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Research Update:

Republic of Ireland Rating Lowered To 'AA+'; Outlook Negative On Public Finance Concerns And Economic Growth Potential

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Rationale

On March 30, 2009, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the Republic of Ireland to 'AA+' from 'AAA.' At the same time, the 'A-1+' short-term rating on the Republic was affirmed. The rating outlook is negative.

The downgrade reflects our view that the deterioration of Ireland's public finances will likely require a number of years of sustained effort to repair, on a scale greater than factored into the government's current plans. We believe that the magnitude of the fiscal adjustment to place public finances on a sustainable footing, and the possible need for additional public support of the banking system, are closely tied to the trajectory of Ireland's economic recession and recovery. We expect that the Irish economy will materially underperform the Eurozone economy as a whole over the next five years, recording minimal growth in real and nominal GDP, on average, during the period. As a result, we believe that Ireland's net general government debt burden could peak at over 70% of GDP by 2013, a level we view as inconsistent with the prospective debt burdens of other small Eurozone sovereigns in the 'AAA' category.

The medium-term prospects for the Irish economy are constrained by three interrelated factors: first, the impact on domestic demand as the private sector reduces its high debt burden, which stood at 280% of GDP in 2008; second, the scale of the deterioration of asset quality in the banking sector and possible need for additional capital; and, third, the support from external demand Ireland can expect as global economic conditions improve.

Regarding domestic demand, we think it is likely to remain depressed for an extended period as the process of reducing household indebtedness gains momentum. A complicating factor, relating to Ireland's membership of the Eurozone, is the prospect that Irish wages and prices will rise more slowly (or even decline for an extended period) relative to the rest of the monetary union. Already, as the unemployment rate rises toward 10%, nominal wages are being cut sharply in both the public and private sectors. Both unemployment and wage levels need to stabilize for households to begin reducing their leverage in earnest.

Second, regarding the Irish banking sector, we continue to believe that more public sector resources may be required to recapitalize the banking sector, beyond the €7 billion the government has already committed. This reflects the following considerations: the need to recapitalize Anglo-Irish bank in advance of its return to private ownership; the need to fund the proposed public asset management vehicle, which aims to remove some nonperforming assets from banks' balance sheets; and, more broadly, the

prospect that additional public capital resources will be required to deal with a further deterioration in banks' asset quality in a protracted recession. Taking these factors into account, we believe that the total gross fiscal cost to the government of supporting the Irish banking sector could reach €15-€20 billion (as much as 11% of GDP). Even after uncertainties about Irish banks' capitalization are removed, however, we think that domestic credit may still shrink as households reduce their debt burdens.

Third, as an open economy, Ireland will doubtless ultimately benefit from a recovery of exports and investment from its leading trading partners--the Eurozone countries, the U.K., and the U.S. However, we believe that the pickup in external demand we expect in 2010-2011 is likely to be more muted than in past economic cycles, and particularly in the U.K., so long as the pound sterling's exchange rate versus the euro remains depressed.

The government has already taken steps to contain the budgetary impact of these pressures, and further adjustments in taxation and spending, amounting to 2%-2.5% of GDP, are expected to be announced in next month's supplementary budget. At best, however, these measures will contain this year's general budget deficit to around 10% of GDP and lay the basis for a slow reduction in nominal budget deficits in future years. We are concerned, however, that a credible multi-year fiscal consolidation strategy will not emerge until after the next general elections, due by 2012. Accordingly, on current trends, we believe Irish net general government debt will likely exceed 70% of GDP by 2013 before beginning to trend downwards.

Outlook

The negative outlook reflects the ongoing deterioration in the public finances along with our concerns about the medium-term growth prospects of the Irish economy.

The ratings on Ireland could be lowered again if the public finances weaken substantially further than what we currently assume. The outlook could be revised to stable if the government embraces a fiscal strategy that contains the rise in the public debt burden in line with Ireland's modest economic growth prospects.

Ratings List

Downgraded; Ratings Affirmed

	To	From
Ireland (Republic of) Sovereign Credit Rating	AA+/Negative/A-1+	AAA/Negative/A-1+

NB: This list does not include all ratings affected.

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