Goodbody STOCKBROKERS

Ireland

Irish Economic Commentary

Recovery in sight

- **Another upgrade -** Prospects for a recovery in the Irish economy have improved over recent months. While we entered 2009 with uncertainty as to the extent of the likely economic contraction, focus has now turned to what trajectory the economic recovery will take on. We are more confident that a recovery is indeed on the way, which will be led by an improvement in exports. This is reflected in our further upgrade in this note; we now expect GDP to contract by 1.1% in 2010 (previously -3.7%), before expanding by 2.4% in 2011 (previously 1.2%).

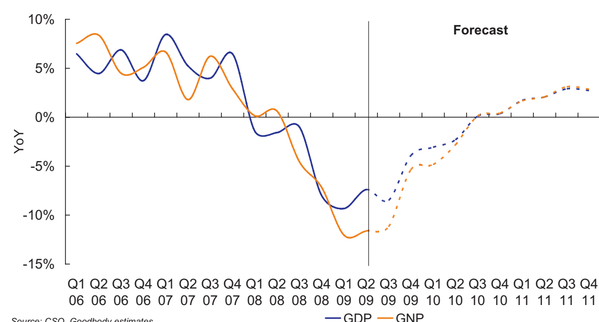
- **Not a V-shaped recovery -** Fiscal consolidation and deleveraging, though, will continue to be a drag on domestic momentum in the coming years. Fiscal tightening of 3% of GDP is pencilled in for 2010 and 2011, while the unravelling of high private sector debt levels will be a slow process. Private sector debt levels are forecast to increase to 225% of GDP in 2009, and are unlikely to fall below 200% until 2012. Given that Ireland is one of the most indebted economies in the developed world, by definition, it has benefited most from the collapse in interest rates. This benefit will not be repeated and will instead act as a drag on businesses and consumers going into 2011 in particular.

- **Are household debt levels sustainable? -** We repeat an analysis of household debt in this note that we originally undertook back in 2005. Despite household debt levels increasing further over the past few years (to 175% of disposable income), our original thesis remains the same: Irish households are better able to sustain higher debt levels due to a younger population and low interest rates, but high debt levels increase the sensitivity of Irish households and the economy overall to interest rate changes, both on the way up and the way down.

- **An average banking crisis? -** Analysis of previous banking crises in developed economies since 1970 suggests that a quicker resolution reduces the overall net cost to the state. While the domestic banking crisis will lead to a net cost, this principle should be followed to minimise the fiscal damage.

- **Progress being made on the fiscal situation -** The budget deficit is likely to remain high in the coming years and we do not believe that the Government will reach its target of hitting the 3% of GDP deficit by 2013. Despite this, we have become more confident about the outlook for the sovereign over recent months. Government bond yields are down, policies have been put in place for resolving the banking crisis, a budget consolidation plan has been drawn up, funding is complete for this year and has begun for 2010 and recent rhetoric suggests that more focus is going to be placed on expenditure cuts in the coming Budget rather than further damaging tax increases. Risks remain but the outlook has brightened considerably.

Worst of recession has passed, growth in H2 2010

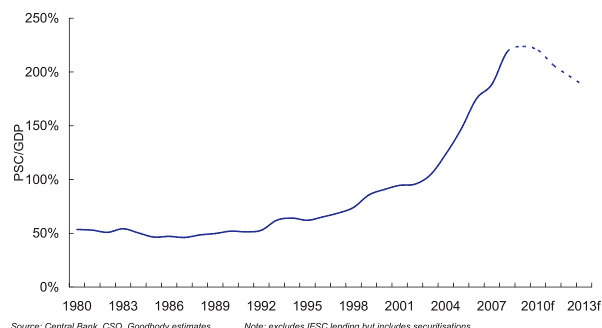


Source: CSO, Goodbody estimates

Irish Growth Aggregates

	2008	2009f	2010f	2011f
Consumption	-1.0%	-7.5%	-2.0%	1.0%
Government	2.6%	-0.6%	-2.5%	-2.5%
Investment	-15.5%	-32.4%	-19.8%	3.3%
Domestic Demand	**-4.6%**	**-12.3%**	**-5.3%**	**0.6%**
Exports	-1.0%	-2.0%	1.5%	3.0%
Imports	-2.1%	-7.5%	-2.8%	0.9%
GDP	**-3.0%**	**-7.4%**	**-1.1%**	**2.4%**
GNP	**-2.8%**	**-10.5%**	**-1.3%**	**2.5%**

Deleveraging will be a slow process - Credit/GDP



Source: Central Bank, CSO, Goodbody estimates *Note: excludes IFSC lending but includes securitisations*

Economist: **Dermot O'Leary** T *+353-1-641-9167* E *dermot.c.oleary@goodbody.ie*
Economist: **Deirdre Ryan** T *+353-1-641-6005* E *deirdre.a.ryan@goodbody.ie*

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KEY THEMES

Improving global prospects spurring a recovery

- Despite being in recession, prospects for a recovery in the Irish economy have brightened significantly in recent months for a number of reasons. First and foremost, the international economy has stopped contracting and is now in a recovery phase. Doubts still linger about its sustainability, but there is no doubt about its current momentum.

- Secondly, we are encouraged domestically that banking sector reforms continue to advance, with the transfer of assets over to NAMA now imminent. Risks surrounding the Irish sovereign have also diminished recently due to an increase in global risk appetite and domestic progress on fiscal consolidation. In addition, a broad range of indicators have pointed to an easing in the pace of recession domestically. In all, we are more confident that a recovery is indeed on the way, both globally and domestically.

Growth to resume in H2 10...

- For these reasons, we have adjusted our economic growth projections upwards once again in this Commentary. These forecast upgrades mainly stem from the improvement in the international economy, which will feed through to higher Irish exports over the coming two years, relative to our previous expectations. We are also making slight changes to our domestic demand projections on the back of this improved international backdrop. We now expect GDP to decline by 1.1% in 2010 (previously -3.7%) with GNP to decline by 1.3% (previously -3.8%). We expect the Irish economy to grow sequentially in the second half of 2010, before GDP expands by 2.4% in 2011 (previously 1.2%). GNP is expected to increase by 2.5% in 2011 (previously 1.2%).

- In comparison with most developed economies, Irish exports held up very well over the past 12 months in the face of the biggest global recession since the second World War. This is due to the composition of Irish exports, with 50% of merchandise exports in the pharmaceutical area. With the recent improvement in global economic activity, this gives us confidence that exports will grow next year, while imports will continue to contract due to the still weak domestic demand environment. We expect exports to grow by 1.5% in 2010 and 3% in 2011 (previously -0.6% and 2.1%). With imports expected to fall by 2.8% in 2010 and grow by a modest 0.9% in 2011 (previously -3.1% and 0.3%), net exports will make a significant contribution to Irish economic growth.

...but be wary of the domestic drags

- We also feed through some of the benefits, such as employment and investment, of a better international environment into domestic demand projections. However, we are still very aware of the domestic drags of budget consolidation and deleveraging. The former will take €4bn out of the economy in the next two years, equivalent to c.3% of GDP. With employment and earnings in decline, we believe that consumption will decline further in 2010. However, we now expect a decline of 2% (previously -3%), with an increase of 1% expected in 2011 (previously -0.4%), mainly on the back of a fall in the savings ratio in that year. Investment is expected to decline a further 20% in 2010 (previously -23%) before growth of 3% in 2011 (previously 2%).

Progress being made on fiscal & banking problems

- With Government estimates now available on the amount of bonds that will be issued to the banks in exchange for a large proportion of their property and development loans, it is possible to come up with an estimate of the fiscal cost of the banking crisis. We would warn, however, that the uncertainty around the net cost of these measures is huge, given that NAMA is likely to have a life of up to ten years or possibly more. The net cost may come to 6% of GDP. Analysis of previous banking crises reveals that moving quickly to resolve the problems in the banking sector reduces its cost.

- Outside of the banking sector, Ireland is facing a series of very high budget deficits over the coming years. Our estimates suggest that the deficit will hit 12% of GDP this year. In recognition of the need to reduce this large deficit, the Irish Government has already begun the process of fiscal consolidation. It is clear that the budget consolidation will be a multi-year process. The Government plans to reduce the budget deficit to 3% of GDP by 2013. However, we feel that this target may prove to be overly ambitious. We put the budget deficit at 4.5% of GDP in that year, with the main areas of divergence lying in tax revenue projections. While the Irish Government has pledged to reduce the deficit to the Stability and Growth Pact limit of 3% of GDP by 2013, it should not be viewed as a disaster if this target is not met, as long as it is clear to the international markets that the Government is making real strides to solve its fiscal problems. Reducing the deficit to 4.5% from 12% three years earlier would confirm that willingness in our view and reduce the risks of a funding crisis as a result of loss of confidence in Ireland Inc.

Deleveraging will be a slow process

- Private sector debt levels in Ireland are now among the highest in the developed world. We estimate that the private sector debt/GDP ratio will rise to 225% this year, compared to 86% a decade ago. However, the process of deleveraging has now begun. Since its peak last November, outstanding credit has fallen by 3%. However, this is a very slow process, and we feel that it represents the most significant medium-term concern for the Irish economy, given that, by definition Irish households and business will have been the biggest benficiaries of the dramatic fall in interest rates over the past twelve months, but this will reverse, albeit slowly over the coming years. We assume that private sector debt/GDP ratio will fall to only 211% by the end of 2011.

- The banking sector is also closely linked into this deleveraging process. For the domestic financial system (domestic deposits and credit), the loan to deposit ratio rose substantially over the 2003-2008 period, mainly due to an increased dependence on interbank lending. The LDR rose from 150% to 250% over that time period. It is clear that this LDR will have to adjust downwards to more sustainable levels. It is difficult to know the appropriate level and the timescale that it will take, but if the LDR was to revert to close to the level pertaining before the boom, under the assumption of 5% per annum deposit growth, credit levels would essentially need to remain flat over that period.

Household interest burden has fallen dramatically

- Household debt now amounts to 175% of disposable income, up from 102% five years earlier. As a result, Irish households have become among the most indebted in the world. However, falling interest rates have helped greatly in the servicing of this debt more recently. Household interest payments totalled €9.3bn in 2008, but we estimate that this burden fell by €3.6bn in 2009. In other words, interest payments will command 6% of disposable income by the end of this year compared to 9.5% of incomes at the peak, representing a boost of 3.5% to disposable incomes in 2009 due to lower interest rates. From the peak, the household interest bill has fallen by €5bn, a drop of 37%. While little movement in official interest rates is anticipated for most of next year, beyond that, interest rates will be well on the way to returning to more normalised levels. As such, the interest burden is likely to tick back up slightly and we see it reaching 7.4% of disposable income in that year, while the increase in interest payments in 2011 will amount to 1.2% of disposable income. As such, payback for the current extremely low level of interest rates will begin in earnest in that year.

Falling interest costs for businesses amounted to 3% of GNP

- According to the monthly Central Bank statistics, total non-financial corporate debt amounted to €167bn in July 2009, representing a three-fold increase in only six years. However, despite rising spreads by financial institutions, interest rates are now at record low levels, aiding non-financial corporates in their ability to service these loans. Indeed, the net interest bill (annualised) has halved over the past twelve months, due to the combination of declining outstanding credit and interest rates. As a percentage of GNP, this amounts to 2.8%, illustrating the extent to which businesses have benefited from a cashflow perspective from these developments. However, from 4.2% of GNP in July 2009, the interest burden is expected to rise to 6% of GNP by the end of 2011, under our assumptions. This will contribute to a slow recovery in our view.

Household debt levels more sustainable than they first appear

- Mirroring the trend in Ireland, debt burdens have been on the rise internationally for most of this decade. We have repeated an analysis of international household debt levels that we originally completed back in 2005. Despite household debt levels having increased further over the past few years, our original thesis remains the same: Irish households are better able to sustain higher debt levels due to a younger population and low interest rates, but increasing interest burdens may become a drag as interest rates return to normal levels.

The other side of the household balance sheet

- At the end of 2006, total household assets amounted to €824bn, representing a 97% increase in value over the previous five year period. However, since that time Ireland has experienced significant wealth destruction. By the end of next year, asset values are set to amount to €654bn, a drop of 20% from the peak and close to levels last seen in 2004. This can be very much attributed to property, given Irish households' dependence on this source of wealth. By the end of 2010, we estimate the value of the housing stock will stand at €342bn, a drop of a third from the peak. Relative to disposable income, the value of Ireland's housing assets are expected to fall from 600% to 350% over the four year period 2006-2010. On a net basis, net assets will amount to 490% of disposable income on our estimates by next year, down from 737% at the peak.

