
3 months – 1 year	8,324	3,929
1 – 5 years	22,980	30,502
Total	**445,504**	**58,636**

(i) This item consists mainly of a claim arising from reverse operations with Eurosystem counterparties amounting to EUR 339.1 million, in connection with the US dollar Term Auction Facility. Under this program, USD 20 billion were provided by the Federal Reserve to the ECB by means of a temporary reciprocal currency arrangement (swap line) with the aim of offering short-term US dollar funding to Eurosystem counterparties. The ECB simultaneously entered into swap transactions with NCBs that have adopted the euro, which used the resulting funds to conduct liquidity-providing operations with the Eurosystem counterparties (Note 37).

Note 13: Claims on Non-Euro Area Residents in Euro

	2007	2006
	€000	€000
Balances with Banks	410,508	1,909,450
Security Investments – MTM (i)	658,039	706,131
Security Investments – HTM (i)	483,955	303,754
Reverse Repurchase Agreements (ii)	–	324,000
Total	**1,552,502**	**3,243,335**

Maturity Profile	2007	2006
	€000	€000
0 – 3 months	485,465	2,353,562
3 months – 1 year	184,713	115,584
1 – 5 years	613,385	613,562
5 – 10 years	268,939	160,627
Total	**1,552,502**	**3,243,335**

(i) MTM (Marked to Market) refers to marketable securities held and valued at mid-market closing prices at year-end. HTM (Held to Maturity) refers to securities held in long-term investment portfolios. See Accounting Policy (h).

(ii) See Accounting Policy (j).

Note 14: Lending to Euro Area Credit Institutions related to Monetary Policy Operations in Euro

	2007	2006
	€000	€000
Main Refinancing Operations (i)	12,140,354	10,822,237
Longer Term Refinancing Operations (ii)	27,309,061	16,221,526
Total	**39,449,415**	**27,043,763**

These consist of advances to local credit institutions and reflect the Bank’s participation in Eurosystem monetary policy operations. All the advances are fully secured by collateral approved by the Eurosystem.

(i) The Main Refinancing Operations generally comprise weekly tenders for funds with maturity of one week and at rates close to market rates. Operations conducted over the end of 2007, were for a maturity of two weeks.

(ii) The Longer Term Refinancing Operations comprise monthly tenders with maturity of three months and at rates close to market rates.

Note 15: Other Claims on Euro Area Credit Institutions in Euro

	2007	2006
	€000	€000
Balances with Banks	428,913	805,477
Reverse Repurchase Agreements (i)	–	255,000
Total	**428,913**	**1,060,477**

(i) See Accounting Policy (j).

Note 16: Securities of Euro Area Residents in Euro

	2007	2006
	€000	€000
Security Investments – MTM	7,190,572	5,361,260
Security Investments – HTM	2,693,313	1,776,195
Total	**9,883,885**	**7,137,455**

These securities comprise debt issued by specified euro area and supranational issuers. MTM (Marked to Market) refers to marketable securities held and valued at mid-market closing prices at year-end. HTM (Held to Maturity) refers to securities held in long-term investment portfolios. See Accounting Policy (h).

Maturity Profile	2007	2006
	€000	€000
0 – 3 months	344,485	1,101,267
3 months – 1 year	668,946	2,080,212
1 – 5 years	7,428,462	3,020,450
5 – 10 years	1,441,992	897,618
More than 10 years	–	37,908
Total	**9,883,885**	**7,137,455**

Note 17: Participating Interest in ECB

This represents the Bank's contribution to the capital of the European Central Bank. See Accounting Policy (k)(iii) and Note 5.

Note 18: Claims Equivalent to the Transfer of Foreign Reserves

The change in the Capital Key in 2007 lead to a reduction in the level of foreign reserves transferred of €1.2 million. See Accounting Policy (k)(vi) and Note 1.

Note 19: Items in Course of Settlement

Items in the course of settlement represent a claim on credit institutions in respect of cheques lodged in the Bank by its customers on the last business day of the year and presented to the banks on the first business day of the New Year.

