

Chapter 3 Central Government

National Debt

National Debt

3.1 The National Debt reported in the financial statements of the National Treasury Management Agency (the Agency) is recorded after taking account of liquid assets. Figure 3 sets out the composition of the National Debt in gross and net values over the past three years.

Figure 3 National Debt of Ireland 2006 - 2008

Year	2006	2007	2008
	€m	€m	€m
Gross National Debt	39,505	42,047	72,457
Liquid Assets	(3,588)	(4,487)	(22,059)
Net National Debt	35,917	37,560	50,398

Note: The National Debt is stated at redeemable par values (nominal values).

3.2 The Net National Debt increased by €2.8 billion between 2007 and 2008 of which €2.7 billion was applied towards funding the Exchequer Deficit for the year².

3.3 The net present value³ of the Net National Debt at the end of 2008 was €2.5 billion (€3.6 billion at the end of 2007).

General Government Debt

3.4 In addition to borrowings reported in the financial statements of the Agency further debt liabilities arise on foot of other borrowing activity. The relationship between the Gross National Debt and the General Government Debt⁴ (GGD) is set out in Figure 4.

Figure 4 Gross Government Debt 2006 - 2008

Year	2006	2007	2008
	€m	€m	€m
Gross National Debt	39,505	42,047	72,457
Other Debt Liabilities	4,651	5,519	7,712
General Government Debt	44,156	47,566	80,169

3.5 Other Debt Liabilities comprise a range of borrowings by State Bodies and local government, related assets, as well as financial obligations of the State. They are summarised in Figure 5 for the past three years.

² The remaining €0.1 billion mainly relates to the effects of issuing bonds at a discount to the nominal value and foreign exchange rate movements.

³ Net present value of the debt reflects total of all future cash flows (both interest and principal) discounted using the appropriate market rates at the end of the year. It will differ from the nominal amount to the extent that the contracted coupon rate differs from the market rate at the valuation date.

⁴ The General Government Debt is the standardised measure of indebtedness of EU governments taking account of all liabilities included in the National Debt, without any offsetting of liquid assets, together with the liabilities of non-commercial State agencies and local authorities. In addition, it includes the build-up of accrued interest on certain government borrowings, in particular on the Government Savings Schemes.

Figure 5 Other Debt Liabilities^a 2006 - 2008

Year End	2006	2007	2008
	€m	€m	€m
Non-commercial State Bodies (including Housing Finance Agency)	3,461	4,703	5,897
Intra Government Balances and Deposits	(2,761)	(2,840)	(3,116)
Post Office Bank Fund Deposits (excluding government bonds)	1,478	1,205	1,618
Local Government Debt (excluding debt due to central government)	807	947	924
Coinage	588	653	697
Accrued Interest on Savings Schemes	1,033	780	653
Westlink Buy-out ^b	—	—	546
Accrued Interest on Debt	—	24	489
Miscellaneous	45	47	4
Total	4,651	5,519	7,712

Notes:

- a The Other Debt Liabilities are derived mainly from the preliminary return to the EU made in March 2009 under the single currency rules.
- b See Chapter 27 Westlink Buy-out.

3.6 As a percentage of GDP⁵ the General Government Debt (GGD) was 44% at the end of 2008 (25% at the end of 2007). The accumulation of liquid resources equivalent to 12% of GDP at 31 December 2008 accounted for a large element of the debt increase.

3.7 It is expected that the GGD/GDP ratio⁶ will increase to 77% by 2013 as a result of significant further borrowing by the Exchequer. This estimate is calculated before taking account of debt issued in connection with measures to address the quality of loan assets held by financial institutions.

Borrowings by the Agency

3.8 An extra €30.4 billion was borrowed by the Agency in 2008. €22 billion of total borrowings was placed on deposit, mainly with the Central Bank, resulting in an increase in liquid assets held at the year end of €17.6 billion. The main features of the debt raised in 2008 are set out in Figure 6.

