

**30 December 1999**

**PRESS RELEASE**

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The information below is based on bond prices quoted on the Irish Stock Exchange on 30 December 1999 and, in the case of foreign exchange, on rates notified by the Central Bank as of close of business today, 30 December 1999. All figures in this statement are preliminary. Unless indicated otherwise, all figures are shown in Irish pounds.

**An overview of the main features of the year and the principal highlights of the results announced this evening by the National Treasury Management Agency (NTMA) are presented in the first four pages of this press release. More detailed explanatory information is given in the subsequent pages.**

**OVERVIEW OF 1999**

- 1. The launch of the euro in 1999 gave rise to the very real risk that the Irish Government bond market would be “dead in the water” with a consequent increase in debt service costs to the Exchequer. This risk arose because of the opening up of the euroland markets, with no exchange risk to Irish investors and because of the negative impact on prospective new investors of the small size of the Irish market and the high coupons and price levels of Irish bonds. The Agency’s efforts were concentrated in removing this last-mentioned disadvantage – the only one remaining to be tackled after the technical changes made in 1998 and early 1999 – while counteracting the small size of the market by continuing to actively trade in bonds and other securities and by providing repo facilities to the market.**
- 2. Outstanding Government bonds carried interest coupons – in some cases of 8 and 9 per cent – which were issued in pre-euro circumstances and which carried prices on the Stock Exchange which were way above their nominal value of 100.**

Foreign investors, in particular, were unwilling to buy them because, while they would receive high annual interest returns, they would ultimately have to show a capital loss when their bonds were redeemed. Unless something was done the consequent lack of trading would inevitably mean that the Agency would have to pay more for its borrowings than would be the case if this technical disadvantage were removed. The solution was to offer bond holders an opportunity to exchange their high price, high coupon stocks for a larger nominal amount of lower price, lower coupon stock – the idea being that the bonds would be exchanged on an equal economic value basis with neither party losing on the transaction, but both parties gaining in the future. The Agency would gain through raising future funding at lower cost while the investors would enjoy greater liquidity and tradability in their bonds.

3. The Agency launched its Securities Exchange Programme (SEP) as soon as the necessary changes in tax law were made in the Finance Act 1999 (which essentially provided that the tax situation of anyone participating in the Programme would not be adversely affected). An extensive marketing programme was undertaken to explain to investors the issues involved and a success rate of over 90% was achieved (see Appendix 1). This take-up rate was significantly higher than that achieved by other major issuers.

From the point of view of the Exchequer finances, what the Programme involved was a significant alteration in the timing of cash flows. The annual interest charge on the budget was sharply reduced in 1999 and in later years. On the other hand, this reduction in interest payments was reflected in a higher nominal amount of debt outstanding. Coupons on the new bonds range from 2.75% to 4.6% per annum, compared with 6% to 9.25% on the old ones. The increase in the nominal amount of outstanding debt as a result of the programme was IR£2.7 billion. The reduction in interest payments was some IR£130 million in 1999 and IR£280 million in 2000; the reduction in the interest bill will continue until 2015 (see Appendix 6).

The overall economic impact of the SEP is that the Exchequer should be able to raise funds at a cheaper rate than would otherwise be the case.

4. The Finance Act 1999 also provided that certain debts (IR£375 million) incurred by the Minister for Agriculture, Food and Rural Development under the FEOGA arrangements should be added to the National Debt.
5. The Minister for Finance decided in late 1999 to pay a sum of IR£307 million into the Capital Services Redemption Account (CSRA). The total amount outstanding in this account – currently IR£458 million – can be applied by the Exchequer towards debt service expenditure in future years. This payment into the CSRA included not only the interest savings on the Securities Exchange Programme but also some further funds provided for interest in the 1999 Budget but not required for that purpose.
6. Set out below are the actual figures for 1999. In view of the significant exceptional changes that have taken place during the year, however, figures on a “like-for-like” basis with 1998 are also given for comparison purposes.

#### Actual Position

- (a) interest payments on the Debt fell by IR£244 million in 1999 to IR£1,852 million, which was IR£348 million below the 1999 Budget figure (this allows for a IR£307 million build-up in the balance on the Capital Services Redemption Account and the payment in December of IR£8 million interest due in early January 2000 in order to reduce Y2k exposure). The Securities Exchange Programme led to IR£130 million of this drop in debt service expenditure. Expenses of borrowing were some IR£3 million higher than budget. Overall the total debt service figure (which includes sinking funds) was IR£345 million below the Budget estimate

- (b) while the National Debt, in nominal terms, declined by IR£1.3 billion pre exceptional items (Feoga IR£375 million, SEP IR£2,700 million), it increased by IR£1.9 billion after the foregoing exceptional items to IR£31.4 billion.
- (c) the General Government Debt/GDP ratio fell by 2 percentage points to 47%, giving Ireland the third lowest debt ratio (after Luxembourg and Finland).

