

## CURRENCY, CREDIT AND CRISIS

The global financial crisis in 2008 brought central banking centre stage, prompting questions about the role of national central banks and – in Europe – of the multi-country European Central Bank. What can central banks do, and what are their limitations? How have they performed? *Currency, Credit and Crisis* seeks to provide a coherent perspective on the functions of a central bank in a small country by assessing the way in which Ireland's financial crisis from 2010 to 2013 was handled. Drawing on his experiences as Governor of the Central Bank of Ireland and in research and policy work at the World Bank, Patrick Honohan offers a detailed analytical narrative of the origins of the crisis and of policymakers' conduct during its most fraught moments.

Patrick Honohan is Honorary Professor of Economics at Trinity College Dublin, Nonresident Senior Fellow at the Peterson Institute for International Economics and a Research Fellow of the Centre for Economic Policy Research (CEPR).

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(Continued after Index)

# Currency, Credit and Crisis

*Central Banking in Ireland and Europe*

**PATRICK HONOHAN**

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## Contents

|   |                 |
|---|-----------------|
| <i>List of Figures, Table and Boxes</i> | <i>page</i> vii |
| <i>Acknowledgements</i>                 | ix              |
| <i>List of Abbreviations</i>            | xiii            |
| <i>Banking Dramatis Personae</i>        | xvi             |
| Introduction                            | 1               |
| PART I CURRENCY                         |                 |
| 1 Currency Choices                      | 21              |
| 2 Towards the Euro                      | 49              |
| 3 The Euro Area Crisis                  | 73              |
| PART II CREDIT                          |                 |
| 4 Safe and Sound Banking                | 99              |
| 5 Faults in Financial Services          | 126             |
| 6 The Role of the Central Bank          | 153             |
| PART III CRISIS                         |                 |
| 7 The Guarantee                         | 179             |
| 8 The Race to Stabilize the Banks       | 209             |
| 9 The Bailout                           | 232             |
| 10 Cleaning Up                          | 256             |

## PART IV TAKING STOCK

|    |                                     |     |
|----|-------------------------------------|-----|
| 11 | The European Decade of Bank Failure | 289 |
| 12 | The Irish Economy in Boom and Bust  | 312 |
| 13 | Lessons Learnt                      | 339 |
|    | <i>References</i>                   | 354 |
|    | <i>Index</i>                        | 364 |

## Figures, Table and Boxes

### Figures

|      |  |                |
|------|--|----------------|
| I.1  | Total numbers at work, 1998–2018   | <i>page</i> 15 |
| I.2  | Distribution of population, 1961–2016                                      | 16             |
| 1.1  | Consumer prices in Ireland, 1914–2018                                      | 26             |
| 1.2  | Nominal anchor: Alternative exchange rate regimes, 1970–2018               | 28             |
| 2.1  | Relative hourly earnings, 1975–2008  | 52             |
| 2.2  | Real interest rates, 1983–2013   | 53             |
| 2.3  | Nominal effective exchange rate, 1979–2008                                 | 63             |
| 2.4  | Ireland and Iceland: Real wages, 2000–14                                   | 66             |
| 3.1  | Yield spread roughly equals exchange rate risk plus credit risk, 1990–2013 | 78             |
| 4.1  | Total assets of six Irish banks, 1998–2008                                 | 111            |
| 4.2  | Dublin real house prices, 1971–2018  | 112            |
| 4.3  | Share of new mortgages at high loan-to-value ratios, 2004–7                | 113            |
| 5.1  | Variable mortgage interest rates Ireland and the UK, 2003–13               | 129            |
| 5.2  | Number of owner-occupier mortgages in arrears, 2009–18                     | 136            |
| 5.3  | Repossessions and surrenders of owner-occupied properties, 2009–18         | 137            |
| 7.1  | Ireland: Allocation of banking losses                                      | 201            |
| 8.1  | Central bank financing of the Irish banking system, 2003–12                | 228            |
| 10.1 | Projections and outcomes, 2010–15  | 281            |
| 10.2 | Scale of austerity compared to bank creditor bailout, 2008–15              | 283            |
| 12.1 | Total employment, 1970–95 and 1998–2018                                    | 317            |
| 12.2 | Unemployment rates: Ireland, the UK and euro area, 2006–14                 | 319            |
| 12.3 | Unemployment in two cycles, 1967–92 and 1993–2017                          | 319            |

|      |  |     |
|------|--|-----|
| 12.4 | Real per capita personal disposable income, 1970–90<br>and 1996–2016                 | 320 |
| 12.5 | Irish long spread over bunds, 1971–91 and 1998–2018                                  | 323 |
| 12.6 | Actual and hypothetical GDP, 2000–10   | 325 |
| 12.7 | Fall in numbers employed from 2007 peak to trough and to 2017,<br>European countries | 334 |
| 12.8 | Numbers at work: Selected EU countries, 1998–2017                                    | 335 |

