
The Irish Public Finances: A Post-Budget 2018 Overview

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Budget 2019 featured a total of €1.8bn of spending increases and tax reductions, part financed by over €700mn of revenue-raising measures

Budget 2019 Package	€mn
<i>Extra current spending</i>	1,385
<i>Tax reductions</i>	365
<i>Extra capital spending</i>	35
Total package	1,785
Funded by:	
Resources available per Summer Economic Statement	800
Additional revenue measures	715

Source: Department of Finance

- But note: this is an incomplete picture of government fiscal decisions & plans due to the extra Eur660mn of net spending for 2018 (dominated by an extra €680mn for Health) confirmed in the pre-Budget estimates last Friday

40% of all extra spending (amounting to over €550m) is earmarked for Health, with a further 25% allocated to Social Protection; €180m extra to be spent on housing

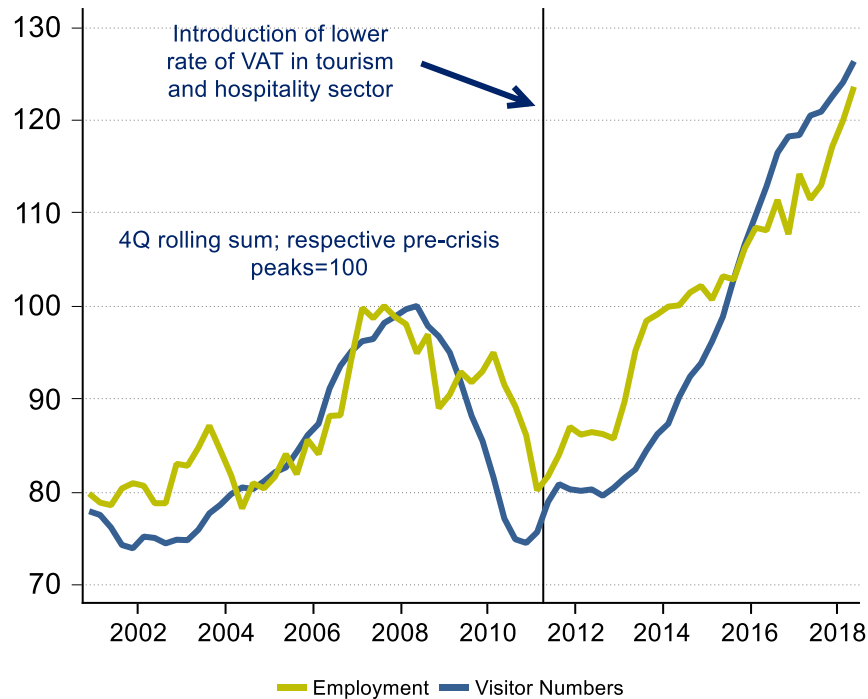
Budget 2019, Allocation of Additional Spending

	Eur m	%
Health	554	39
Social Protection	361	25
Housing	178	13
Children	120	8
Education	119	8
Other, incl. Brexit measures and misc offsets	51	4
	=	
Total Current Expenditure Measures	1,383	98
	+	
Total Capital Expenditure Measures	35	2
	=	
Total	1,418	100

