

## ***Irish Banks***

The Irish economy is in a mess and, with Poland, Greece and Spain is now one of Europe's 'PIGS' economies. It is now mentioned in the same breath as Latvia and is described by the EU as having 'excessive government deficits'. EU forecasts are that the deficit in Ireland will be 11% of GDP this year, the Economist (27th February 2009) quotes a Budget deficit of 10% for this year (EU 'rules' are that this should not exceed 3%) – to put that in perspective, the forecast for Spain's deficit is 6.2% and Portugal's is 4.6%.

This has potential problems for investors throughout the EU (and beyond) who flocked to the Irish Banks when their Government announced a 100% guarantee on all deposits held with Irish Banks. It seems likely that Ireland may have intended to guarantee existing deposits and did not anticipate the rush of depositors into their banks.

Even the Post Office (which has Bank of Ireland as its supplier of banking products) has announced that its depositors are now covered by Ireland's banking guarantees rather than the FSCS which, on the surface, offers a lesser guarantee capped at £50,000.

Depositors with UK banks take heart from the apparent fact that the UK Government will never let a UK bank collapse and there is an implicit belief that the Government would bail out every UK bank were it to become necessary. So the rush from the UK to Ireland does seem a little strange.

The UK economy is, however, healthy compared to that of Ireland so there is some concern over how much 'credit' can be given to the Irish guarantee. The cost of insuring against a total loss on Irish Sovereign debt recently reached 3.5% - that's £3.50 to safeguard a £100 investment. Two years ago the cost would have been just 10p. Ireland is currently paying 2% more to borrow than Germany and it is expected that its bonds will lose their AAA rating within (estimated) the next 12 to 18 months. Moodys recently changed their outlook on Irish debt from 'stable' to 'negative'.

Ireland was the first European economy to move into recession, it has been hit by an enormous drop in house prices (to be fair these were definitely over valued as part of the general over enthusiasm generated by 10 years of boom on the part of the Celtic Tiger) and job losses seem to have been announced in pretty much every sector. Ireland has two major trading partners – the UK and the US and both have followed Ireland into recession. January saw Ireland move into deflation with inflation running at minus 0.1% and public sector pay cuts (a pension levy of anything from 6% to 9%) have now been announced as part of a 5 year 'austerity' package – not that the present government is expected to last 5 years. Core to the package are significant tax increases which fly in the face of the generous tax regime introduced in Ireland as part of its dramatic growth plans and which have made it a very attractive centre for the international arms of many UK insurance companies.

Ireland's economic boom was largely fuelled by construction and property inflation. The collapse of these sectors is what has hit their banks which had little exposure to the US toxic debt market.

There seems little likelihood of Ireland's economic plight improving in the next 12 months according to most analysts. The positives for the Irish Economy are that it has relatively little debt and there is a healthy surplus in its, funded, pension fund. The pension fund has already provided the 7 billion bailout package made available to Irish banks earlier in the year.

However, as we have seen with Iceland, the world is not ready to see any economy collapse. The IMF has bailed out Iceland and it is rumoured that the ECB has already developed plans to help Ireland should that become necessary. German Finance Minister Peter Steinbrück is on record as saying (Feb 17th 2009) that Ireland may need assistance from other members of the euro zone. CB President Jean-Claude Trichet has (Feb 19th 2009) stated that Ireland is not 'the weak link of the euro area and there is no weak link in the euro area' so it seems likely that the Eurozone will stand behind and member country perceived to be in trouble.

The Observer (22nd February) reports that if a European Union member country did 'go bust' the European Central Bank would be prohibited from providing loans or financial support to that country – this would not prevent pre-collapse support. The same article includes a statement from a spokesman for the EU Economic and Monetary Policy Affairs commissioner, Joaquin Almunia. He refused to comment on whether the EU had drawn up plans to deal with the financial collapse of a member state but added that he believed there was almost zero risk of any country leaving the Euro – which is pretty much the only route a member state would have to regain control of its own economy. The collapse of Ireland would thus cause grave damage to one of the world's major currencies and it seems highly unlikely that the IMF would fail to act – having already propped up Iceland, Hungary and Latvia in recent months.

At this stage it is unlikely that Ireland will be allowed to collapse but there are no guarantees on this. Concerned depositors who do not face penalties on withdrawal may be better off moving their deposits to the UK.