

RESEARCH

Research Update:

Ireland Rating Lowered To 'AA' On Potential Fiscal Cost Of Weakening Banking Sector Asset Quality; Outlook Negative

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(**Editor's Note:** In the original version of this release, one of the long-term ratings in the "Ratings List" was misstated. A corrected version follows.)

Overview

- Standard & Poor's has lowered its long-term sovereign credit rating on the Republic of Ireland to 'AA' from 'AA+'. The outlook is negative.
- We have lowered the long-term rating on Ireland because we believe that the fiscal costs to the government of supporting the Irish banking system will be significantly higher than what we had expected when we last lowered the rating in March 2009, and, consequently, that the net general government debt burden will also be significantly higher over the medium term.

Rating Action

On June 8, 2009, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the Republic of Ireland to 'AA' from 'AA+'. The outlook is negative. At the same time, Standard & Poor's has affirmed its 'A-1+' short-term rating on the Republic.

Rationale

We have lowered the long-term rating on Ireland because we believe that the fiscal costs to the government of supporting the Irish banking system will be significantly higher than what we had expected when we last lowered the rating in March 2009, and, consequently, that the net general government debt burden will also be significantly higher over the medium term. Our revised opinion follows the recent announcement by Anglo Irish Bank of losses at the upper end of Standard & Poor's expectations, as well as the government's announced intentions regarding the scope of the operations of the new National Asset Management Agency (NAMA), which is set to play an important role in bolstering the financial health of the Irish banking system.

Under the government's plans, up to €90 billion of performing and impaired property-related exposures and associated commercial lending will be transferred from Irish banks to NAMA (which we understand will be established under legislation expected to come into effect in September 2009). The government also expects NAMA to acquire the assets at a significant discount to their current face value, with market estimates we have seen of the projected cost, based on average purchase prices, currently in the range of €55-€75 billion. The purchase of these assets, in turn, is to be financed by the issuance of government bonds. The government has announced that its objective is for NAMA to pay down some or all of this additional debt in future years from the proceeds of maturing loans and from asset disposals and recoveries.

In our view, NAMA's ability to minimize the cost to the government of its financial operations will depend on the prices it pays for the assets and their future performance. We consider that NAMA's ability to meet its financial objectives is uncertain because of the risk that cash flows from its assets could fall below its funding costs if their underlying performance worsens compared with NAMA's expectations at the time of purchase. At the same

time, we believe the recently announced losses (for the six months to the end of March 2009) at nationalized Anglo Irish Bank Corp. Ltd. (A-/Watch Neg/A-1) highlight both the continued fragility of the Irish banking sector and its reliance on the government for ongoing financial support. We also maintain our opinion that Irish real and nominal GDP is likely to remain below 2008 levels until 2013. Taking these factors and NAMA's likely borrowings into account, along with our revised estimate of recapitalization costs to the government of €20-€25 billion (compared with our previous estimate of €15-€20 billion), we now believe that Ireland's net general government debt could exceed 100% of GDP over the medium term--a level that is higher than for Ireland's 'AA' rated Euro-zone sovereign peers.

Outlook

The rating could be lowered again if asset quality in the Irish banking system deteriorates at a faster pace than we expect and if, as a result of its support for the sector or due to an even more pronounced downturn in economic growth, the government's fiscal performance weakens further than we currently assume. The ratings could also be lowered if the average maturity of the government's debt shortens materially for a sustained period. Conversely, the outlook could be revised to stable if the Irish banking sector stabilizes more quickly and at a lower fiscal cost to the government than we now think likely.

Ratings List

	To	From
Sovereign credit ratings	AA/Negative/A-1+	AA+/Negative/A-1+

N.B.--This list does not include all affected ratings.

Additional Contact: Sovereign Ratings;
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