Explaining Standard & Poor's Adjustments To Ireland's Public Debt Data

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Standard & Poor's Ratings Services' analysis of the fiscal cost of the official support for the Irish banking system, as well as what we view to be the country's lower GDP growth prospects, has put the Republic of Ireland's long-term rating under downward pressure since January 2009. We have increased our estimate of the cumulative total cost to the Irish government of providing support to the financial sector from about ?80 billion to ?90 billion. This commentary explains Standard & Poor's treatment of the most significant financial system support measures in our calculations of gross and net general government debt and how and why it differs from the Irish government's accounting treatment (see table 1).

Table 1

Indicative Comparisons Of Irish Government And Standard & Poor's 2010 Projections For Gross And Net General Government Debt

2010, % GDP	Irish government*	Standard & Poor's estimates?
Gross general government debt	77.9	128.6
Of which related to National Asset Management Agency securities issued	0.0	25.6
Of which related to our estimate of the government's recapitalization costs in 2010	0.0*	23.0
General government assets?	31.7	27.4
Of which cash balances	17.7	17.7
Of which National Pension Reserve Fund	14.0	14.0
Of which adjustment for government shareholdings in Bank of Ireland and Allied Irish Bank	N/A	(4.3)
Net general government debt	46.2	101.2

*December 2009 Stability and Growth Programme. Standard & Poor's expects the government to incorporate an estimate of recapitalization costs when it next updates its forecast. ?As of Aug. 24, 2010. ?Based on a 2009 estimate of general government assets, because the Irish government does not publish forecasts for these variables. N/A--Not applicable.

We understand the differences to include:

- Standard & Poor's incorporates obligations of the National Asset Management Agency (NAMA; AA-/Negative/A-1+, see "**Ireland National Asset Management Agency (NAMA) Assigned 'AA/A-1+' Issuer Ratings; Outlook Neg; NAML Notes Rated 'A-1+'**", published on June 21, 2010) and its subsidiary companies in Ireland's gross general government debt, while the Irish government excludes them.
- When calculating net general government debt, Standard & Poor's subtracts what it considers to be the government's cash and cash-equivalent assets, but not the estimated value of NAMA assets.
- The Irish government's latest forecasts do not include an estimate of the impact of expected recapitalization costs on the government's deficit and debt burdens. However, recent decisions by Eurostat, the EU's statistical agency, suggest that the Irish government is likely to incorporate such an estimate when it next updates its forecast.

Our estimate of the cumulative total cost to the Irish government of providing support to the financial sector now stands at ?90 billion (58% of 2010 GDP, see "**Republic of Ireland Long-Term Rating Lowered To 'AA-' On Higher Banking Sector Fiscal Costs; Outlook Negative**," published on Aug. 24, 2010). This incorporates two components: the upper end of our estimate of the cost to the Irish government of injecting capital into the banks and our expectation with regard to the liabilities incurred by the government through its purchase of assets from the banks.

We estimate the Irish government's cumulative recapitalization costs could reach ?45 billion-?50 billion (29%-32% of 2010 GDP). We also estimate that the Irish government will incur further liabilities of around ?40 billion by offering guarantees on securities issued through NAMA in exchange for bank assets. We treat this debt as a direct liability of the Irish government, rather than a contingent liability, as we view NAMA as a branch of the Irish government providing direct support to the Irish banking system.

We understand that NAMA has been organized in such a way as to keep it off the Irish government's balance sheet under Eurostat's accounting rules. We take a different approach and have treated similar off-balance-sheet arrangements to support national financial systems in other countries as direct obligations of the government. For example, our estimate of the debt we expect to be issued by the Fondo de Reestructuraci?n Ordenada Bancaria (AA/Negative/A-1+) in Spain (AA/Negative/A-1+) adds 3% of GDP to our estimate of the Spanish government's gross general government debt. Similarly, the Cypriot government's scheme to provide liquidity to local banks by

Economic Growth Potential," published March 30, 2009). We include these estimates in Ireland's gross general government debt burden because we assume that the government will be creating new financial obligations by providing this support.