### “Like for Like” Comparison

On a “like-for-like” basis the situation would have been:

- (a) interest payments on the National Debt would have fallen by IR£114 million compared with 1998, versus the larger actual fall of IR£244 million; this outturn would have been IR£218 million below the 1999 Budget as compared with the larger actual variance of IR£348 million.
  - (b) the nominal value of the National Debt would have fallen by IR£1.3 billion to IR£28.2 billion.
  - (c) the General Government Debt/GDP ratio would have fallen to 43%, which would have given Ireland the second lowest debt ratio (after Luxembourg).
7. The market value of the National Debt – i.e. the amount of cash that would be required at end-year to pay off the total amount outstanding – fell by some IR£2.5 billion due mainly to
- (a) the Government Budget surplus

- (b) **the fall in the market value of Government bonds (as interest rates rise, the market value of bonds falls), of which IR£135 million was due to the SEP.**
  - (c) **the debt management activities of the Agency**
  
- 8. Total cash flow through the Agency (purchases and sales of bonds and short term notes, repos, deposits, swaps etc) increased by 20% to IR£266 billion.**
  
- 9. A major feature of 1999 was the decision by the Government, announced in July, to extend the Agency's legal powers to facilitate the establishment of both a State claims agency and a central treasury service for the public sector, and to enable the Agency to provide investment management services to the Exchequer. Considerable work has been done by the Agency in recent months in conjunction with other parts of the public service in preparation for these new functions and legislation is now being drafted. Regarding the planned establishment of reserve funds to meet the Exchequer's growing future pensions liability, as previously announced by the Minister, legislation has just been passed this month establishing a temporary holding fund and giving the Agency responsibility for the interim management of these funds pending the preparation, in the early part of next year, of more comprehensive legislation for these funds.**

## **2. DEBT SERVICE OUTTURN**

**In summary, Exchequer debt service costs in 1999 were IR£345 million lower than provided for in the Budget.**

The Government set the debt service budget for 1999 at IR£2,542 million. Debt service costs were effectively lower than this by some IR£345 million as a result of a number of factors including, in particular, the favourable 1999 impact of IR£130 million from the SEP, realised gains of IR£100 million from interest rate and currency swaps, and buoyancy in the Government's finances.

Reported 1999 Exchequer debt service expenditure was IR£2,512 million, some IR£30 million below the budget of IR£2,542 million. Included in this debt service expenditure were two unplanned items:

- a payment of IR£307 million to the CSRA in December at the direction of the Minister for Finance; and
- the payment in late 1999, in order to reduce Y2K transaction risk in early January, of IR£8 million of interest due in the first two weeks of the new year.

Allowing for these items, the adjusted Exchequer debt service expenditure was IR£2,197 million. The overall result, therefore, as shown in the table below, was a favourable debt service variance of some IR£345 million relative to the Budget estimate.

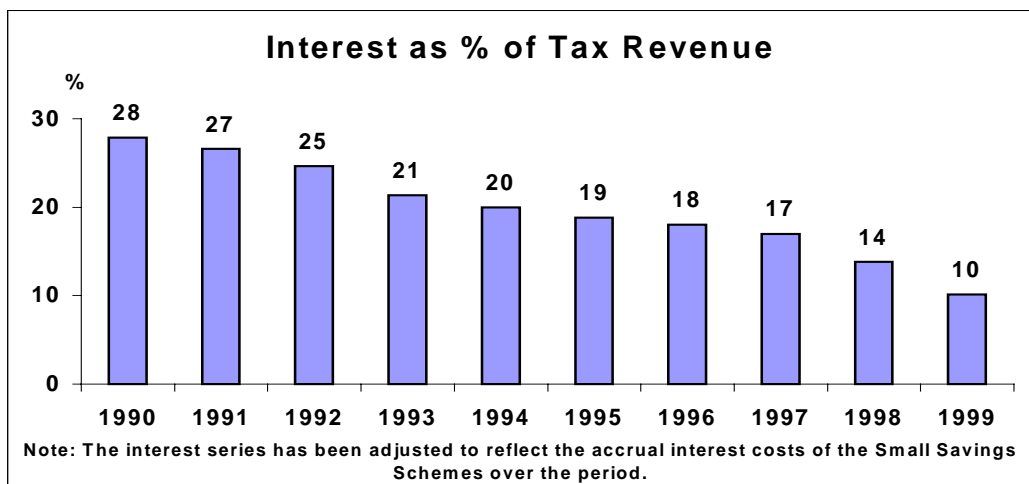
Of this IR£345 million, IR£307 million has been carried forward in the balance in the CSRA, and is available to the Exchequer in future years; the IR£8 million relating to January 2000 interest costs has been factored into the 2000 budget; and some IR£30 million went towards increasing the 1999 Exchequer surplus.

