

Statement by John Corrigan, Chief Executive NTMA, to the Joint Committee on Finance, Public Expenditure and Reform

9 September 2011

Chairman, Deputies, Senators

Introduction

I am pleased to have the opportunity to meet with the Committee today. In my opening remarks I propose to concentrate mainly on the areas of debt management and the banking system as – along with NAMA - these are the NTMA activities most pertinent to the Committee's discussions. However, before I get into these issues I believe it would be useful if I briefly outline the remit of the NTMA and update the Committee on recent developments regarding the transfer of banking functions back to the Department of Finance.

The NTMA was established with a commercial remit outside the public service structure to borrow for the Exchequer and manage the National Debt. Since its establishment the NTMA has grown considerably and now has a range of functions assigned to it by the Government which provide financial and risk management services to the State. These include the State Claims Agency, the National Pensions Reserve Fund, the National Development Finance Agency and the National Asset Management Agency. From March 2010 to August 2011 they included certain banking system functions of the Minister for Finance related to the oversight and management of the State's interest and holdings in those financial institutions covered by the 2008 Government guarantee.

The NTMA has taken on two of these functions – NAMA and banking –as part of the State's response to the financial crisis. In particular the establishment of NAMA from a standing start in December 2009 to become fully operational with a €30 billion balance sheet by end 2010 was a major logistical challenge and has increased the complexity of the organisation. Because of NAMA's size the NTMA has seen a major expansion in staff numbers since end 2009 rising from 169 then to 384 currently of which 164 are assigned to NAMA. Management of NAMA's operations is a matter for the NAMA Board and its Chief Executive Officer. The NTMA's role is to provide NAMA with staff and business and support services including HR, IT, market risk, communications and the execution and processing of treasury and hedging transactions.

The Minister for Finance announced, in April 2011, the creation of a stand-alone unit accountable to him through the Department of Finance to provide State oversight of the banking system and drawing on the resources of the NTMA to carry out its work. The delegation of banking system functions to the NTMA was revoked with effect from August 2011 and the NTMA banking team has been seconded to the Department of Finance. I am pleased that the staff recruited by the NTMA form the cornerstone of the new Banking Unit in the Department and that their valuable commercial and specialist skills continue to be utilised by the State.

While the NTMA itself no longer has any statutory responsibilities in the banking area, resolution of the banking sector issues is, of course, as well as being critical to the recovery of the broader economy, crucial in driving down yields on our bonds and enabling a return to the international debt markets.

Funding Requirement

The EU/IMF programme was designed to meet both the cost of running the State on a day-to-day basis and the cost of recapitalising the banks. The banking stress tests carried out by the Central Bank in the first quarter of 2011 quantified the additional capital support required by the banking sector at €24 billion. The NTMA Banking Unit has worked very hard to minimise the amount of this additional capital to be provided by the taxpayer. Through initiatives like burden sharing with the junior bondholders and the sourcing of private capital for Bank of Ireland, the net amount of this capital provided by the State is now expected to be around €16.5 billion. The savings generated can be redirected to funding the day-to-day operation of the country. This means that €68.5 billion of the total €85 billion funding under the Programme is available to the Exchequer – an amount sufficient to meet our funding needs through to late 2013.

The NTMA has maintained a low level presence in the very short term bond markets throughout recent months. Subject to broader circumstances we hope to expand that programme through the latter part of 2012 by slowly extending the maturity of the debt we raise before beginning our efforts to raise long-term debt.

Ultimately the timing of these decisions will depend on many different circumstances – national and international – and our continued success in implementing the EU/IMF programme. We envisage a phased re-engagement with the markets before we fully resume normal debt raising operations.