Note 20: Other Assets

	2007	2006
	€000	€000
Shares in the Bank for International Settlements (i)	15,766	16,487
Stocks of Materials for Note Production	2,606	1,883
AIB plc/ICAROM Interest Bearing Loan (ii)	70,108	97,383
Accrued Interest Income	333,750	213,447
Prepayments	373	439
Fixed Assets (Note 21)	60,737	65,371
Other	77,246	37,578
Total	**560,586**	**432,588**

(i) The Bank holds 8,564 shares (2,564 paid up) in the Bank for International Settlements (Notes 5 and 33).

(ii) Under arrangements, which commenced in 1993 for the financing of the administration of ICAROM plc (formerly Insurance Corporation of Ireland plc), €11.1 million per annum until 2012 is being collected from Allied Irish Banks plc and passed on to the Administrator of ICAROM plc. The mechanisms used to collect these monies are (i) a back-to-back loan and deposit arrangement between Allied Irish Banks plc and the Bank and (ii) the reduction of interest paid on the minimum reserve balances held by Allied Irish Banks plc with the Bank. The matching back-to-back deposit is shown in Other Liabilities (Note 29).

Note 21: Fixed Assets

€000	Premises		Plant and Machinery		Computer Equipment		Other Equipment		Furniture, Fixtures & Fittings		Total Fixed Assets	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
At Cost – 1 January	53,038	49,814	47,004	47,014	12,575	11,650	9,059	7,788	9,383	8,976	131,059	125,242
Acquisitions (+)	61	3,224	77	5	1,413	925	273	1,271	266	407	2,090	5,832
Disposals	–	–	–	(15)	–	–	(101)	–	–	–	(101)	(15)
At Cost – 31 December	53,099	53,038	47,081	47,004	13,988	12,575	9,231	9,059	9,649	9,383	133,048	131,059
Accumulated Depreciation at 1 January	11,291	10,275	31,136	28,165	9,674	8,586	6,138	5,330	7,449	6,733	65,688	59,089
Depreciation for Year (i)	1,155	1,016	2,853	2,971	1,124	1,088	846	808	728	716	6,706	6,599
Disposals	–	–	–	–	–	–	(83)	–	–	–	(83)	–
Accumulated Depreciation at 31 December	12,446	11,291	33,989	31,136	10,798	9,674	6,901	6,138	8,177	7,449	72,311	65,688
Net Book Value at 31 December	**40,653**	**41,747**	**13,092**	**15,868**	**3,190**	**2,901**	**2,330**	**2,921**	**1,472**	**1,934**	**60,737**	**65,371**

(i) Of the total of €6.7 million (2006: €6.6 million) depreciation charge, €0.15 million (2006: €0.16 million) in respect of Mint machinery was charged to the Currency Reserve. See Accounting Policy (e).

Note 22: Banknotes in Circulation

This item consists of the Bank's share of euro banknotes issued by the Eurosystem. The total value of euro banknotes in circulation is allocated to each National Central Bank on the last working day of each month in accordance with the banknote allocation key. See Accounting Policy (k)(iv).

Note 23: Liabilities to Euro Area Credit Institutions related to Monetary Policy Operations in Euro

	2007	2006
	€000	€000
Minimum Reserve (i)	10,820,031	12,910,313
Overnight Deposits (ii)	3,019,358	5,000
Fixed Term Deposits (iii)	8,000,000	–
Total	**21,839,389**	**12,915,313**

(i) Credit institutions in the euro area are required to hold minimum average reserve deposits with their respective NCBs. The purpose of these reserve requirements is to maintain a structural liquidity shortage. Interest is paid on these deposits at rates close to short-term market interest rates (Note 14). These accounts are also used as current/settlement accounts through which transactions across the TARGET system are settled.

(ii) This deposit facility is available to counterparties to place deposits with the Bank on an overnight basis.

(iii) A fixed term deposit is a fine-tuning operation used to drain excess liquidity from the market for a fixed period, normally overnight.

Note 24: Liabilities to Other Euro Area Residents in Euro

	2007	2006
	€000	€000
General Government (i)	8,025,191	5,462,514
Other	98	98
Total	**8,025,289**	**5,462,612**

These items have a maturity of less than one year.

(i) Included under this heading are deposits totalling €302,303 held by the Official Assignee in Bankruptcy under the provisions of the *Bankruptcy Act*, 1988.

Note 25: Liabilities to Non-Euro Area Residents in Euro

	2007	2006
	€000	€000
Central Banks	6	93
International Financial Institutions	97	3,919
EU Agencies	2,179	5,375
Total	**2,282**	**9,387**

These items have a maturity of less than one year.

