



NUI MAYNOOTH

Ollscoil na hÉireann Má Nuad

The U.S. and Irish Credit Crises: Similarities and Differences

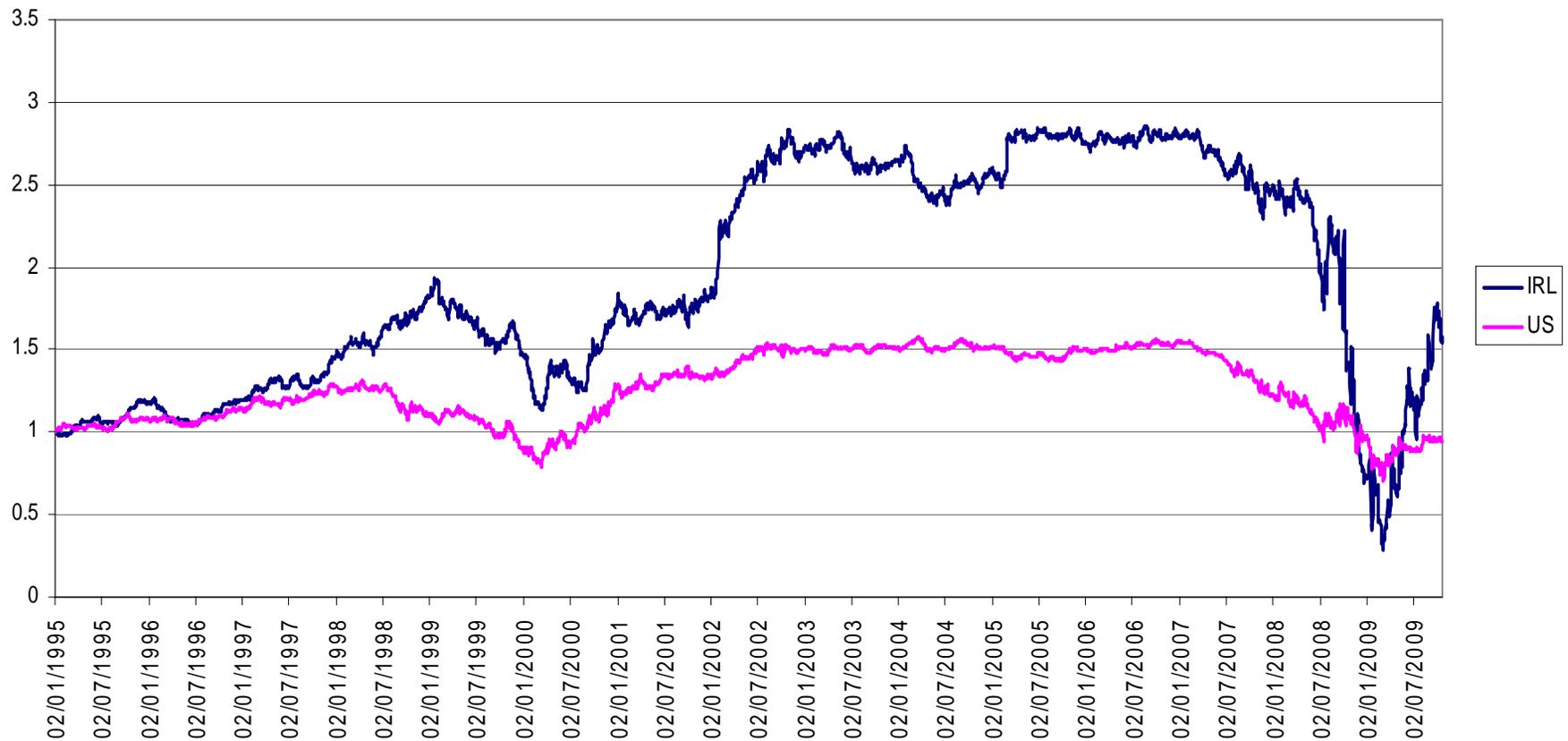
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Irish Financial Crisis

- Ireland has experienced a severe financial crisis
- Our leading financial institutions had to be saved from extinction
- Crisis has spilled over to the real economy and the Irish recession is most severe among advanced economies



Financial Equity Index growth relative to Total Market



Motivation of this study

- Ireland – victim of global crisis or author of its own downfall?
- *“We are exposed to the harsh winds that are blowing in the Anglo-American world at present”.*
Minister for Finance, Brian Lenihan, June 08
- Was it that simple or was there more?