NAMA Debt

The face value of the total loan assets we expect NAMA to acquire is about ?80 billion. However, NAMA is acquiring these loans at a significant write-down and the impact on the banks' respective balance sheets will likely be offset in part by the Irish government injecting capital into the banks transferring loan assets to NAMA. A haircut of 52% has been applied by NAMA to the first two tranches of loans it has acquired (as of August 2010). The first two tranches represented 34% of our expectation regarding total NAMA-bound loans.

We do not expect the level of impairment on future tranches to be as severe. As a result, we have only slightly increased our estimate of the average haircut likely to be applied to the aggregate portfolio to 46% from 45%. In turn, our estimate of NAMA debt issuance has decreased to ?40 billion from ?43 billion. We have adjusted this amount to take account of the fact that 5% of NAMA's payment to the banks is intended to be in subordinated debt that has no recourse to the government. NAMA's own business plan applies a discount of 50% on the nominal amount of loans it expects to be transferred from the banks.

NAMA Assets

When Standard & Poor's assesses a sovereign's fiscal flexibility, one of the key variables it analyzes is the general government net debt burden (see "**Sovereign Credit Ratings: A Primer**," published on May 29, 2008). However, in contrast with conventional measures of net debt--as calculated, for example, by national governments, the EU, or the International Monetary Fund--we deduct only those assets which we believe to be equivalent to cash.

In our view, the loans that NAMA is acquiring have limited liquidity and cannot readily be sold in the near term. NAMA applied a haircut of 52% to the nominal value of the first ?27 billion in assets it acquired from the banks. We view these loans as having value, and as recoveries occur in the medium term we expect them to be available to pay down general government debt. However, based on the information available to us, we would not expect recoveries to amount to much more than ?16 billion (10% of GDP) over the time frame that our ratings address. As and when recoveries on NAMA's assets materialize, we may revise our forward-looking estimates of Ireland's gross and net general government debt.

Republic of Ireland Government Assets

Our measure of Ireland's government assets in 2009 includes approximately ?26 billion (16% of GDP) in government deposits at the central bank, around ?2 billion (2% of GDP) in government deposits at other banks, and ?15 billion (10% of GDP) related to assets held by the National Pension Reserve Fund (NPRF). This fund supports the government's move from a fully pay-as-you-go to a partly prefunded public pension system.

We have subtracted NPRF's 2009 investment of ?7 billion in Bank of Ireland (A-/Stable/A-2) and Allied Irish Banks PLC (A-/Negative/A-2) bank shares from our estimate of its liquid assets. In our view, the Irish government is unlikely to be able to divest these shares in the near term, and so we view them as illiquid assets.

Promissory Notes

The Irish government injected capital into Anglo Irish Bank Corp. Ltd. (BBB/Watch Neg/A-2) and Irish Nationwide Building Society (not rated) in 2010 in the form of nonnegotiable promissory notes. Although these recapitalization amounts do not require market funding, they do increase the general government debt.

Related Criteria And Research

- **Republic of Ireland Long-Term Rating Lowered To 'AA-' On Higher Banking Sector Fiscal Costs; Outlook Negative**, Aug. 24, 2010
- **Ireland National Asset Management Agency (NAMA) Assigned 'AA/A-1+' Issuer Ratings; Outlook Neg; NAML Notes Rated 'A-1+'**, June 21, 2010
- **Criteria For Determining Transfer And Convertibility Assessments**, May 18, 2009
- **Rating Sovereign-Guaranteed Debt**, April 6, 2009
- **Sovereign Credit Ratings: A Primer**, May 29, 2008
- **Enhanced Methodology And Assumptions For Rating Government-Related Entities,** June 29, 2009
- **Republic of Ireland 'AA/A-1+' Sovereign Ratings Affirmed; Outlook Remains Negative,** April 8, 2010
- **Republic of Ireland 'AA/A-1+' Sovereign Ratings Affirmed; Outlook Negative,** Dec. 18, 2009
- **Ireland Rating Lowered To 'AA' On Potential Fiscal Cost Of Weakening Banking Sector Asset Quality; Outlook Negative,** June 8, 2009
- **Republic of Ireland Rating Lowered To 'AA+'; Outlook Negative On Public Finance Concerns And Economic Growth Potential,** March 30, 2009
- **Republic of Ireland Outlook To Negative On Concerns About Public Finances; Ratings Affirmed,** Jan. 9, 2009

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