Source: Dept. of Finance

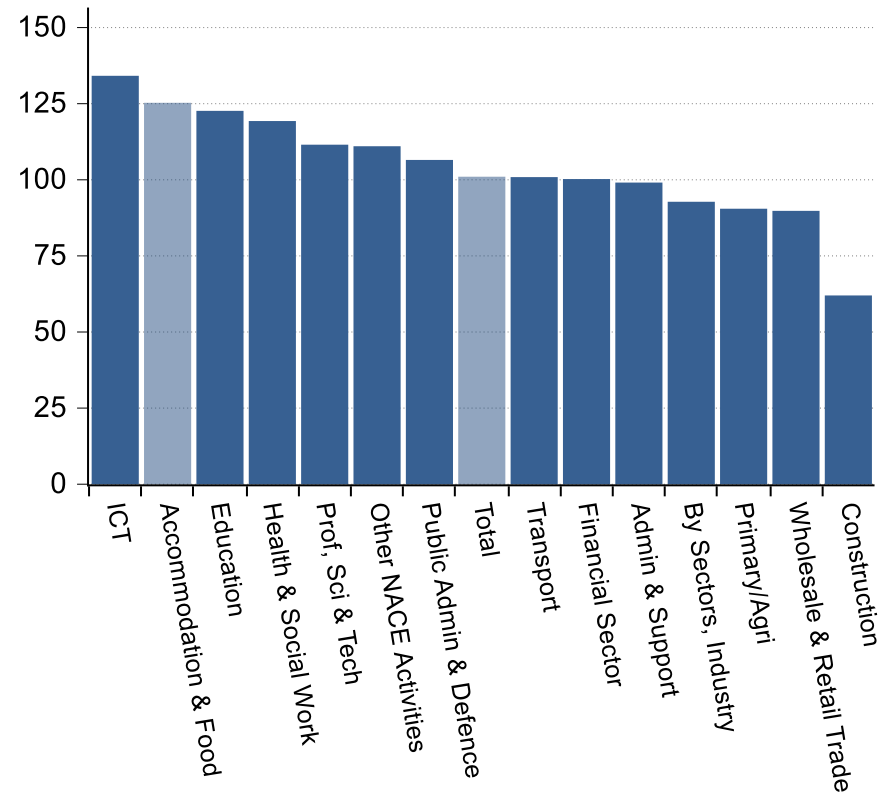
The decision to remove the special, lower VAT rate on hospitality won't be popular with industry stakeholders, but the exceptional strength of the sector's recovery made its further renewal very difficult to justify on economic grounds

Indicators of Activity in Hospitality,
Employment in Accommodation & Food Services and
Overseas Trips to Ireland



Source: UB / Macrobond

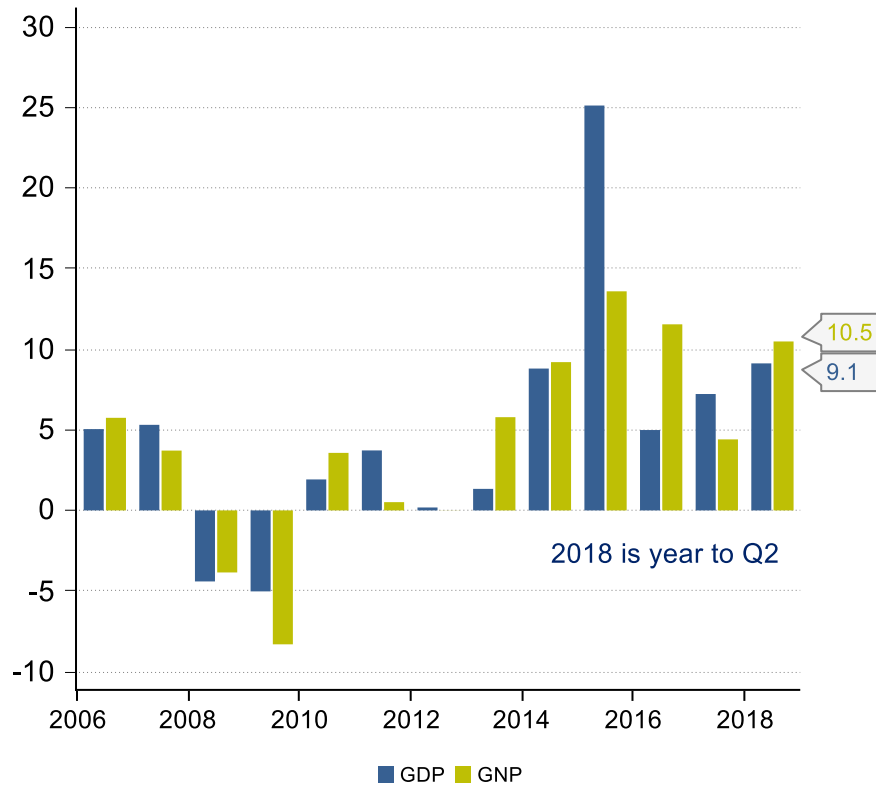
Employment by Sector, 2007 Q4=100 for each sector