Economic Background

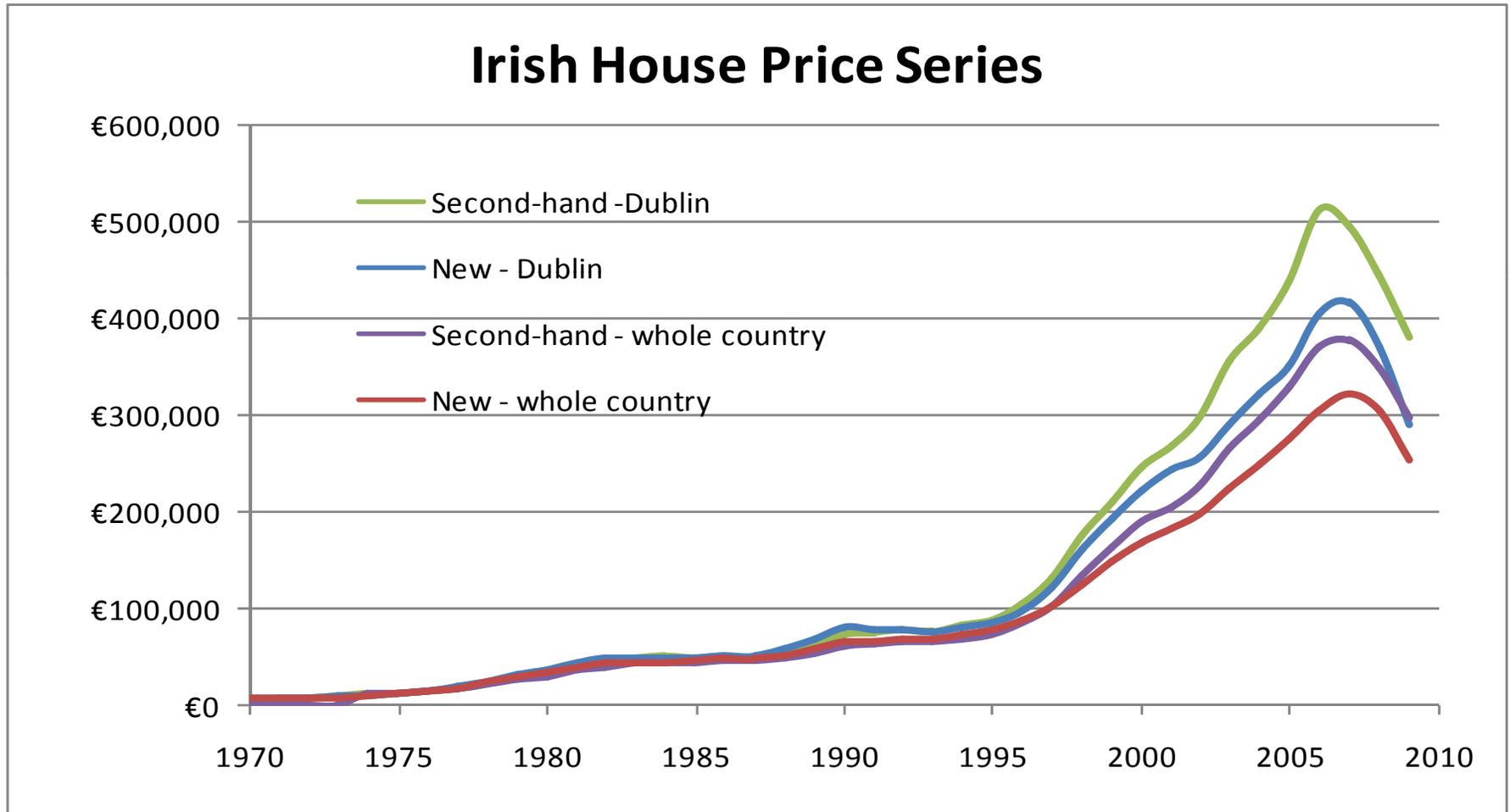
- The Irish economy became the great rags to riches story over the period 1994 – 2006.
 - Average annual economic growth of approx 7%
 - achieved full employment at about 4%
 - increases in standards of living
 - population increased by about 20% to 4.2m.