**Table**

|     |                               |     |
|-----|-------------------------------|-----|
| 7.1 | Main banks in Ireland in 2008 | 199 |
|-----|-------------------------------|-----|

**Boxes**

|      |  |     |
|------|--|-----|
| 2.1  | Foreign Exchange Reserves  | 69  |
| 4.1  | Glimpses of the Banks' Risk Culture from the Banking Inquiry                               | 118 |
| 4.2  | Two Costly Risk Management Failures: Neglecting Bubble Risk<br>and Cross-Collateralization | 120 |
| 7.1  | Iceland  | 203 |
| 12.1 | The GDP Measurement Problem  | 323 |



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xi

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## Abbreviations

|        |  |
|--------|--|
| ACC    | Agricultural Credit Corporation                |
| AIB    | Allied Irish Banks                             |
| BdL    | Bank deutsche Länder                           |
| BIS    | Bank for International Settlements             |
| BNP    | Banque Nationale de Paris                      |
| BOSI   | Bank of Scotland Ireland                       |
| BRRD   | Bank Recovery and Resolution Directive         |
| C&AG   | Comptroller and Auditor General                |
| CCAR   | Comprehensive Capital Analysis and Review      |
| CEBS   | Committee of European Bank Supervisors         |
| CFD    | contract for difference                        |
| CHC    | Custom House Capital                           |
| CoCo   | contingent capital security                    |
| DEPFA  | Deutsche Pfandbriefbank                        |
| DGCOMP | Directorate General for Competition            |
| DM     | deutsche mark                                  |
| DSG    | Domestic Standing Group on Financial Stability |
| EBS    | Educational Building Society                   |
| ECB    | European Central Bank                          |
| ECU    | European Currency Union                        |
| EFSF   | European Financial Stability Facility          |
| EFTA   | European Free Trade Area                       |
| ELA    | emergency liquidity assistance                 |
| EMS    | European Monetary System                       |
| EMU    | European Economic and Monetary Union           |
| ERM    | Exchange Rate Mechanism                        |
| ESM    | European Stability Mechanism                   |

|       |  |
|-------|--|
| ESRB  | European Systemic Risk Board                           |
| ESRI  | Economic and Social Research Institute                 |
| EU    | European Union   |
| FDI   | foreign direct investment                              |
| FHLMC | Federal Home Loan Mortgage Corporation                 |
| FMS   | Financial Market Stabilisation Wertmanagement AöR      |
| FNMA  | Federal National Mortgage Association                  |
| FRN   | floating rate note                                     |
| G7    | Group of Seven   |
| GDP   | gross domestic product                                 |
| GFC   | global financial crisis                                |
| GNI   | gross national income                                  |
| GNP   | gross national product                                 |
| GPA   | Guinness Peat Aviation                                 |
| HAMP  | Home Affordable Modification Program                   |
| HBOS  | Halifax Bank of Scotland                               |
| HRE   | Hypo Real Estate                                       |
| IBRC  | Irish Bank Resolution Corporation                      |
| ICI   | Insurance Corporation of Ireland                       |
| IFAC  | Irish Fiscal Advisory Council                          |
| ILP   | Irish Life and Permanent                               |
| IMF   | International Monetary Fund                            |
| INBS  | Irish Nationwide Building Society                      |
| ISTC  | International Securities Trading Corporation           |
| LCH   | London Clearing House                                  |
| LTI   | loan-to-income ratio                                   |
| LTRO  | longer-term refinancing operation                      |
| LTV   | loan-to-value ratio                                    |
| MNC   | multinational corporation                              |
| NAMA  | National Asset Management Agency                       |
| NCB   | national central bank (in euro area)                   |
| NPRF  | National Pension Reserve Fund                          |
| NTMA  | National Treasury Management Agency                    |
| OECD  | Organisation for Economic Co-operation and Development |
| OMT   | outright monetary transactions                         |
| OPEC  | Organization of Petroleum Exporting Countries          |
| PCAR  | prudential capital adequacy review                     |
| PMPA  | Private Motorists Protection Association               |
| PN    | promissory note  |

