Ireland

Irish Fiscal Advisory Council

Country note, January 2019

Key messages:

- **Rapid cyclical recovery:** Irish economy close to its potential in 2018, and moving beyond it from 2019.
- **Fiscal stance:** The Government's budgetary plans are assessed as being inconsistent with prudent management.
- **Fiscal risks:** Repeated failures to prevent unbudgeted spending increases leave Ireland exposed.
- **Medium-term budgetary plans are not credible.** Previous medium-term objectives have been effectively dropped.
- **Rules breach:** The Government's estimates of their own budget plans show breaches of the fiscal rules for 2018 and 2019.

Macroeconomic outlook

The economy in Ireland has been growing rapidly for about five years, driven by a cyclical recovery in demand (Chart 1). Relevant estimates of the output gap by the Department of Finance (DoF) indicate that the economy will be just above its potential in 2019 and growth is expected to exceed its potential in the next few years (Chart 2). Significant overheating pressures could build up if a faster-than-expected pick-up in housing construction materialises. While the short-term outlook for the Irish economy remains strong, a slowdown in coming years is inevitable. Brexit may prove to be more costly than assumed. Other risks are posed by the concentration of Ireland's exporting sector in a handful of specialised areas, the global rise in protectionism, and possible future changes in the international tax environment.

Short-term fiscal outlook

For 2018, the Government decided to increase spending by a further €1.1 billion beyond what was originally envisaged just four months earlier, largely due to health overruns. These overruns are likely to be long-lasting spending items. There has been no improvement in the budget balance excluding interest costs since 2015: non-interest spending has been increased at essentially the same pace as government revenues. As much of the improvement in revenues may be cyclical or temporary, this suggests that the structural position has deteriorated (Chart 3). This is a worrying pattern as it means opportunities to strengthen the budget balance during the upswing in the cycle are being missed.

Medium-term fiscal outlook

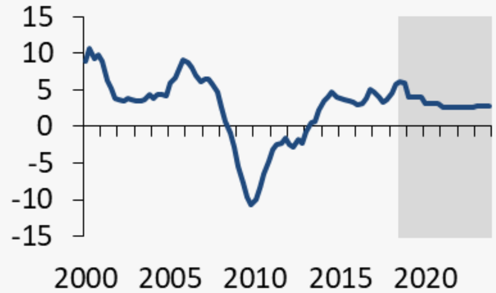
The current intention to run budget surpluses for the foreseeable future if conditions allow is vague. Previous commitments to outperform the requirements of the EU fiscal rules and to reduce debt to 55 per cent of GDP over the medium term—itself an insufficiently ambitious target and with no clear timing—are no longer referenced. The Government's system of three-year budget ceilings is not working, with repeated, procyclical, upward revisions to ceilings taking place. Medium-term spending forecasts are based on technical assumptions that look unrealistic. Though potentially useful, the current design of the National Surplus (Exceptional Contingencies) Reserve Fund is insufficient to offset faster-than-prudent growth rates allowed under the Expenditure Benchmark as applied. Annual allocations to the Fund have been lowered from previously planned amounts, despite a surge in corporation tax receipts.

Fiscal framework and national fiscal rules

The Government's own estimates show breaches of the fiscal rules for 2018 and 2019. Using an alternative measure of the output gap, such as the Department of Finance's preferred estimate, the structural balance deteriorates to a small deficit in 2018. However, this remains above the medium-term budgetary objective (MTO) of –½ of a per cent of GDP. Net expenditure growth is expected to be within with the Expenditure Benchmark limits for 2018 and 2019. However, the Expenditure Benchmark limits are likely to be inappropriately high, as the methodology depends on estimates of potential economic growth produced by the Commonly Agreed Methodology (CAM). IFAC previously highlighted that these estimates are prone to procylical bias. Furthermore, the application of a negative convergence margin results in a spending limit for Ireland of 7 per cent in 2019, according to European Commission estimates. Such a rapid net increase in expenditure or decrease in taxation would be inappropriate for Ireland while economic growth remains strong.

Chart 1: Underlying domestic demand[a]

Percentage change (four-quarter moving sum)



[a]Consumption, government and investment excluding aircraft and intangibles.

Chart 2: Output gap turning positive

Percentage of potential output (DoF methodology)

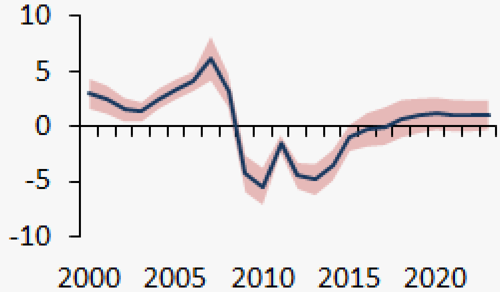
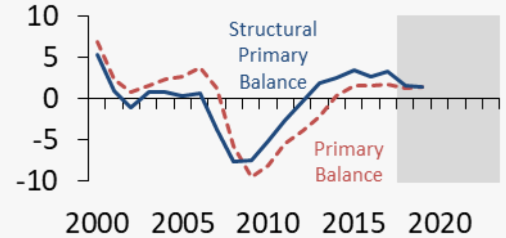


Chart 3: Primary Balance

Percentage of GDP (based on DoF output gap)



Key indicator forecast

		2017	2018 f	2019 f	2020 f	2021 f	2022 f	2023 f	Source
Real GDP growth rate	% y-to-y	7.2	7.5	4.2	3.6	2.5	2.6	2.7	1
Output Gap	%	-2.9	-0.4	0.2	0.9	1.0	1.3	1.7	1
GG balance	% of GNI*	-0.4	-0.2	0.0	0.5	1.1	1.8	2.3	1
GG debt	% of GDP	68.4	64.0	61.4	56.5	55.3	53.1	51.1	1
GG debt	% of GNI*	111.1	105.2	101.0	93.1	91.2	87.8	84.5	1
GG structural balance (CAM)	% of potential GDP	0.4	-1.0	-0.7	0.0	0.5	1.0	1.4	1
GG structural balance (DoF)	% of potential GDP	1.4	-0.1	-0.1	-0.2	0.2	0.4	0.5	1
Adjusted real GG expenditure growth	% y-to-y	3.4	5.0	4.3	3.4	3.0	3.0	2.3	2
Discretionary revenue measures	% of GDP	0.0	0.3	0.3	0.1	0.0	0.0	0.0	1

Sources:

1 – Department of Finance (DoF) estimates;

2 – IFAC estimates;

Commonly Agreed Methodology (CAM), General Government (GG)

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