<b>ANALYSIS OF EXCHEQUER DEBT SERVICE OUTTURN RELATIVE TO BUDGET</b>		
<b>(IR£ million)</b>		
	<u>OUTTURN</u>	<u>BUDGET</u>
Exchequer Debt Service Expenditure	2,512	2,542
Less: Payment to CSRA	(307)	-
Less: Y2K early interest payment	<u>(8)</u>	<u>-</u>
Adjusted Exchequer Debt Service Expenditure	<u>2,197</u>	<u>2,542</u>
<b>Adjusted Favourable Variance from Budget</b>	<b>345</b>	

Debt service costs of IR£2,512 million included interest payments of IR£2,159 million, sinking fund payments of IR£329 million and expenses of IR£24 million. The interest payments of IR£2,159 million included the above mentioned transfer of IR£307 million to the CSRA. The underlying interest cost to the Exchequer was IR£1,852 million.

### **3. DEBT SERVICE BURDEN**

The debt service burden continued to fall in 1999. As represented by the ratio of interest payments on the Debt to tax revenues, the debt service burden declined by 4 percentage points to 10%. This continues the strong downward trend of the past several years as can be seen below; the debt service burden is now at just over one third of the level of 1990.



Note: 1999 figure based on latest forecast for tax revenue.

#### **4. MAJOR RESTRUCTURING OF THE IRISH GOVERNMENT BOND MARKET**

Following the launch of the euro, the Agency decided that a major initiative was required to bring the Irish bond market into line with competitor markets. Bonds which had been issued in the past when yields were higher were trading very substantially above their par values; in addition, the outstanding amount in each bond was less than the IR£2 – IR£4 billion regarded as the minimum to ensure liquidity in trading in the new euro environment. Both these factors acted as disincentives for investors. In the absence of steps to address these deficiencies, there was a risk that the market would become peripheral and trade at yields inappropriate to Ireland's credit rating. The initiative taken was the Securities Exchange Programme (SEP), under which holders of old bonds could exchange them for new bonds which carried coupons close to current yields and had technical characteristics analogous to those in other euro zone markets. The bulk of the Programme was carried out in three phases, viz on 11<sup>th</sup>, 17<sup>th</sup> and 25<sup>th</sup> May. On completion of the third phase, over 91% of the outstandings in the old bonds covered by the Programme had been exchanged for four new bonds whose issue sizes ranged from IR£2.2 billion to IR£4.4 billion. Details of the Programme are outlined in Appendix 1.

As part of this Programme the Agency introduced changes in the technical conventions which apply to new bond issues. New Irish bonds have no ex-dividend period; they settle on the basis of T+3 (i.e. three business days after the trade date); and they carry the same day count convention for interest calculation purposes as the core euro denominated sovereign bonds. Arrangements were also put in place to ensure timely settlement of trades in Irish Government bonds between members of the Central Bank's Securities Settlements Office (CBISSO) and the two major international settlement systems - Euroclear and Cedel. Previously these trades took an extra day to settle compared with other sovereign euro bonds. This was a disincentive for potential foreign investors.

The tax changes necessary to facilitate the participation of the Irish insurance companies in the Programme were incorporated in the 1999 Finance Act.

## **5. BOND MARKET DEVELOPMENTS**

During 1999 the Agency raised IR£1.2 billion through a series of nine auctions which were conducted through the six Primary Dealers. The bonds auctioned were the 6½% Treasury Bond 2001, the 3½% Treasury Bond 2005, the 6% Treasury Bond 2008 and the 4% Treasury Bond 2010. This last bond replaced the 6% Treasury Bond 2008 as the new ten year benchmark.

Maturing debt in 2000 amounts to over IR£3.1 billion and, after account is taken of the projected Exchequer surplus, bond issuance of IR£1.6 billion will be required. As in 1999, this will be executed by auctions via the Primary Dealer system. Given that the Irish fund managers have recently adopted a new benchmark in which Irish Government bonds have only a 1.3 per cent weighting, they are likely to have limited appetite for Irish bonds. Against this background, the Agency is planning a comprehensive overseas marketing campaign aimed at new bond investors.

Turnover in Irish government bonds in 1999 amounted to IR£88 billion. Excluding the impact of the Securities Exchange Programme, underlying turnover at IR£40 billion was down by about 45 per cent. Other comparable bond markets in the euro zone experienced similar or greater reductions in turnover. The general fall in turnover in these markets can be attributed in large measure to the heavy concentration of trading in the euro zone in the German 10 year futures market, the benchmark against which other markets are compared. There were, however, encouraging signs in November and December that turnover was beginning to pick up in the Irish bond market.

The yield on the ten year benchmark Irish Government bond started the year at 3.92% and during the year it traded in a range of 189 basis points from a low of 3.83% on 25 January to a high of 5.72% on 20 October. It closed the year at 5.59%.