⁵ The ratio of General Government Debt (GGD) to Gross Domestic Product (GDP) is a standard measure applied for the purposes of the single currency.

⁶ As estimated in the Supplementary Budget for 2009.

Figure 6 Debt Raised in 2008

Type of Borrowing	Borrowing Proceeds	
	€m	
New Bond Issues	10,929	Two major bonds were issued in 2008 <ul style="list-style-type: none"> ▪ an eleven year bond was issued with a nominal value of €7 billion at a yield of 4.51% ▪ a three year bond was issued with a nominal value of €4 billion at a yield of 4.028%.
Commercial Paper Programme	18,425	Under its Commercial Paper programme the Agency raises short-term funds from the international money markets normally at low interest rates. These borrowings can be in a range of currencies, but all non-euro borrowings are immediately swapped back into euro using foreign exchange contracts.
Government Savings Scheme and Post Office Savings Bank	1,129	Savings Schemes attracted a substantial increase in deposits in 2008. Some €680 million was received during the month of September, before the Government's bank guarantee scheme was announced on 30 September 2008.

3.9 The National Debt is composed of a variety of borrowing elements with differing maturity profiles. Figure 7 sets out the break down of the Debt into its major component types.

Figure 7 Composition of the Gross National Debt (in nominal terms)

At End of	2007	2008	June 2009
	€m	€m	€m
Government Bonds – maturity more than one year	30,947	41,863	57,453
Other Medium/Long-Term Debt – maturity more than one year	615	483	670
Short-Term Debt – maturity less than one year	3,286	21,783	27,555
Borrowings from the Minister for Finance ^a	2,258	2,605	2,079
Government Savings Schemes – maturity of up to 5½ years	4,941	5,723	6,531
Gross National Debt	42,047	72,457	94,288

Note:

a The main element of this borrowing relates to the Post Office Savings Bank Fund.

3.10 The composition of the Gross National Debt had changed significantly by the end of 2008 in that short-term debt i.e. debt with a maturity of less than one year made up 30% compared with just 8% at the end of 2007.

3.11 Most of the Medium and Long-Term Debt is borrowed in the form of government bonds which have differing maturities, the longest of which at the end of 2008 was eleven years. Figure 8 compares the maturity profile of government bonds at the end of 2007, 2008 and at the end of June 2009.

Figure 8 Maturity Profile of Government Bonds

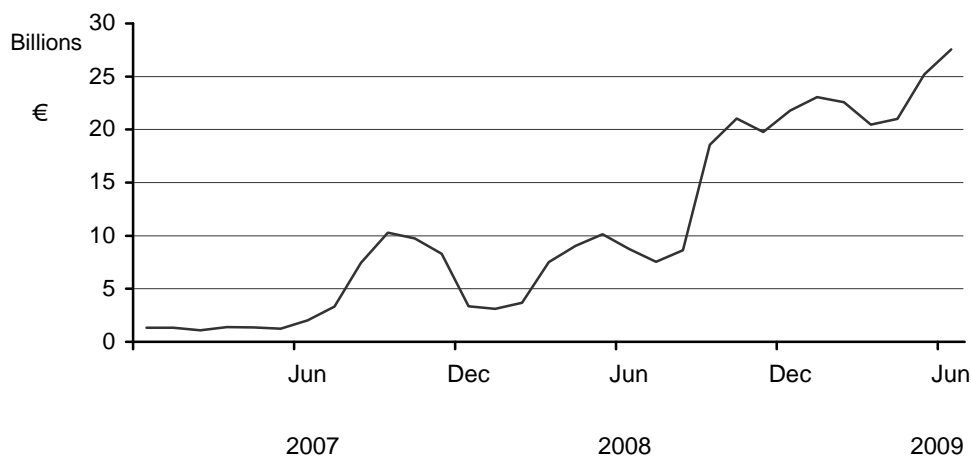
Duration	2007	2008	June 2009
	€m	€m	€m
Under 5 years	5,939	15,931	15,895
5 to 10 years	11,927	11,857	27,574
Over 10 years	13,080	14,075	13,984
Total	30,947	41,863	57,453

3.12 Short-term debt which is debt with a maturity of less than one year, is comprised mainly of borrowings under the Agency's Commercial Paper Programme. Figure 9 compares the maturity profile of short-term debt at various dates.

