How the economic crisis started ... and where we are now

By Thomas Molloy, Deputy Business Editor

(1) Ireland joined the euro in 1999 and began using notes and coins in 2002. Having a single currency across Europe means that the European Central Bank sets the basic interest rate. This brought down interest rates in Ireland to levels that had not been seen here in generations. That made borrowing less expensive. It promoted rapid growth here which encouraged foreign banks to lend money to Irish banks which then lent money to people to buy houses, cars and holidays. As money poured into the country, Irish people were able to borrow at very cheap rates. This encouraged them to borrow even more money which pushed up property prices to levels never seen before. Ireland had a huge property boom.

(2) Similar things were happening in many other parts of the world, especially in countries like the US and Britain where governments also encourage people to own houses thanks to generous tax reliefs. As more and more people in the US bought homes, banks chased the remaining people without houses. These people often knew very little about finance and were encouraged to take on big loans that were never likely to be paid back. Banks wrapped these loans together in large bundles with other property loans and then sold them to other banks.

(3) In 2006 and 2007, some banks began to worry that these "toxic loans" were valueless. After years of lending to people who would never repay loans, the banks and investment companies such as hedge funds, which invest money on behalf of other people, began to panic. Banks all over the world very quickly began looking for their money back from other banks and stopped lending. No bank trusted any other bank and lending between banks almost came to a standstill. Good banks and bad banks were caught up in this "credit freeze".

(4) Here in Ireland, the banks were borrowing far more money from foreign banks and investors than they were getting from depositors. They used this money to fund the boom in Ireland, mainly in property. When foreign banks began pulling back lending, Irish banks were in real trouble. The problem became really serious after the US government allowed an influential bank called Lehman Brothers to collapse in 2008. When Lehman went to the wall, banks everywhere refused to lend. This forced the chief

executives of the biggest banks in Ireland to beg the Irish government to "guarantee" all the money lent to Irish banks. The government was in a bind. Failure to guarantee the banks' borrowing would have led to foreign banks demanding immediate repayment and pushed at least some Irish banks to the wall. In the end, the government issued a "bank guarantee scheme" which appeared to protect the banks from foreign creditors.

(5) The guarantee worked for a few weeks but investors became worried that the State could not afford to pay the banks' debts. Investors stopped lending to the Irish government as well. This created a real problem for the government. Just when it needed money the most, it could not borrow money except at a very high cost. When Anglo Irish Bank, which specialised in property lending, went bust, the State was forced to honour the guarantee and take the bank under State control. The cost of doing this was around €35bn or roughly the same amount as the entire country owed before the credit crisis began.

(6) As the Irish banks faced demands from foreign banks for the return of their money, lending to Irish companies dried up. Many companies and small businesses that rely on borrowing collapsed. Some of these businesses had borrowed foolishly to buy land or fund lifestyles but many other businesses were well run companies that had always relied to lending at certain times of the year. Some banks were so focussed on property lending that they did not understand lending to other types of business. The so-called credit crunch began destroying the country's companies, leading to closures and high unemployment.

(7) Things went from bad to worse as the government had to pump tens of billions into the two big banks, Allied Irish Banks and Bank of Ireland. In total, the State pumped €64bn into the banking sector - money that it could not borrow because nobody wanted to lend to Ireland. The government was forced to ask for help from the International Monetary Fund and from the European Union. In return for massive loans of €85bn (called a bailout) the government had to agree to a programme of spending cuts and tax increases to get our budget deficit back under control over a few years. To oversee this programme officials from the organisations helping Ireland visit here regularly to monitor our progress.

(8) While the bailout saved Ireland from complete collapse, it triggered doubts in many investors' minds about whether the European Union itself would be able to rescue Ireland alongside Greece and Portugal who were in similar trouble. As those doubts became stronger and stronger, many investors sucked their money out of Europe and invested in countries such as Brazil and India. The debt crisis in Europe became worse throughout 2010 and 2011 as people began to fear that it would destroy Europe's biggest economies or the euro.