The spread at which Irish Government bonds traded relative to German Government bonds and the bonds issued by other smaller euro area Governments has improved over the course of the year. This improvement can be attributed to the effect of the Securities Exchange Programme which resulted in Ireland having large liquid benchmark bonds whose technical characteristics are similar to core euro issues. Adjusting for differences in coupons and maturity dates, the Irish ten year bond commenced the year trading at 31 basis points above Germany and finished the year at 23 basis points above Germany. Graphs showing the evolution of five and ten year spreads relative to Germany are shown in Appendix 3. A similar pattern of improved spreads emerges when Irish bonds are compared with those of other euro area countries.

## **6. NATIONAL DEBT / GENERAL GOVERNMENT DEBT**

The nominal value of the Debt as traditionally measured (National Debt), which is calculated net of cash balances, is estimated to be IR£31.4 billion at end 1999, some IR£1.9 billion above the end 1998 level of IR£29.5 billion. Details of the increase are shown in Appendix 4 and reflect the accounting effect of the SEP and the absorption of FEOGA debt into the National Debt. Excluding these exceptional items, the Debt would have fallen by IR£1.3 billion.

Consistent with this underlying decline in the Debt, the market value of the Debt<sup>1</sup> at end 1999 is estimated at IR£31,300 billion, a decline of IR£2,506 billion over the estimated market value of the Debt at the end of last year. This is because the SEP did not add to the market value of the Debt as it merely altered the timing of cash flows. The main factors underpinning the decline in the market value of the Debt were the estimated Exchequer surplus of IR£1.1 billion, a present value decline of IR£1.4 billion due to an increase in bond yields during the year and a decline of IR£135 million as a result of the lengthening of the duration of the portfolio due to the timing

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<sup>1</sup> The market value of the Debt represents the amount of cash that would be required at present to pay off the Debt and in that respect is a useful measure of the Debt as a call on future Exchequer resources.

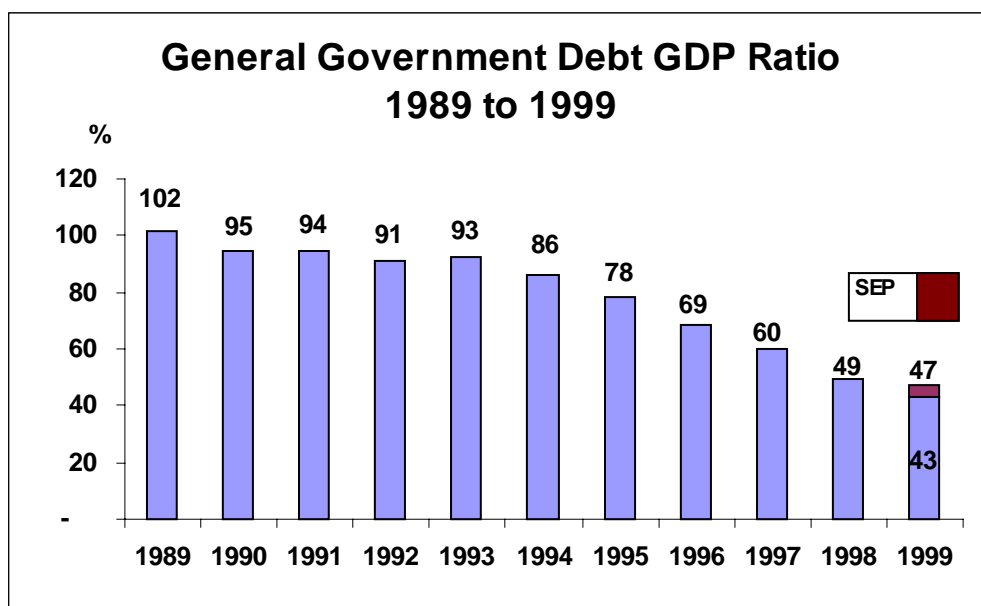
of the implementation of the SEP. Details of the change in the market value of the Debt are shown in Appendix 3.

Due primarily to the IR£2,700 million impact of the Securities Exchange Programme and also to additional Local Authority borrowing and other exceptional items, the General Government Debt increased during the year by an estimated IR£2.5 billion to some IR£33.9 billion. (As noted earlier, this SEP impact does not involve any incremental cost for the Exchequer but rather represents an offset to the current and future reduction in interest costs arising from the Programme. See Appendix 6).

Despite this increase, the GG Debt/GDP ratio actually declined during the year – from 49% at the end of last year to 47% at end 1999, reflecting the approximately 12% growth of GDP this year. Excluding the SEP, the Debt/GDP ratio would have fallen to 43%.