Note 26: Counterpart of Special Drawing Rights Allocated by the IMF

This is the liability of the Bank to the IMF in respect of the allocation of SDRs to Ireland. The Bank's SDR assets can change as a result of IMF lending operations or exchanges of SDRs for foreign currency with the IMF itself, IMF members and other official holders of SDRs. SDR holdings may also change as a result of interest payments made by the IMF on the Bank's Reserve Position in the IMF and on the Bank's SDR holdings net of SDR allocations.

Note 27: Liabilities related to the Allocation of Euro banknotes within the Eurosystem

This item consists of the liability of the Bank *vis-à-vis* the Eurosystem in relation to the allocation of euro banknotes within the Eurosystem. See Accounting Policies (k)(ii) and (k)(iv) and Note 22.

Note 28: Other Liabilities within the Eurosystem

This item represents the net liability to the ECB as a result of euro cross-border payments transacted over the TARGET system by all NCBs participating in the ESCB. See Accounting Policy (k)(ii).

Note 29: Other Liabilities

	2007	2006
	€000	€000
AIB plc/ICAROM Deposit (Note 20)	70,108	97,383
Profit & Loss Appropriation (i)	152,184	57,864
Deposit Protection Accounts (ii)	526,093	460,570
Interest Accruals	272,336	160,102
Other Accruals	5,040	2,860
Other	3,528	4,809
Total	**1,029,289**	**783,588**

(i) This represents the balance of surplus income owing to the Exchequer after payments on account made during the year (Note 9).

(ii) These are balances placed by credit institutions with the Bank as part of the Irish Deposit Protection Scheme (IDPS) under the *European Communities (Deposit Guarantee Schemes) Regulations*, 1995. The IDPS is funded by credit institutions, which are authorised by the Financial Regulator.

Note 30: Provision

Irish banknotes formerly issued by the Bank ceased to be legal tender with effect from 9 February 2002. As at 31 December 2002, notes to the value of €299.7 million were outstanding, at which point a provision of €60 million was created to meet obligations in respect of unredeemed Irish pound banknotes. At 31 December 2007, the provision stood at €7.3 million (2006: €11.6 million) (Note 33).

Note 31: Revaluation Accounts

	2007	2006
	€000	€000
At 1 January	58,206	65,067
Revaluation Surplus/Deficit	30,031	(6,861)
Total	**88,237**	**58,206**

The foreign exchange rates used *vis-à-vis* the euro for the end-year valuations are as follows:

	2007	2006
Currency	**Rate**	**Rate**
US dollar	1.4721	1.3170
Japanese yen	164.93	156.93
Sterling	0.73335	0.6715
Swiss franc	1.6547	1.6069
Danish krone	7.4583	7.4560
Swedish krona	9.4415	9.0404
Canadian dollar	1.4449	1.5281
SDR	0.9311	0.8760
The gold prices used were:		
Euro per fine ounce	568.236	482.688

Note 32: Capital and Reserves

€000	Capital (i)	General Reserve	Currency Reserve	Total
At 31 December 2006	**30**	**743,876**	**352,928**	**1,096,834**
Retained profit for the year (ii)		35,185	-	35,185
Transfer to Pension Liability (iii) (Note 34 (d))		-	(170)	(170)
Net Proceeds of Coin Issue (iv)		-	58,018	58,018
Transfer to the Exchequer (v)		-	(59,100)	(59,100)
Actuarial gain on Pension Liability (vi) (Note 34 (e))		33,880	-	33,880
At 31 December 2007	**30**	**812,941**	**351,676**	**1,164,647**

(i) The authorised capital of the Bank is fixed under Section 9(1) of the *Central Bank Act*, 1942 at €50,790. Issued and paid up capital is €30,474 all of which is held by the Minister for Finance. The balance is payable as agreed by the Board and the Minister.

(ii) Under the Central Bank of Ireland (Surplus Income) Regulations, 1943, the Board approved a transfer from the Profit and Loss Appropriation account to the General Reserve of €35.2 million and a transfer from the Pension Liability to the General Reserve Account of €33.9 million in respect of an actuarial gain on the pension liability for 2007 (Note 34 (e)).

