The Rise, Fall and Revival of the Celtic Tiger

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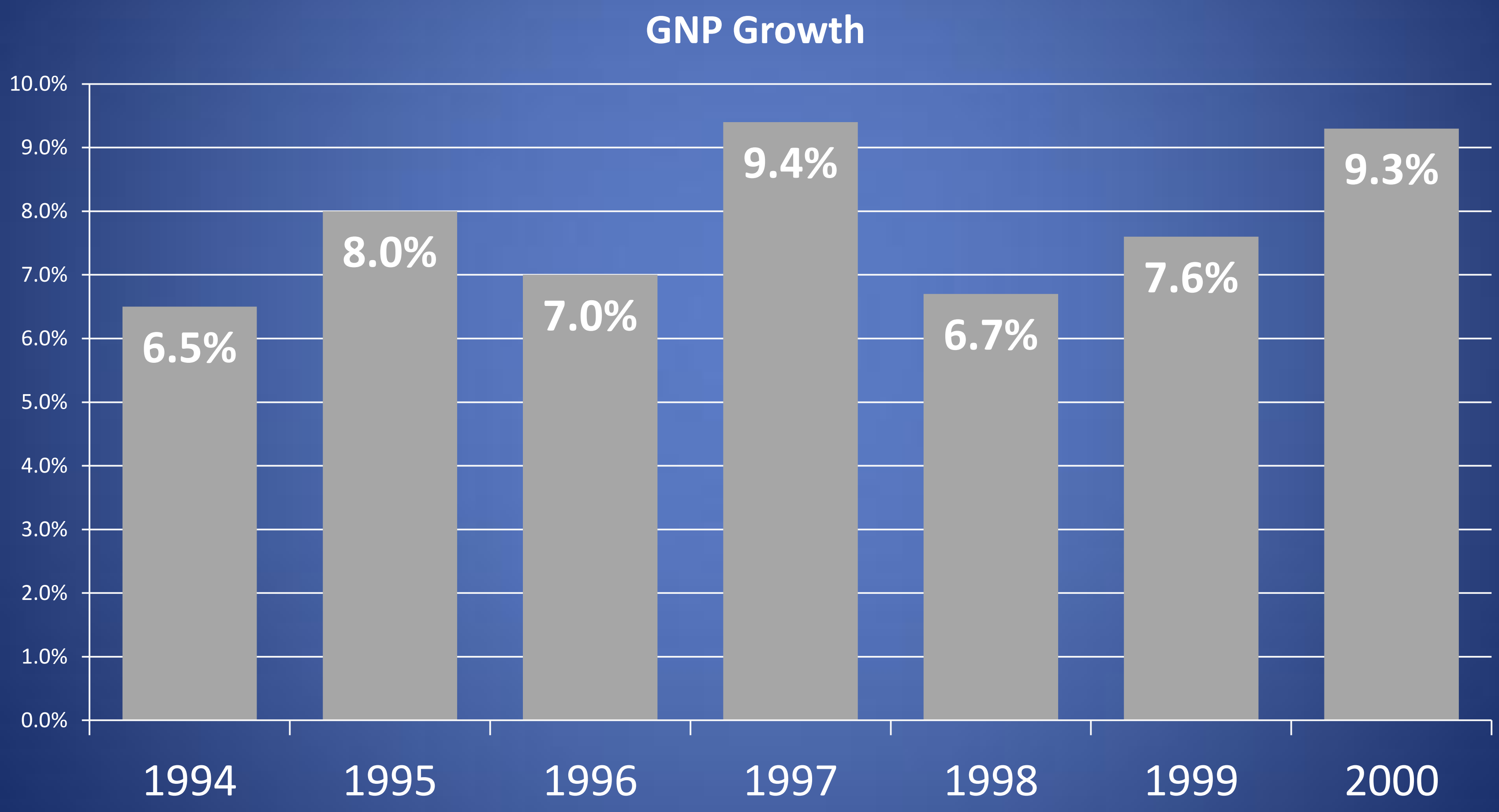
Phase 1 1994-2000 The Golden Years: The Rise of the Celtic Tiger



How Was This Growth Achieved?

