Irish letters

On 6 November 2014, the Governing Council of the European Central Bank decided to publish a letter written by former ECB president Jean-Claude Trichet on behalf of the Governing Council to then Irish Finance minister Brian Lenihan in November 2010.

With this decision, the ECB honoured the European Ombudsman's call for the Governing Council to re-consider the release of the letter. The Governing Council also decided to disclose a further three letters that were part of correspondence between the ECB and the Irish authorities in the run-up to the official application of Ireland for support under an EU/IMF adjustment programme.

Also included below are public documents with statements and positions of the ECB on Ireland.

Letters

- Letter of the ECB president to the Irish Minister for Finance dated 15/10/2010 on the large provision of liquidity by the Eurosystem and the Central Bank of Ireland to Irish banks
- Reply letter of the Irish Minister for Finance dated 04/11/2010
- Letter of the ECB president to the Irish Minister for Finance dated 19/11/2010 on the large provision of liquidity by the Eurosystem and the Central Bank of Ireland to Irish banks and the need for Ireland to agree to an adjustment programme
- Reply letter of Irish Minister for Finance dated 21/11/2010

What were the main sources of the crisis in Ireland in the lead-up to the EU/IMF adjustment programme?

- In the years leading up to the crisis, the Irish economy experienced a build-up of imbalances that eventually inflicted large damage on the economy. The economy had become overly reliant on the construction sector as both a driver of growth and a source of tax revenue. In this context, credit growth expanded excessively along with public expenditure. Private debt reached unsustainably high levels, resulting in huge risks for Irish banks.
- This toxic dynamic was aggravated by the fact that the domestic banking sector, for which the Irish authorities bore responsibility, was insufficiently regulated at that time. Moreover, Ireland's higher inflation led to real interest rates significantly below euro area average levels for a number of years, fuelling incentives to borrow. Finally, the Irish economy became less competitive in those years. Between 1998 and 2008, unit labour costs had increased by 50%, compared with 19% in the euro area as a whole during the same period.
- For a more detailed overview, please see "The Irish case from an ECB perspective", a speech given by Jörg Asmussen, then Member of the Executive Board of the ECB, at the Institute of International and European Affairs in Dublin on 12 April 2012.

What was the role of policy-makers in the accumulation of such imbalances and vulnerabilities in the Irish economy?

- While it is fully understandable that Irish citizens feel acutely aggrieved by the legacy of the crisis, it was domestic policy-makers who were responsible for the inadequate polices relating to e.g. banking supervision, public finances and the loss of competitiveness. In particular, it was a lack of adequate domestic macro-prudential policies which failed to mitigate the excessive credit growth and subsequent housing boom.

- Undoubtedly, there were also external aggravating factors which contributed to the crisis in Ireland, including the fact that the crisis prevention framework in the euro area was neither complete nor sufficiently effective. The reforms to EU governance introduced during the crisis will help to prevent future crises.

What was the impact of the government guarantee of bank liabilities that was introduced on 30 September 2008, and what was the position of the ECB at the time?

- The ECB took a critical view of the government guarantee of bank liabilities for a period of two years (see ECB Opinions CON/2008/44 and CON/2008/48). It triggered an intense negative spiralling effect between the banking sector and the sovereign. The guarantee was introduced by the Irish government without any coordination with European partners. It was superseded by the Eligible Liabilities Guarantee (ELG) scheme in December 2009, which was formally consistent with European agreements on guarantee schemes.

- The expiry of the two-year bank guarantee was one of the main factors leading to the loss of market access. Market concerns, especially from the second half of October 2010 onwards, that future bail-outs may involve burden-sharing with private investors, acted as an additional aggravating factor in the surge of yields in stressed euro area countries. Ultimately, markets lost confidence and, as a consequence, the Irish government had to ask for official support.

Does the ECB bear responsibility for the start of the programme? What was the role of the just released exchange of letters between the former ECB President and the former Irish Minister for Finance, which are dated 15 October 2010, 4 November 2010, 19 November 2010, and 21 November 2010?

- The decisions outlined above by the Irish authorities, the sheer scale of the domestic crisis and aggravating external factors led to Ireland’s application for an EU/IMF adjustment programme.