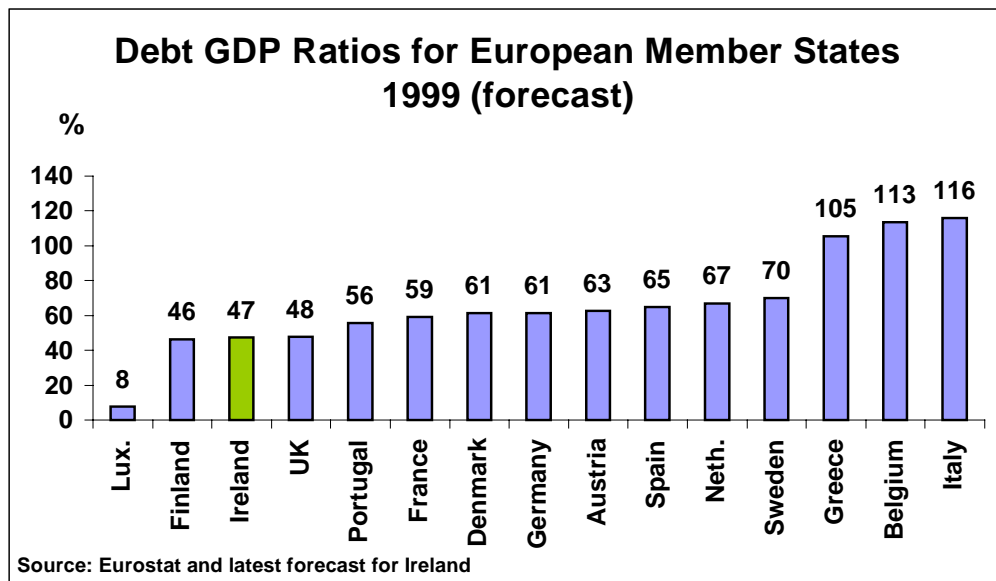
The General Government Debt (GG Debt) is the standard measure used within the EU. The National Debt, as traditionally measured, is the principal component of the GG Debt, but as the GG Debt is a gross measure of debt, it does not allow for the netting of Exchequer balances; in addition it applies a wider definition of Government which includes Local Government debt and some other minor liabilities of Government.

As can be seen below, the GGD/GDP ratio would have fallen to approximately 43% had it not been for the effect of the SEP. A further decline in the ratio, by some 6%, is



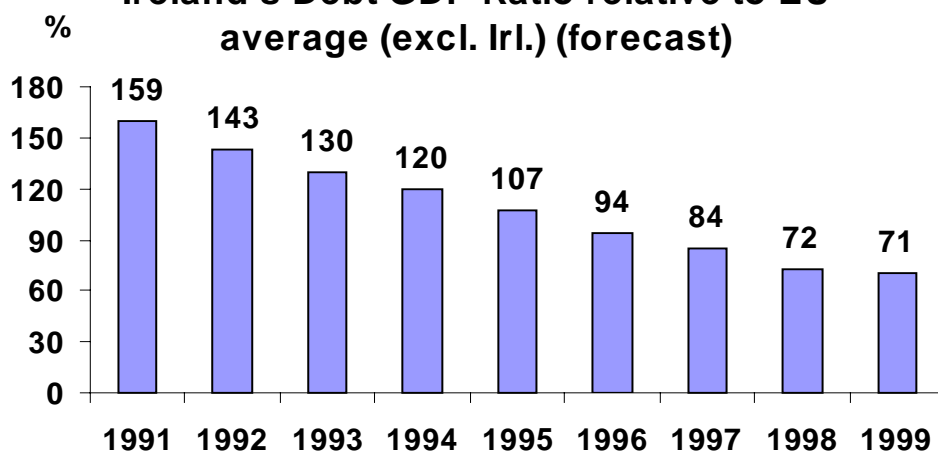
expected in the coming year based on latest budgetary forecasts.

A comparison of Ireland's Debt / GDP Ratio with other EU countries is set out below and shows Ireland having the 3<sup>rd</sup> lowest level of indebtedness relative to GDP amongst the 15 EU Member States.



Ireland's Debt / GDP Ratio has now fallen to some 71% of the EU average at end 1999, contrasting sharply with a ratio of almost 160% in 1991.

**Ireland's Debt GDP Ratio relative to EU average (excl. Irl.) (forecast)**



Source: Eurostat and latest forecast for Ireland.

## **7. ADDITIONAL POWERS FOR THE AGENCY**

During 1999, the Government announced that it would introduce new legislation which will extend substantially the role of the NTMA to provide for the establishment of:

- A State Claims Agency
- A Central Treasury Service, and
- A Fund Management Service

As regards the State Claims Agency, the intention is to enable the NTMA to manage civil law accidental personal injury and property damage compensation claims against the State, to provide advice on risk management and, in time, to provide a captive insurance service for the State. The Minister for Finance has stated that the main benefits expected from the setting up of the Claims Agency are savings in settlement costs and legal charges and, through its risk advice role, to reduce the incidence of claims.