(iii) The transfer to the pension liability account of €170,000 is in respect of interest on pension liability for staff involved in the production of coin. The current service cost of €107,000 for such staff is included in the Mint operating costs (see Note 8).

(iv) Under the provisions of the *Coinage Act*, 1950, the *Decimal Currency Acts*, 1969-1990 and the *Economic and Monetary Union Act*, 1998, income and expenses related to coin are transferred directly to the Currency Reserve. See Accounting Policy (e) and Note 8.

(v) As a result of the *Finance Act*, 2002, and as directed by the Minister for Finance the Bank is permitted to transfer the proceeds from the issue of coin directly to the Exchequer. In 2007 the Bank transferred €59.1 million to the Exchequer. Details of net proceeds for the year are included in the table below:

Net Proceeds of Coin Issue	2007	2006
	€000	€000
Coin issued into circulation	65,032	47,803
Specimen Coin Sets	2,624	1,996
Withdrawn Irish coin	(580)	(821)
Proceeds from smelted coin	151	338
Total	**67,227**	**49,316**
Less Operating Costs (Note 8)	**(9,209)**	**(8,642)**
Net Proceeds	**58,018**	**40,674**

(vi) Actuarial gain on pension liability.

Note 33: Contingencies

The Bank hold 8,564 shares in the Bank for International Settlements, 2,564 of which are paid up. The Bank has a contingent liability in respect of the balance (Notes 5 and 20(i)).

Under the Statute of the ESCB the Bank may be called upon in the future, along with all other participating NCBs, to transfer further amounts of capital (Article 28) and foreign reserve assets (Article 30) to the ECB.

The Bank has a contingent liability in relation to Irish pound banknotes that are no longer legal tender and that may be presented at a future date (€299.7 million was outstanding at 31 December 2002). At 31 December 2007, there was €247 million of Irish pound banknotes still outstanding (Note 30).

Note 34: Superannuation Liabilities

The pension entitlements of past and current permanent Bank staff arise under a defined benefit pension scheme. Under the scheme Bank staff receive the same entitlements as established civil servants. The Scheme is operated on a non-contributory basis for staff employed before 6 April 1995, with the exception of contributions made to the Spouses' and Children's Pension Scheme and payments received from eligible staff for the purchase and transfer of notional added service. In the case of staff employed on or after 6 April 1995 contributions are also payable in respect of the main scheme. The Bank operates a pay-as-you-go system in that assets are not separately identified to provide for the Bank's pension liabilities.

The Bank discloses the cost of providing benefits in accordance with Financial Reporting Standard ('FRS') 17 'Retirement Benefits'.

The *Central Bank and Financial Services Authority of Ireland Act*, 2003, included a provision for the Bank to establish the pension scheme on a funded basis. Approval has been granted by the Minister for Finance for the establishment of the Funded scheme in 2008.

An update of the actuarial review was completed as at 31 December 2007 to comply with disclosure requirements under FRS 17.

FRS17 Disclosure

(a) The principal financial assumptions used for FRS 17 purposes were:

	2007	2006
	%	%
Rate of increase in salaries	4.25	4.00
Rate of increase in pensions	4.25	4.00
Discount rate	5.50	4.75
Rate of price inflation	2.50	2.25

Note 34: Superannuation Liabilities (continued)

The following amounts were measured in accordance with the requirements of FRS 17 – Retirement Benefits:

(b) Demographic Assumptions	**2007**	**2006**
Mortality Pre Retirement*	PMA92/PFA92 (c=2030)	PMA92/PFA92 (c=2020)
Mortality Post Retirement*	PMA92/PFA92 (c=2030)	PMA92/PFA92 (c=2020)
Retirements	Evenly spread over age 60 to 65 (for those with option to retire at 60)	Evenly spread over age 60 to 65 (for those with option to retire at 60)
Ill Health Retirement	Allowance made	Allowance made
Early Retirement	No allowance	No allowance
Withdrawals	No allowance	No allowance
Percentage married	90%	90%
Age difference between spouses	A male is assumed to be 3 years older than his spouse	A male is assumed to be 3 years older than his spouse

* PMA92/PFA92 are both published mortality tables prepared for the Actuarial Profession in the UK by the Continuous Mortality Investigation Bureau. The mortality assumptions chosen are based on standard tables reflecting typical pensioner mortality and they allow for increasing life expectancy over time.

