Ireland

Country note, July 2018

Irish Fiscal Advisory Council

Key messages:

- **Rapid Cyclical Recovery:** Forecasts show the Irish economy close to its potential in 2018; moving beyond it from next year.
- **Risks:** Near term upside risks from housing sector undersupply; Brexit and tax environment represent medium-term risks.
- **Fiscal Position:** Debt burden still among highest in OECD and underlying primary balance stalled since 2015.
- **Short-Term Fiscal Stance:** Council assesses that Government should at least stick to existing budget plans for 2019.
- **Medium-Term Fiscal Stance:** Be prepared to be more cautious than rules allow; develop Rainy Day Fund and debt target.

Macroeconomic outlook

A rapid cyclical recovery has taken place since at least 2014 and is forecast to continue at a strong pace, only gradually moderating. There is much uncertainty, yet most coherent estimates suggest that the domestic economy has been growing faster than its potential growth rate since 2014. Estimates suggest that the economy is producing close to its medium-term potential in 2018 and will move beyond it next year and after. There are substantial risks that a faster-than-assumed pick-up in housing output could arise where persistent undersupply has been evident. Unless offsetting measures are taken elsewhere, including through fiscal policy, this could prompt overheating in the economy. Medium term, there are clear downside risks, namely those associated with Brexit, US trade policy and the international tax environment.

Short-term fiscal outlook

Improvements in the primary balance have stalled since 2015 despite the strong cyclical recovery and a number of favourable tailwinds. Non-interest spending has risen at essentially the same pace as buoyant cyclical tax revenue since 2015. Allowing for the estimated effects of the cycle, the structural position would appear to have deteriorated since 2015. An appropriate policy for next year would be to increase government expenditure in line with the sustainable long-term growth rate of the economy implying 3¼ per cent plus inflation. This implies an approximate limit for spending increases or tax cuts of up to €3½ billion in 2019. Improving the budget balance more than currently planned would be desirable, especially given the risks of overheating and the opportunity provided by favourable times.

Medium-term fiscal outlook

Focusing on the right budgetary stance and being prepared to be more cautious than the fiscal rules allow is the correct approach for the Government to follow. Yet the current policy framework is insufficiently equipped to prevent a return to procyclical fiscal policy. Sensible tools such as the Rainy Day Fund and a medium-term debt target set up to help with medium-term budgeting, are only half-formed and need more development if they are to be effective. The shortening of the horizon in the Government's most recent projections from five to three years ahead is not compatible with the aim of achieving medium-term fiscal stability.

Fiscal Framework and National Fiscal Rules

The Medium Term Objective (MTO) of a structural deficit of no less than 0.5 per cent of GDP was reached in 2017. From an economic perspective – and in terms of the technical application of the fiscal rules – it would seem that the Government's budgetary position is currently close to balance. As the MTO was met last year, requirements to adjust the structural deficit are not expected to bind for 2018. Over the medium term (2019–2021), plans currently show compliance with the rules based on the EU Commonly Agreed Methodology.

Chart 1: Ireland's Cyclical Recovery

IFAC Output Gap Estimates, % Potential

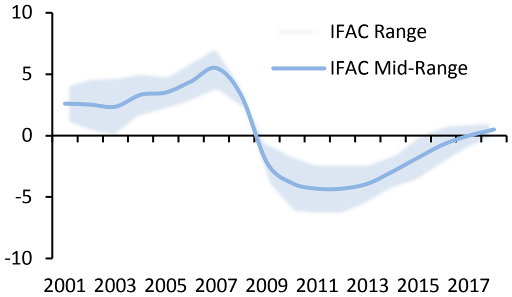
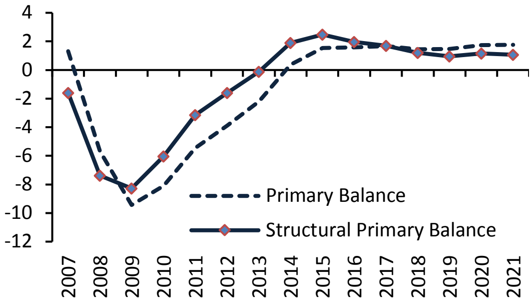


Chart 2: Primary Balance

% GDP, General Government Basis



Key indicator forecast

		2016	2017	2018f	2019 f	2020 f	2021 f	Source
Real GDP growth rate	% y-to-y	5.1	7.8	5.6	4.0	3.4	2.8	1
Output Gap (IFAC mid range)	%	-0.7	0.0					2
GG balance	% of GNI*	-0.8	-0.5	-0.4	0.2	0.4	0.6	1
GG debt	% of GDP	72.8	68.0	66.0	63.5	60.2	58.7	1
GG debt	% of GNI*	106.0	100.1	96.9	93.6	88.9	86.8	1
GG structural balance – CAM-based.	% of potential GDP	-0.9	-0.4	-0.9	-0.4	0.1	0.3	1
Adjusted real GG expenditure growth	% y-to-y	1.3	3.2	4.0	3.6	1.9	2.4	2
Discretionary revenue measures	% of GDP	-0.3	0.0	0.3	0.0	0.0	0.0	1

Sources: 1 - Department of Finance (DoF) estimates as of SPU 2018

2 – IFAC estimates

CAM –Commonly Agreed Methodology. GG – General Government

f - forecast

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