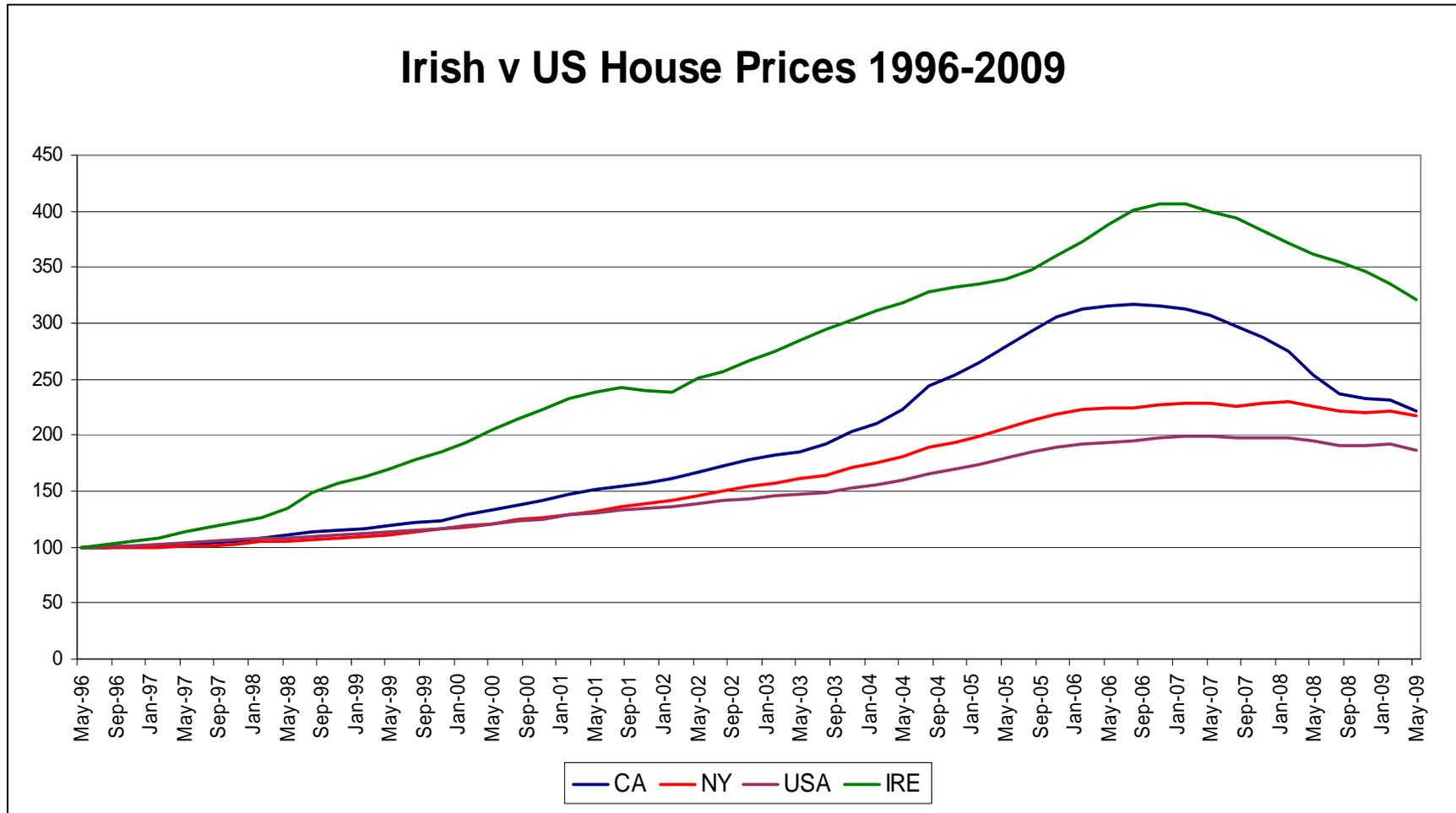
Timing of the Crisis

- Irish Financial Crisis started later than in the US
- Irish house prices began to slow down from March 2007 but mainly due to uncertainty about future tax policy
- Economy grew strongly during 2007 and it appeared that our financial sector had avoided the worst of the crisis

Common Root cause

- As in the US, the root cause of the Irish crisis lay within a financial sector that was over-exposed to the property sector
 - In Ireland, major problems lay in lending for property development and construction
- Bank funding mis-match
 - International Euribor borrowing funding long-term property development loans