(c) Balance Sheet Recognition

The amounts recognised in the balance sheet are as follows:

	31 December 2007
	€000
Present value of unfunded obligations	424,950
Net liability/(asset) recognised in balance sheet	**424,950**

(d) Amount charged to Profit and Loss Account/Currency Reserve

	2007	**2006**	**2005**
	€000	**€000**	**€000**
Interest on pension scheme liabilities	**20,947**	**16,973**	**13,286**
Net charge debited to Other Income (Note 7)	20,777	16,835	13,150
Net charge debited to Currency Reserve (Note 32(iii))	170	138	136
Current service cost	16,355	14,857	9,322
Past service cost	–	–	899
Employee Contributions	(2,227)	(1,898)	(1,695)
Total	**14,128**	**12,959**	**8,526**
Net charge debited to Staff Expenses (Note 8)	14,021	12,861	8,432
Net charge debited to Currency Reserve (Note 32 (iii))	107	98	94
Total pension cost of defined benefit scheme	**35,075**	**29,932**	**21,812**

Note 34: Superannuation Liabilities (continued)

(e) Movement in Deficit during the year

	2007	2006	2005
	€000	€000	€000
Deficit as at 1 January	(428,447)	(387,644)	(273,496)
Movement in year:			
Current service cost	(16,355)	(14,857)	(9,322)
Past service cost	–	–	(899)
Pensions paid	6,919	6,183	5,276
Interest on pension scheme liabilities	(20,947)	(16,973)	(13,286)
Actuarial Loss/Gain Recognised in Appropriation Account	33,880	(15,156)	(95,917)
Deficit at 31 December	**(424,950)**	**(428,447)**	**(387,644)**

(f) Prior Year Comparatives

Amount for the current and previous two periods are as follows:

31 December	2007	2006	2005
	€000	€000	€000
Defined Benefit Obligation	424,950	428,447	387,644
Fair Value of plan assets	-	-	-
Deficit in the plan	424,950	428,447	387,644
Experience adjustment arising on the plan liabilities	(4,081)	(14,810)	(112,298)
Percentage of the scheme liabilities	*(1.0%)*	*(3.4%)*	*(29.0%)*

(g) Expected Contributions to the Plan for the Period Ending 31 December 2008

The following estimates of expected contributions are based on discussions with the bank and based on the current membership and pensionable salary roll of the plan participants.

	31 December 2008
	€000
Contributions by the employer	4,891
Contributions by plan participants	2,322
Total	**7,213**

Note 35: Management of Financial Risk

The liabilities and assets of the Bank are primarily determined by the nature of the Bank's statutory functions, rather than commercial considerations. At the same time the Bank actively manages the market risks associated with its investment portfolio (i.e. holdings of foreign currency and euro-denominated assets).

The parameters within which the Bank's investment portfolio is managed are determined by the Board of the Bank; these include the currency composition of assets, the choice of investment instruments and the overall degree of risk that the Bank considers appropriate for its investment activities.

The risks (i.e. currency, market, credit, liquidity and operational) inherent in the investment portfolio are managed by a comprehensive system of limits and procedures. An Investment Committee of the Board reviews investment policy and performance, and is supported by the Bank's Investment Assets Committee which considers policy issues and strategy relating to the investment of the reserves. This committee, under the chairperson of the member of Management Board responsible for Financial Operations, consists of management and senior staff of the Financial Markets, Payments and Securities Settlement and Financial Control Departments. A Standing Investment Strategy Committee, comprising Financial Markets management and dealers meet weekly to formulate short-term investment strategy.

An Investment Desk comprising a team of dealers carries out the day-to-day dealing activities that are required to implement decisions and to ensure that the portfolios are fully invested. A separate Risk Management Unit is responsible for the measurement, monitoring and reporting of the Bank's financial risk exposures and for monitoring and reporting compliance with limits, etc. The Unit also measures the return on the Bank's investment portfolios.

On an organisation-wide level, financial risk exposures are managed by a formal operational risk management framework which ensures that potential exposures are identified and that appropriate controls and procedures, aimed at minimising and monitoring such risks, are implemented.