- A giant technological revolution in Silicon Valley, California
- The growth of high tech Silicon Valley companies in Ireland
- The Europeanisation of the Irish Economy

The Changing Economic and Political Geography

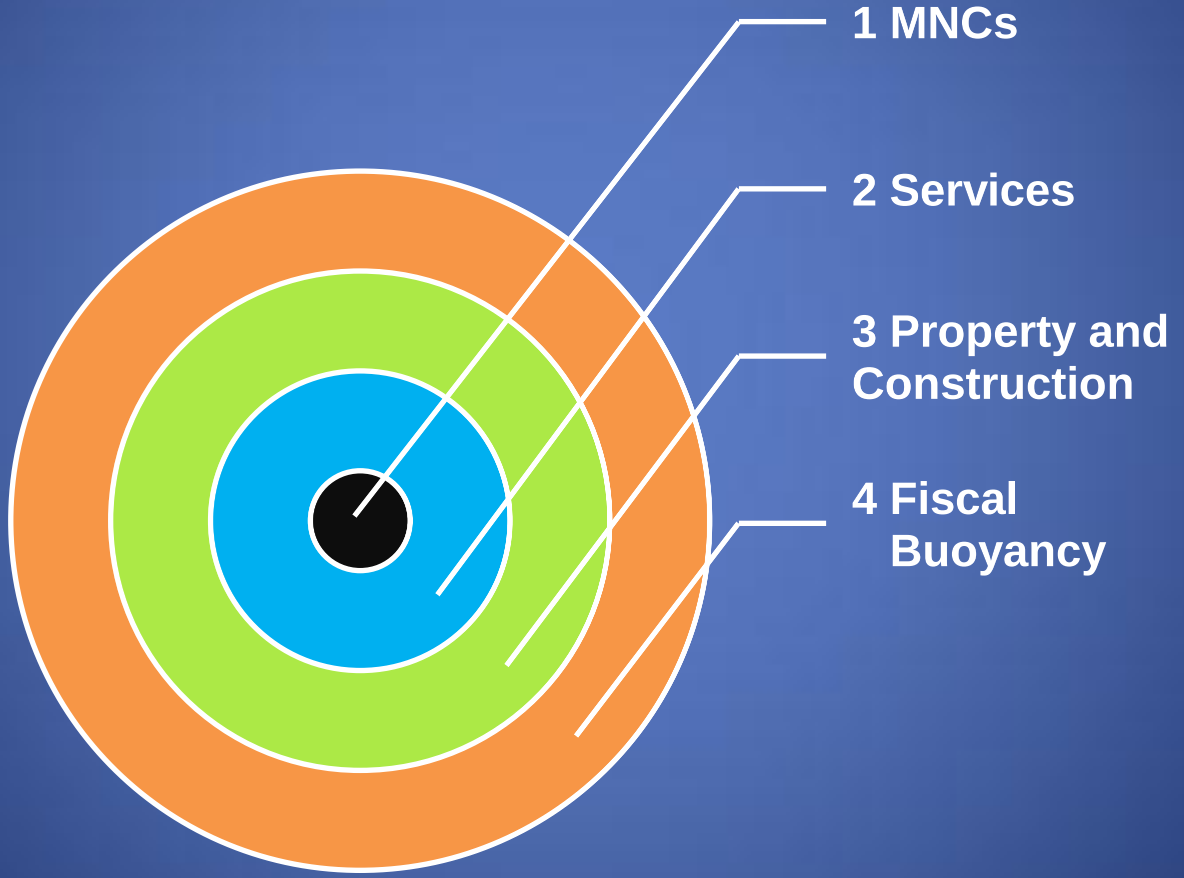
Silicon Valley

European Union

A Compression
Of the Technological
And Trading
Space

A Compression of the
Economic and Political
Space – Creation of the
Single Market and the
Euro

The Celtic Tiger Phenomenon



Evolution of International Financial Environment

International Developments

Glut of Savings

Changing Ideology (EMH and NCM)

Low Interest Rates

International Wholesale Money Market

Financial De-Regulation

Financial Innovation

Sub-Primes
100% LTV
Tracker
Mortgages

Chronology of Events

2000 - The Apogee of the Celtic Tiger:

- ✓ High growth
- ✓ low unemployment
- ✓ budgetary equilibrium
- ✓ low debt to GDP ratio

2001- <u>Major downturn in the Irish property market</u>.

- ✗ Fall-off in growth of exports due to fall in global trade
- ✗ Events of 9/11 add to global trade pessimism

Phase 2 – The Fall of the Celtic Tiger: 2001-2013

- Budget 2002 provided the tax incentives to re-ignite the property market.
- The growth in building and construction suggested that a second phase of the Celtic Tiger had emerged.
- The Irish banks, with first time access to an apparently infinite pool of credit, engaged in Ponzi financing with the builder/developers.

Characteristics of the Irish ‘bubble’ environment

- **<u>Property Market Fever </u> - Human psychology. The leveraging of hope, the belief that all can be wealthy.**

- **<u>Herding by transactors</u>**

- **<u>Little or no regulation </u>**from the Central Bank of Ireland, the Regulatory Authority, the Department of Finance, and the European Central Bank.