IRELAND AT A GLANCE

	2008	*2009F*	*2010F*	*2011F*
Growth Components				
Consumption	-1.0%	-7.5%	-2.0%	1.0%
Government	2.6%	-0.6%	-2.5%	-2.5%
Investment	-15.5%	-32.4%	-19.8%	3.3%
Domestic Demand	-4.6%	-12.3%	-5.3%	0.6%
Exports	-1.0%	-2.0%	1.5%	3.0%
Imports	-2.1%	-7.5%	-2.8%	0.9%
GDP	-3.0%	-7.4%	-1.1%	2.4%
GNP	-2.8%	-10.5%	-1.3%	2.5%
Housing Statistics				
Completions	51,724	23,000	12,000	10,000
Average House Price (€k)	261,573	222,337	195,657	187,830
House Price Inflation (end-year)	-9.1%	-15.0%	-12.0%	-4.0%
Mortgage Credit Growth (end-year)	5.6%	-2.7%	-5.0%	-5.0%
Prices				
Consumer Price Inflation	4.1%	-4.3%	-0.9%	1.5%
Wage Inflation (GBS)	4.3%	-0.3%	-3.6%	-1.6%
Fiscal				
Exchequer Balance	-12,714	-22,310	-18,712	-14,827
Exchequer Balance / GNP	-8.2%	-16.3%	-14.1%	-10.9%
General Government Balance	-11854.8	-20022.4	-18866.0	-15054.0
GGB / GDP	-6.5%	-12.0%	-11.6%	-9.0%
Debt/GDP	42.2%	57.9%	72.2%	80.8%
Consumer Profile				
Employment Growth (end year)	-4.0%	-9.0%	-2.8%	1.1%
Employment Growth (Full-year average)	-1.1%	-8.4%	-4.7%	-0.5%
Unemployment Rate (end-year)	7.6%	13.3%	14.1%	13.1%
Debt/Disp. Income	175%	170%	164%	156%
Interest Rates (At year end)				
ECB	2.50%	1.00%	1.75%	3.00%
BoE	2.00%	0%-0.25%	2.50%	3.50%
Fed	0.50%	0%-0.25%	2.00%	3.75%
Trade				
Current Account (€m)	-8,375	-4,566	1,134	3,868
CA as a % of GNP	-5.4%	-3.3%	0.9%	2.8%
Exchange Rates (Average for the year)				
€/$	1.47	1.40	1.40	1.35
€/£	0.80	0.90	0.85	0.80

Main Forecast Changes

	2009F		2010F		2011F	
	New	Old	New	Old	New	Old
Consumption	-7.5%	-7.5%	-2.0%	-3.0%	1.0%	-0.4%
Government	-0.6%	-0.6%	-2.5%	-2.5%	-2.5%	-2.5%
Investment	-32.4%	-32.6%	-19.8%	-23.4%	3.3%	2.1%
Domestic Demand	-12.3%	-12.4%	-5.3%	-6.5%	0.6%	-0.5%
Exports	-2.0%	-2.1%	1.5%	-0.6%	3.0%	2.1%
Imports	-7.5%	-7.5%	-2.8%	-3.1%	0.9%	0.3%
GDP	-7.4%	-7.5%	-1.1%	-3.7%	2.4%	1.2%
GNP	-10.5%	-10.6%	-1.3%	-3.8%	2.5%	1.2%

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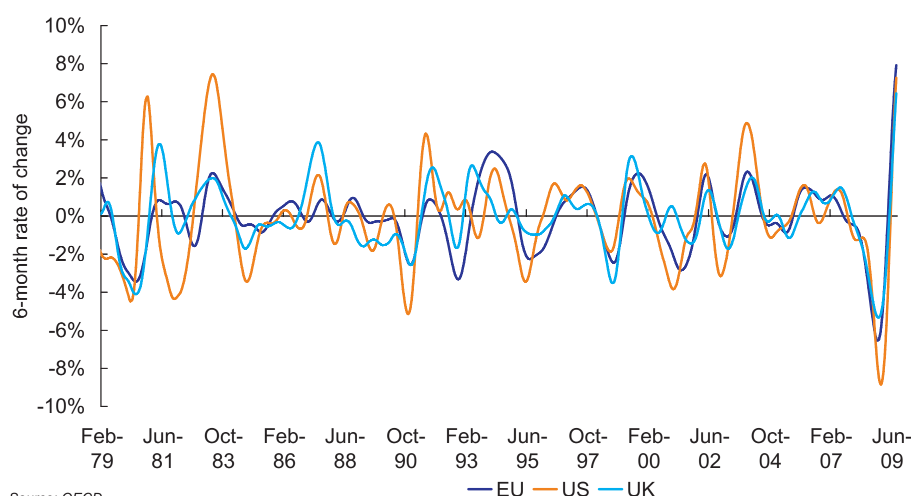
PAST THE WORST, BUT WHAT WILL THE RECOVERY LOOK LIKE?

Despite still being in recession, prospects for a recovery in the Irish economy have brightened in recent months for a number of reasons. First and foremost, the international economy has stopped contracting and is now in its recovery phase. Doubts still linger about its sustainability, but there is no doubt about its momentum. Recently, the IMF and the OECD both upgraded their economic projections. While the link between global trading patterns and the performance of Irish external trade has not proven to be very strong in the past, it does give us enough confidence to predict that we will now get modest growth in exports next year (as opposed to our previous expectation of a further decline). This improvement in global economic fortunes is clearly shown in the significant improvement in the OECD leading indicators for our three main trading partners in recent months.

Doubts still linger about sustainability of international recovery but no doubting the momentum...

OECD leading indicators



Source: OECD

...which has brought about improved prospects for Irish exports in 2010 and 2011...

...and is the central reason for upgrades to economic forecasts

Although Ireland is a very open economy and is influenced by global developments, it must be stressed that the recession in Ireland was not caused by global trading patterns. In fact, exports have held up remarkably well in Ireland as global trade has collapsed. We are taking the opportunity in this note to upgrade our views of the prospects for a recovery in Irish exports in 2010 and 2011, in line with signs of both a more vigourous recovery in the global economy and an improvement in the export orders components of domestic PMI surveys. This also has some positive implications for employment and investment. As a result, we now expect GDP to contract by 1.1% in 2010, before growing by 2.4% in 2011.

However, we believe that the shape of the recovery will be heavily influenced by developments in domestic demand. A collapse in domestic demand has been the cause of the recession in Ireland. After contracting by c.5% in 2008, domestic demand is expected to fall by a further 12% in 2009 and 5% in 2010, before growing modestly in 2011.

Trajectory of consumer spending will contribute to a slower recovery path for the domestic sector

The trajectory of consumer spending will play an integral role in the speed of the economic recovery in Ireland. In this note, we explain how consumer deleveraging and, in 2011, rising interest rates, will contribute to a rather slow recovery in consumer spending over the next two years, leading to a slow recovery path for overall domestic demand.

Recent Developments

Our Economic Commentaries over the past two years have had little in the way of positive trends to report on the prospects for the short-term. However, at last, there are now some more positive signs that we can point towards. As recently as June, we stated that the uncertainties around the Irish economy were as large as they have ever been. These uncertainties have been reduced significantly in the past few months:

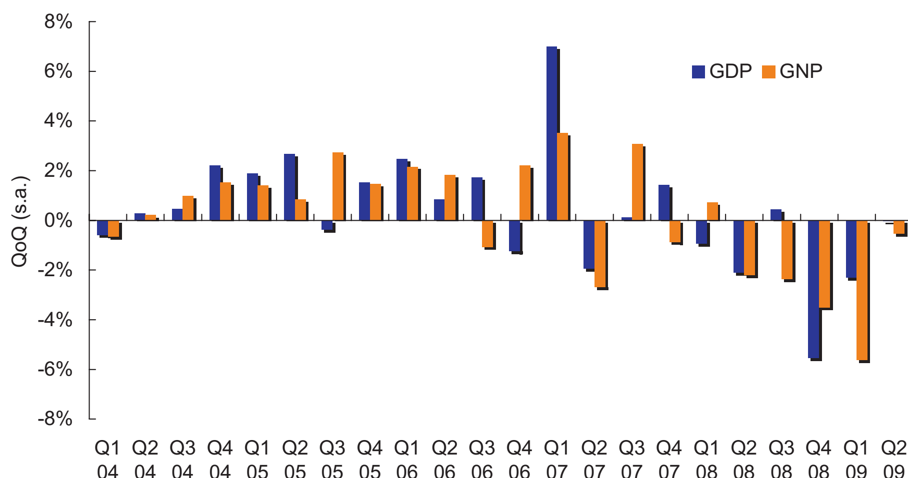
Many reasons to be more optimistic regarding Irish outlook

(1) ***More encouraging global recovery prospects:*** As detailed already, prospects for a global economic recovery have increased significantly over recent months, as economies have responded to an extraordinary degree of stimulus.
(2) ***Domestic banking sector reforms proceeding:*** the basic framework to restore confidence in the banking sector (NAMA) is now in place, with assets likely to move to the new agency imminently.
(3) ***Sovereign risk reduced:*** Sovereign bond spreads have reduced significantly in recent months (see page 22), while pre-funding for the Irish Exchequer has already begun for 2010.
(4) ***Ongoing progress in consolidation of public finances:*** Further progress has been made on the fiscal consolidation path with the identification of possible spending cuts and the Minister for Finance has made it clear that measures contained in Budget 2010 will focus on spending rather than tax increases (see page 18).
(5) ***Pace of recession easing domestically:*** Finally, a broad range of indicators have pointed to the view that the pace of the recession is easing. For example, after falling by 5.2% in Q1 on a seasonally-adjusted basis, consumption increased modestly on a quarterly basis in Q2. Investment spending followed a similar path in Q2, while survey indicators have bounced off their lows in recent months.

Quarterly economic growth can be volatile...

We would caution against concentrating too much on quarterly variations when looking at the Irish data, as it can be notoriously volatile. For example, according to the statistics from the CSO, GDP actually increased by 0.5% in Q3 08, after two consecutive quarterly declines. It subsequently declined for the next two quarters, before remaining flat in Q2 09. Seasonally-adjusted GNP growth is not as volatile, but this still declined by a further 0.5% in Q2, after falling by 5.6% in Q1. Taking the first half of the year combined, the decline in GNP was actually more than the decline in GDP.

Quarterly economic growth will continue to be volatile



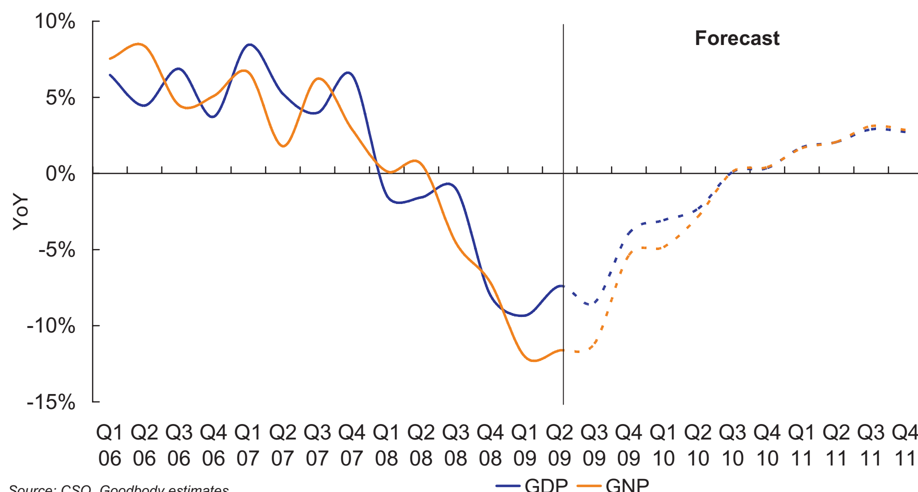
Source: CSO

...but worst of the annual contraction has already passed

Due to the scale of the downturn in Q4 08 and Q1 09, annual comparisons will start to improve in the next few months. As was the case in almost all developed economies, Q4 08 and Q1 09 represented the worst of the contraction in the Irish economy. For this reason, annual comparisons will continue to improve over the coming few months in particular.

Annual comparisons will improve in months ahead as Q4 08 and Q1 09 represented the worst of the contraction

Worst of recession has passed, growth in H2 2010



Source: CSO, Goodbody estimates

Short-term forecasts for the economy

Here is a brief synopsis of our views on the propects for the main economic aggregates:

Consumer spending – With somewhat of a divergence opening up in official forecasts on the Irish economy, it is important to know where these divergences lie. With consumer spending accounting for almost 60% of GNP, differences in views in this area are likely to play a role.

Collapse in car sales and increased savinsgs have had huge effect on consumer spending numbers...

Consumer spending growth troughed in Q1 at -10% yoy, mainly due to the collapse in car sales at the beginning of the year. Some of this was caused by a large spike in precautionary savings at the end of 2008 on the part of Irish consumers because of the large degree of uncertainty that prevailed at the time. Our forecasts suggest that the savings ratio rose to 11% in 2009, from 8% in 2008. Within our forecasts, we assume that the savings ratio falls in 2010 and 2011. However, at the same time, we are forecasting a fall in disposable incomes, for a number of reasons:

...while disposable income is set to decline next year, and there will be no added boost from further savings on interest costs....

(1) The increased income tax burden for the full-year as a result of Budget changes already introduced.
(2) A continued decline in employment.
(3) Falling wage rates in the private and public sectors.
(4) Possible reductions in welfare rates

Allied to these four issues, households received a boost equivalent to 3% of disposable income as a result of declining interest rates in 2009 that will not be repeated. In fact, as we address later in the report, rising interest rates will represent a drag on household disposable incomes in 2010 and 2011. We also discuss the dramatic falls in household wealth levels later in this note as a result of the collapse in the housing market. The following table shows the primary drivers of consumption growth, with forecasts up to 2011.

...making for a weak recovery in spending trends

Consumer spending & its drivers

	2007	2008	2009f	2010f	2011f
Real Consumption growth	5.9%	-1.0%	-7.5%	-2.0%	1.0%
Employment growth (full-year average)	3.6%	-1.1%	-8.4%	-4.6%	-0.5%
Employment growth (end-year)	2.9%	-4.0%	-9.0%	-2.7%	1.1%
Wage growth	5.4%	4.3%	-0.6%	-3.7%	-1.8%
Savings ratio	2.3%	7.6%	10.9%	10.1%	8.0%
Unemployment rate (full-year average)	4.6%	6.3%	12.1%	14.0%	13.8%
Unemployment rate (end-year)	4.2%	7.6%	13.6%	14.2%	13.3%

Source: CSO, Goodbody estimates

Funding outlook and scale of oversupply mean investment activity will be weak for a prolonged period

Investment – Construction spending accounts for the bulk of investment in Ireland and the visibility on this is quite decent. House completion forecasts stem from trends in housing starts, while it is clear that private non-residential construction will be weak for a prolonged period given the funding outlook and the scale of oversupply in the sector. We

Components of investment

	2007	2008	2009f	2010f	2011f
Investment	**2%**	**-16%**	**-32%**	**-20%**	**3%**
Construction	2%	-13%	-32%	-24%	-6%
Residential	-6%	-26%	-40%	-32%	-2%
Non-residential	20%	9%	-24%	-17%	-8%
Machinery & Equipment	14%	-15%	-19%	-7%	21%

Source: CSO, Goodbody estimates

also have a good idea of public spending on construction from the published Government spending plans. These all point to a significant decline. A bigger uncertainty surrounds investment in machinery and equipment. This can be heavily influenced by the timing of the imports of planes, but outside of these, we are anticipating a fall in business investment of 10% in 2010, followed by an increase in 2011 of 20%.

Government spending – With the clear stated preference of the Government to concentrate more on spending cuts going forward, this component of GDP is set for a decline over the coming two years.