- In the months leading up to the application for a programme, information about the extent of the difficulties in the banking sector was entering the public domain while the fiscal implications stemming from the collapse in revenues were becoming ever more apparent. The Irish government started to prepare an ambitious four-year economic strategy, in close cooperation with the Commission in liaison with the ECB. This notwithstanding, markets eventually lost confidence. As described in the letter of the former Irish Minister for Finance to the former ECB President dated 4 November 2010, Irish spreads started widening considerably. When an economy does not have market access, it is no longer capable of functioning and requires an adjustment programme to restore sustainability, instil confidence and restore market access. The Irish government needed, therefore, to ask for official support.

- Turning to the role of the ECB, for several years prior to the commencement of the EU/IMF adjustment programme, as well as in the subsequent period, the level of liquidity provided by the Eurosytem in support of Ireland's banking system had been extraordinary. In the period preceding the start of the adjustment programme, the Eurosystem had already been providing exceptional levels of support to Irish banks. In January 2010 the Eurosystem was providing approximately €90 billion – including Emergency Liquidity Assistance (ELA) – to Irish banks. This support began to accelerate rapidly in the latter part of the third quarter of 2010 and had reached about €140 billion (including ELA), or around 85% of Irish GDP, by November 2010. This represented around one fourth of the ECB's total lending – an unprecedented level of exposure to a country such as Ireland, whose share in the capital of the ECB was less than one percent.

- While the ECB always acted within its remit and in line with rules established for the whole of the euro area, there are limits to the support that the Eurosystem can provide to banks in the Member States. Such limits are governed by the widely accepted rules to which the participation in Eurosystem credit operations is subject. First, collateral has to be adequate; and second, counterparts have to be financially sound and solvent. The letter dated 15 October 2010 from the former ECB President recalled these rules and their implications for Ireland.

- As outlined in the subsequent letter sent by the former Irish Minister for Finance to the former ECB President on 4 November 2010, by early November 2010 the situation in Ireland had rapidly deteriorated. It was on account of the extreme severity of the crisis engulfing Ireland, as well as the rules that govern Eurosystem credit operations, that the Governing Council of the ECB had a duty to address the situation. Consequently, a letter on behalf of the Governing Council was sent by the former ECB President to the former Irish Minister for Finance on 19 November 2010. This letter explained the conditions under which further provisions of ELA to Irish financial institutions could be authorised. In his already public reply of 21 November 2010, the Irish Minister for Finance stated that he fully understood the concerns raised by the ECB Governing Council.

Why did the ECB oppose the bail-in of bondholders in 2010? Would a different approach to the burden-sharing of debt issued by Irish banks not have been preferable at the time?

- The involvement of the ECB in the area of burden-sharing in Ireland has frequently been misunderstood and at times misrepresented. Moreover, when assessing certain policy choices, one has to bear in mind the situation at the time, as well as the counterfactual scenario.

- First of all, one fact that is often overlooked in commentaries is that there was a substantial bail-in of subordinated debt issued by the Irish banks. Over the period 2009-2011, the total cash gained from the burden-sharing of subordinated debt was just under €14 billion.

- As regards the possible bailing-in of senior debt in late 2010, it is important to recall the words of EU leaders in a European Union statement of 29 October 2010 and during the G20 meeting in South Korea on 12 November, according to which burden-sharing of senior debt would not be applied until mid-2013. It should be emphasised that this took place amid an environment of heightened uncertainty and following a surge in the yields of stressed euro area countries in the previous month.

- Furthermore, the necessary EU governance tools to address the bail-in of creditors, which were set out in the Bank Recovery and Resolution Directive (BRRD) and have been fully endorsed by the ECB, were not available in late 2010.

- It was against this adverse backdrop and after the statement issued at the G20 meeting that the negotiations over Ireland's EU/IMF adjustment programme took place.

- Following the statements in late 2010, which were designed to calm markets and support financial stability, any potential burden-sharing of senior debt in the immediate aftermath would first and foremost have had negative spillover effects on the financial stability of Ireland, as well as on other European countries.

- It was not until the latter part of 2011 that the possible bail-in of senior debt issued by Irish banks, notably Anglo Irish Bank, came actually to the fore within the Irish EU/IMF programme.

When the issue of burden-sharing of senior debt issued by Anglo Irish Bank was on the programme's agenda in late 2011, why did the ECB not support the bail-in of its remaining senior debt?

- In line with the aforementioned statements by EU leaders, the ECB was of the view that the Irish authorities' decision to fully honour the outstanding senior debts of Anglo Irish Bank was the least damaging course of action to pursue. There is no doubt that this was a very difficult decision for them to take and Irish citizens to accept.