- **<u>Groupthink </u>**– ‘This time it is different’. The official belief that the economy would continue to grow, the property market sector would continue to be the driver. At worst, if there were problems, there would be a soft landing.

Bubble Behaviour – The Minsky Model

Three Phases of Financing:

1. **Hedge Financing** – Principal and interest payments made

2. **Speculative Financing** – Interest only paid

3. **Ponzi Financing** – Principal and interest not paid - Assumption that asset prices will continue to rise

Mortgage Lending by Irish Banks (€ billions)

	2003	2008	Growth Rate (%)
AIB	13.2	31.6	139
Bank of Ireland	30.9	60.1	95
Total	44.1	91.7	108

Property and Construction Lending by Irish Banks 2003-2008 (€ billions)

	2003	2008	Growth Rate (%)
AIB	11.1	47.9	332
Bank of Ireland	6.6	35.6	439
Anglo (Development Book)	18.4	74.1	303
Total	36.1	157.6	337

Growth Rates in Property Lending by AIB, Bank of Ireland and Anglo-Irish (per cent)

	2004	2005	2006	2007	2008
AIB	32	53	41	32	32
Bank of Ireland	63	34	40	46	20
Anglo Loan Book	34	41	45	34	9.9

Property Market Crisis

Banking Crisis

Bank Borrowing Guaranteed by the Sovereign

Fiscal Crisis

Growing Budget Deficit

+

Increasing International Borrowing Problem

Financial Crisis

The evolution from the Property Market Crisis to the Financial Crisis

1. Property market starts to crash, a trend accentuated from 2008 onwards.
2. Falling property prices create **the property market crisis**.
3. Bankruptcy of Lehman Brothers causes the international wholesale money markets to freeze.
4. The frozen money markets cause the Irish banks to experience major liquidity problems.
5. Ponzi financing of the builder/developers exposes the solvency of the Irish banks.
6. **The banking crisis** emerges, temporarily concealed by the September 2008 banking guarantee.
7. The collapse of the property market destroys part of the tax base of the government.
8. This allied with excessive government expenditure causes the budget deficit to soar resulting in **the fiscal crisis**.
9. There is capital flight from the banks. The banks can only borrow from the ECB (and indirectly from the CB). The government can no longer borrow to roll over debt or to finance the budget deficit.
10. **The financial crisis** emerges and the Troika arrives.

November 2010 –The Troika's Bailout Programme

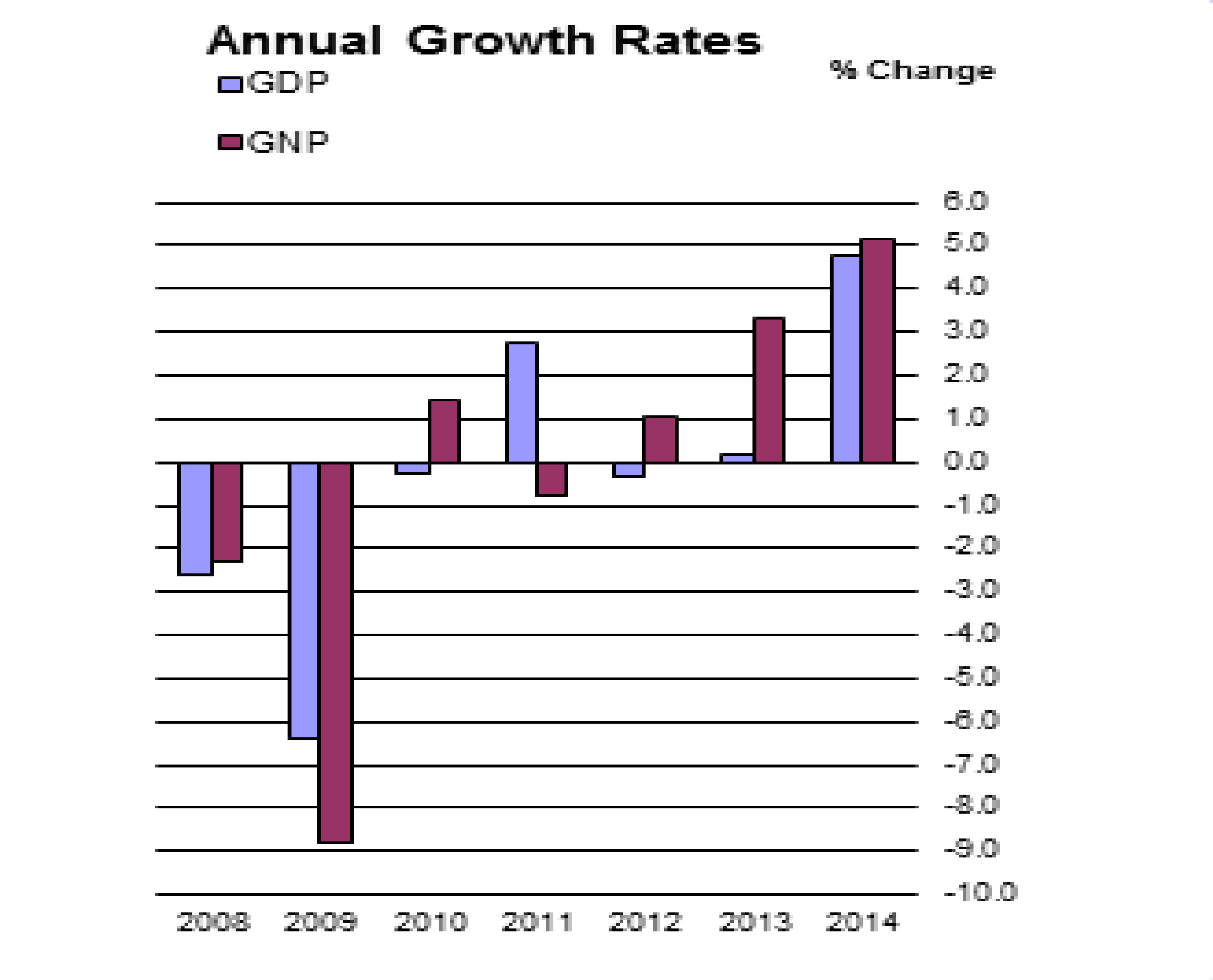
- Control of the banking system effectively vested in the ECB.
- Transfer of Fiscal Sovereignty to the Troika