Big uncertainty over net exports but resilence over recent quarters means outlook is promsing in the face of a global recovery

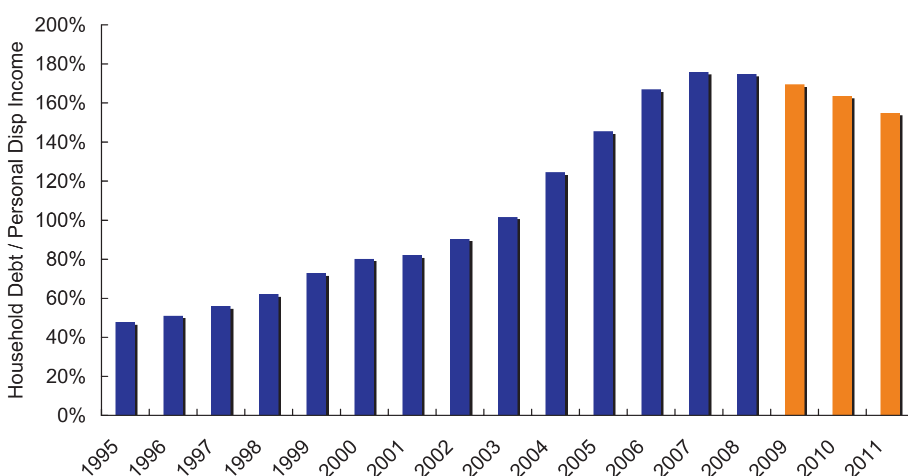
Net exports – This is where the biggest uncertainty exists in our view. There has been a notable resilience in Irish exports, but this also reveals that the types of goods that Ireland exports are largely insensitive to the economic cycle. The same should apply on the way up to, while domestic exporters are now at a significant disadvantage due to the rise in the value of the euro over the last two years. Nevertheless, we do believe that Ireland will reap some benefits from an improvement in the international economic environment and this is behind the reasons for our forecast upgrade in this note.

Analysis of debt levels - Public & Private

The setting up of the National Asset Management Agency (NAMA) is the biggest financial decision that the Irish state has ever made and will be a step-change in terms of debt levels in the private and public sectors. This note aims to put the recent trends in debt levels into context. Much focus has been placed on the extent of the fiscal crisis. This was for good reason, as ballooning budget deficits threaten the sustainability of Ireland Inc. However, progress continues to be made on this score, with the next part of the process being Budget 2010 in December. The key point here, though, is that the hysteria that existed at the beginning of the year has now abated for a number of reasons. There are still huge political and economic decisions to be made by the Government and progress needs to continue, but assuming these hurdles are negotiated successfully, Ireland's debt position at the end of the fiscal consolidation period will be in line with its international peers.

Huge political and economic decisions remain, but progress is being made

Household debt as a % of disposable income has peaked



Source: Central Bank of Ireland, Goodbody estimates

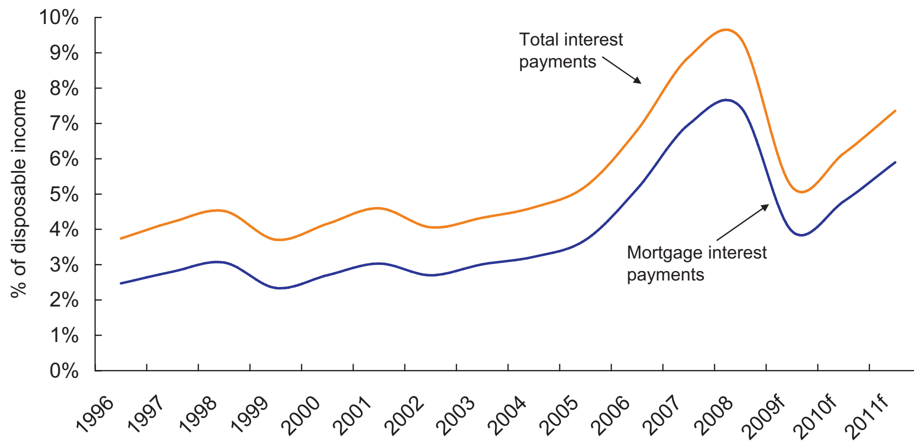
This analysis also includes the cost of the banking sector crisis resolution, where we estimate the gross cost will amount to €70bn, with the net cost possible totalling €9bn. Excluding NAMA, we estimate that the cost will come to €19bn, while the net cost will amount to €4.9bn. If this turns out to be the case, the cost will be far below the worst banking crises in developed economies in the past forty years. In fact, excluding NAMA, the costs would be substantially less than the average cost of resolving a banking crisis.

Our estimates on the fiscal cost of the banking crisis are substantially lower than the average cost of crisis resolution

The same cannot be said for private sector debt levels. Private sector debt currently amounts to 219% of GDP in Ireland, relative to 211% in the UK and 212% in the US. Even allowing for a reduction in credit outstanding over the next few years, we estimate that private sector debt levels will only fall to 206% in 2011. For households, the debt disposable income ratio hit 175% in 2008, and is expected to only fall very slowly to 155% by 2011. When we wrote about household debt levels back in 2005, we cautioned that more volatile economic cycles may lie ahead because of the increase in debt. This has indeed proved to be the case. However, by definition, Irish households have gained significantly from the fall in interest rates over the past twelve months. However, interest rates are obviously at emergency settings. The reversal of this policy will curtail any rapid improvement in consumer spending as we go into 2011.

Private sector debt levels among the highest in the world and, we believe, will be very slow to unwind from these highs

Reduction in household interest burden a temporary reprieve



Source: Goodbody estimates

IRISH DEBT LEVELS IN A NAMA WORLD

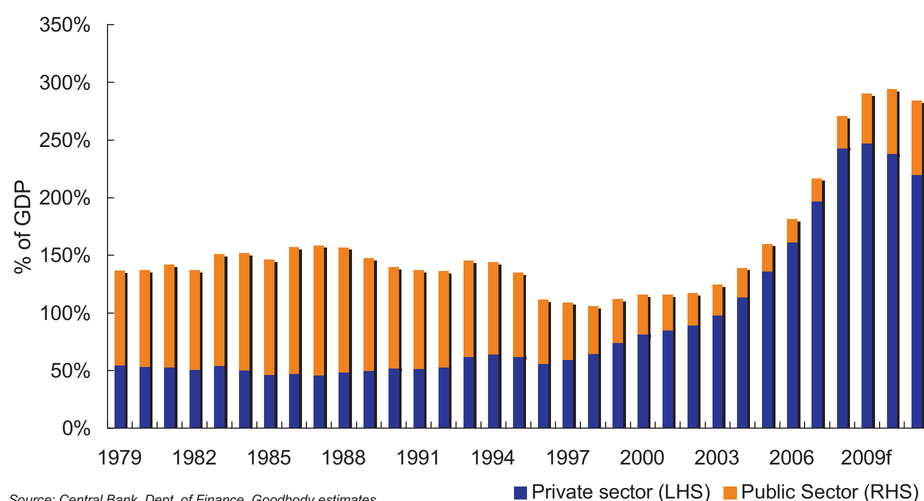
The Irish economy has had a mixed performance with debt levels over the past three decades. In the 1980s, private sector debt levels remained steady at close to 50% of GDP and were low by international standards. In the mid-1990s and particularly the first half of this decade, this ratio rocketed, and is estimated to peak at 233% of GDP by the end of 2009.

Public sector debt has been moving in the opposite direction to private sector debt levels for much of the last decade....

Public sector debt levels were going in the opposite direction for much of this period. For example, from 1984 to 1988, Government debt levels were above the 100% of GDP mark, but fell continuously throughout the 1990s and into the current decade. The chart below shows Exchequer debt, which fell to a trough of 20% of GDP in 2007. The more commonly used measure of Government debt (General Government Debt) fell to a low of 25% of GDP in that year. This public sector debt development was dwarfed by the explosion in private sector debt levels. Government debt levels, of course, are now on their way up again, while the slow process of deleveraging is in train in the private sector. The latter is not a process that can happen overnight and, in our view, represents the more significant medium-term issue for the Irish economy. This report aims to explain the sustainability of these levels of debt in the context of the setting up of the National Asset Management Agency and the fiscal crisis that the Government is now tackling.

...but both are now on a rising trend

Debt levels in Ireland - Private & Public



Source: Central Bank, Dept. of Finance, Goodbody estimates

Fiscal cost of NAMA & the Banking Crisis – Expensive but affordable

With Government estimates now available on the amount of bonds that will be issued to the banks in exchange for a large proportion of their property and development loans, it is possible to come up with an estimate of the gross cost of the banking crisis resolution. At the outset, we warn that the uncertainty around the net cost of these measures is huge, given that NAMA is likely to have a life of up to ten years or possibly more.

We now have a good sense of the gross cost of the banking crisis. The table below breaks down the costs and the likely repayments associated with the banking crisis resolution in Ireland. Costs are broken down between preference shares, recapitalisations and the estimated cost of the bank guarantee on Government debt issued over the period (which we have to make broad assumptions on, detailed below). Excluding NAMA, we estimate that this cost comes to €19bn, representing 11% of GDP.

Excluding NAMA, cost of fiscal crisis will be €19bn or 11% of GDP

Repayments include the income on the preference shares, the value of the warrants, the payments for the guarantee and the possible value of reselling the stakes. We would stress that there is a higher degree of uncertainty surrounding the estimates for equity injections into the non-quoted institutions involved in NAMA, due to the absence of information at this stage.

There will be repayments, however, and total net cost is set to amount to €9bn

Nevertheless, despite this high degree of uncertainty involved, we calculate that the total net cost of the banking crisis to the Government will come to €9bn, with the majority of the cost coming from equity injections, which will not be recouped (mainly Anglo Irish Bank) and the increased cost of Government debt issued over the period. This is made up of €70bn in gross cost and the recouping of €61bn. We must stress though that this is not including the Government-calculated Long Term Economic Value for the assets that are being transferred to NAMA.

Capital & commitments from the State to the financial sector (€m)

	AIB	BOI	Other NAMA institutions	Post NAMA total
	Jun-09	Mar-09	Various	
Preference shares	3,500	3,500	150	**7,150**
Equity capital	0	0	6,068	**6,068**
Possible equity capital if not available from private sources	1,270	705	200	**2,175**
Cost of guarantee*				**3,173**
Total (excl. NAMA)				**18,566**
NAMA bond payment				**51,300**
Total gross investment	**4,770**	**4,205**	**6,418**	**69,866**
Repayable	3,500	3,500	150	**7,150**
Income on preference shares	760	760	36	**1,556**
Resellable	1,270	705	200	**2,175**
Intrinsic value of warrants	762	950	0	**1,712**
Bank payment for guarantee (2 years)	350	350	300	**1,000**
Value of likely offsets (excl. NAMA)	**6,642**	**6,265**	**686**	**13,593**
Current value of assets				**47,000**
Value of likely offsets	**6,642**	**6,265**	**386**	**60,593**
Net cost (excl.NAMA)				**4,973**
Net cost pre long term economic value of NAMA assets & levy	**-1,872**	**-2,060**	**6,032**	**9,273**

Source: Company reports, Department of Finance & Goodbody estimates
**We make the assumption that 0.7% of the excess spread paid on Government bond issuance over the 2009/2010 period is due to the bank guarantee. It is not possible to separate the increased risk premium between increase debt and deficit levels and the banking sector issues.*

Just an average banking crisis?

Evidence from previous banking crises suggest that it is not just the cost of recapitalisations and guarantees that end up costing the State significant amounts of money. Depending on the success of the resolution of the banking crisis, a significant amount of the cost can stem from the overall damage done to the economy by not having a functioning banking sector. This is almost impossible to quantify, but the absence of a fully-functioning banking sector is likely to cost the Government significantly more than €9bn over the coming years. The following table illustrates that, based on our analysis of an IMF database on financial crises for developed economies, the gross cost of the resolution of the domestic crisis will match exactly the average for developed economies as a whole over the past forty years.

Gross cost of resolution of the crisis will match exactly the average for developed economies over the past forty years

Systemic Banking Crises in Developed Economies since 1970

Country	Systemic Banking Crisis (starting date)	Share of NPLs at peak (in %)	Fiscal Cost (gross, as % of GDP)	Output loss (IMF) (as % of GDP)	Minimum real GDP growth rate (in %)
Czech Republic	1996	18.0	6.8		-0.8
Finland	1991	13.0	12.8	59.1	-6.2
Hungary	1991	23.0	10.0		-11.9
Japan	1997	35.0	24.0	17.6	-2.0
Korea	1997	35.0	31.2	50.1	-6.9
Norway	1991	16.4	2.7		2.8
Slovak Republic	1998	35.0			
Spain	1977		5.6		0.2
Sweden	1991	13.0	3.6	30.6	-1.2
United States	1988	4.1	3.7	4.1	-0.2
Average		**21.4**	**11.2**	**32.3**	**-2.9**

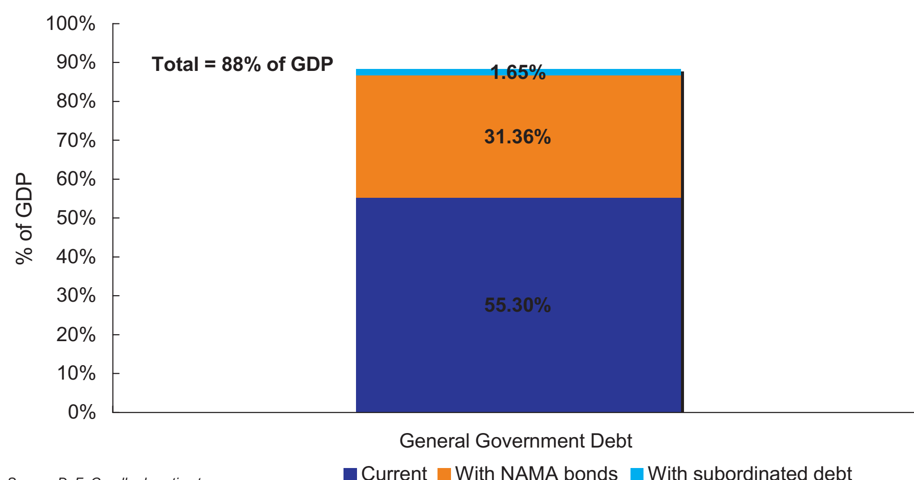
Source: Laeven and Valencia, 2008. "Systemic Banking Crises: A New Database", IMF Working Paper.