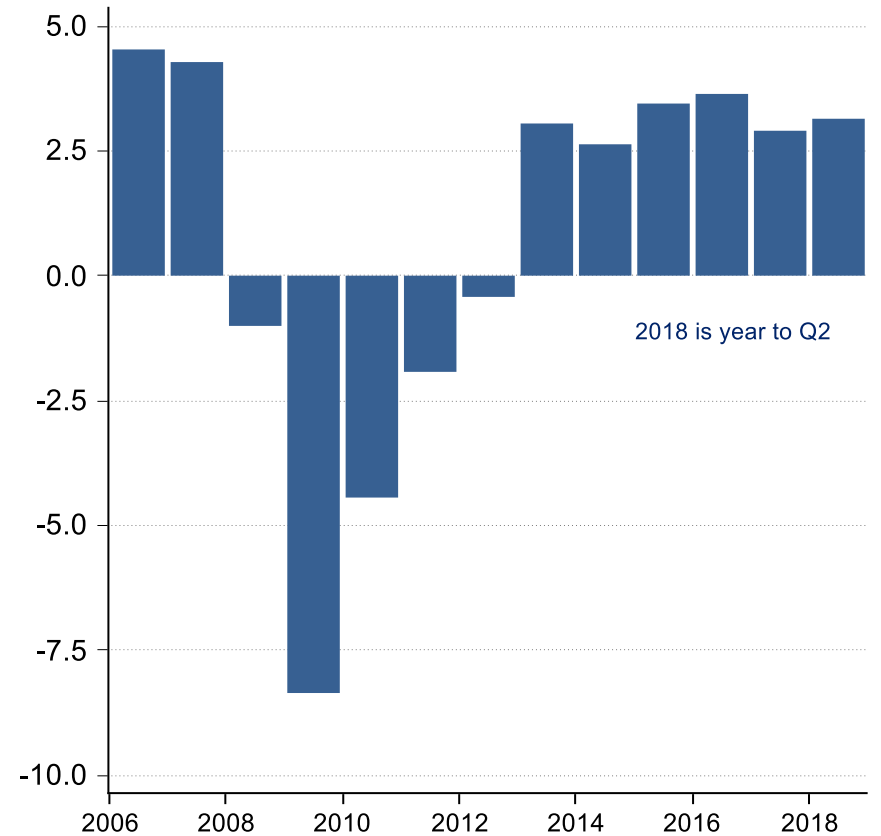
Source: UB / Macrobond

While the headline growth metrics flatter the picture, there is no doubting the strength of the Irish recovery; a 6th consecutive year of rapid employment growth highlights the impressive pace of ongoing improvement...