- It should be stressed that this decision was taken during a period of still acute uncertainty. In addition, the potential benefits arising from any burden-sharing with senior bondholders of Anglo Irish Bank were considerably outweighed by the possible risks this could entail, particularly in the context of an ongoing recapitalisation of the Irish banking sector and the continued fragile state of the sector as a whole. Therefore, the negative spillover effects of the bail-in would primarily have had an impact on the other Irish banks, some of which held senior bonds for even higher amounts than Anglo Irish Bank, as well as on other European countries.

- More specifically, it should be emphasised that the potential amount of savings that could be made when, in late 2011, the issue of burden-sharing of senior debt issued by Anglo Irish Bank went on the programme's agenda, was limited – somewhere between €3 and €4 billion. This should be compared with the risks that the bail-in option would have entailed at that point in time, when market sentiment was severely shaken and there were no clear EU rules on a pecking order in crisis resolution. First and foremost, the Irish government was in the process of undertaking a very significant recapitalisation of Irish banks to an amount of around €24 billion, or approximately 14% of GDP. This undertaking was a cornerstone of the programme and a key element in securing the recovery of the Irish banking sector and, consequently, the overall economy. It was pertinent that the effectiveness of this measure would not in any way be undermined, in the ultimate interest of the Irish tax-payers. Second, the bank guarantee/ELG made it much more complicated to pursue the bail-in option. Third, and more generally, given the extraordinary stress and great uncertainty in financial markets at the time, a bail-in could have had very adverse consequences for financial stability in Ireland, with negative spillover effects on banks in Ireland and other euro area countries.

- In summary, the sequence of actions undertaken laid the foundations for the significant rebound in confidence that the Irish banking system has subsequently experienced, especially in the past two years. This virtuous circle may not have materialised had confidence in the banking sector been undermined in 2011.
- At the same time, the ECB does welcome that the necessary EU governance tools are now available to facilitate the possible bail-in of bank creditors. This is outlined in the ECB Opinion on a proposal for a directive establishing a framework for recovery and resolution of credit institutions and investment firms (CON/2012/99).

Did the ECB contribute in any other ways to the return of both market confidence and market access in Ireland?

- It should be noted that, along with the other euro area countries, Ireland has benefited from both the ECB's standard and non-standard monetary policy measures. These have been crucial for the country's stabilisation, in particular the announcement on Outright Monetary Transactions (OMT) over the course of the summer of 2012.

Interviews with ECB Executive Board members

- Excerpts from interviews with ECB Executive Board members
- Transcript of an interview of Lorenzo Bini Smaghi with RTE of 27/01/2011 on, among other things, the origins of the Irish crisis
- Transcript of an interview of Jean-Claude Trichet with RTE of 07/07/2011 on various issues relating to the Irish programme
- Transcript of an interview of Jörg Asmussen with RTE of 23/09/2013 on various issues relating to the Irish programme

Press conferences

Press conference statements on Ireland

Speeches

Speech Jörg Asmussen 12/04/2012 – The Irish case from an ECB perspective

ECB Opinions

- 03/10/2008: Opinion on financial support measures for credit institutions
- 15/10/2008: Opinion on the implementation of financial support measures for credit institutions
- 17/11/2008: Opinion on the extension of the scope of the Deposit Guarantee Scheme
- 25/02/2009: Opinion on legislation to allow the Minister for Finance to direct the National Pensions Reserve Fund to invest in financial institutions as part of the recapitalisation of the banks
- 25/06/2009: Opinion on changes to financial support measures for credit institutions
- 31/08/2009: Opinion on the establishment of the National Asset Management Agency
- 09/11/2009: Opinion on the extension of the Irish State guarantee of certain liabilities of credit institutions
- 16/09/2010: Opinion on the extension of the Irish State guarantee of certain liabilities of credit institutions
- 02/11/2010: Opinion on the extension of the Irish State guarantee of certain liabilities of credit institutions
- 17/12/2010: Opinion on emergency stabilisation of credit institutions
- 26/04/2011: Opinion on recovery and resolution measures for credit institutions
- 09/09/2011: Opinion on new measures strengthening supervision and enforcement in financial regulation
- 21/10/2011: Opinion on recovery and resolution measures for credit institutions
- 07/11/2011: Opinion on the extension of the Irish State guarantee of eligible liabilities of credit institutions

- 16/07/2011: Opinion on new measures strengthening supervision and enforcement in financial regulation
- 29/11/2012: Opinion on the extension of the Irish state guarantee of eligible liabilities of credit institutions

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