Effect of NAMA on Government debt levels

It is still uncertain as to whether these issued bonds will have to be included in the official estimate of Irish Government debt. This is awaiting a ruling from Eurostat. If the debt were to be included in the calculation of the National Debt, it would increase it by 33% of GDP. Nevertheless, it must not be forgotten that there is an asset that is being transferred in exchange for these loans.

Irish government is still awaiting a ruling from Eurostat regarding the inclusion of the NAMA bonds in the national debt calculation

Possible effect on Irish Government Debt Levels



Source: DoF, Goodbody estimates

Where are public debt levels heading in any case?

Outside of the banking sector, Ireland is facing a series of very high budget deficits over the coming years. Our estimates suggest that the deficit will hit 12% of GDP this year. In recognition of the need to reduce this large deficit, the Irish Government has already begun the process of fiscal consolidation. In the period from October 2008 to April 2009, the total package of spending cuts and tax increases amounted 6% of GDP in a full-year. Reports commissioned by the Government in relation to possible tax and spending changes have now both been published and will be an important input into the budget consolidation process. The following table illustrates the run of events over the past two years.

Budget consolidation package is in train, with measures totalling 6% of GDP implemented to date

Timeline of the Irish Fiscal Crisis

Date	Event
Jan-08	An Exchequer deficit of 1% of GDP is announced for 2007, the largest since 1996. The deficit is largely due to an underperformance from tax revenues.
Feb-08	Commission on Taxation is set up to redesign Ireland's tax system but also with the remit of "keeping the overall tax burden low".
Jul-08	Disappointing half-year Exchequer returns triggers an immediate review of expenditure options
Sep-08	With tax revenues falling by almost 10% and the deficit widening, the Government makes the decision to announce an early Budget
Oct-08	Emergency Budget for the first time since the 1980s. Tax-raising measures of € 2bn were introduced, but forecasts for a deficit of 6.5% of GDP in 2009 looked optimistic.
Jan-09	Government takes decision to nationalise Anglo Irish Bank. Subsequent recapitalisation will require more Government funds
Feb-09	Irish CDS and bond yield spreads balloon to record levels as perceived threat of default increases on international markets
Feb-09	Government imposes pension levy averaging 7.5% for public sector employees
Apr-09	Supplementary Budget takes place . Budget consolidation amounting to a full -year €5.4bn is announced, split 2/3 tax increases and 1/3 spending cuts
Jul-09	McCarthy report on possible areas of expenditure reductions released . It identifies € 5.4bn in spending reductions
Sep-09	Commission on Taxation report released.
Sep-09	Details of discount to loans being transferred to NAMA are announced . €54bn will be paid for €77bn book value of loans
Dec-09	Budget 2009 to be announced…

Budget consolidation a multi year process

It is clear that the budget consolidation will be a multi-year process. The Government plans to reduce the budget deficit to 3% of GDP by 2013. However, we feel that this target may prove to be overly ambitious. We put the budget deficit at 4.5% of GDP in that year, with the main areas of divergence lying in tax revenue projections.

We see deficit of 4.5% of GDP remaining by 2013...

Planned Fiscal Consolidation (€bn)

	2010		2011		2012	2013	Total
	First Year	Full Year	First Year	Full Year			
Taxation	1,750	2,500	1,500	2,100			**4,600**
Current Expenditure	1,500	1,500	1,500	1,500			**3,000**
Capital Expenditure	750	750	1,000	1,000			**1,750**
Unspecified					4,000	3,000	**7,000**
Total	**4,000**	**4,750**	**4,000**	**4,600**	**4,000**	**3,000**	**16,350**
% of GDP	**2.5%**	**2.9%**	**2.4%**	**2.8%**	**2.3%**	**1.7%**	**9.7%**

Source: DoF, Goodbody estimates

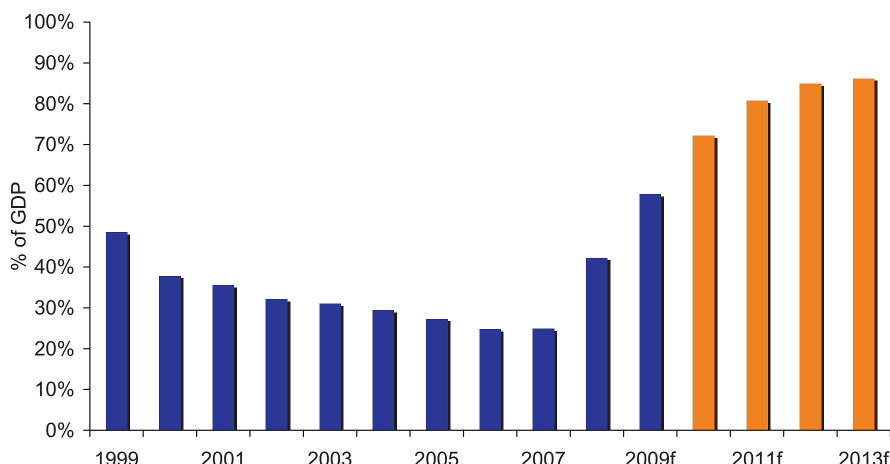
Not a disaster if target of 3% deficit target is not met by 2013

While the Irish Government has pledged to reduce the deficit to the Stability and Growth Pact limit of 3% of GDP by 2013, it should not be viewed as a disaster if this target is not met, as long as it is clear to the international markets that the Government is making real strides to solve its fiscal problems. Reducing the deficit to 4.5% from 12% three years earlier would confirm that willingness in our view and reduce the risks of a funding crisis as a result of loss of confidence in Ireland Inc. Moreover, with the vast majority of the members of the European Union now in breach of the rules under the Stability and Growth Pact, including some of the larger states, there is likely to be less pressure emanating from official European sources, in the short-term at least.

...although evidence of continued improvement is the most important element

However, the high deficits have led to a substantial increase in overall Government debt levels. On our forecasts, the general government debt level rises to 86% of GDP by 2013, from a trough of 25% in 2007. Importantly, given that trend nominal economic growth in Ireland is likely to be in the range of 4%-5%, the Debt/GDP ratio will fall as long as the deficit is below this level, which we expect from 2013 onwards.

General government debt level is set to hit 84% of GDP by 2013....



Source: Dept. of Finance, Goodbody estimates

This is clearly a substantial increase in the deficit over a short period of time, but the real question is whether debt at such a level is sustainable. On a comparative basis, projected Irish Government debt levels do not appear excessive. The European Commission forecasts that average general government debt levels in the euro-area in 2010 will be 84% of GDP, close to4 the expected level in Ireland (see table below).

...at which time it will be in line with average Eurozone government debt levels

Estimated 2010 General Government Debt Levels

	% of GDP
Italy	116
Greece	108
Belgium	101
France	86
Euro-area	84
UK	82
Portugal	82
EU	79
Germany	79
Austria	75
Ireland	73
Malta	69
Netherlands	63
Spain	62
Cyprus	48
Finland	46
Slovakia	36
Slovenia	35
Luxembourg	16

Source: European Commission, Goodbody estimates

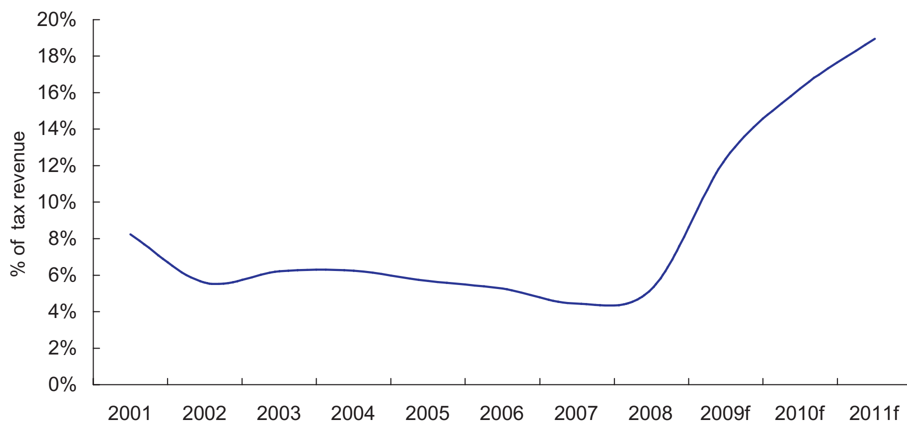
Sustainability of the debt depends on the interest rate environment

Interest on national debt will increase from 2.4% of GDP in 2009 to 5% of GDP by 2013...

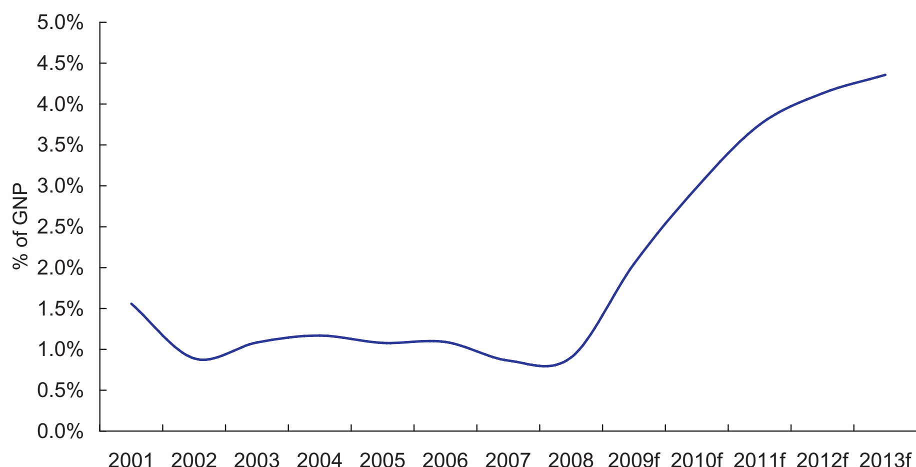
There are other ways of looking at public debt sustainability. One metric is assessing the interest component as a percentage of both tax revenues and GDP/GNP. These are shown in the following charts. In 2009, the interest cost on the national debt is expected to amount to 2.4% of GDP, but we expect this to double to 5.0% of GDP by 2013. The long-term average for metric is 5.6%, while in the 1980s, given the high funding costs and debt levels, interest payments on the national debt amounted to an average of 9.3% of GDP.

...although this is still below the highs of 9.3% of GDP seen in the 1980's

Debt repayments will take up a significant portion of the governement tax take



Source: Goodbody estimates



Source: DoF, Goodbody estimates

Tight rein will need to be kept on public finances, even beyond 2013...

Despite this, there are a number of reasons to suggest that the current level of interest burden is too high and must be reduced through putting a very tight rein on the public finances, even beyond 2013:

(1) The Irish Government now has a commitment, under the Stability and Growth Pact, to keep its deficit below 3% of GDP.

(2) In the 1980s, Ireland benefited from transfers from the EU in the form of structural funds. In the 1980s, these transfers amounted to 4% of GDP. These transfers have now, in the most part, ceased.

(3) Finally, high debt servicing costs will put significant constraints on public spending plans, given that debt servicing will account for fully 20% of total tax revenues by 2013.

This analysis confirms that while the debt level and the burden will remain below levels seen in the 1980s, funnelling resources towards the maintenance of such a high debt level necessitates reduced resources being channelled to other more productive areas of public spending.

Public debt crisis is still real, but has abated since the beginning of the year

...however, falling bond yield spreads reflect the progress that has been made thus far

The key point here is that there is still a clear need to address the deficit in the public finances and big decisions to make. However, significant progress has been made and this has been recognised in the international bond markets by the large fall in Irish bond yield spreads over recent months. Allied to that, funding concerns that were prevalent at the beginning of this year have now passed. Funding has already been completed for 2009 and the recent €7bn syndicated deal has got the ball rolling on funding for 2010.

Irish bond Auctions: Jan-Oct 09

Date	Maturity	Duration	Coupon	Amount raised €bn	Spread above bunds	Bid/Cover
08/01/2009	Jan-14	5-year	4.0%	6.0	1.71	N/A
25/02/2009	Mar-12	3-year	3.9%	4.0	2.51	N/A
24/03/2009	Nov-11	2-year	4.0%	0.4	2.23	3.8
24/03/2009	Apr-20	11-year	4.5%	0.9	2.82	2.7
21/04/2009	Jan-14	5-year	4.0%	0.3	1.89	1.6
21/04/2009	Oct-18	10-year	4.5%	0.8	1.78	1.1
19/05/2009	Jan-14	5-year	4.0%	0.3	1.21	4.8
19/05/2009	Jun-19	10-year	4.4%	0.8	1.63	1.8
16/06/2009	Mar-12	3-year	3.9%	0.7	1.30	2.2
16/06/2009	Apr-16	7-year	4.6%	0.7	1.57	2.5
23/06/2009	Oct-19	10-year	5.9%	6.0	2.53	N/A
21/07/2009	Mar-12	3-year	3.9%	0.4	0.86	4.3
21/07/2009	Jan-14	5-year	4.0%	0.9	1.27	3.1
18/08/2009	Jan-14	5-year	4.0%	0.5	0.95	3.7
18/08/2009	Oct-18	10-year	4.5%	0.7	1.24	2.7
15/09/2009	Jan-14	5-year	4.0%	0.3	0.92	4.0
15/09/2009	Apr-20	11-year	4.5%	0.7	1.55	2.3
06/10/2009	Mar-25	15-year	5.4%	7.0	1.80	N/A
Total raised				31.4		
Estimated Total Requirement				26.0		

Source: NTMA, Datastream

Yield spread - 10 yr Irish Gov bonds vs 10 yr German Gov bonds

Source: Datastream

PRIVATE SECTOR DEVELOPMENTS

Private sector debt at 225% of GDP ...

Private sector debt levels in Ireland are now among the highest in the developed world. We estimate that the private sector debt/GDP ratio will rise to 225% this year. In 1999, the private sector credit/GDP ratio stood at 86% in the euro-area, exactly in line with the ratio in Ireland. If one uses GNP as a measure of output in Ireland, the ratio jumps to 257% in 2008, significantly above international peers.

