

Moody's downgrades Ireland to Aa1; outlook negative

Moody's Investors Service has today downgraded Ireland's government bond ratings to Aa1 from Aaa. The outlook is negative.

The rationale behind the downgrade stems from three key drivers of our credit analysis regarding debt: affordability, financeability and reversibility – which for Ireland are weakened as compared to Aaa peers.

"The review process focused on the nature of the policy response and the extent to which the Irish economic model was durably affected by a sudden and brutal economic and financial adjustment," said Dietmar Hornung, a Vice President - Senior Analyst in Moody's Sovereign Risk Group. "These are the key parameters for our assessment of Ireland's credit standing," he added.

Moody's concluded that there was a case for only a moderate rating downgrade at this stage in light of the decisiveness of the policy response as well as the government's strong balance sheet position prior to the crisis.

The negative outlook reflects the risk of a further gradual deterioration in terms both of debt affordability – the share of government revenues used for interest payments – and financeability – the cost at which Ireland can raise further debt. Moreover, Ireland's ability to reverse the negative debt dynamics in a non-supportive global environment will be tested. Overall, debt dynamics will remain unfavourable for several years, and, in Moody's opinion, downside risks outweigh upside risks in the near to medium term.

"The pronounced weakness in the economic activity has been translating into a severe deterioration of Ireland's public finances, and the country is set to emerge from the current economic crisis with a considerably higher debt burden for the foreseeable future," explains Dietmar Hornung. "The deterioration of government financial strength has been further aggravated by liabilities arising from the recapitalisation of troubled banks," says Mr. Hornung. That being said, from a credit point of view, the creation of a National Asset Management Agency (NAMA) has a limited impact on Ireland's net, as opposed to gross, debt levels.

Ireland's debt reversibility will hinge on its capacity to adjust both in economic and fiscal terms. The strength of the economic recovery will depend on Ireland's capability to restore competitiveness, particularly to reduce nominal wages – which are currently among the highest in the

eurozone. “A meaningful fiscal adjustment will require an additional structural improvement of Ireland’s primary budget balance,” says Mr. Hornung.

In case Ireland’s adjustment capacity proves to be insufficient to keep debt affordability and financeability at levels compatible with a high Aa rating, a further rating downgrade would follow. In that context, we will closely monitor the specific measures to be announced by the government in the autumn as part of the fiscal consolidation plan, which will or will not validate the central scenario on which our assumptions are based.

Moody's most recent rating action on Ireland was implemented on 17 April 2009, when the rating agency placed Ireland’s Aaa government bond ratings on review for possible downgrade. Today’s action concludes the review. Ireland was a country whose Aaa status was identified as "vulnerable" by Moody's in its February 2009 report ("How Far Can Aaa Governments Stretch Their Balance Sheets?").

The principal methodology used in rating Ireland was Moody's Sovereign Bond Methodology, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating Ireland can also be found in the Credit Policy & Methodologies directory.