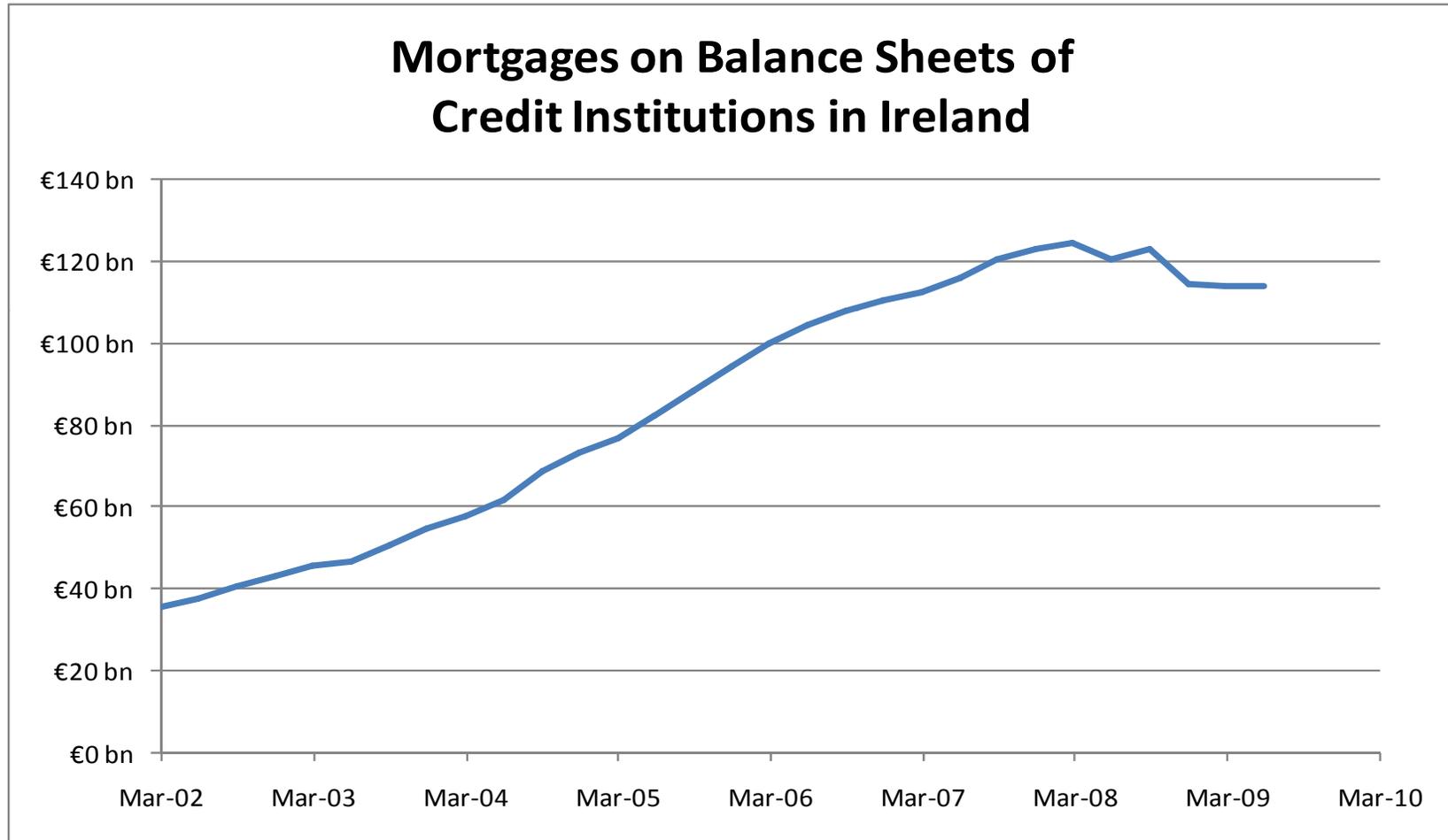