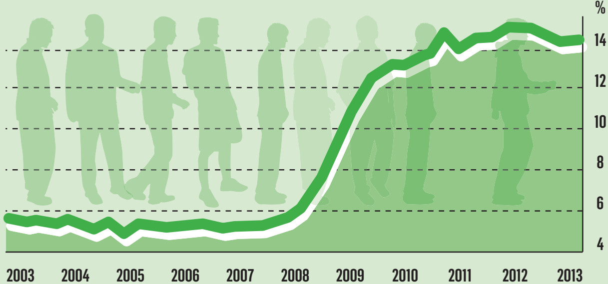
(9) In 2012, European leaders finally took action. They allowed Greece to cancel some debts and promised everybody

that the single currency would be kept together at all costs. This promise, combined with lots of extra money for European banks from the European Central Bank, quickly had a calming effect on the markets. No country benefited more than Ireland. Greece and Portugal did not recover quickly because the government and economy were seen to be inefficient. Ireland did well, with the cost of borrowing falling, because the country was seen to have a resilient economy, very high exports and a government that did not break promises.

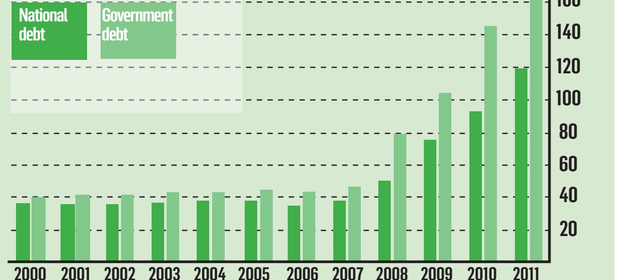
(10) In 2012, the economy here slowly started to grow again. In fact, the economy grew in 2011 but the expansion was so small after years of contractions that nobody believed the return of growth. In 2012, the economy expanded again and all the forecasters expect growth again this year. Unfortunately, companies are still very cautious which means unemployment and emigration remain very high. People are also shopping less because taxes have increased, many salaries have fallen and many people must repay debts borrowed during the first half of the last decade. While these trends will continue for a long time, more and more economists believe the worst is over for Ireland despite the serious challenges ahead.

People in employment, unemployed, total work force (thousands)

2000	1,684.1	79.6	1,763.7
2001	1,738.0	69.4	1,807.4
2002	1,768.5	82.3	1,850.8
2003	1,800.0	86.7	1,886.7
2004	1,852.2	87.8	1,940.0
2005	1,944.6	95.8	2,040.4
2006	2,034.9	97.9	2,132.8
2007	2,113.9	103.1	2,217.0
2008	2,112.8	126.7	2,239.6
2009	1,938.5	264.6	2,203.1
2010	1,859.1	293.6	2,152.7
2011	1,821.3	304.5	2,099.9



Irish unemployment was among the lowest in Europe during the boom but shot up after the global financial crisis began.



Ireland had one of the smallest debt piles in the world in the first half of the last decade as revenue from property sales filed government coffers.

Nama
The National Asset Management Agency (NAMA) was established in December 2009 to take away the mountain of bad property loans in Irish banks which had made them insolvent. Because the banks had no money to lend, the economy was being stifled. NAMA acquired the loans from the banks at a heavy discount. It took on around €80bn in property loans for which it paid the banks around €54bn. At the same time the state put more capital into the banks, effectively nationalising them. The aim was to enable the banks to function again in the normal way, making loans to businesses and individuals. NAMA's objective is to obtain the best achievable financial return for the State on the property loans by holding them until the market improves. It is likely that many of the loans will be held for at least ten years.

Bailout target
The IMF/EU bailout for Ireland of €85bn was necessary to allow the state to function when it could no longer borrow money. The growth in state spending during the boom, followed by the collapse in tax revenue when the boom ended, had led to unsustainable budget deficits. As part of the deal to get the bailout money Ireland had to agree to reduce the budget deficit each year over a four year programme. The agreed aim is to reach a budget deficit of 3pc of GDP by the year 2015.

Deal to reduce cost of our bank debt
The bailout of Anglo Irish Bank cost the State an astonishing €34bn. Because the government did not have the money, it reached a very complicated arrangement in 2010 with the European Central Bank which involved borrowing the money at low interest rates in an unusual way using promissory notes. A promissory note is like an IOU. The government agreed to return the money by repaying around €3.1bn a year for the next decade. As things got worse in the economy over the past two years, it became clear that the government was not in a position to meet these payments. To avoid repaying the money, Finance Minister Michael Noonan held many months of talks with the ECB which finally resulted in a new deal which will spread out the repayment over many decades. Mr Noonan hopes that the sums involved will seem quite small in 20 or 30 or 40 years time. The government also hopes to convince the ECB to help with the €31bn cost of bailing out the other banks. Discussions on this continue and a result is not likely until the end of the year.