Written by **Bruce Walker** on April 1, 2011

Irish Bank Woes Underline European Financial Crisis

This statement followed publication of "stress tests" on four Irish banks — a requirement of Ireland's international bailout — which indicated that the collapsing real estate market would produce thousands more home foreclosures, leaving banks with more unpaid loans.

Irish voters just delivered the most massive defeat for a governing political party in 90 years, when on February 25 the Fianna Fail saw its governing parliamentary strength drop from 77 seats to 20, and the Green Party, its junior coalition group, lose all its parliamentary seats. The Irish financial crisis and the precipitous decline in property values were the primary causes of the defeat. The Fine Gael, the more market-oriented of the country's political parties, won 76 seats — almost a majority. The stress tests reflected the policies of the previous government, but in the quiet desperation that is gradually taking hold of a land known until a few years ago as the "Celtic Tiger," they will doubtless create political instability for the foreseeable future.

Last November the European Union and the International Monetary Fund offered loans to Ireland worth a total of €95 billion, but access to these funds was conditioned upon the Irish banks passing "stress tests," which looked at the worst-case scenario for the banks. The bailout itself — not the public debt, but just the outside help by international bailout — is a whopping €22,000 for every single person in Ireland. The Irish government since 2009 has been forced to put in about €66,000 per citizen just to prevent the banks from collapsing. It has been nationalizing banks and other institutions to prevent a complete collapse — now owning 93 percent of Allied Irish Bank and all of the Educational Building Society. Although it does not yet own the Bank of Ireland or the Irish Life & Retirement Bank, their takeovers seem imminent.

The bailout plan announced yesterday calls for Allied Irish Bank to receive another €20 billion, the Bank of Ireland about €8 billion, and Irish Life & Retirement about €2.2 billion. This would bring the loan-to-deposit ratios down from the current perilous 1.8 to 1 to a more manageable 1.22 to 1. The Irish Central Bank is providing €133.5 billion in short-term loans and the European Central Bank is supplying a similar amount. These loans, which must be renewed every two weeks, bear high interest rates. Ireland had been pushing for these loans to be medium term, in order to reduce service costs as well as lessen the control of the lending international banks.

As noted here in January, Ireland has not helped its own case. Early in 2011, the Irish Central Bank began — with notice to the European Union but without actual approval — to simply print its own euros. Worse, the bank gave false or misleading data to the Irish Department of Finance. Worst of all, while printing euros, the bank was paying enormous bonuses to executives. This scandal, which broke a few weeks before the general election, was a prime contributor to the collapse of the governing Fianna Fail Party.

The whole European financial system is still perilous. The same day Ireland revealed its bank crisis, Portugal announced that its annual budget deficit (not the national debt) was 7.3 percent higher than had been projected — now 8.3 percent of its Gross Domestic Product.

This grim news comes on the heels of a March 29 announcement that Standard & Poor’s has downgraded Portugal's bonds to BBB- — one notch above what is considereed "junk bonds" — and those of Greece to BB-, even lower. The rates of interest on those nations’ bonds both jumped to euro-history highs. S&P had previously downgraded Irish bonds in February from A to A-, and many analysts expected the rating to drop again this spring. This additional downgrading of the bonds will further pressure the new Irish government to make moves to increase investor confidence, such as seriously cutting government spending; however, the government is loath to take such unpopular actions.

The European Union's main problem now is confidence. The Greek government has been accused of tinkering with the books in order to make its creditworthiness appear greater than it is; the Portuguese government significantly understated its budget deficit; and, as mentioned, the Central Bank of Ireland has begun printing its own euros. Additionally, the four Irish banks tested on their ability to stay solvent in the event of a downturn all failed.

The question is, how much confidence do investors have in these nations now? Seemingly, about as much as in politicians keeping their promises.

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