International Investor Views

Given the events of late 2010 and our seeking financial assistance through the EU/IMF funding programme, it is easy to forget that the NTMA was able to raise its full 2010 funding target of €20 billion at an average interest rate of 4.7 per cent. We achieved this through frontloading of our borrowing programme to take advantage of the positive investor sentiment towards Ireland which existed early in the year. I mention this point to emphasise the fact that investor sentiment can change very quickly and in both positive and negative directions. We need to use the breathing space afforded by the EU/IMF funding programme to address those issues which led to us being unable to access the international markets. A core task for the NTMA is to ensure that international investors, most of whom do not spend a lot of time analysing the Irish economy, are fully informed on the progress being made by Ireland in addressing its fiscal and banking issues and to appraise the Government of the views of the international investment community.

In the sovereign debt markets, Ireland is a small player with a strong dependence on international investors, who hold more than 80 per cent of Ireland's long-term bonds. Therefore, even though we are currently out of the longer term markets, we continue to work hard to maintain strong, supportive relationships with key international investors in Irish Government debt and to identify and develop relationships with prospective new investors. Indeed with the recent downgrading of Ireland's credit rating, a part of Ireland's existing investor base – which has credit rating constraints on the bonds in which it can invest – is no longer open to it and a key challenge for the NTMA is to further broaden the prospective investor base.

Since the publication of the results of the bank stress tests under the Central Bank's PCAR/PLAR process on 31 March last the NTMA has met over 200 investment institutions both in Dublin and in

North America, Europe and Asia as part of an intensified investor relations programme. Investors we have met are mostly of the view that Ireland is the best positioned of the eurozone periphery countries to deal successfully with the crisis as it has a more flexible open economy and is recognising and taking action to deal with its problems on the basis of the measures set out in the IMF/EU/ECB (the troika) programme.

The clear messages coming out of these meetings are that the key criteria investors will consider in deciding to invest in Irish bonds are:

- continuing progress in meeting fiscal targets agreed with the troika,
- completion of bank recapitalisation,
- progress on bank deleveraging,
- further sale of NAMA assets, and
- action at EU level on the wider eurozone crisis.

I would like to touch briefly on each of these issues.

Fiscal Targets

Investors demand that the fiscal targets agreed with the troika are at the very least achieved. Beating these targets would be the ideal result and would further distinguish Ireland from other troubled countries.

In order to stabilise our debt/GDP ratio Ireland needs to get back to running a primary budget surplus (the budget balance excluding interest payments) as soon as possible. Indeed in the context of debt sustainability, this metric is far more important than the absolute level of debt per se. Ireland still has the biggest primary deficit of any eurozone country, a fact not lost on investors. I would note that the projections published by the Department of Finance in last April's Stability Programme Update are for the General Government Debt/GDP ratio to peak at 118 per cent of GDP in 2013 – when the debt is projected to reach a nominal value of some €200 billion - and to start to decline thereafter. The troika calculate that Ireland requires a 1 per cent primary budget surplus to stabilise the debt as a per cent of GDP.

Ireland's economic recovery so far has been led by the export sector. However, risks to the global economy have increased and global growth is already slowing. This has negative implications for official forecasts for the Irish economy and indeed the IMF has signalled its intention to lower its projection for Ireland's GDP growth in 2011 and 2012. Although exports are proving to be very resilient, there is still a risk that slower export growth will result and that GDP will be lower than projected. This would clearly make the achievement of the fiscal targets more challenging.

Banking System

Ireland has made huge strides in restoring its banking system to health during 2011. Publication of the results of the bank stress tests under the Central Bank's PCAR/PLAR process on 31 March last and the resultant recapitalisation finally drew a line under the Exchequer exposure to the banking

system and will ensure that the banks are adequately capitalised to meet even the most stressed scenarios. We also secured an important commitment from the ECB when, in its statement of 31 March last welcoming the Irish authorities' decision to strengthen the banks, it expressly affirmed its commitment to continue to provide liquidity to banks in Ireland.

The implementation of the EU/IMF programme has been a fundamental driver of the work of the NTMA Banking Unit which has been closely engaged in the development of the deleveraging and restructuring plans for the relevant institutions. It has also managed the State's capital injections into the institutions.