Ireland, Annual GDP & GNP, Constant Prices, y/y %

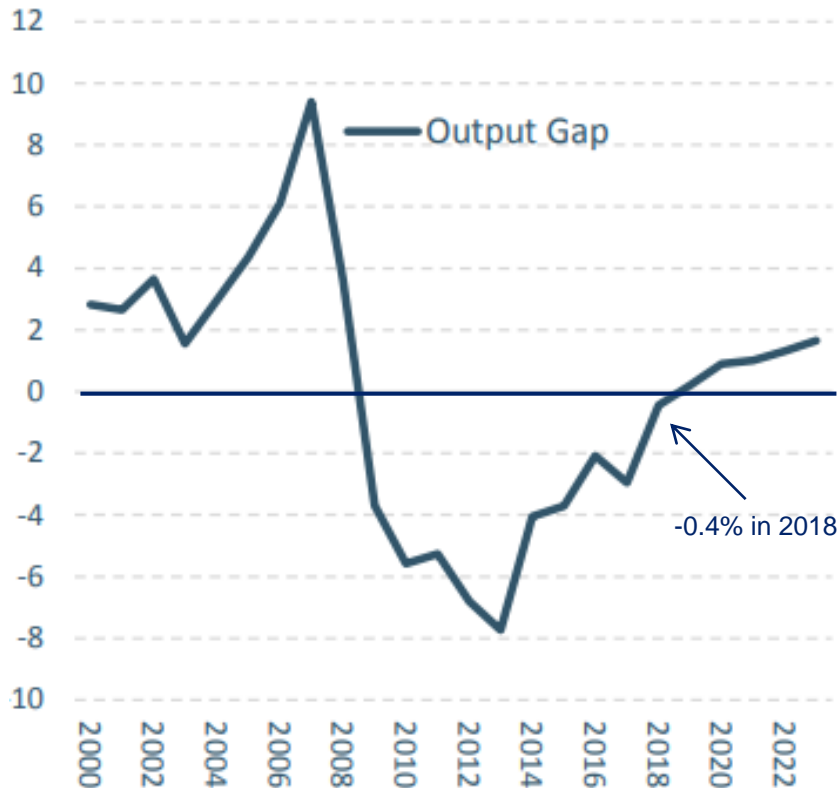


Ireland, Annual Employment, y/y %



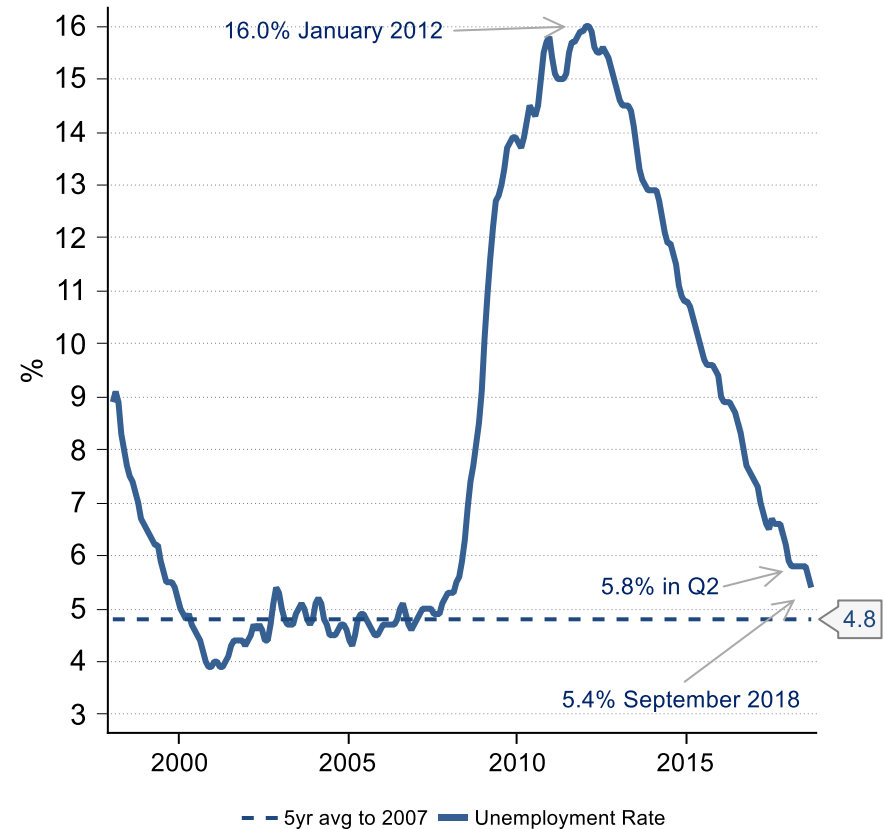
...though a range of indicators, including new estimates of potential GDP from the Dept. of Finance as well as the unemployment rate, suggest that there is very little remaining spare capacity in the economy...

Ireland, Output Gap Estimate, GDP-based Measure



Source: DoF

Ireland, Monthly Unemployment Rate, sa



Source: UB / Macrobond

The forecasts underpinning the Budget look reasonable, and have been endorsed by IFAC (Irish Fiscal Advisory Council); the outlook remains broadly favourable and is looking a bit stronger in the near-term than was projected by last year's Budget