Ireland's PSC to GDP ratio has increased from 86% to 225% since 1999

Private sector credit/GDP ratios

Rank		Ratio	Rank		Ratio
1	Ireland*	225	11	Australia	127
2	Denmark	218	12	Canada	120
3	US	212	13	Austria	119
4	UK	211	14	France	108
5	Spain	198	15	Germany	108
6	Netherlands	193	16	Italy	105
7	New Zealand	151	17	Belgium	95
8	Japan	150	18	Norway	92
9	Portugal	147	19	Finland	89
10	Sweden	130			

Source: Datastream
**Goodbody estimate adjusted for IFSC debt and securitisations*

...with property related lending accounting for the lion's share of the lending

In the following table, we detail where most of this growth in credit has emanated from using the detailed statistics from the Central Bank. Total loans outstanding increased by 423% over the ten-year period to June 2009. Within this, real estate lending grew dramatically from €4bn to €89bn, while construction-related lending increased by 836%. Other categories of lending experienced significant increases over the period, but it is clear that property-related lending accounted for the lion's share of the increase. We estimate it accounted for 67% of the total growth over the period, despite only accounting for 36% of total loans at the start of the period. The transfer of €77bn book value of loans for €54bn, the majority of which are property or construction related, will force the participating banks to write-down the difference much earlier than they ordinarily would.

Total loans outstanding have grown by 423% over this period....

...with an 836% increase in construction-related lending

Sectoral Credit Breakdown

	Jun-09	% of Total	Jun-08	% of Total	Jun-04	% of Total	Jun-99	% of Total
Outstanding Amounts (€m):								
Agriculture etc	5,341	1%	5,221	1%	3,271	2%	2,986	4%
Fishing	381	0%	400	0%	364	0%	105	0%
Mining etc	441	0%	661	0%	221	0%	237	0%
Manufacturing	7,821	2%	9,180	2%	5,673	3%	4,881	6%
Electricity, Gas, etc	1,015	0%	1,141	0%	551	0%	318	0%
Construction	19,002	5%	24,688	6%	7,572	4%	2,031	3%
W/sale, Retail	13,236	3%	13,755	3%	7,107	4%	3,235	4%
Hotels & Restaurants	11,295	3%	12,246	3%	6,486	4%	2,987	4%
Transport etc	3,283	1%	3,323	1%	1,986	1%	1,375	2%
Financial Intermediation	86,752	21%	73,465	18%	36,125	20%	25,457	32%
Real estate, renting & business	95,563	23%	95,040	23%	26,973	15%	5,757	7%
:of which real estate	*89,401*	21%	*87,908*	21%	*20,812*	11%	*3,959*	5%
Education	823	0%	691	0%	374	0%	82	0%
Health & Social Work	2,638	1%	2,520	1%	688	0%	210	0%
Other community & Social	2,926	1%	3,205	1%	1,689	1%	750	1%
Personal (incl. securitisations)	170,724	41%	170,865	41%	82,305	45%	30,153	37%
:of which mortgages	*148,856*	35%	*146,494*	35%	*66,593*	37%	*23,143*	29%
Total (Incl. securitisations)	**421,238**	100%	**416,402**	100%	**181,385**	100%	**80,591**	100%
Property & construction related	***257,259***	*61%*	***259,090***	*62%*	***94,977***	*52%*	***29,133***	*36%*

% Growth:	**1-year**	**5-year**	**10-year**
Agriculture etc	2%	63%	79%
Fishing	-5%	5%	262%
Mining etc	-33%	100%	86%
Manufacturing	-15%	38%	60%
Electricity, Gas, etc	-11%	84%	219%
Construction	-23%	151%	836%
W/sale, Retail	-4%	86%	309%
Hotels & Restaurants	-8%	74%	278%
Transport etc	-1%	65%	139%
Financial Intermediation	18%	140%	241%
Real estate, renting & business	1%	254%	1560%
:of which real estate	*2%*	*330%*	*2158%*
Education	19%	120%	904%
Health & Social Work	5%	283%	1156%
Other community & Social	-9%	73%	290%
Personal (incl. securitisations)	0%	107%	466%
:of which mortgages	2%	124%	543%
Total (Incl. securitisations)	**1%**	**132%**	**423%**
Property & construction related	**-1%**	**171%**	**783%**

Source: Central Bank of Ireland

Recent developments in credit

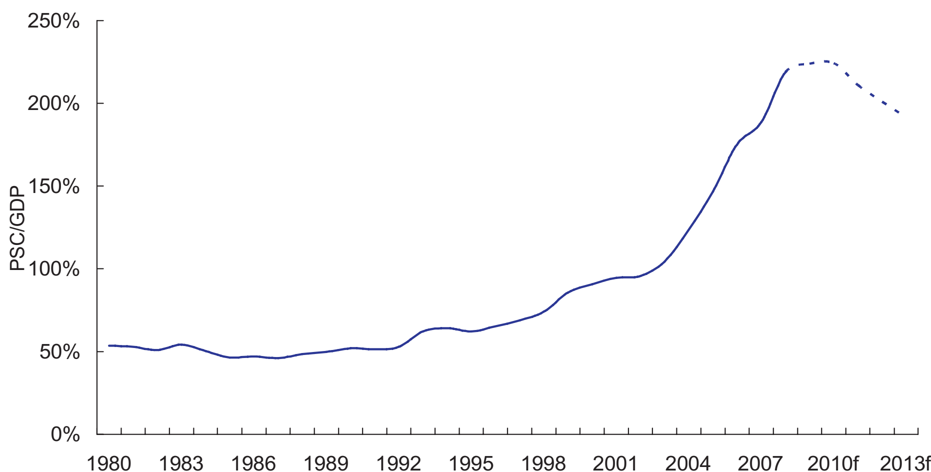
The process of deleveraging has now begun for the Irish private sector. Adjusting for securitisations and IFSC lending, private sector credit was flat on an annual basis in August 2009. However, outstanding credit has fallen by 3% since its peak last November, with most of this fall attributable to write-downs by the financial institutions.

Outstanding credit has fallen 3% from the peak, mostly due to write-downs

The process of reducing these debt levels, however, will be very slow, although NAMA will assist in this process, as write-downs on property and development loans will have to be recognised earlier. Under the assumption that €7bn has already been written down by the financial institutions which are transferring assets to NAMA, a further €16bn, given that the long-term economic value has been calculated to be €54bn, will have to be written down. Taking this and also an assumption that underlying private sector credit contracts by 5% in 2010 and 2011, the PSC/GDP ratio only falls to 206% on our forecasts. This is a very slow process.

While NAMA will assist in the process, the PSC to GDP ratio will still stand at 206% of GDP by 2011

Deleveraging will be a slow process - Credit/GDP



Source: Central Bank, CSO, Goodbody estimates

This is very much linked to the changing face of the banking sector. In the early part of this decade, Irish financial institutions increased their exposure to foreign sources of lending quite significantly. This led to a large jump in the net external liabilities of Irish financial institutions, which grew to 75% of GNP by 2008, up from 16% at the beginning of the decade. Another consequence of this was substantial increases in the loan-to-deposit ratios for domestic firms. For some of the financial institutions involved in NAMA, the process will represent a step-change, reducing the LDRs quite significantly, as can be seen in the following table.

Net external liabilities of financial institutions amounts to 75% of GNP, up from 16% at the turn of the decade

Government bank guarantee & impact of NAMA (€m)

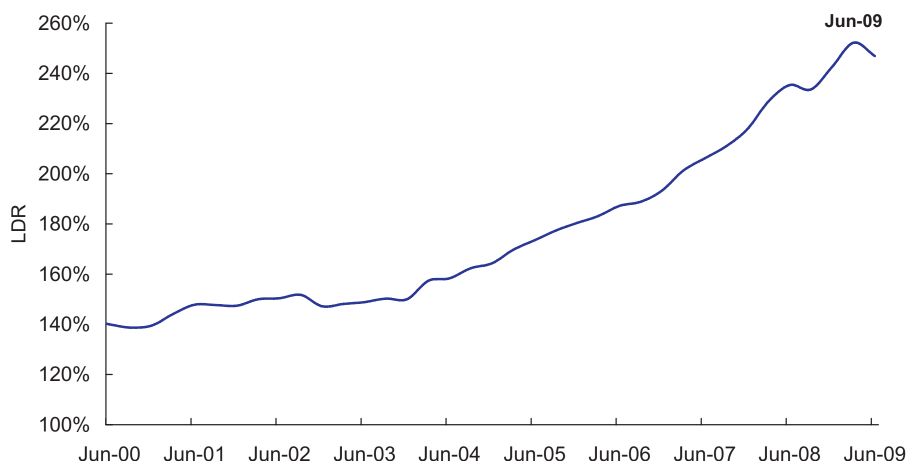
	AIB	BOI	Other NAMA institutions	Pre NAMA total	Post NAMA total
	Jun-09	Mar-09	Various		
Interbank deposits	44,987	28,814	37,292	**111,093**	**111,093**
Customer accounts	82,710	83,119	51,236	**217,065**	**217,065**
Debt securities	24,453	45,133	23,909	**93,495**	**93,495**
Subordinate debt & other capital instruments*	4,351	4,599	2,767	**11,717**	**11,717**
	156,501	**161,665**	**115,204**	**433,370**	**433,370**
Liquid assets					
Interbank lending	4,954	7,886	11,133	**23,973**	**23,973**
Financial assets	31,951	34,587	11,137	**77,675**	**131,675**
	36,905	**42,473**	**22,270**	**101,648**	**155,648**
Covered liabilities less liquid assets	**119,596**	**119,192**	**92,934**	**331,722**	**277,722**
Loans	129,031	133,740	94,148	**356,919**	**286,577**
Loan to deposit ratio	156%	161%	184%	**164%**	**132%**

Source: Company reports, Department of Finance & Goodbody estimates

Some of these financial institutions have a deposit base outside of Ireland. For the domestic financial system though, the LDR is substantially higher, as can be seen in the following chart.

The domestic financial system LDR ratio is c.230% and has increased dramatically since 2003

Loan to Deposit ratio for Irish residents



Source: Central Bank of Ireland

What is an appropriate LDR?

It is difficult to know what the appropriate level is for the LDR, but it is clear from the chart above that the ratio increased dramatically post-2003, coinciding with developments in the global financial environment in relation to the boom in interbank lending in particular. In the following table, we have calculated, based on different assumptions for deposit growth and a target LDR over the next five years, what level of credit growth would be required.

We have assumed that €70bn is removed from the loan side of the equation, which takes the LDR down from 260% to 210%.

We have highlighted that if deposit growth runs at 5% per annum, credit would effectively be flat if the LDR were to adjust to 150%. This, once again, highlights the slow nature of the deleveraging process. The impact on the economy overall would depend on the industries that would get access to credit, given that this of course is a net number.

To get the LDR to 150% requires 5% deposit growth per annum and flat credit growth annually over the next five years

Post-NAMA - Change in credit outstanding required to meet target LDRs in five years

5-year cumulative

Deposit growth	200%	175%	150%	125%
0.0%	5.0%	-8.1%	-21.2%	-34.4%
2.5%	18.8%	4.0%	-10.9%	-25.7%
5.0%	34.0%	17.3%	0.5%	-16.2%
7.5%	50.8%	31.9%	13.1%	-5.8%
10.0%	69.1%	48.0%	26.9%	5.7%
12.5%	89.3%	65.6%	41.9%	18.3%
15.0%	111.2%	84.8%	58.4%	32.0%

Annual change in credit

Deposit growth	200%	175%	150%	125%
0.0%	1.0%	-1.7%	-4.7%	-8.1%
2.5%	3.5%	0.8%	-2.3%	-5.8%
5.0%	6.0%	3.2%	0.1%	-3.5%
7.5%	8.6%	5.7%	2.5%	-1.2%
10.0%	11.1%	8.2%	4.9%	1.1%
12.5%	13.6%	10.6%	7.3%	3.4%
15.0%	16.1%	13.1%	9.6%	5.7%

Current LDR=210%

Serviceability of non-financial debt

We discuss the sustainability of household debt in a different section of this note. But what about the sustainability, or serviceability of non-household debt? According to the monthly Central Bank statistics, total non-financial corporate debt amounted to €167bn in July 2009, representing a three-fold increase in only six years. However, despite rising spreads by financial institutions, interest rates are now at record low levels, aiding non-financial corporates in their ability to service these loans. On the other side, the interest rate being earned from deposits has also fallen dramatically over the past eighteen months. The following table illustrates the extent to which these dynamics have affected non-financial corporates. The last row is probably the most instructive as it quantifies the impact of the dramatic fall in interest rates in the recent past. Simplistically, given that Ireland is one of the most highly indebted economies in the world, by definition, it had most to gain from the slashing of interest rates.

Non financial debt has tripled in just six years

Non-financial corporate credit, deposits & the interest burden

	Q3 03	Q3 04	Q3 05	Q3 06	Q3 07	Q3 08	Q3 09
Credit outstanding (€m)	57,191	71,376	90,211	120,855	157,441	180,136	167,287
Deposits (€m)	39,212	42,594	52,336	61,587	69,523	65,329	55,163
Interest rate paid	5.2%	4.8%	4.6%	5.3%	6.4%	6.8%	3.5%
Interest rate received	1.4%	1.4%	1.4%	2.1%	3.0%	3.5%	1.3%
Annualised interest payment (€m)	3,000	3,431	4,167	6,372	10,063	12,314	5,884
Annualised interest received (€m)	557	586	750	1,276	2,080	2,276	738
Net interest bill (€m)	2,443	2,846	3,417	5,096	7,983	10,038	5,145
Interest burden as a % of GNP (annualised)	**1.8%**	**2.1%**	**2.3%**	**3.3%**	**4.9%**	**6.5%**	**3.7%**

Source: Central Bank, Goodbody estimates

As can be seen in the table, the net interest bill (annualised) has halved over the past twelve months, due to the combination of declining outstanding credit and interest rates. This amounts to 2.8% of GNP, illustrating the extent to which businesses have benefited from a cashflow perspective from these developments. Current interest rate settings though are unsustainable, so this effect will soon have to reverse, due to rising ECB rates. Before that, however, there will also be further increases in the spread that banks charge on their lending activities.

The decline in the interest bill for corporates has amounted to 2.8% of GNP

Where is the interest burden heading for non financial corporates?