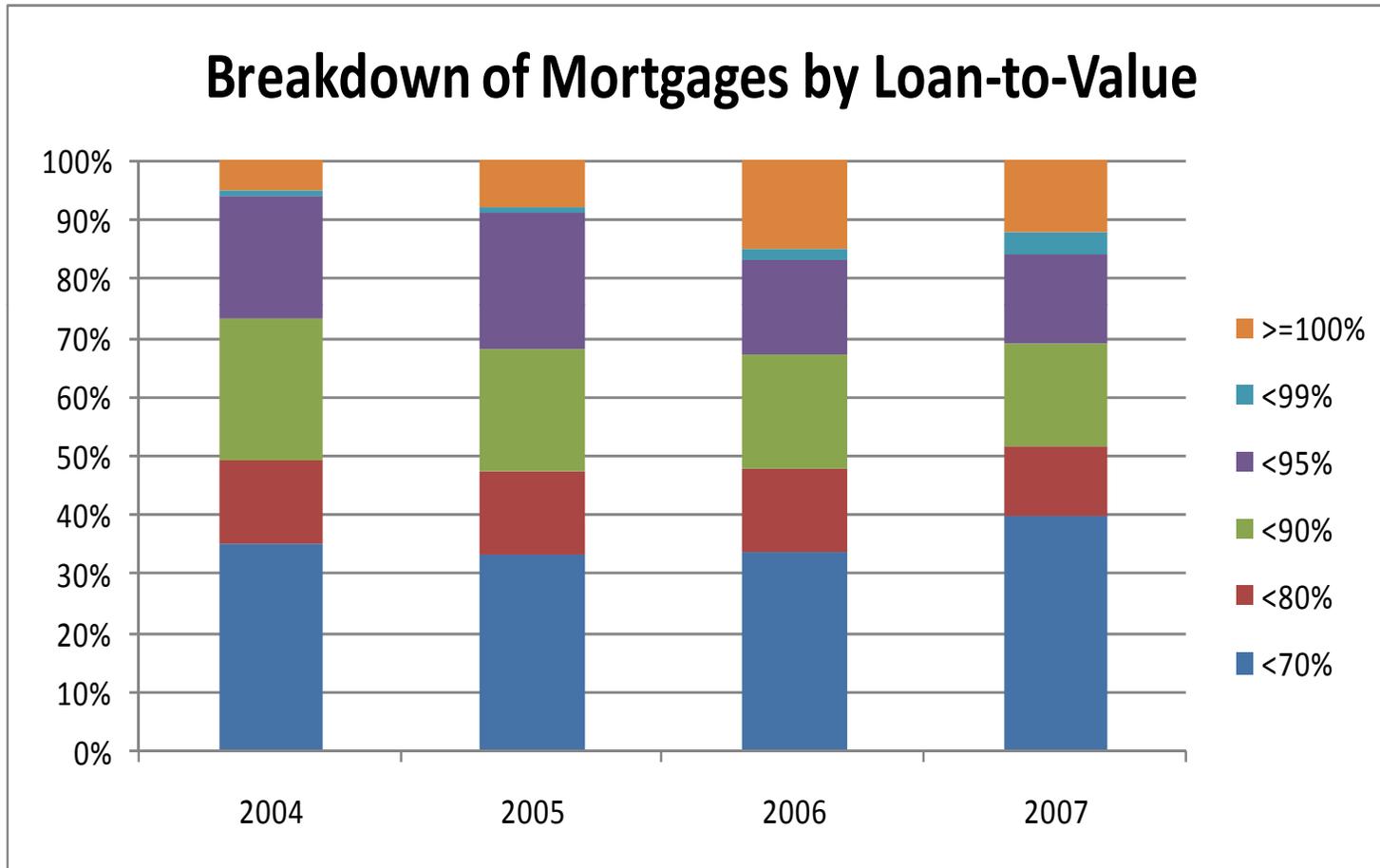
Where did it all go wrong?