Note 36: Investor Compensation Act, 1998

Under Section 10 of the *Investor Compensation Act*, 1998, the Bank has formed and registered 'The Investor Compensation Company Limited', a company limited by guarantee. The Company administers the investor compensation scheme to reimburse the clients of failed investment firms. The Bank provides administrative and other services to the Company, the costs of which are recovered from the Company. The Company prepares its own Annual Report and audited Statement of Accounts.

Note 37: Unmatured Contracts in Foreign Exchange

Unmatured Foreign Exchange Contracts at 31 December 2007 were as follows:

	Unmatured Purchases	Unmatured Sales	Unmatured Purchases and sales
	000s of currency units		
Euro	894,868	62,659	832,209
US dollar	–	1,193,134 (i)	1,193,134

(i) Forward liabilities to the ECB with an equivalent value of €399,101 remained outstanding as at 31 December 2007. These items arose in connection with the US dollar Term Auction Facility established by the Federal Reserve (Note 12).

Note 38: Unmatured Contracts in Securities

As a result of commitments made in December 2007 there were unmatured forward purchases of nominal US dollar 15.4 million and unmatured forward purchases of €60.6 million.

All contracts had matured by 3 January 2008.

Total forward purchases valued at mid-market closing exchange rates of 31 December had a nominal value of €71.1 million.

Note 39: Related Parties

(a) The Bank provides several services to the Minister for Finance, its sole shareholder, and to other government departments and bodies.

The main services during the year to 31 December 2007 were:

- provision of banking services including holding the principal accounts of Government;
- provision and issue of coin;
- holding and maintaining the register of Irish Government securities.

(b) As a participating member of the ESCB, the Bank has ongoing relationships with the other NCBs and the ECB.

Note 40: Post-Balance Sheet Events

There was no post-balance sheet adjusting events.

Note 41: The Irish Financial Services Regulatory Authority

The Irish Financial Services Regulatory Authority (Financial Regulator) was established in May 2003 under the terms of the CBFSAI Act 2003. It is a constituent part of the CBFSAI and is responsible for the regulation of the financial services industry in Ireland. The following is a summary of the income and expenditure of the Financial Regulator for the year ended 31 December 2007 together with comparatives for the year ended 31 December 2006.

Irish Financial Services Regulatory Authority – Statement of Income and Expenditure for 2007

Income		2007	2006
		€000	€000
Industry Funding			
Credit Institutions		8,174	7,423
Insurance Undertakings		4,707	4,854
Intermediaries		2,071	2,888
Securities and Investment Firms		1,653	1,445
Collective Investment Schemes and Service Providers		4,318	3,529
Credit Unions		1,417	1,298
Moneylenders		187	158
Approved Professional Bodies		22	20
Exchanges		168	101
Bureau de Change/Moneytransmitters		40	28
Total Funding		**22,757**	**21,744**
Less: Provision/Write Offs		448	350
Net Industry Funding	(i)	**22,309**	**21,394**
Excess of Income over Expenditure from previous year		2,193	2,110
Subvention from Central Bank and Financial Services Authority of Ireland	(ii)	25,375	24,364
		49,877	47,868
Other Income	(iii)	3,329	2,887
Total Income		**53,206**	**50,755**
Expenses			
Direct Expenses	(iv)	33,651	31,469
Shared Services	(v)	15,627	14,206
		49,278	45,675
Other Expenses	(iii)	3,329	2,887
Total Expenses		**52,607**	**48,562**
Excess of Income over Expenditure Carried Forward	(vi)	**599**	**2,193**

Note 41: The Irish Financial Services Regulatory Authority (continued)

(i) Net Industry Funding and Provisioning

Net Industry Funding income is included in the Statement of Accounts of the CBFSAI under Other Income. This figure comprises income from levies imposed upon the above industry categories (net of appeals and adjustments) under the *Central Bank Act*, 1942 (Sections 33J and 33K), Regulations 2004 (as amended by the 2007 Regulations) and other income in respect of fees and charges. An amount of €448,000 in respect of provision/write-offs has been offset against total funding income to arrive at Net Industry Funding. Outstanding levy amounts are being pursued as part of the ongoing debt recovery process.