Discussing the proposal to establish a Central Treasury Service, the Minister has stated that this would enable the NTMA to offer advisory and cash management services including deposit, overdraft and borrowing facilities to health boards, vocational education committees, local authorities and other designated public sector bodies with the objective of making savings for the Exchequer.

On the proposal to give the NTMA a formal investment management role, the Minister has stated that the Government's professional investment expertise is concentrated in the NTMA and so it is appropriate that the NTMA should be given the task of managing and investing long term funds held by the State. In this context, it is noted that the Agency has been managing the short term investment of the funds put aside this year by the Government as part of its announced plan to establish social welfare and public sector employee pension reserve funds. Legislation providing for an interim holding fund for these moneys and their investment was recently enacted;

preparatory work on legislation covering the longer term management of these pension reserve funds is under way.

## **8. FEOGA DEBT ASSIGNED TO NTMA IN 1999.**

The NTMA absorbed two tranches of FEOGA Guaranteed Borrowings into the National Debt during the year. These borrowings had previously been managed by the Department of Agriculture, Food and Rural Development. The total amount of debt taken over was IR£375 million. Assignments of the debt were executed with four banks with whom the Department had facilities. These bank facilities have now been extinguished and the borrowings now form part of the overall National Debt, resulting in savings to the Exchequer due to the Agency's lower borrowing costs.

## **9. CREDIT RATING**

In 1999 Ireland maintained its top long term credit rating of AAA from Moody's, FITCH IBCA and Duff and Phelps as well as the AA+ rating from Standard & Poor's.

Ireland also maintained the top short term credit ratings of A1+, P1, F1 and D-1+ from Standard & Poor's, Moody's, FITCH IBCA and Duff and Phelps respectively.

## **10. GOVERNMENT SAVINGS SCHEMES**

The balance outstanding in the Government savings schemes fell by a net IR£101 million in 1999, reflecting the Agency's reduced need for funds last year. Within this total, there was a net inflow of some IR£34 million from Prize Bonds, an increase of IR£10 million over the previous year; the low interest rate environment generally has enhanced the appeal of alternative retail savings products such as Prize Bonds.

## **11. CASH BALANCES**

Cash on deposit - with both the Central Bank and domestic and international banks - and available to the Exchequer at end 1999 is estimated to be in the order of IR£1,100

million. This will be reduced somewhat by cheques drawn on the Exchequer by 30 December but not yet cleared. The Agency thus has ample liquidity going into the New Year.

## **12. ULYSSES SECURITISATION PLC**

Ulysses Securitisation p.l.c. was established in November 1995 for the purpose of securitising local authority mortgage payments. The two bond issues totalling IR£190 million, arranged during 1995 and 1996, are still outstanding. The NTMA continues to manage Ulysses and to provide accounting and administration services in respect of its outstanding debt and its corresponding pool of assets. The bonds were redenominated into euro on 1 January 1999.

## **13. TARGET**

The NTMA became a full member of TARGET on 5 October 1999. TARGET is a system, organised by the European Central Bank, for making payments in euro. The NTMA, by joining TARGET, has gained greater flexibility and efficiencies (including extended settlement time limits) in making and receiving euro denominated payments to and from banks and other counterparties.

**National Treasury Management Agency**

**30 December 1999**

## APPENDIX 1

### Securities Exchange Programme

<b><u>Bonds Bought Back</u></b> <b>(nominal value)</b>	<b><u>May 1999</u></b> <b>IR£ m</b>	<b><u>% of</u></b> <b><u>Original issue</u></b>
6½% Treasury Bond 2001	706	30%
9¼% Capital Stock 2003	1,002	81%
6¼% Treasury Bond 2004	1,503	83%
8% Treasury Bond 2006	2,107	94%
6% Treasury Bond 2008	1,506	93%
8¾% Treasury Bond 2012	975	96%
8¼% Treasury Bond 2015	<u>1,866</u>	98%
	9,665	

