Ireland

Country Note, June 2017

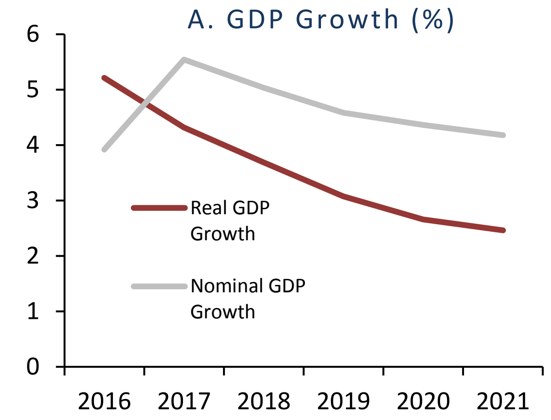
Irish Fiscal Advisory Council

Key messages:

- **Strong cyclical recovery expected in the near term, so that further fiscal stimulus is unwarranted.**
- **Further ahead, fiscal policy should be cautious, to reflect high debt levels and risks to long term revenue and growth.**
- **Gross debt burden is distorted by GDP and remains high at 243% total revenue, but is expected to decline steadily.**
- **In-year spending increases mean slower fiscal improvements in 2015-2016, and non-significant beaches of rules.**

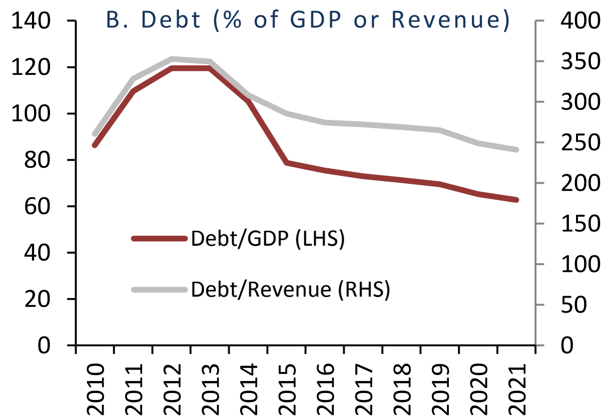
Macroeconomic outlook

Initial estimates suggest that the recent recovery in output continued in 2016, with growth of 5.2% (GDP) and 9.0% (GNP). This strong growth was also reflected in the labour market, with employment growth of 2.9% recorded. According to forecasts from the Department of Finance, GDP growth is forecast to moderate in the near term, from 4.3% in 2017 to 3.7% in 2018. While not showing clear signs of overheating yet, if the strong recent growth were to continue there would be a risk of the economy overheating. Fiscal policy may therefore have to play a role in leaning against the wind. While the near term prospect for the Irish economy looks positive, there are substantial headwinds in the medium term. Brexit is set to negatively impact on the Irish economy, with lower demand for Irish exports and a less favourable exchange rate two of the most obvious channels. Given that this could negatively impact trend growth rates and future revenues, fiscal policy should be cautious.



Short-term fiscal outlook

The General Government balance for 2016 is estimated at -0.7 per cent of GDP, representing an improvement of 0.4 percentage points relative to 2015. The balance is forecast to be -0.4 per cent of GDP this year. Debt measured as a percentage of GDP likely understates the true debt burden, given some of the distortions impacting GDP. Debt as a percentage of revenue remains very high (274% in 2016). In-year increases in spending have resulted in a slower rate of improvement in the public finances in 2015 and 2016. These have largely been funded by unexpected increases in corporation tax and lower than expected debt interest costs.



Medium-term fiscal outlook

Irelands Medium Term Objective (Structural balance of -0.5 per cent of GDP) looks set to be met in 2018. If this is indeed achieved, further scope for new revenue and expenditure measures will be available under the fiscal rules. Complying with the expenditure benchmark after the MTO is met/exceeded would help to steer fiscal policy more appropriately and to re-build the capacity to withstand future shocks. Current plans see the general government balance moving into surplus in 2019. While government debt is forecast to fall steadily, it is still set to remain high as a percentage of revenue by 2021 (241%).

Fiscal framework and national fiscal rules

As the deficit fell below 3 per cent of GDP, Ireland has successfully exited the corrective arm of the Stability and Growth Pact. The structural balance pillar was not complied with in 2016, with an improvement of 0.3 per cent of GDP as opposed to the 0.6 per cent requirement. Had a one-off financial transaction in 2015 been excluded, the expenditure benchmark would also have been breached in 2016. To date, the breaches of the rules have not been sufficient to trigger potential sanctions. For 2017, Government forecasts show planned breaches of both rules. This suggests that expenditure should be managed carefully as the room for manoeuvre under current plans is very limited.

Key indicator forecast

		2016	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate	[% y-y]	5.2	4.3	3.7	3.1	2.7	2.5
Output Gap	[%]	1.2	1.4	0.8	0.5	0.3	0.0
GG balance	[% of GDP]	-0.6	-0.4	-0.1	0.1	0.6	1.0
GG structural balance (CAM)	[% of GDP]	-1.4	-1.2	-0.5	-0.1	0.4	1.0
GG structural primary balance (CAM)	[% of GDP]	1.0	1.0	1.5	1.7	2.1	2.6
GG debt	[% of GDP]	75.4	72.9	71.2	69.5	65.2	62.9
GG debt	[% of Revenue]	274.6	272.1	268.9	265.0	249.2	241.3
Adjusted real GG expenditure growth	[% y-y]	1.6	2.1	1.1	1.2	1.5	1.1
Discretionary revenue measures	[% of GDP]	-0.3	0.0	0.0	0.0	0.0	0.0

Sources: Department of Finance (DoF) estimates as of SPU 2017.

f – forecast

CAM – Department of Finance estimates based on Commonly Agreed Methodology