The provision/write-offs are as follows:

	2007	2006
	€000	€000
Opening Provision for Unpaid Levy Notices	186	213
Less: Write-Offs 2004 Levy	82	68
Less: Write-Offs 2005 Levy	148	127
Less: Write-Offs 2006 Levy	8	182
Less: Write-Offs 2007 Levy	–	–
Add: Charge to Income & Expenditure Account – Provision/Amounts Written Off	**448**	**350**
Closing Provision for Unpaid Levy Notices	**396**	**186**

(ii) Subvention from Central Bank and Financial Services Authority of Ireland

By agreement with the Minister for Finance in September 2006, over the three-year period 2007-2009 approximately 50 per cent of the total costs of the Financial Regulator have been met by the imposition of levies on the industry. The balance of the total annual costs is provided by the CBFSAI in accordance with Section 33(L) of the *Central Bank Act*, 1942 (as inserted by Section 26 of the *Central Bank and Financial Services Authority of Ireland Act*, 2003). In 2007, the CBFSAI, with the approval of the Minister for Finance, bore the full cost of certain securities market supervision activities carried out within the Financial Regulator. These costs totalling €2.2 million were excluded from the Net Industry Funding levies collected from the industry in 2007.

(iii) Other Income/Other Expenses

In 2007 the Irish Stock Exchange collected €3.3 million in fees payable to the Financial Regulator in accordance with Regulation 109 of the Prospectus (Directive 2003/71/EC) Regulations, 2005, and Regulation 78 of the Transparency (Directive 2004/109/EC) Regulations, 2007. In accordance with Part 17(h) of the Prospectus Directive and Market Abuse Directive, delegation agreements entered into by the Financial Regulator with the Irish Stock Exchange, the Financial Regulator confirmed to the Irish Stock Exchange that it could retain the sum of €3.3 million to put towards the costs that it had incurred in undertaking the delegated functions under the delegation agreements.

Note 41: The Irish Financial Services Regulatory Authority (continued)

(iv) Direct Expenses

	2007	2006
	€000	€000
Salaries/Allowances	22,231	20,498
PRSI	1,573	1,484
	23,804	21,982
Pension Provision	3,380	3,121
Staff Expenses	**27,184**	**25,103**
Training, Recruitment & Other Staff Costs	477	449
Equipment, Stationery & Requisites	449	414
Business Travel	775	664
Publishing & Media Relations	2,833	3,016
Professional Fees	1,749	1,669
Miscellaneous	184	154
Non-Pay Operating Expenses	**6,467**	**6,366**
Direct Expenses	**33,651**	**31,469**

(v) Shared Services

Shared services (excluding the pension provision of €1.1 million) are included in the Statement of Accounts of the CBFSAI as set out in Note 8 to those accounts.

The Financial Regulator receives various services including premises, human resources administration, accounting, internal audit, statistical and information technology services from the CBFSAI. The cost of these services in 2007 was €15.6 million (2006: €14.2 million).

The costs involved have been determined by the application of a cost allocation methodology which has previously been reviewed by independent external consultants. Allocation is based on well-recognised industry practice including occupied floor space, PC numbers and headcount (staff numbers) as appropriate. The main components of the above costs are as follows:

	2007	2006
	€000	€000
Corporate Services incl. Premises	7,576	6,802
Information Technology Services	2,848	2,655
Human Resources	2,242	2,077
Other Services	2,961	2,672
Total	**15,627**	**14,206**

(vi) Excess of Income over Expenditure

This represents the amount of levies collected from industry in 2007 in excess of the 2007 funding requirement. The 2007 funding requirement is the total of Direct Expenses and Shared Services (€49.3 million) expenditure less the subvention from the CBFSAI. The excess of income over expenditure has been carried forward and the calculation of the amount of industry levies for 2008 has been adjusted to take account of this excess.

Note 42: Approval of Accounts

The Board of Directors approved the Statement of Accounts on 17 June 2008.

Report of the Comptroller and Auditor General for presentation to the Houses of the Oireachtas

I have audited the Statement of Accounts of the Central Bank and Financial Services Authority of Ireland ("the Bank") for the year ended 31 December 2007 under the Central Bank Act 1942, as amended by the Central Bank and Financial Services Authority of Ireland Act 2003.

The Statement of Accounts, which has been prepared under the accounting policies set out therein, comprise the Accounting Policies, the Profit and Loss and Appropriation Account, the Balance Sheet and the related notes.