Figure 9 Maturity Profile of Short-Term Debt

Duration	2007	2008	June 2009
	€m	€m	€m
Less than one month	2,376	3,880	6,833
One to three months	711	5,518	11,673
Three to six months	198	5,803	6,963
Over six months	1	6,582	2,086
Total	3,286	21,783	27,555

3.13 Short-term borrowings have increased in the past two years as outlined in Figure 10. The Agency launched a new Treasury Bill programme in March 2009 consisting of short-term borrowings.

Figure 10 Level of Short-Term Borrowings in the period 2007 to June 2009

Audit Concern

The Agency undertook €2 billion in borrowings, mainly in the form of short-term debt, in excess of that immediately required to meet the budget deficit for 2008. I sought the Accounting Officer's explanation for the build up in borrowings and the steps taken by the Agency to manage any additional exposures and risks arising.

Views of the Accounting Officer

3.14 The Accounting Officer stated that the 2008 Budget forecast an Exchequer Borrowing Requirement (EBR) of just under €5 billion. As the year progressed the Agency forecasts indicated that this target would be overshot and, in the event, the outturn was almost €3 billion. In addition, the capital markets, which had already been volatile since August 2007, worsened considerably from September 2008 following the collapse of Lehman Brothers. The Agency notified the Department in July 2008 that the target cash balance of €5 billion set out in the Ministerial Guideline was not consistent with the emerging Exchequer deficit. The Department formally altered the guideline in December 2008 *'in light of the prevailing circumstances in the financial markets...exceptionally, that no formal limit on total cash balances shall apply at end-2008'*.

3.15 In order to manage the emerging liquidity risks the Agency used short-term debt markets to build-up a cash 'war chest' in the Exchequer. This protected the Exchequer in a number of ways

- Despite the rapid deterioration in the public finances, the Exchequer had cash available at all times to meet its obligations. The cash balances also gave an indication to the markets that Ireland was in a position to meet unforeseen liabilities relating to the banking crisis and contingent liabilities taken on under the bank guarantee scheme.
- The 2009 EBR was forecast at just over €20 billion. In addition, a €5 billion bond was due for redemption. The build-up of cash balances had assisted in the timing of borrowings in 2009, ensuring that the Agency could raise funds as opportunities arise without having to enter the market at particularly turbulent times.

3.16 The Accounting Officer stated that the EBR of €12.7 billion was funded mainly by €1 billion in medium-term and long-term bonds and receipts of €1.2 billion in the Government Savings Schemes. Short-term paper was used almost exclusively to build up the cash balance in order to manage liquidity risks and to provide flexibility with regard to the timing of long-term issues. He stated that the impact on borrowing costs of building up the cash balances was not significant as the increased loan interest was largely offset by deposit interest receivable. The Agency estimated that the additional net interest cost when measured on an accruals basis amounted to €1.8 million.

3.17 The Accounting Officer also stated that the increase in short-term borrowings was undertaken to reduce and manage risks in the following areas

- Liquidity risk, particularly funding and replacement risks
- Concentration risk with regard to investors, and
- Fiscal risk, which is the risk of committing the Exchequer to elevated interest rates for the longer term.

3.18 The Agency had introduced a number of new procedures to report and manage liquidity risk which include additional liquidity profiling and reporting procedures. A Treasury Bill programme was launched in March 2009 in response to strong investor demand and with the aim

of diversifying the sources of short-term borrowing and access new investors in the commercial paper market with the aim of reducing concentration risk. An additional short-term borrowing programme had also been introduced, viz. a US Commercial Paper Programme which was launched in July 2009.