The Banking Unit has engaged with the banks to drive an agenda of burden sharing with subordinated bondholders. Since 2009 burden sharing measures have delivered €15 billion which would otherwise have had to be provided by the taxpayer. This includes €5.2 billion in burden sharing since 31 March 2011 following the Central Bank's PCAR/PLAR review.

The bank recapitalisation and burden sharing programme was substantially completed by end-July. As I have already said the NTMA banking team has been seconded to the Department of Finance with effect from August and will continue its work as part of the new Banking Unit established in the Department of Finance.

The next step in the resolution of the banking sector issues, and the main focus of investors, will be the execution of the banks' deleveraging plans. The Central Bank has required the institutions to prepare deleveraging plans targeting a reduction in loan-to-deposit ratios to 122.5 per cent by end 2013. This will require the run-off and disposal of up to €70 billion in loans. This deleveraging will reduce dependence on wholesale funding, while helping to place the banking sector on a stable footing to support the economy.

There are significant challenges inherent in the deleveraging process. The disposal of non-core assets will be dependent on the market appetite for such assets at a time when there are a large number of potential sellers of similar assets. Not alone do assets held by NAMA and Anglo/INBS fall to be disposed of but there are also substantial portfolios of assets held by non-Irish banks which may also be on the market. The objective of the deleveraging process is to achieve a more prudent loan to deposit ratio for the institutions concerned through a reduction of their balance sheet assets of some €70 billion while avoiding sales at prices which absorb excessive capital.

NAMA Asset Sales

Sales of NAMA assets are important to investors for a number of reasons. They reduce the State's contingent liabilities, provide evidence that NAMA is working and help to improve liquidity in the property market. I will leave it to the NAMA CEO, Brendan McDonagh, to brief you on the progress that has been made in this area. Continued progress is important to boosting investor confidence. Similar challenges to those I have referred to in relation to bank deleveraging also apply to NAMA as it seeks to dispose of assets in an orderly and phased manner and to generate the maximum return for the taxpayer.

Developments at EU level

The eurozone Heads of State and Government announced a broad range of measures on 21 July 2011. They agreed to expand the role of the European Financial Stability Facility and they agreed a new second aid package for Greece. They also agreed to a lower interest rate and longer maturities for borrowings under the existing aid programmes for Ireland, Portugal and Greece. There was also a commitment to continue to provide assistance for Ireland, Portugal and Greece until such time as they can regain access to the markets, provided they continue to implement the agreed financial programmes. The Heads of State and Governments are working to construct a permanent crisis resolution mechanism which is robust enough to deal with the current crisis but also with future crises possibly involving other larger countries.

The measures announced on 21 July were very significant for Ireland. The lower interest rates, the longer maturities and the promise of continued support should facilitate Ireland's return to the markets.

Conclusion

This year we finally drew a line under the Exchequer exposure to the banking system and the focus is now on reduction of the deficit and stabilisation of the debt. We have had public affirmation from the troika expressing complete satisfaction with how Ireland is dealing with its problems on all fronts. Indeed, despite the more general difficulties across the eurozone over the summer Irish bonds have rallied with yields on ten year bonds falling from about 14 per cent in mid July to about 8.5 per cent currently. By comparison, Portuguese ten year bonds are trading at 11 per cent whereas Greek ten year bonds trade at 19 per cent.

Our ultimate aim, of course, is to regain access to the bond markets. While resolution of the wider eurozone issues is fundamental to Ireland being able to achieve bond market access this does not obviate the need to continue to address our domestic issues. International investors have made it very clear what they expect of us in this regard. These expectations are priced into the current yield on our bonds and a further decline in the yield will be hugely dependent on us delivering on investor expectations. Irish bonds comprise only some 1 per cent of the eurozone sovereign bond market. Unlike the case in larger countries there has always been a job of work in selling Irish bonds and in building up the liquidity and range of maturities that appeals to a diversified international investor base. The NTMA will continue to work with investors to make the investment case for Ireland so that we can exit the EU/IMF programme as quickly and smoothly as possible.

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