Respective Responsibilities of the Directors of the Bank and the Comptroller and Auditor General

The Directors' responsibilities for preparing the Statement of Accounts in accordance with applicable law are set out in the Statement of Directors' Responsibilities. The Directors are also responsible for ensuring the regularity of transactions.

My responsibility is to audit the Statement of Accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

I report my opinion as to whether the Statement of Accounts gives a true and fair view and has been properly prepared on the basis described in paragraph (a) of the Accounting Policies. I also report whether in my opinion proper books of account have been kept. In addition, I state whether the Statement of Accounts is in agreement with the books of account.

I report any material instance where moneys have not been applied for the purposes intended or where the transactions do not conform to the authorities governing them.

I also report if I have not obtained all the information and explanations necessary for the purposes of my audit.

I review whether the Statement on Internal Financial Control reflects the Bank's compliance with the Code of Practice for the Governance of State Bodies and report any material instance where it does not do so, or if the statement is misleading or inconsistent with other information of which I am aware from my audit of the Statement of Accounts. I am not required to consider whether the Statement on Internal Financial Control covers all financial risks and controls, or to form an opinion on the effectiveness of the risk and control procedures.

I read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of Audit Opinion

In the exercise of my function as Comptroller and Auditor General, I conducted my audit of the Statement of Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and by reference to the special considerations which attach to State bodies in relation to their management and operation. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures and regularity of the financial transactions included in the Statement of Accounts. It also includes an assessment of the significant estimates and judgments made in the preparation of the Statement of Accounts, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations that I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the Statement of Accounts is free from material misstatement, whether caused by fraud or other irregularity or error. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the Statement of Accounts.

Opinion

In my opinion, the Statement of Accounts, which has been properly prepared on the basis described in paragraph (a) of the Accounting Policies, gives a true and fair view of the state of the Bank's affairs at 31 December 2007 and of its surplus income for the year then ended.

In my opinion, proper books of account have been kept by the Bank. The Statement of Accounts is in agreement with the books of account.

John Buckley
Comptroller and Auditor General

17 June 2008

Independent Auditors' Report To The Board Of Directors Of The Central Bank And Financial Services Authority Of Ireland

We have audited the Statement of Accounts.

Respective responsibilities of directors and auditors

The directors, as described in the Statement of Directors' Responsibilities, are responsible for preparing the Statement of Accounts.

Pursuant to the requirements of Article 27 of the Statute of the European Central Bank, we have been appointed to audit the Statement of Accounts of the Central Bank and Financial Services Authority of Ireland ('the Bank'). Our responsibilities, as independent auditors, are established by Article 27 of the Statute of the European Central Bank and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Bank's Board of Directors as a body in accordance with Article 27 of the Statute of the European Central Bank and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Statement of Accounts gives a true and fair view and is properly prepared on the basis described in paragraph (a) of the accounting policies. We state whether we have obtained all the information and explanations we consider necessary for the purposes of our audit and whether the Statement of Accounts is in agreement with the accounting records. We also report to you our opinion as to whether the Bank has maintained proper accounting records. We are not required to form an opinion on the effectiveness of the Bank's system of internal financial controls.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Statement of Accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Statement of Accounts, and of whether the accounting policies are appropriate to the Bank's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Statement of Accounts is free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Statement of Accounts, the basis of which is described in paragraph (a) of the accounting policies.

Opinion

In our opinion the Statement of Accounts has been properly prepared on the basis described in paragraph (a) of the accounting policies and, on this basis, the Statement of Accounts gives a true and fair view of the state of the Bank's affairs as at 31 December 2007 and of its profit for the year then ended.

We have obtained all the information and explanations we consider necessary for the purposes of our audit. In our opinion, proper accounting records have been kept by the Bank. The Statement of Accounts is in agreement with the accounting records.

Deloitte & Touche
Chartered Accountants and Registered Auditors

Dublin
17 June 2008

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"Assessing the Role of Income and Interest Rates in Determining House Prices" by Kieran McQuinn and Gerard O'Reilly, *Economic Modelling,* Vol. 25, 2008

"Measuring Bank Profit Efficiency" by Kieran McQuinn and Trevor Fitzpatrick, *Applied Financial Economics,* Vol.18, 2008

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Monthly Statistics

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EUROSYSTEM

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