Debt Service Costs

3.19 The debt service cost disclosed in the Agency's accounts for 2008 amounts to €2.1 billion (2007: €2.1 billion) when measured on a cash basis. However, this includes a transfer of €488m (2007: €466m) from current funds to a sinking fund to repay debt bringing the current servicing cost to €1.6 billion (2007: €1.6 billion). However, measurement of these costs on a cash basis masks the effect of servicing obligations which had accrued by year end but remained to be discharged.

3.20 When the debt service cost is measured on an accruals basis which recognises the costs incurred rather than those paid, the servicing cost for 2008 amounts to €2 billion (2007: €1.6 billion). Figure 11 shows the breakdown of the debt service cost as measured on an accruals basis. The increase in interest payable arises due to the increase in borrowings in 2008. Fees on borrowings rose mainly due to fees on saving schemes increasing in line with the level of deposits in the schemes, and increased bond syndication fees due to the extra volume of issuance and higher fee rates.

Figure 11 Debt Service Costs Measured on an Accruals Basis

Year End	2007	2008
	€m	€m
Interest Payable (net of interest receivable on deposits)	1,571	1,970
Agency's Administration Costs for Borrowings	9	11
Fees on Borrowings	26	33
Total	1,606	2,014

3.21 The Agency's day-to-day responsibility for borrowing and management of the National Debt is exercised in accordance with guidelines given by the Minister for Finance. Detailed benchmark targets and performance measurement rules are agreed with his Department. The agreed benchmarking system compares the performance of the Agency against a monetary benchmark target in relation to its debt management activities.

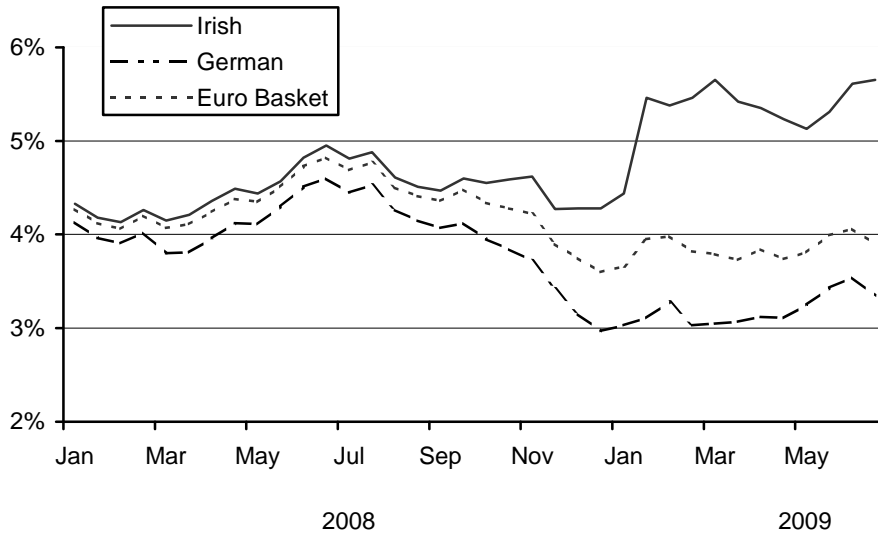
3.22 A firm of accountants is engaged to independently audit the benchmark results. For 2008 these verified results indicate that the Agency outperformed its benchmark by €130 million in relation to its management of the National Debt.

Future Debt Management Costs

3.23 The average interest cost of servicing the National Debt fell from 8.5 per cent in 1991 to 3.5 per cent in 2008 due to a combination of factors including the downward trend in global interest rates, Ireland's improved credit ratings, the Agency's debt management initiatives and Ireland's participation in the euro area. However, in recent months some credit rating agencies have downgraded Ireland's debt rating.