- “We drank too deeply from the national cup of, I suppose, confidence . . . The national mood of self-confidence brewed itself up into overdrive.”
 - AIB chairman, Dermot Gleeson, May 2009

Role of the financial sector

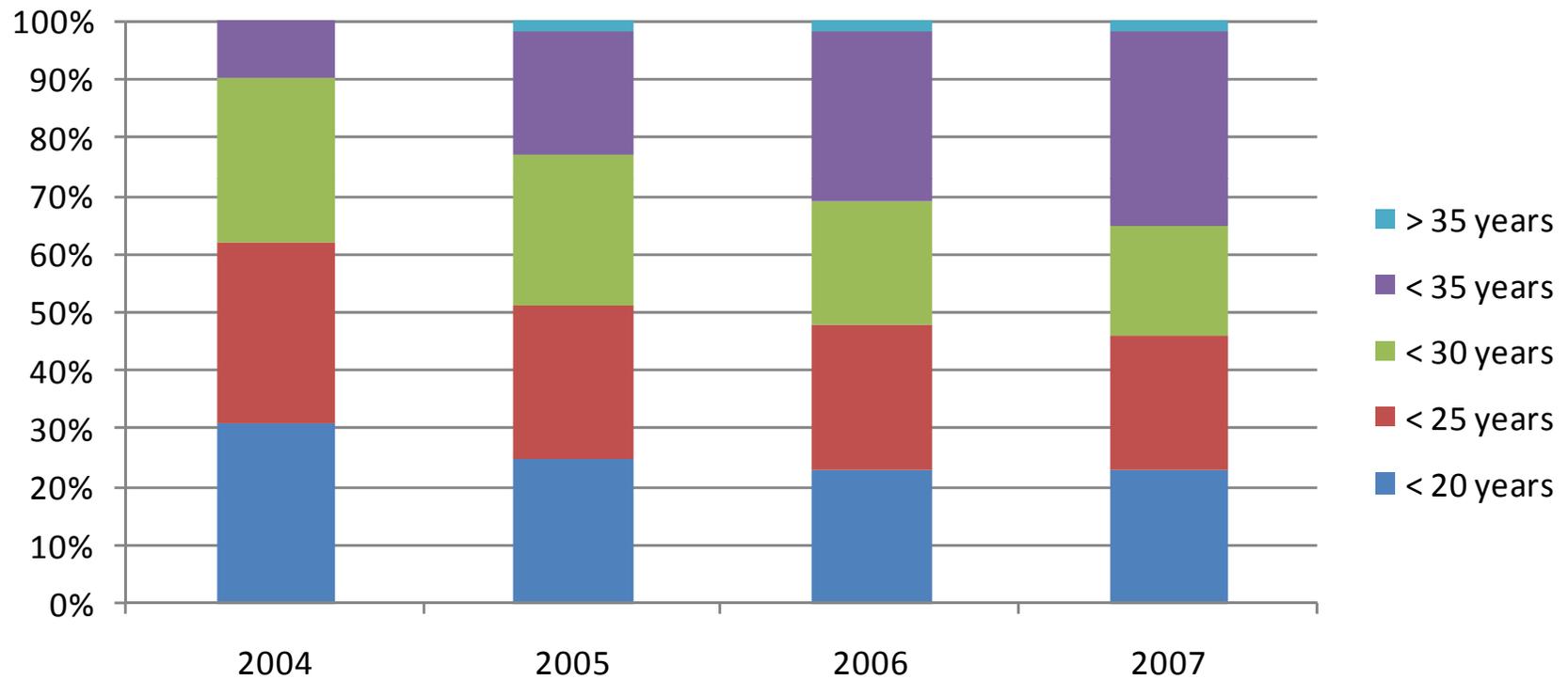
- Financial Innovation
 - Little securitization
 - Banks typically retained loans on balance sheet
 - Originate & hold **NOT** Originate & distribute
- Declining standards applied to lending
 - Low cost of funding (Eurocurrency)
 - Battle for market share
 - Huge increase in credit extended