Budget 2018

October 2017

SPU 2018*

April 2018

Budget 2019

October 2018

Real GDP % Growth

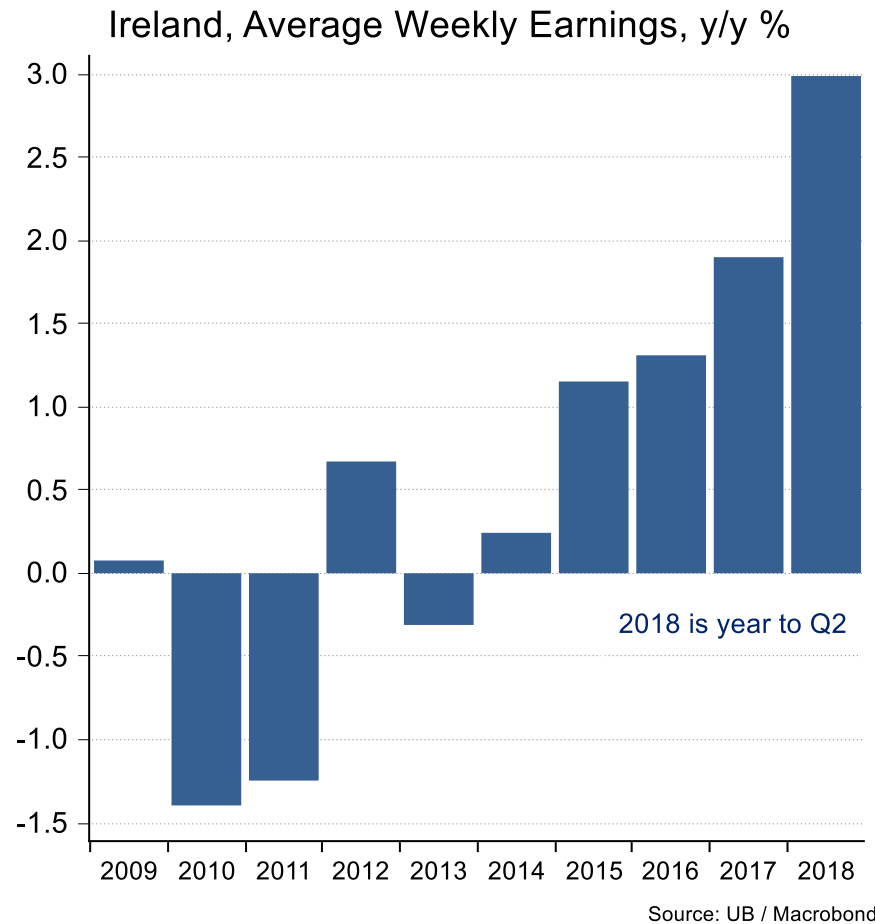
2017	4.3	7.8	7.2
2018	3.5	5.6	7.4
2019	3.2	4.0	4.2
2020	2.8	3.4	3.6

Employment % Growth

2017	2.8	2.9	2.9
2018	2.3	2.7	3.0
2019	2.1	2.3	2.8
2020	1.8	1.9	2.2

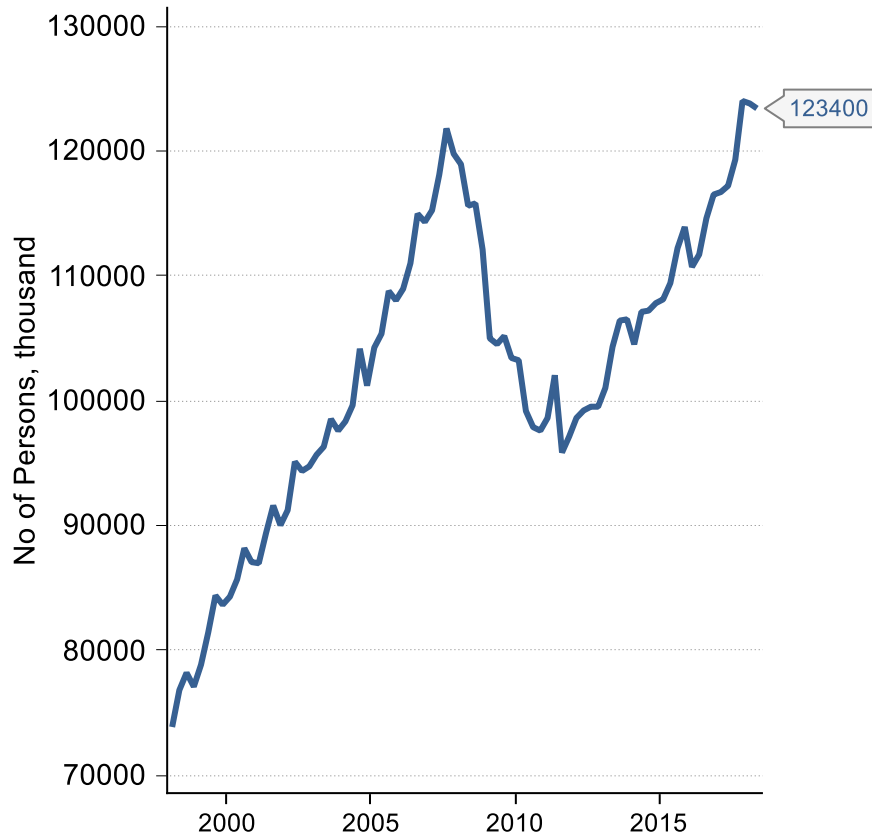
*Stability Programme Update 2018

Risks of overheating warrant close monitoring, especially if a hard Brexit is avoided and / or upside risks to housing activity crystallise...