3.24 In recent years, the yields⁷ on Irish government bonds closely followed the German yields. However the difference or spread in the yields started to grow in recent times, most significantly from September 2008 onwards following the deterioration in international markets with the collapse of Lehman Brothers and the Government's announcement of the bank guarantee scheme. Figure 12 shows the yield on ten-year benchmark bonds for Ireland, Germany and a basket of euro-zone countries from the start of 2008.

Figure 12 Yield Spreads on Ten Year Benchmark Bonds



3.25 New borrowing to be undertaken by the Agency to fund expected budget deficits over the period 2009 to 2013, based on forecasts contained in the Supplementary Budget for 2009, will be in the region of €81 billion. In addition, the Agency will also need to fund debt that matures before the end of 2013 bringing the gross funding requirement to €97 billion over that period⁸. This does not include any debt issued in connection with measures announced to address the quality of loan assets of Irish financial institutions.

3.26 Based on conditions prevailing at the time of the 2009 Supplementary Budget the expected interest on the National Debt in the period to 2013 was projected to increase to 4.2% of GDP. The borrowing cost, in addition to being influenced by the volume of borrowing, may be impacted upon by increased servicing costs arising out of demand by lenders for increased yields to mitigate perceived risks. Based on current levels the impact of yield spread increases would contribute at least €3.5 billion to the cost of debt servicing up to 2013. However, over the five year period this projection is likely to alter due to factors such as fiscal management, economic performance, general market sentiment, market risk perceptions relating to lending between different countries, general supply and demand factors in the market, and investor demand for particular financial instruments.

⁷ The yield to maturity of a newly issued bond is the discount rate at which the present value of all future cash flows from the bond will equate to the issue price. It is a better measure of the true cost of borrowing than the coupon rate. Issuers of bonds refer to certain bonds as 'benchmark bonds' which provide a standard for measuring the cost and price of the bonds.

⁸ This is the position at the end of 2008 and does not take account of any new bond issued since that date and maturing before the end of 2013.

Audit Concern

The spread in bond yield raises concerns regarding the impact on debt service costs. I asked the Accounting Officer about any steps being taken to mitigate the effect of the bond yields. I also enquired about progress being made in securing the additional borrowing to meet the expected budgetary position.

Views of the Accounting Officer

3.27 The Accounting Officer stated that the Agency had taken a number of steps to address the risks arising from the spread in the bond yield including

- marketing initiatives and investor presentations
- introducing the Treasury Bill programme
- introducing a new US Commercial Paper programme.

3.28 The secondary trading portfolio⁹ was also expanded to boost liquidity in the Irish Government bond market. This, together with secured commitments from the primary dealers for the quotation of Irish bonds in the secondary markets within specified bid-offer spreads, aimed to improve the marketability of bonds thereby impacting positively on the bond yield prices.

3.29 He also stated that the Agency had raised €1.9 billion in medium-term and long-term funding to the end of July 2009, amounting to 87% of the total of this type of borrowing sought for the year. Three syndications raised a total of €16 billion. The remaining €5.9 billion was raised in five auctions. When borrowing under the retail schemes was taken into account, the NTMA had raised 92% of the total funding requirement for 2009 by end July. The new Treasury Bill programme also raised significant short-term funds with almost €15 billion outstanding at the end of July. The US Commercial Paper which had been launched to strong demand on 22 July 2009, raised €1.3 billion in its first week. The Agency planned to continue its monthly bond auctions and to tap the syndicated market whenever it considered it appropriate to do so.

Conclusions

Ireland's Gross National Debt at 31 December 2008 has increased to €72.5 billion from €42 billion at the end of 2007. An element of this was accounted for by the strategic build up of liquid resources with an eye to debt management demands in 2009 and the management of liquidity risks. Funding demands have increased due to the emergence of budget deficits and the cost of bank stabilisation measures. These demands which will lead to net borrowing of around €1 billion up to 2013 (before taking account of funding in relation to the proposed asset management agency) will, in combination with market forces, increase borrowing costs substantially in the medium-term.

⁹ The Agency maintains a secondary trading function which trades its bonds with other market participants in order to provide liquidity to the market.