Business lending rates are ordinarily priced off Euribor rates, but in the following chart we show the effect on the interest burden under our ECB interest rate forecasts under the following assumptions:

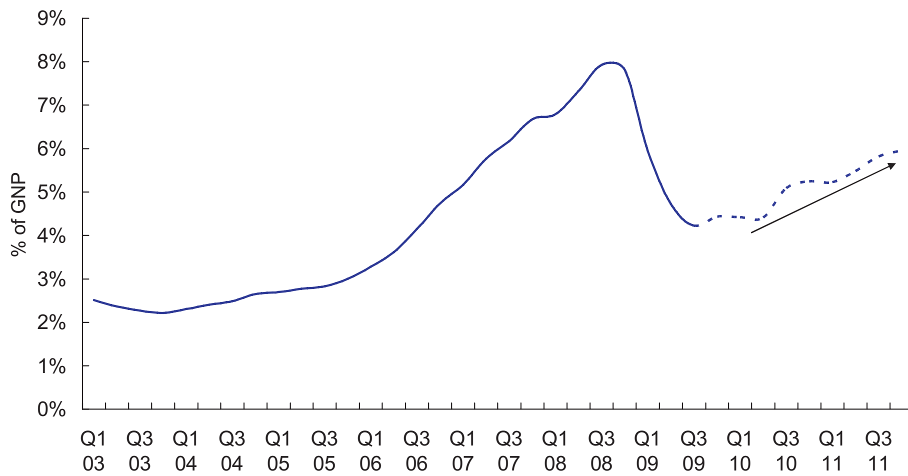
(1) ECB rates rise to 3% by the end of 2011. Business lending over ECB rates increases to 2.7%, its average since 2003.
(2) Outstanding credit declines at an annual rate of 5% over the period.
(3) GNP progresses in line with our forecasts.

One can argue whether these assumptions are too aggressive or not, but it reveals the following trend with regard to the interest burden for businesses. From 4.2% of GNP in July 2009, the interest burden is expected to rise to 6% of GNP by the end of 2011, using the assumptions detailed above. The key point here is that while we believe interest rates will rise slowly from here, the current emergency settings are unsustainable, and will mean that businesses will have to deal with the onset of these in the latter part of next year in our view and particularly into 2011. This may mute the strength of the economic recovery somewhat.

Interest burden set to rise from 4.2% of GNP to 6% of GNP by end of 2011 on our assumptions ....

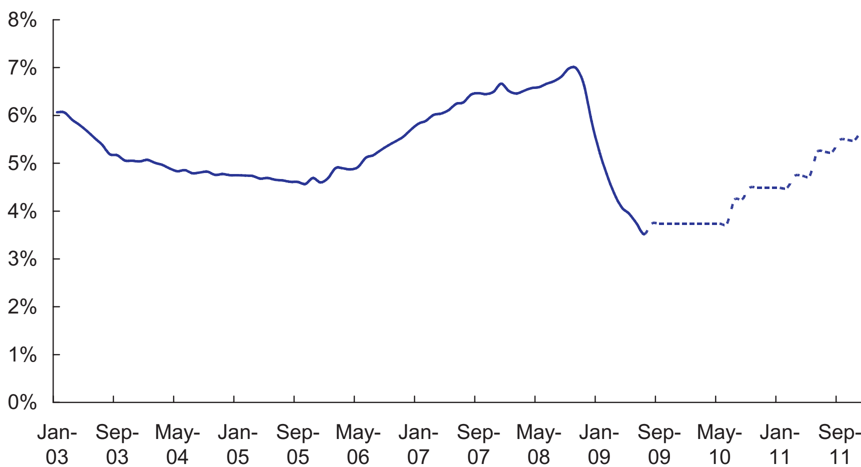
...which may mute the strength of the economic recovery

Interest burden for non-financial corporates



Source: Central Bank, CSO, Goodbody estimates

Likely path of lending rates for businesses



HOUSEHOLD DEBT LEVELS

The growth in household debt has been phenomenal over the past 13 years. Since 1995, Irish household indebtedness has increased from 48% of disposable income to 175% as at the end of 2008. Even at the end of this year, household debt will still amount to 170% of disposable income. In 2003, the household debt to disposable income ratio stood at 102%, so the period 2003-2007 was clearly marked by extremely advanced rates of credit growth, particularly for mortgages. Growth in debt relative to disposable income over the whole period, 1995-2007, has been of the order of 267%, while even over the four years 2003-2007, the debt to disposable income ratio increased by 73%.

Irish household debt to disposable income ratio currently at 175%, up from 102% in 2003

How does Irish household indebtedness compare internationally?

Such an increase in debt levels has seen Ireland make a rapid ascent up the household debt league with Irish households now among the most highly indebted in the developed world. While there has been little change in the countries occupying the top of the list since 1995, as seen in the table below, the surge in Irish household debt levels has ensured that Ireland is now firmly included in the list of highly indebted households.

Ireland has surged up the international debt league

Household Debt / Disp income ratios - Ireland has moved up the league table

		1995			Latest	Year	% increase in ratio 1995-2008
1	Denmark	188	1	Denmark	285	2008	38%
2	Japan	130	2	Netherlands	275	2007	118%
3	Norway	119	3	Norway	200	2008	64%
4	Netherlands	113	4	UK	183	2008	63%
5	UK	106	**5**	**Ireland**	**175**	**2008**	**267%**
6	Canada	103	6	Australia	171	2006	106%
7	Germany	97	7	New Zealand	160	2007	67%
8	New Zealand	96	8	Sweden	139	2006	54%
9	US	93	9	US	134	2008	48%
10	Sweden	90	10	Canada	143	2008	26%
11	Australia	83	11	Spain	130	2008	120%
12	France	66	12	Portugal	125	2006	123%
13	Finland	64	13	Japan	128	2007	-16%
14	Spain	59	14	Finland	102	2006	59%
15	Belgium	57	15	France	100	2008	9%
16	Portugal	54	16	Germany	99	2008	3%
17	**Ireland**	**48**	17	Austria	88	2006	159%
18	Austria	34	18	Belgium	75	2006	32%
19	Italy	31	19	Italy	73	2007	113%

Source: OECD, various central banks, Goodbody estimates

While Irish household debt levels are often compared to that of the UK, the UK has traditionally had higher levels of household indebtedness relative to Ireland. Among our league of countries, the UK ranking has barely altered over the past decade. Furthermore, the increase in the UK household debt to disposable income ratio, at 63% in the period 1995-2008, is only a fraction of the growth in Irish household debt levels. In terms of the composition of debt, the debt outstanding predominantly comprises of mortgage debt, which is set to account for €148bn or 86% of the total indebtedness of households by year end.

Growth in UK household debt to disposable income ratio has been only a fraction of that for Ireland

Servicing debt levels - the household debt burden

The excessive rate of growth in household indebtedness, as well as its current high level comparably, raises the question of debt servicing.

The debt burden is influenced by two key factors: **(1)** the amount of debt, and: **(2)** the level of interest rates. Irish households had been accumulating debt at a very rapid pace at a time of falling borrowing costs. Furthermore, the great majority of Irish household debt is mortgage-related, as indicated above. Irish households have been shown to be more sensitive to changing interest rates than most other countries due to this fact.

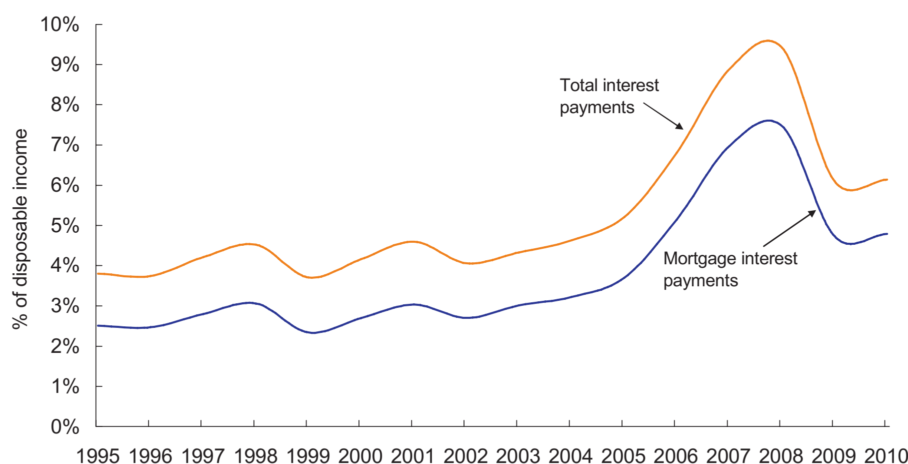
Mortgages account for 86% of household debt outstanding

Debt servicing costs increased rapidly between 2004 and 2008…

Between 1995 and 2004, interest payments totalled between 3.5-4.5% of disposable income despite rapidly accumulating debt levels over the same period. This was largely due to the fact that interest rates were falling as part of the convergence process pre-EMU for much of the 1990s. Interest rates then remained at ultra low levels for an extended period at the start of this decade. Such an accommodative monetary policy backdrop allowed the debt burden to remain consistently low over this period. However, the doubling of ECB interest rates between December 2005 and August 2008 had a significant effect on debt servicing costs, with the interest burden effectively doubling. Interest payments on debt commanded 9.5% of disposable income in 2008, with over 80% of this attributable to mortgage interest costs. Furthermore, ongoing increases in the interest bill over this period took up a quarter of the increase in disposable incomes, on average, per year.

Household debt burden peaked at 9.4% of disposable income in 2008

Mortgage interest costs have eased significantly



Source: Goodbody estimates

…but ultra low interest rates have seen the debt burdens fall sharply of late

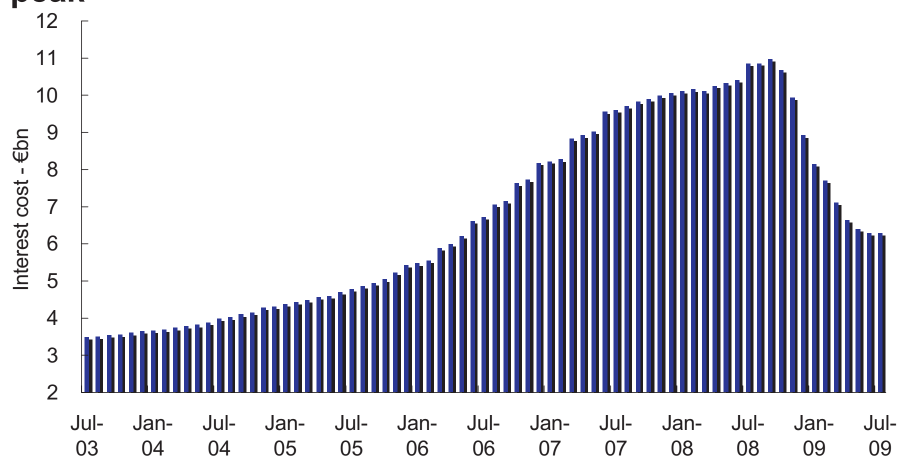
However, this trend very much reversed over the last twelve months. Household interest payments totalled €9.3bn in 2008 but, on our estimates, this will fall by €3.6bn in 2009. Such a substantial drop will see interest payments command 6% of disposable income by the end of this year compared to 9.5% of income at the peak. In other words, the reduction in interest payments has benefited households to the tune of 3.5% of disposable income.

Savings in interest costs this year has amounted to 3.3% of disposable income...

Using a somewhat different method, we have calculated the fall in the interest burden on a monthly basis in the following chart. It reveals that household interest costs have fallen by an annualised €5bn from the peak, representing a drop of 37%. At a time when disposable income is under severe pressure through increased taxation and a rapid increase in unemployment, this has been a very welcome reprieve.

...while the interest bill has fallen €5bn from the peak

Household interest costs have fallen by 37% from the peak



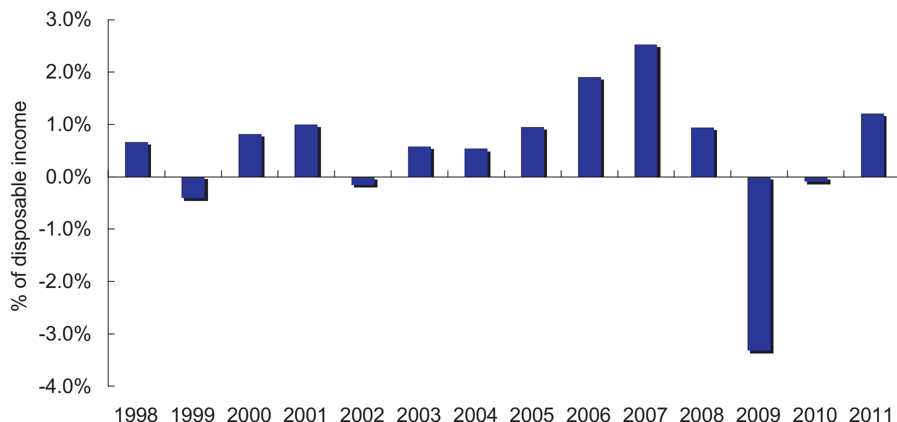
Source: Central Bank, Goodbody estimates Note: Figures relate to annual interest costs

Breathing room likely to remain until H2 2010 at least

Given our belief that interest rates will remain at their current ultra low levels for much of next year, the debt burden will remain relatively unchanged over the next number of quarters. We see it amounting to 6% of disposable income for next year also. Beyond that, interest rates should begin to return to more normalised levels and the interest burden is likely to tick back up slightly to 7.4% of disposable income in 2011. The additional increase in interest payments in 2011 will amount to 1.2% of disposable income in that year. As such, payback for the current extremely low level of interest rates will begin in earnest in that year.

Rising interest rates into 2011 will see households face a rising debt burden once again

Increase / decrease in interest payments as % of disposable income



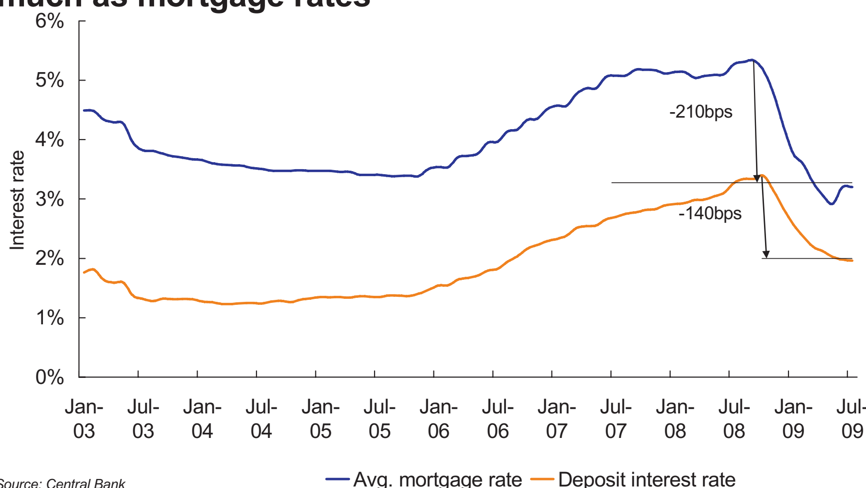
Source: Goodbody estimates

Falling interest rates have also had an impact on the deposit side

The significant reduction in interest rates has also had an impact on household deposit interest. Deposit interest rates have not fallen by the same extent as mortgage interest rates, due to the intense competition among financial institutions for consumer deposits over recent quarters. According to Central Bank data, average mortgage rates have fallen more than 210bps from the peak, while the decline in deposit interest rates has been only 140bps.

