Ireland

Irish Fiscal Advisory Council

Country note, January 2018

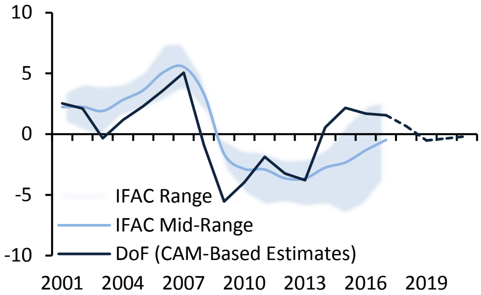
Key messages:

- **Fiscal stance for 2018 assessed to be conducive to prudent economic and budgetary management.**
- **The Medium-Term Objective (MTO) of structural deficit of 0.5 per cent is expected to be achieved in 2018.**
- **Budgetary plans allow for a gradual pace of debt reduction and increases in current and capital spending over the medium-term, while complying with the requirements of the fiscal rules.**
- **Forecasts of economic growth are favourable, though there is a risk of overheating in the coming years.**

Macroeconomic outlook

The strong rebound in the Irish economy has continued into 2017, with growth of 7.4 per cent (GDP) in the first three quarters. The strong pace of growth in recent years – notwithstanding distortions arising from the activities of multinationals – means that the negative output gap is now estimated to be almost closed (see the IFAC mid-range of estimates, Chart 1). Macroeconomic forecasts from the Department of Finance (DoF), endorsed by IFAC, show real GDP growth set to moderate in the near term, from 4.3% in 2017 to 3.5% in 2018. Looking to the medium term, there is a risk that the economy may experience overheating should a rapid – albeit necessary – response from the construction sector to persistent housing supply shortfalls arise which is not offset by countercyclical measures elsewhere. Downside risks relate to the uncertain impact of Brexit, which could be more negative than assumed, changes to the international tax environment, and the highly concentrated production and export base.

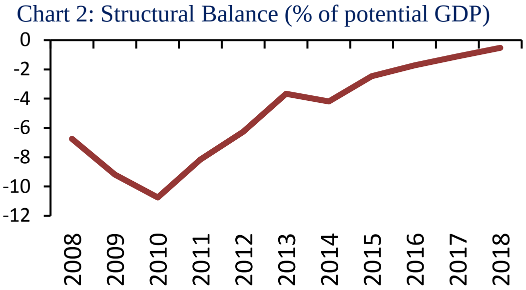
Chart 1: Output gap estimates (% of potential GDP)



Short-term fiscal outlook

The fiscal stance for 2018 was judged by IFAC to be conducive to prudent economic and budgetary management. The net spending and tax changes announced for 2018 were consistent with the estimated gross fiscal space of €1.7bn (0.6% of GDP) allowable under the fiscal rules. Revenue-raising measures were introduced to fund additional increases in expenditure. The General Government balance is forecast to improve to -0.3 per cent of GDP in 2017. Based on the EU Commonly Agreed Methododology (CAM), the structural balance is expected to reach the MTO of -0.5% GDP in 2018 (Chart 2). Government debt has fallen rapidly as a share of GDP recently; however debt-to-GDP understates the debt burden due to distortions arising from the activities of multinationals. Net general government debt is 4th highest in the OECD when using a more appropriate measure of national income (GNI*), and 5th highest when compared to general government revenue.

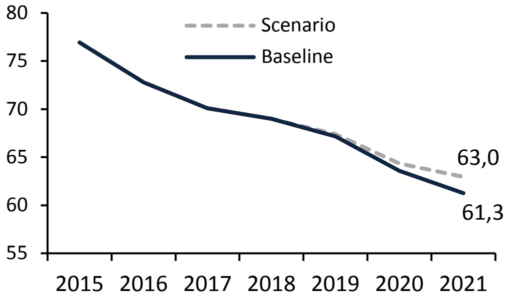
Chart 2: Structural Balance (% of potential GDP)



Medium-term fiscal outlook

If the MTO is indeed achieved in 2018, further scope for new revenue and expenditure measures will be available under the fiscal rules. Previously stated Government policy was to use all available fiscal space for expenditure increases and tax reductions. Forecasts from the Department currently assume that not all of the estimated fiscal space in the later years (2019-2021) is used. If the previous policy of using all fiscal space is maintained, then both the debt and government balance would look less favorable. Chart 3 shows the government's official forecasts for government debt and IFAC's alternative estimates based on a scenario where all of the fiscal space available under the expenditure benchmark is used. Government debt is forecast to fall steadily, yet still remain high as a percentage of revenue by 2021. Current plans see the general government balance moving into surplus in 2020.

Chart 3: Government Debt (baseline and minimum compliance scenario, % of GDP)



Fiscal framework and national fiscal rules

As the deficit is now below 3 per cent of GDP, Ireland has exited the corrective arm of the Stability and Growth Pact. Budget 2018 forecasts suggest a risk of non-compliance with the Expenditure Benchmark over a two-year assessment for 2017 and 2018, with forecast spending 0.1 per cent of GDP in breach of the two-year average for these years. Planned breaches of the Expenditure Benchmark should be avoided. In addition, European Commission estimates of policy induced revenue increases would suggest larger breaches of the rules than if the Government's own estimates were used.

Key indicator forecast

		2015	2016	2017 f	2018 f	2019 f	2020 f	Source
Real GDP growth rate	% y-to-y	25.6	5.1	4.3	3.5	3.2	2.8	1
Output Gap (IFAC mid range)	%	-2.3	-1.3	-0.5				2
GG balance	% of GDP	-1.9	-0.7	-0.3	-0.2	-0.1	0.2	1
GG debt	% of GDP	76.9	72.8	70.1	69.0	67.1	63.5	1
GG debt	% of GNI*	116.6	106.0	106.5	104.7	101.8	96.4	1
GG structural balance – CAM-based.	% of potential GDP	-2.5	-1.7	-1.1	-0.5	0.2	0.4	1
Adjusted real GG expenditure growth	% y-to-y	5.8	-1.2	2.2	1.2	1.6	1.9	2
Discretionary revenue measures	% of GDP	-0.3	-0.3	0.0	0.3	0.0	0.0	1

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

2 – IFAC estimates

CAM –Commonly Agreed Methodology. GG – General Government

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