Breakdown of Mortgages by Loan Maturity

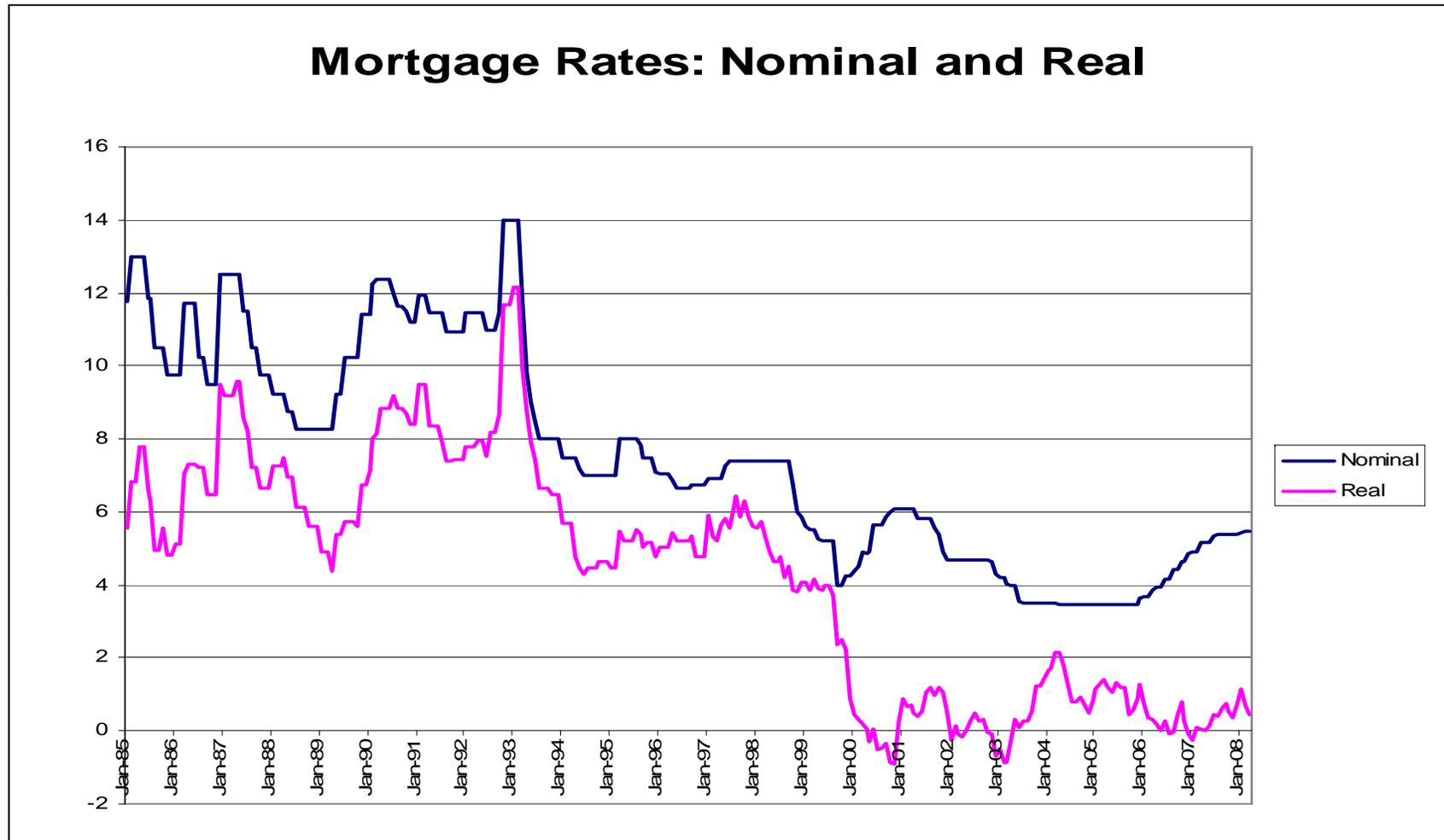


Undiversified Loan Book

- Woods (2007) shows that as a proportion of lending to the private sector, property-related lending grew from 38% in 2001 to over 62% in 2007.
- Increasing proportion to Commercial property where income yields were very low relative to other Euro zone countries

The role of the Euro

- Ireland signalled their intention to join the Euro project at the earliest opportunity
- As date of single currency approaches, nominal rates fall
- Throughout period of Euro, real rates have been very low as Irish inflation outstripped that of Euro partners



Role of Government

- Encouraged people to invest in property through a series of tax-incentive schemes
 - Hotels
 - Rural regeneration
- Failure to regulate
 - Importance of stamp duty to public finance
 - Cronyism
 - ‘Bureaucratic gambling’

Manifestation of the Crisis

- In late September 2008, Irish financial sector and government have to acknowledge severity of the crisis
- Freezing of Interbank lending markets after Lehman Brothers collapse
- At least one bank unable to roll-over their foreign borrowings
- The crisis then moves to a Resolution phase

Resolution Phase

- The government provided a blanket guarantee to the depositors and all creditors of six domestic banks
- Government feared that contagious effects due to the concentrated nature of Irish bank could create systemic risk

Resolution Phase

- Government promise a recapitalization programme
 - Jan 09: Nationalization of Anglo Irish Bank
 - Feb 09: €7bn injection for BOI and AIB
- Establish National Asset Management Agency (NAMA)
 - (Bad) Asset purchase scheme
- No fiscal stimulus package

Euro Membership in the Crisis

- Avoided a currency attack
- ECB has been an important provider of liquidity to Irish banks



Summary

Causes of the Crises	US	Ireland
Securitization	✓	X
Effective closure of market trading	✓	X
Decline in Lending standards	✓	✓
Easy credit	✓	✓
Lack of diversification	?	✓
Irrational exuberance	✓	✓
Government Policies	✓	✓

Conclusion

- Although the US credit crisis precipitated it, the Irish crisis is identifiably separate
- Many common features but these are often arrived at by differing routes
- Global events hastened Irish crisis but fundamental weaknesses already existed
- Resolution of crisis has common elements but important differences