Deposit interest rates have held up relatively better

Falling interest rates have not impacted deposit rates as much as mortgage rates



Source: Central Bank

On a net basis, (i.e. interest paid less interest received), the interest bill of households fell by 42% yoy on an annualised basis (€4.3bn relative to €7.4bn). The timing of this relief in interest costs has been very helpful for households, occurring in a period when unemployment was rising significantly. However, this reprieve will soon come to an end. As highlighted above, there will be a minimal additional boost to disposable income from interest cost savings next year, while the debt burden is set to increase once again from 2011 onwards as monetary policy reverts to a more normalised setting. At this stage households will face increased pressure to meet their debt servicing obligations.

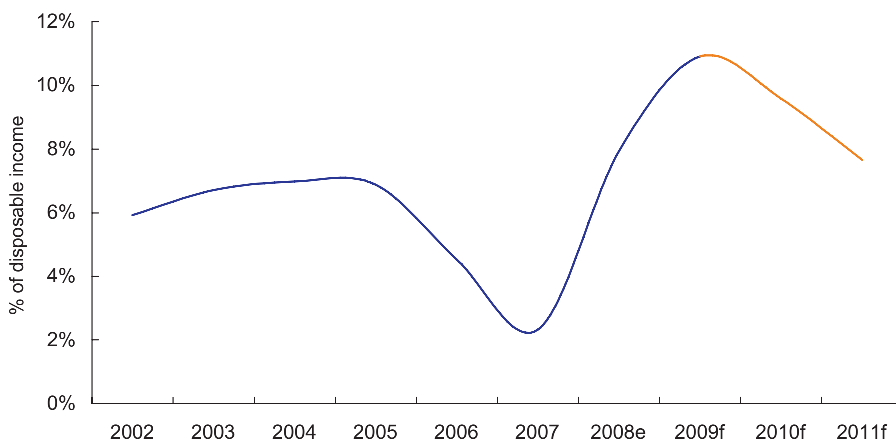
One off boost to household disposable income will not be repeated

Reduced interest payments allowing consumers to boost savings

Decreased interest costs should have the effect of boosting disposable income. However, given the trends we have witnessed over recent months, it is likely any gain was not spent and instead caused a spike in the savings ratio earlier this year. We estimate that the household savings ratio rose to close to 11% in 2009 in total (it may have been higher in the first half of the year), from c.8% in 2008. Given that (i) consumer confidence levels having rebounded since then, (ii) the rate of unemployment increase has slowed substantially; and (iii) concerns are easing over the public finances, given that some action has already been taken, the household savings rate has likely peaked at this stage. Indeed, we may see the savings rate fall back slightly next year.

Lower interest costs and increased uncertainty have seen consumers boost their savings....

Irish household savings ratio



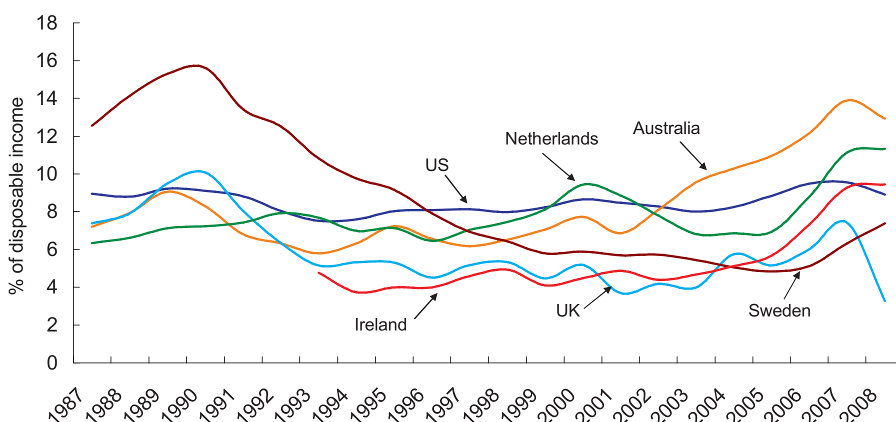
Source: CSO, Goodbody estimates

...with the household savings rate jumping to 11% this year, up from 8% in 2008

How do Irish debt interest burdens compare internationally?

Given that dramatically falling interest rates have been a global feature over the past 12 months, easing debt burdens have been a common occurrence internationally over this timeframe. This can be seen in the chart below, which tracks the debt burdens of a number of nations.

The cost of debt servicing - Ireland's debt burden not totally out of synch with other countries



Source: BIS

Notwithstanding the very recent moves downward, debt burdens have been on the rise internationally for most of this decade, mirroring the Irish trend. The household debt burdens of both Australia and the Netherlands have risen in a similar pattern to Ireland's, with the debt burden of Irish households now at a similar level to that for the US. While Irish households are quite highly indebted by international standards, the debt burden does not appear overly excessive. Even allowing for the fact that interest rates will rise imminently from their current level, the debt burden of the household sector in Ireland is not totally out of kilter with the international situation.

International household interest burden bears a similar pattern to Ireland's

Comparing household indebtedness - some other points to consider

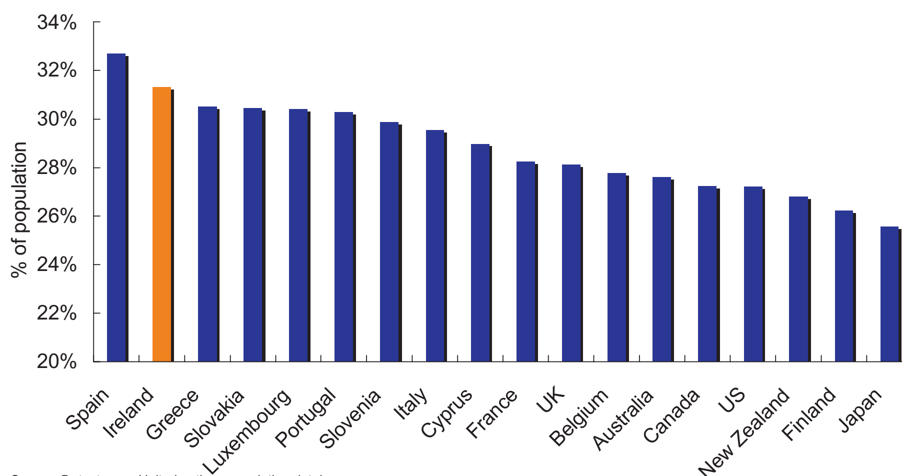
A simple comparison of indebtedness and debt burdens across nations does not provide a complete picture in assessing the relative indebtedness of households. There are some other important factors that need to be taken into consideration. We originally addressed this issue in a note entitled Living a Li-ability back in October 2005. We present an updated version here.

1) Population profile

The age structure of the population is one such factor. Earnings potential is much greater for those of a younger age profile. As such, relatively younger populations have an increased ability to take on larger amounts of debt which can then be repaid as the population ages. This is related to the life cycle hypothesis whereby households borrow in their earlier years so as to smooth out consumption patterns over their whole lifetime. We can look at the proportion of the population in the 20-40 cohort as a proxy for the age structure of the whole population. Ireland's population remains amongst the youngest in Europe, with only Spain having a higher cohort of its population in the 20-40 age bracket (see chart below). Therefore, given Ireland's younger population structure, a higher debt level, relative to older populations, is more sustainable.

Life cycle hypothesis implies the population profile is an important point when comparing international household debt levels

% of population aged 20-40

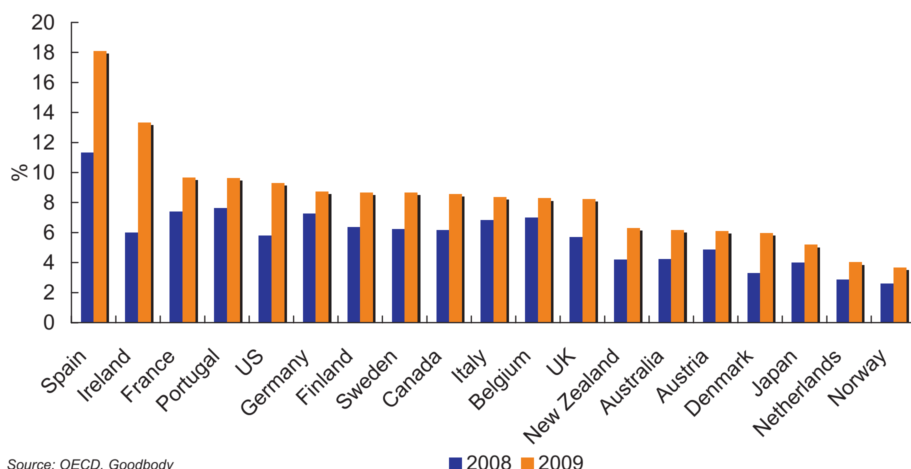


Source: Datastream, United nations population database

2) Unemployment rates

However, the employment level among the population must also be considered. This is even more important at the current time, given that unemployment is on the ascent globally. Ireland, especially, is in the midst of a very significant shock to the labour market, having experienced a dramatic increase in unemployment since the onset of the recession. The increase in unemployment is matched only by Spain. As such, while Ireland may have a relatively young population, it now also has one of the highest rates of unemployment in the western world.

High unemployment rates may affect debt servicing ability of households

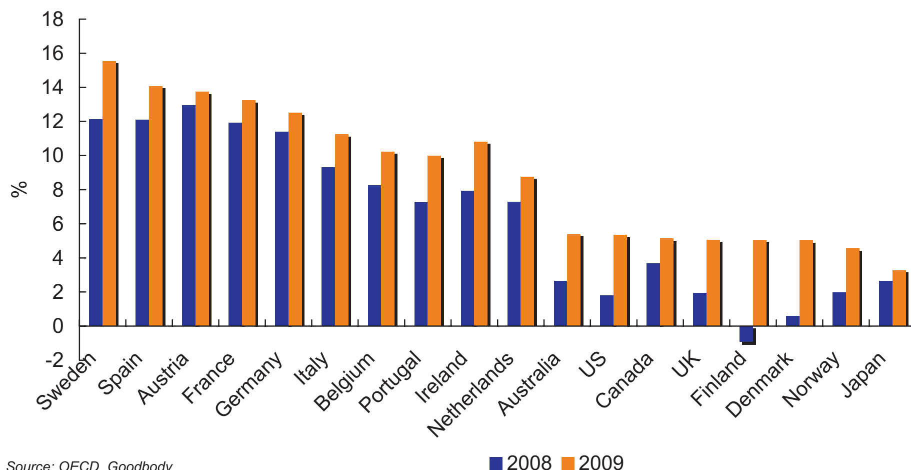


Source: OECD, Goodbody

3) Household savings

The rate of households savings should also be considered. A downward trend in savings was a feature of many countries between 2004 and 2006, in tandem with excessive increases in household leverage. Ireland was no exception. This was also a feature in the US and the UK, with savings rates turning negative in the US at one point. Irish households, too, have done much to repair their balance sheets since the onset of the recession, and there has been a surge in household savings. We estimate the savings rate rose to 11% in 2009. This is only a very recent development, with household savings rates having dropped below their long-term average in the mid part of the decade.

Household savings provide an important buffer for households , and have been on the rise internationally



Source: OECD, Goodbody

So how can we combine these important considerations into a single measure that compares the indebtedness of households in particular countries? We will employ a method used in that previous report, which we called the Goodbody Household Debt Index.

Goodbody Household Debt Index

The Goodbody Household Debt Index is a measure which aims to incorporate all the factors mentioned so as to compare the relative indebtedness of households internationally. We have taken 19 countries from across the developed world and compiled data for each country in relation to the variables highlighted above, namely household debt to disposable income ratios, interest rates, savings rates, a measure of population structure and unemployment rates.

We combine these variables into an index, the Goodbody Household Debt Index (GHDI), which is calculated as follows:

GHDI = (((D/DI) – SAVE)/(AGE* % EMPLOY))* RATE

Where:

- D/DI is the household debt to disposable income ratio
- SAVE is the savings ratio
- AGE is the proportion of the population aged between 20 and 40
- RATE is the average base interest rate prevailing over the past year
- % EMPLOY is the % of the population in employment

Goodbody Household debt index aims to combine all these different elements into one measure

The debt to disposable income ratio captures the indebtedness of households, while subtracting the savings ratio gives the net debt position (although we do recognise that this is a stock relative to a flow). We adjust this measure of indebtedness for the age structure of the population, because, as mentioned above, the life-cycle hypothesis implies that relatively younger populations will have a higher debt level due to the theory of consumption smoothing. Employment levels are also taken into account in this particular index by using a scaling factor in the calculation.

The result of this calculation is then multiplied by the average interest rate prevailing over the past 12 months, notwithstanding the fact that interest rates are at exceptionally low levels internationally and will increase to more normalised levels in due course.