*List of Abbreviations*

xv

|        |   |
|--------|---|
| PPI    | payment protection insurance  |
| PSI    | private sector involvement  |
| PTSB   | Permanent-Trustee Saving Bank   |
| PWC    | Pricewaterhouse Coopers   |
| QE     | quantitative easing   |
| RBS    | Royal Bank of Scotland  |
| RSA    | Royal and Sun Alliance  |
| SAREB  | Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria  |
| SGP    | Stability and Growth Pact   |
| SMP    | Securities Market Programme   |
| SRB    | Single Resolution Board   |
| SSM    | Single Supervisory Mechanism  |
| SVR    | standard variable rate  |
| TARGET | Trans-European Automated Real-time Gross Settlement Express Transfer System |
| TARP   | Troubled Asset Relief Program   |
| TCD    | Trinity College Dublin  |
| TFEU   | Treaty on the Functioning of the European Union                             |
| TLTRO  | targeted longer-term refinancing operation                                  |
| UBS    | Union de Banques Suisses/Union Bank of Switzerland                          |
| UCD    | University College Dublin   |
| USC    | universal social charge   |
| WaMu   | Washington Mutual Savings Bank  |

## Banking Dramatis Personae

Name changes and mergers among banks complicate the story. To help the reader keep track we provide a simplified and informal list here in alphabetical order of the most important banks involved.

**ACC Bank.** Formerly the government-owned Agricultural Credit Corporation, ACC Bank was a subsidiary of the Netherlands-based Rabo Group. It quit the market in 2013.

**Allied Irish Banks (AIB).** One of the two largest banks active in the Irish market, AIB must not be confused with Anglo Irish Bank. It has sizable operations in Northern Ireland (through its First Trust subsidiary). It sold its sizable and profitable subsidiary in Poland during the crisis to help boost cash and strengthen its capital.

**Anglo Irish Bank.** Grew to be the third largest domestic bank with a total asset size of about €100 billion, of which almost 40% was lost in bad loans. It was Anglo's liquidity position that triggered the guarantee of September 2008. Anglo is not to be confused with AIB. In 2011 Anglo was merged with INBS and the group renamed IBRC.

**Bank of Ireland.** Once Ireland's central bank, and sometimes appearing weighed down with an awareness of its 235-year history, Bank of Ireland vies with Allied Irish Banks for first place in size. It has long had sizable activities in Great Britain and Northern Ireland.

**Bank of Scotland Ireland (BOSI).** Formerly the government-owned Industrial Credit Company, BOSI was a subsidiary of the UK-based Lloyds Banking Group, and previously of HBOS. It pulled out of Irish banking at the end of 2010, repaying all of its liabilities.

**Danske Bank.** This Danish group operated a sizable branch in Ireland, formed from National Irish Bank, previously Northern Bank.



(cont.)

Depfa. Formerly Deutsche Pfandbriefbank, it had the largest balance sheet of any bank operating in Ireland, but was essentially an offshore German bank, established in Dublin's International Financial Service Centre doing mainly international business. Bought by another German bank, Hypo RE, in 2007, Depfa's liquidity situation in September 2008 helped bring down Hypo (which had its own loan-loss problems), triggering a rescue by the German federal authorities.

Educational Building Society (EBS). A mortgage lender. At the behest of the Troika it was merged with AIB in 2011.

Irish Bank Resolution Corporation (IBRC). Created in 2011 from the merger of Anglo and INBS. IBRC was liquidated in February 2013.

Irish Life and Permanent (ILP). Formed from the merger of a building society and a life insurance company, ILP's lending activities were mainly in retail mortgages. After the crisis, the life insurance firm was spun off and the bank renamed Permanent TSB (PTSB).

Irish Nationwide Building Society (INBS). A small mortgage lending institution whose venture into property developer lending went sour on an unsurpassed scale. INBS was merged with Anglo in 2011 to form IBRC.

KBC Ireland. A subsidiary of the Belgian group, it was previously known as Irish Intercontinental Bank.

Permanent TSB (PTSB). The surviving banking arm of ILP.

Ulster Bank. A subsidiary of Royal Bank of Scotland, Ulster Bank has long been a full-service bank with a sizable market share on both sides of the border on the island of Ireland.