- €67.5 billion loan provided by the Troika to cover banking losses and to finance budget deficits in the short term. Another €17.5 billion provided from domestic sources, most notably the NPRF

Three years later - December 2013

- By December 2013, some three years after the Troika's arrival, Ireland emerged from the bail-out programme!
- By 2014 the yield on Irish ten year bonds, which in 2010 produced over 20%, had fallen to well below 3%!

Economic Growth Ireland 2008 - 2014



Phase 3 – The Revived Celtic Tiger

- ✓ The Eurozone has become more stable since Mario Draghi's 'whatever it takes' speech. Furthermore the euro has fallen significantly against both the dollar and sterling.
- ✓ Both the US and the UK, two of our major trading partners, have moved back into a growth phase which is undoubtedly helping Irish exports.
- ✓ As a result Irish GDP is currently growing by at least 6.5% in 2015 and GNP by 5.9%.

GNP AND GDP AT CURRENT MARKET PRICES 2009 AND 2014 (€ billions)

	2009	2014
CONSUMPTION	85	89
INVESTMENT	36	37
GOVERNMENT EXPENDITURE	30	27
EXPORTS	159	215
IMPORTS	136	180
GDP	169	189
NET FACTOR INCOME FLOWS	-28	-26
GNP	141	163

- ✓ MNC Sector – Exports from the MNCs drove the first phase of the Celtic Tiger. They are now creating the third phase of the Celtic Tiger.
- ✓ The cost base for the domestic industrial and services sectors has improved enabling it to become more competitive.
- ✓ International perceptions of Ireland have become more positive as seen by the decline in interest rates on Irish bonds.

Potential Problems

- Excessive Reliance on the MNC Sector
- Downturn in the global economy
- A further euro crisis
- Upward movement in interest rates

Specific Problems Relating To MNCs

- How accurate are the MNC statistics?
- Transfer Pricing
- Tax Inversions
- Contract Manufacturing
- Intellectual Property Rights
- Aircraft Leasing
- IFSC Activities

Future Possibilities

- The economy is now firmly embedded in the third phase of the Celtic Tiger, one that is bringing strong economic growth.
- This export led growth should continue to accelerate with a further impetus coming from growing consumption expenditure.
- There is also considerable potential to come from the investment side. Building and construction investment will increase with a lag as more serious efforts are made to address the housing crisis and the growing shortage of office space.

Austerity, Pragmatism and International Cooperation

- The Irish financial crisis has involved considerable austerity. Maybe instead of austerity we should say it involved a return to common sense.
- This common sense has been manifest in the pragmatism of the Irish public who understood the need adhere to the bail-out programme.
- It must also be recognised that Ireland received significant international assistance in successfully emerging from the bail-out (loans of €67.5 billion)
- In the modern world of interconnected international money, banking, finance, trade, etc., no country is an island.