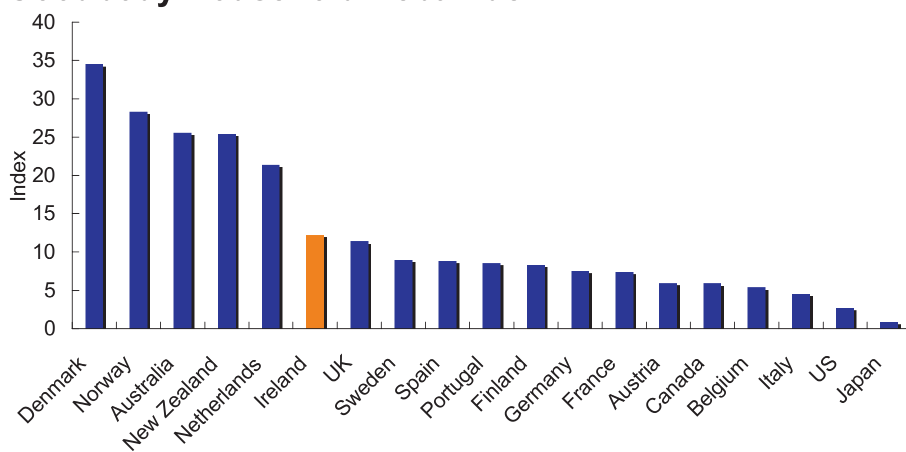
Before calculating the index we have constructed a table to illustrate where the countries stand in terms of these variables. Once we have constructed our index, this will aid us in determining what the most important factors to consider are, when accessing the viability of household sector debt levels.

Debt burden influences

	High debt to disposable income ratio	Higher interest rates	Aged population	Low household savings ratio	High rate of unemployment
Denmark	*		*	*	
Netherlands	*		*		
Norway	*	*	*	*	
UK	*	*		*	
Ireland	*				*
Australia	*	*		*	
New Zealand	*	*	*		
Sweden	*		*		*
US	*			*	*
Canada	*			*	
Spain	*				*
Portugal	*				*
Japan	*		*		
Finland			*	*	*
France			*		*
Germany			*		
Austria					
Belgium					*
Italy					

Source: OECD, Goodbody

Ireland leaning towards the upper end in the Goodbody Household Debt Index



Source: Goodbody estimates

The results show that Ireland is in the second tier of countries. When we first performed this exercise back in October 2005, Ireland also ranked mid-way in our league table. The UK was in third position back in 2005, but the record low interest rates currently put it in a better position. For Ireland, the relative position is unchanged because of low interest rates and a young population compared to other countries, despite the increase in unemployment.

Ireland's position in debt index has remained relatively unchanged since our original analysis

The countries heading up the league have very high household debt to disposable income ratios in commom, while some of the countries also have relatively higher interest rates. Although we have only factored in interest rates over the past year in our calculation, which reside at historic low levels globally, looking at interest rates over a longer term horizon indicates that Norway, New Zealand and Australia have persistently higher rates compared to the Eurozone.

Some positives in Ireland's favour, but rising interest rates will test households

While Ireland has some positives in its favour due to it its younger population and relatively healthy savings ratio, along with the extensive benefits occurring through ultra low interest rates, the high level of debt of the household sector is a concern, nonetheless. This is even more the case at a time when unemployment is on an upward trend and interest rate increases are imminent.

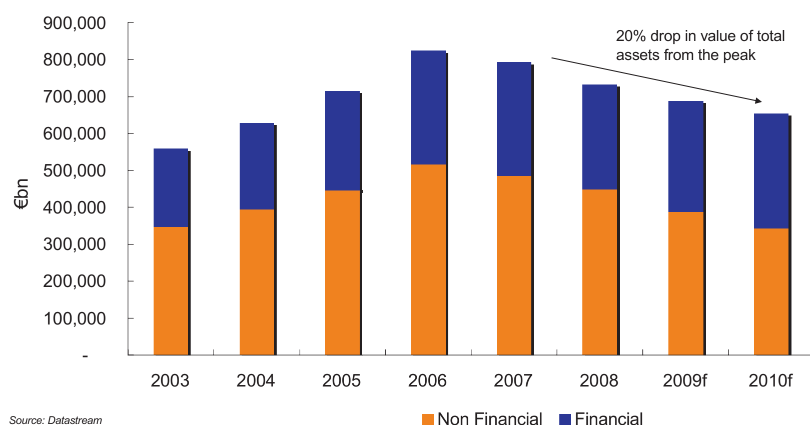
Ireland 's household sector is extremely sensitive to movements in interest rates

IRELAND'S WEALTH LEVELS

Ireland's wealth levels have been on somewhat of a roaster coaster journey over recent years. At the end of the 2006, total assets were valued at €824bn, representing a 97% increase in value over the previous 5 year period. However, since that time, the collapse of the housing market and the onset of recession has meant Ireland has experienced a wealth destruction of vast proportions, one which is set to continue for some time. By the end of next year, asset values are set to amount to €654bn, a drop of 20% from the peak and close to levels last seen in 2004.

Household wealth is set to fall 20% from the peak by end 2010, reverting back to 2004 levels

Ireland undergoing extensive wealth destruction



Source: Datastream

Ireland's household asset situation dictated by trends in the property market

Irish household property assets increased 377% between 1997-2006....

The fortunes of Ireland's wealth levels ties in closely with the path of property values, with the wealth of households very much skewed towards this asset class. This is included in the non-financial component of wealth and after extensive price appreciation at the beginning of this decade it accounted for 62% of total assets. Between 1997 and 2006 we estimate that the value of Ireland's residential property stock increased by 377% in nominal terms, equivalent to c.35% growth on an annual basis. However, since reaching that peak, prices have declined significantly. According to official indices, prices have fallen 25% from the peak, although anecdotal evidence, as well as other price indices, suggest price declines have been more extensive than this, and that prices may be down in excess of 40% from peak levels at this stage. In any case, the peak to trough decline in residential property prices is set to exceed the 40% mark, with declines likely to continue throughout 2010 and to persist into 2011. As such, the value of Ireland's property assets, and thus, overall wealth levels, will continue to come under pressure in the near term. By the end of 2010, we estimate the value of the housing stock (or non-financial assets) will stand at €342bn, a drop of a third in the value from the peak. A decline of this magnitude would bring the value of housing assets back to 2003 levels.

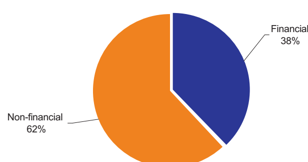
....although declines in house prices in excess of 40% from peak levels will value the overall housing stock at 2003 levels

Households weaning off their dependance on property assets....

Nevertheless, this asset class will remain a significant part to the overall asset portfolio of Irish households even with these extensive declines in values. A 40% decline from peak would still see property account for c52% of total assets by end 2010 implying a much more balanced asset allocation than heretofore. In the early part of this decade non financial assets accounted for almost two thirds of Ireland's household assets.

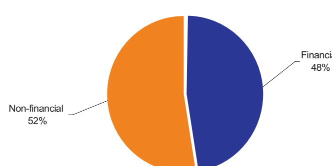
Property will account for c52% of total household assets by end 2010, down from almost two thirds at the peak

Ireland's asset portfolio makeup 2003



Source: CSO, Central Bank

Ireland's asset portfolio makeup - 2010



Source: CSO, Central Bank

...with financial assets set to become more significant in the context of household wealth

Financial assets too, have managed to make strident gains and in any other circumstances an average annual rate of growth in financial assets of 11% between 2001 and 2006 would make for very impressive reading. Irish households continue to be significant deposit gatherers, with deposits of the household sector up 64% between 2003 and 2008. Even since 2006 (when the SSIA scheme matured), deposits have remained on a steady increase (+12% between 2006-2008) implying a large pool of domestic savings now exists. Over this time period we estimate the savings ratio has increased from a low point of 2.3% to its current level of 11%. However, significant declines in equity and security holdings as well as pension fund assets, combined with

Households deposit are up 64% since 2003, implying a significant savings pool now exists

continued increasing financial liabilities has seen a marked drop in net financial assets since 2006. Net financial assets peaked in value at €140bn in that year but by the end of 2008 this had fallen to €81bn, representing a 58% drop over a two year period. Even by 2010, while we see some uplift in financial asset values from here, the net financial assets of Irish households will still remain well below the previous peaks.

Personal (Household) sector Liabilities/Assets, 2002-2008

€m	2002	2003	2004	2005	2006	2007	2008
Credit	**60,296**	**73,065**	**94,905**	**120,059**	**146,736**	**165,480**	**172481**
Of which:							
Mortgages	47,212	59,424	77,029	98,955	123,288	139,842	148117
Other housing finance	801	474	542	629	1,133	1,224	1027
Finance for investment	1,821	2,019	2,633	3,856	5,331	6,041	5825
Other personal	10,462	11,330	14,701	16,618	16,984	18,373	18100
Deposits	**42,815**	**47,865**	**53,688**	**63,393**	**73,848**	**78,687**	**81,584**
Net Balance with credit institutions	**- 17,481**	**- 25,200**	**- 41,217**	**- 56,666**	**- 72,888**	**- 86,793**	**- 90,897**
Insurance companies & pension funds	60,865	80,235	93,855	111,977	132,322	126,627	111,054
Holdings of securities	63,951	67,472	67,470	72,801	80,462	79,707	64,667
Net financial assets	**107,335**	**122,507**	**120,108**	**128,112**	**139,896**	**119,541**	**84,824**
Housing assets	291,891	346,930	394,198	446,102	516,349	484,479	449,968
Net asset position	**399,226**	**469,437**	**514,306**	**574,214**	**656,245**	**604,020**	**534,792**
% change	**-1.9%**	**17.6%**	**9.6%**	**11.6%**	**14.3%**	**-8.0%**	**-11.5%**

Source: Central Bank, Goodbody estimates

The decline in property prices, combined with the above developments on the financial assets side of the household balance sheet have had a dramatic impact on the net wealth levels of Irish households. 2007 and 2008 have seen consecutive drops in net asset values of 8% and 12% respectively and this year is likely to record a further, albeit more moderate, drop in household net asset values, given that although property prices are still in decline equities and pension funds have recovered some ground this year.

Comparing wealth levels to houshold disposable income

We can also gauge the change in the net asset position of Irish households relative to the changes that have been seen in their disposable income. On an absolute basis, as mentioned above, by 2010, net wealth levels will be back to levels last seen in 2003 at €470bn. However, relative to disposable income the collapse in wealth levels will be much more extensive, given the comparatively subdued income declines in our forecasts. By 2010, net assets will amount to 489% of disposable income, down from 737% at the peak. In 2002, the last time nominal net assets amounted to €470 billion, net wealth totalled 655% of disposable income, reflecting the fact once again that disposable incomes will not be giving up much of its gains in the intervening period, while asset values are undergoing very sharp declines.

Net household wealth will amount to 490% of disposable income next year, down from 737% at the peak...

Irish household wealth

	Housing assets	% of disposable income	Financial assets	% of disposable income	Liabilities	% of disposable income	Net wealth	% of disposable income
2002	291,891	438%	184,267	277%	73,846	111%	401,998	604%
2003	346,930	482%	212,191	295%	89,971	125%	472,167	655%
2004	394,198	517%	234,377	308%	110,263	145%	533,056	699%
2005	446,102	540%	268,957	326%	140,140	170%	577,088	699%
2006	516,349	587%	307,823	350%	167,948	191%	648,220	737%
2007	484,479	515%	308,290	328%	190,986	203%	598,976	636%
2008e	449,968	456%	282,535	286%	201,386	204%	531,117	538%
2009e	387,299	393%	300,175	304%	191,877	194%	495,597	502%
2010e	343,100	355%	310,935	322%	181,732	188%	472,303	489%

Source: Central Bank, CSO, Goodbody estimates

Falling property values the culprit

The table above highlights the main source of the deterioration in wealth levels; that is the collapse in the value of Irish housing assets. The value of Ireland's housing assets will fall from close to 600% of disposable income to just 350% of disposable income over a four year period 2006-2010. While financial assets have also experienced sharp declines from the peak, the performance of equity markets and pension funds in the year so far has been impressive and at this stage of the year an uplift in the financial assets of Irish households can be expected. Nevertheless, Irish households are still set to experience a sharp fall in their overall net worth in the near term, both on an absolute basis and relative to disposable incomes.

...led by declines in the value of housing assets, which are set to amount to 350% of disposable income next year down from a peak level of 400%

How do Ireland's houshold wealth levels compare internationally?

But how does Ireland compare to the international situation? Data from the OECD can provide some indications on this point, with the latest numbers relating to 2008. They show that with a net wealth to household disposable income ratio of 538%, Ireland lingered towards the lower-end of the international scale in terms of household wealth, with only the US having a lower net wealth level among the countries for which data are provided. Furthermore, Ireland is likely to be soon propping up the bottom of this league, given our estimate that net wealth to disposable income will fall to 490% by the end of 2010.

Irish household wealth levels now lingering towards the bottom of the league internationally

Household wealth and indebtedness - the international picture

% of disposable income	Net wealth	Net financial wealth	Non-fin assets	Total fin assets	Equity assets	Total liabilities	Mortgage liabilities
UK	909	245	600	429	51	183	138
Italy	868	300	568	373	77	72	41
France	749	185	564	285	64	100	76
Japan	728	383	345	511	47	128	65
Germany	606	185	416	284	54	99	67
Canada	545	209	336	351	97	143	89
Ireland	**538**	**82**	**456**	**286**	**66**	**204**	**147**
US	486	253	233	387	84	134	101

Source: OECD, Central Bank, CSO, Goodbody estimates (Data for Japan and Italy for 2007)

Key features of Irish household balance sheet relative to international peers:

Irish household assets very much property related

The data also highlight two key features of the Irish household wealth situation: (1) how predisposed Irish households are towards assets of a 'non financial' nature, mainly property assets; and (2) the extent of the mortgage indebtedness of Irish households relative to other countries . On the first point, total household financial assets are very much at the lower end of international norms for developed nations, amounting to less than 290% of disposable income. This compares to financial assets totalling 430% of disposable income in the UK and in the US financial assets amount to 387% of disposable income. Only Germany and France have lower financial asset to disposable income ratios among the countries mentioned.

Financial assets make up a lower proportion of household assets than is the case internationally

Financial assets total 290% of disposable income, compared to 430% in the UK

Irish housholds have a much higher level of financial liabilities relative to international norms

On the other hand, Ireland's financial liabilities are also markedly higher than the average of the countries highlighted above and, when measured against disposable income, are almost three times the financial liabilities of Italy, whose financial liabilities total only 72% of disposable income. In particular, and unsurprisingly, Irish household mortgage liabilities are significantly ahead of all other developed countries at 147% of disposable income, with only the UK having mortgage liabilities of the same level.

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Goodbody Stockbrokers, Ballsbridge Park, Ballsbridge, Dublin 4, Ireland
T (+ 353 1) 667 0400 **F** (+ 353 1) 667 0280 **W** www.goodbody.ie **E** goodbody@goodbody.ie