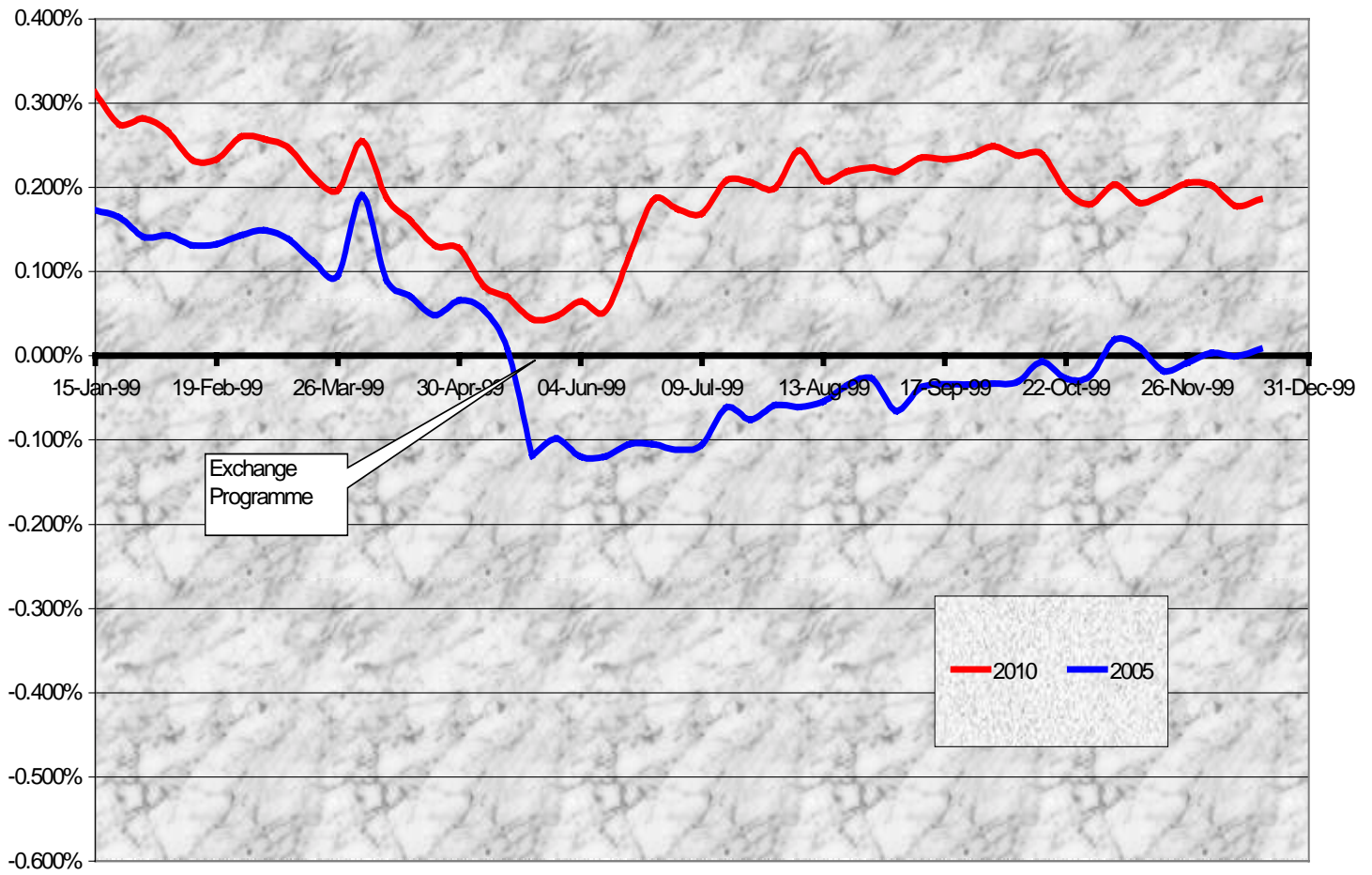
<b>New Bonds Issued</b> <b>(nominal value)</b>	<b>31 May 1999</b> <b>IR£ m</b>	<b>Outstanding as at</b> <b>31 December 1999</b> <b>IR£</b>
2¾% Treasury Bond 2002	2,234	2,375
3½% Treasury Bond 2005	3,421	3,760
4% Treasury Bond 2010	4,380	4,866
4.6% Treasury Bond 2016	<u>2,749</u>	<u>2,740</u>
	12,784	13,741

In the case of the 6½% Treasury Bond 2001, the buyback was limited by the Agency, for market management purposes, to 30 per cent of the outstandings. Excluding the 2001 issue, the average percentage of old issues retired was 91.2%.

Some IR£400 million of funding was arranged as part of the SEP.

## APPENDIX 2

### Irish 5 & 10 year Spread to Germany (Duration Adjusted)



## APPENDIX 3

### Change in Market Value of National Debt in 1999

	<u>IR£ million</u>	<u>€million equivalent</u>
Market value of National Debt (1) (estimated 1/1/99)	33,806	42,295
Less: i) Exchequer Surplus (Dept of Finance forecast)	(1,100)	(1,397)
ii) Reduction due to SEP impact on duration	(135)	(171)
iii) Balance of reduction due to movement in yields	(1,412)	(1,793)
iv) Foreign Exchange Impact	<u>141</u>	<u>179</u>
Market Value of National Debt (1) (estimated end 1999)	31,300	39,743
<b>Reduction in Market Value</b>	<b>(2,506)</b>	<b>(3,182)</b>