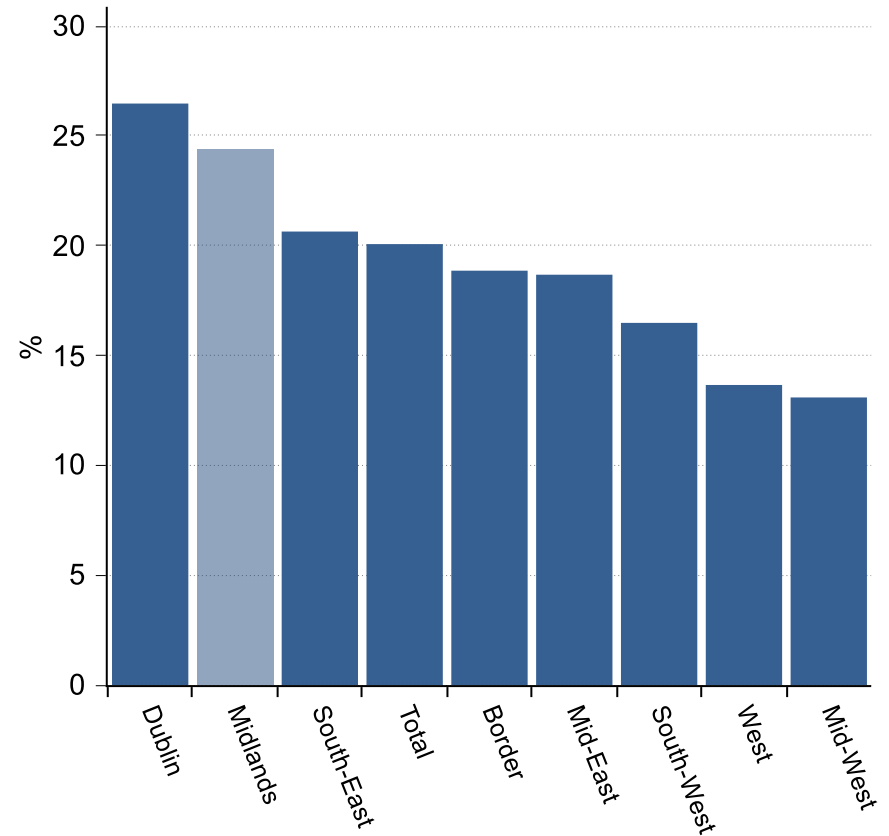
The jobs market in the Midlands has been performing particularly well

Ireland, Employment in Midlands, Total



Source: UB / Macrobond

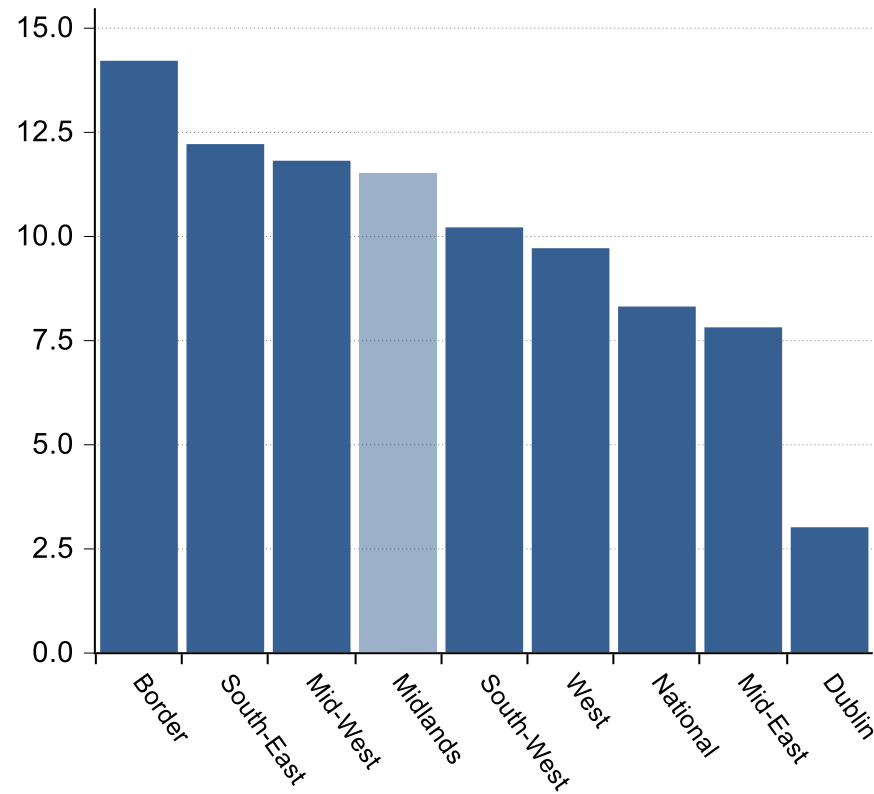
Ireland, Employment by Region, 6 year % change



