Rating Action: Moody's downgrades Ireland to Baa1 from Aa2; outlook negative

17 Dec 2010

Frankfurt am Main, December 17, 2010 -- Moody's Investors Service has today downgraded Ireland's foreign- and local-currency government bond ratings by five notches to Baa1 from Aa2. The outlook on the Baa1 rating is negative. Today's rating action concludes the review for possible downgrade that Moody's had initiated on 5 October 2010.

Today's rating action is in line with the guidance that Moody's gave in a comment published on 22 November 2010, in which the rating agency indicated that the most likely outcome of the rating review would be a multi-notch downgrade that would leave Ireland's rating within the investment-grade category.

The key drivers for today's rating action are:

1. the crystallization of bank related contingent liabilities;

2. the increased uncertainty regarding the country's economic outlook; and

3. the decline in the Irish government's financial strength.

Moody's negative outlook on the ratings of the government of Ireland is based on our forward looking view on the risk that the Irish government's financial strength could decline further if economic growth were to be weaker than currently projected or the costs of stabilizing the banking system turn out to be higher than currently forecast.

Moody's has today also downgraded Ireland's short-term issuer rating to Prime-2 (commensurate with a Baa1 debt rating) from Prime-1. Ireland falls under the Eurozone's Aaa regional ceilings for bonds and bank deposits, which are unaffected by the Irish government's downgrade.

In reaching this decision Moody's notes that the economy's competitiveness and its business-friendly tax environment are credit-positive. The labour market's flexibility is reflected by the considerable wage adjustment that occurred in the course of the crisis. Moreover, recent economic information, in particular healthy export data are factored in to our conclusion.

In a related rating action, Moody's has also downgraded by five notches to Baa1 from Aa2 the rating of Ireland's National Asset Management Agency (NAMA), whose debt is fully and unconditionally guaranteed by the government of Ireland. The rating was also placed on review for possible downgrade on 5 October 2010. The outlook on the NAMA rating is negative, in line with the government bond ratings.

For a more detailed analysis of today's rating action on Ireland, please refer to Moody's Special Comment entitled "Key Drivers of Moody's Decision to Downgrade Ireland to Baa1 from Aa2," which is available on www.moodys.com.

RATIONALE FOR DOWNGRADE

"Firstly, Ireland's sovereign creditworthiness has suffered from the repeated crystallization of bank related contingent liabilities on the government's balance sheet", says Dietmar Hornung, Vice President -- Senior Credit Officer at Moody's Investors Service and lead analyst for Ireland. Further to recent announcements, the Irish government has now committed to injecting around EUR50 billion of capital into its banking sector -- an amount that represents approximately 32% of GDP. Moody's observes that, in the weeks prior to the announcement of the EUR85 billion EU/IMF support package, the problems in the Irish banking sector once again became acute as confidence in and funding of Irish banks evaporated in conjunction with the expiry of the original government guarantee.

"Secondly, the increased uncertainty regarding the outlook for the Irish economy -- an additional determinant of today's rating action -- is the result of the continued severe downturn in the financial services and real estate sectors as well as the ongoing contraction in private sector credit," explains Mr. Hornung. The uncertain economic prospects are amplified by the required fiscal austerity programme, which is likely to weigh on domestic demand. Moreover, the announced EUR15 billion (approximately 9.5% of GDP) reduction in net expenditure over the next four years to reduce the general government budget deficit to 3% of GDP represents a further considerable drag on the country's recovery prospects. Indeed, the EU has acknowledged Ireland's uncertain economic outlook by extending by one year to 2015 the timeframe within which the country has to achieve the 3% general government budget deficit target.

Thirdly, against the backdrop of the crystallization of bank contingent liabilities and the uncertain economic outlook, Ireland's government financial strength has deteriorated significantly. "Taking account of Ireland's subdued growth in the coming years, compliance with the budget targets embedded in the country's five-year fiscal plan and plausible additional bank recapitalization needs, Moody's now expects Ireland's debt ratio to increase to 120% in 2013 from 66% in 2009 before levelling off," says Mr. Hornung. When including the government-guaranteed NAMA debt, Moody's expects the ratio to peak at 140%.

"However, there are a number of reasons why Ireland's rating remains within the investment-grade category," explains Mr. Hornung. Ireland's commitment to fiscal consolidation and structural reforms is impressive, as represented by the four-year fiscal plan and the budget 2011. Ireland also benefits from significant economic and financial integration with Europe, supporting two-way trade and attracting foreign direct investment (FDI) both from EU countries as well as from non-EU corporations that seek access to the EU market by investing in locally based facilities. Moreover, as an EMU member, Ireland can rely on the availability of substantial external support -- as illustrated by the EU/IMF package -- a feature that supports the credit.

Taken Ireland's economic adjustment capacity into account, Moody's believes that, after a period of prolonged retrenchment, Ireland's long-term potential growth prospects remain higher than those of many other advanced nations. While the government's debt-to-GDP burden is expected to be high by EU standards, Ireland has managed high levels of indebtedness in the past, and has shown political cohesion and commitment to enacting difficult fiscal consolidation measures. Furthermore, the government is making considerable investments in its banking system that might ultimately generate income than can be used to help service its debt.

TRIGGERS FOR A POTENTIAL FURTHER RATING DOWNGRADE

Should Ireland's adjustment capacity prove to be insufficient to stabilize debt metrics in the foreseeable future, a further rating downgrade would follow. Moody's will closely monitor the specific measures taken by the government as part of the fiscal consolidation plan. Moreover, a severe deterioration in the country's debt metrics in the event of ongoing support needs for the banking system would exert further downward pressure on the rating. Finally, Moody's will also be monitoring the evolution of plans for the long-term support mechanism under discussion within the EU to determine whether there are any developments that might undermine its external support assumptions.

TRIGGERS FOR A POTENTIAL RATING UPGRADE

Although a positive development is unlikely in the near future, Moody's notes that the outlook on the government's Baa1 bond ratings could stabilize if the country embarks on a sustained consolidation path -- possibly supported by a resumption of economic growth -- that would stabilize government financial strength on a lasting basis.

PREVIOUS RATING ACTION AND METHODOLOGIES

Related Issuers

Allied Irish Banks, p.l.c.

Bank of Ireland

Bank of Scotland (Ireland) Limited

EBS d.a.c.

ICS Building Society

Related Research

Credit Opinion: National Westminster Bank Plc: Update following affirmation

Credit Opinion: Bank of Ireland Group plc: Update following rating action

Credit Opinion: AIB Group plc: Update following rating action

Credit Opinion: Permanent TSB Group Holdings plc: Update following placement of ratings under review for upgrade

Credit Opinion: Government of Ireland – A1 positive: Update following rating upgrade to A1, outlook remains positive

Moody's last rating action affecting NAMA was implemented on 5 October 2010, when the ratings agency placed the senior unsecured debt issued by NAMA, which is backed by a full guarantee from the Irish government on review for possible downgrade. Prior to that, Moody's last rating action on Ireland was taken on 19 July 2010, when the rating agency downgraded the government-backed debt to Aa2 and assigned a stable outlook.

The principal Moody's rating methodology used in this rating was "Sovereign Bond Ratings", published in September 2008 and available on www.moodys.com.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings, parties not involved in the ratings and public information.

Moody's Investors Service considers the quality of information available on the issuer or obligation satisfactory for the purposes of maintaining a credit rating.

The rating has been disclosed to the rated entity or its designated agents and issued with no amendment resulting from that disclosure.

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Please see the Credit Policy page on Moodys.com for the methodologies used in determining ratings, further information on the meaning of each rating category and the definition of default and recovery.

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