**Note** (1) Government Savings schemes and certain minor accounts included at nominal value.

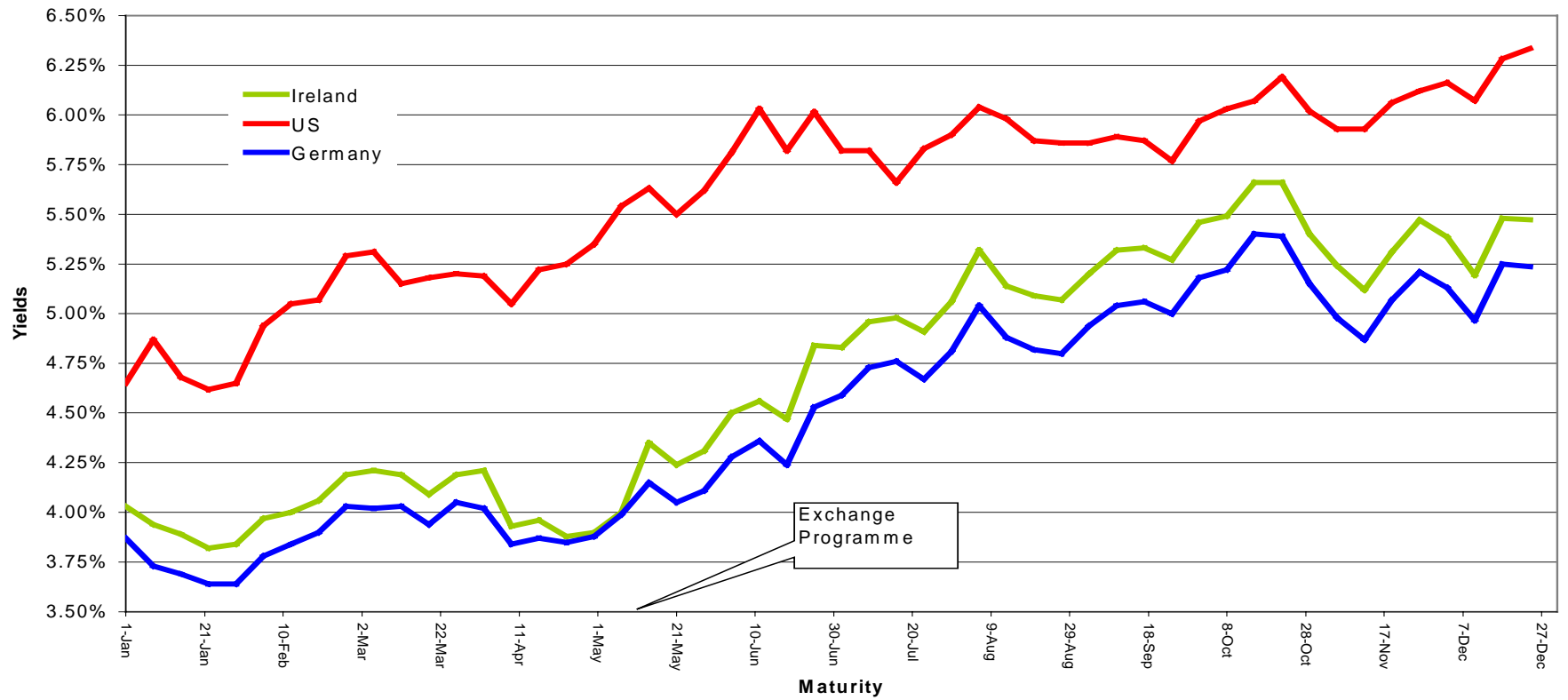
**APPENDIX 4****CHANGE IN NOMINAL VALUE OF NATIONAL DEBT IN 1999**

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	<b>IR£ Million</b>	<b>€million equivalent</b>
<b>Nominal value of National Debt (31/12/1998)</b>	<u>29,540</u>	<u>37,508</u>
Less: i) Exchequer Surplus (Department of Finance forecast)	(1,100)	(1,397)
ii) Exchange Rate Impact	141	179
iii) Impact of change in CSRA current balance	(307)	(390)
<b>Decrease in Debt before exceptional items</b>	<b>(1,266)</b>	<b>(1,608)</b>
<b>Exceptional Items:</b>		
i) Impact of net premia on Tranche and Cancellations		
- SEP IR£2,700      €3,428		
- Other IR£125      €159	2,825	3,587
ii) Absorption of FEOGA borrowing into National Debt	375	476
<b>Increase in Nominal value of National Debt</b>	<u><b>1,934</b></u>	<u><b>2,455</b></u>

# APPENDIX 5

## 10 Year Benchmark Bonds



## Appendix 6

- The increase in the National Debt under the Securities Exchange Programme will be exactly offset by future debt service savings.
- The duration of the National Debt was lengthened under the Securities Exchange Programme.
- As indicated in Appendix 5 the Programme was executed when long-term interest rates were close to their lowest point in the current interest rate cycle.
- The effect of lengthening the duration of the debt at that point in the interest rate cycle is that the Exchequer's debt liabilities are now some IEP135m. lower than they would have been had the Programme not been implemented.