Source: UB / Macrobond

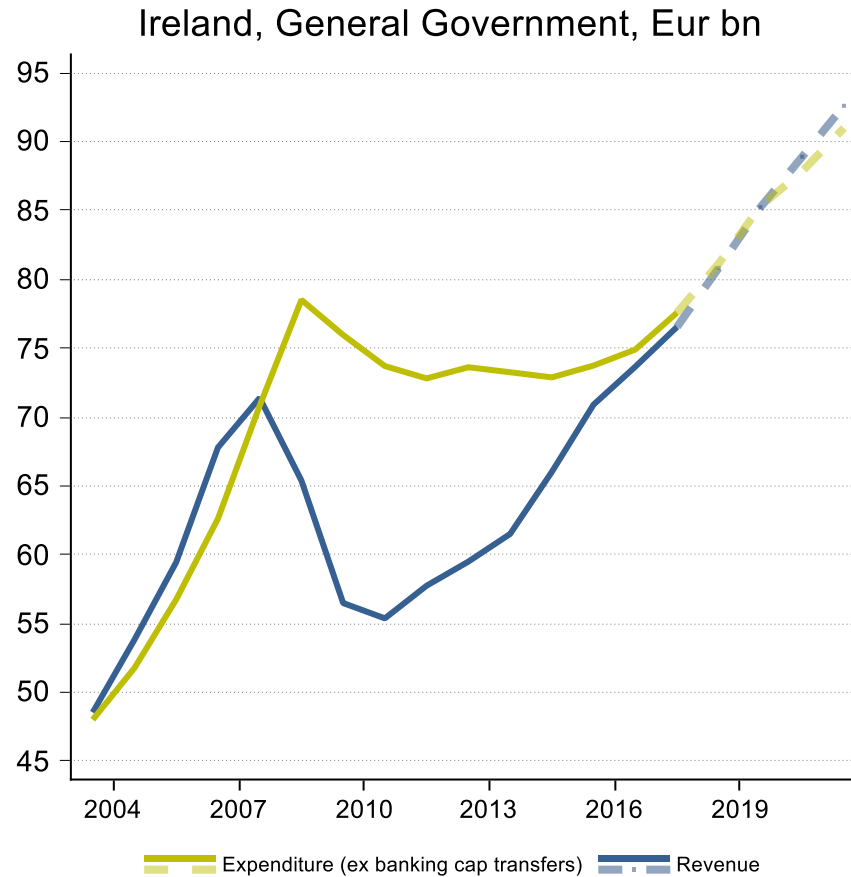
...but a relatively high dependence on the agri-sector highlights the need for businesses in the Midlands to accelerate their Brexit planning, including for hard Brexit scenarios

Agri-Food Employment As % of Total Employment,
by Region



Source: CBol, Census 2016, CSO

Budget 2019 anticipates a return to budget balance next year – marking a notable milestone in what has been a remarkable turnaround in the Irish public finances



Source: UB / Macrobond

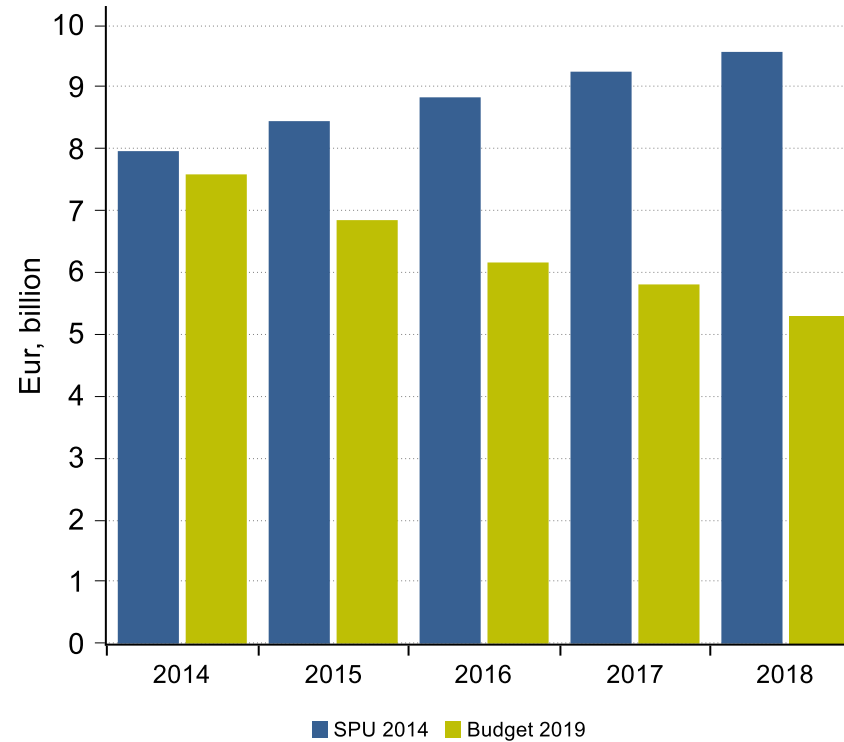
The fiscal turnaround has been underpinned by several factors

These include:

- A major, and extremely painful, fiscal correction featuring severe expenditure cuts and restraint and sharp increases in taxation; this acute phase of Ireland's fiscal correction was concentrated in 2008-2014;
- A large improvement in the cyclical component of the budget balance; i.e. as activity in the economy has recovered sharply, so too have tax receipts, while spending on unemployment-related social welfare supports has declined;
- A number of special factors / tailwinds have also played an important role:
 - Large-scale debt interest savings linked to unprecedentedly low sovereign borrowing costs;
 - An unexpected surge in corporation tax receipts

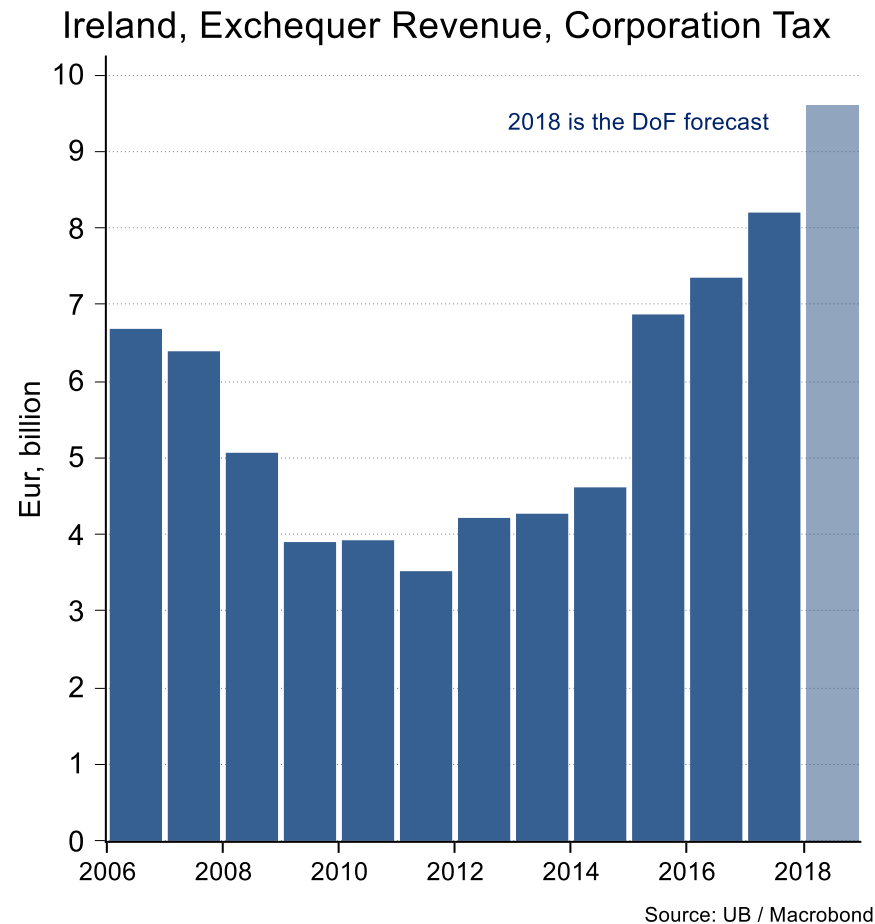
Annual spending on debt interest has fallen by over €2.2bn since 2014, and in 2018 will be €4.2bn lower than was projected in 2014...

Ireland, General Government, Interest Expenditure
Projections:
SPU 2014 vs. Budget 2019

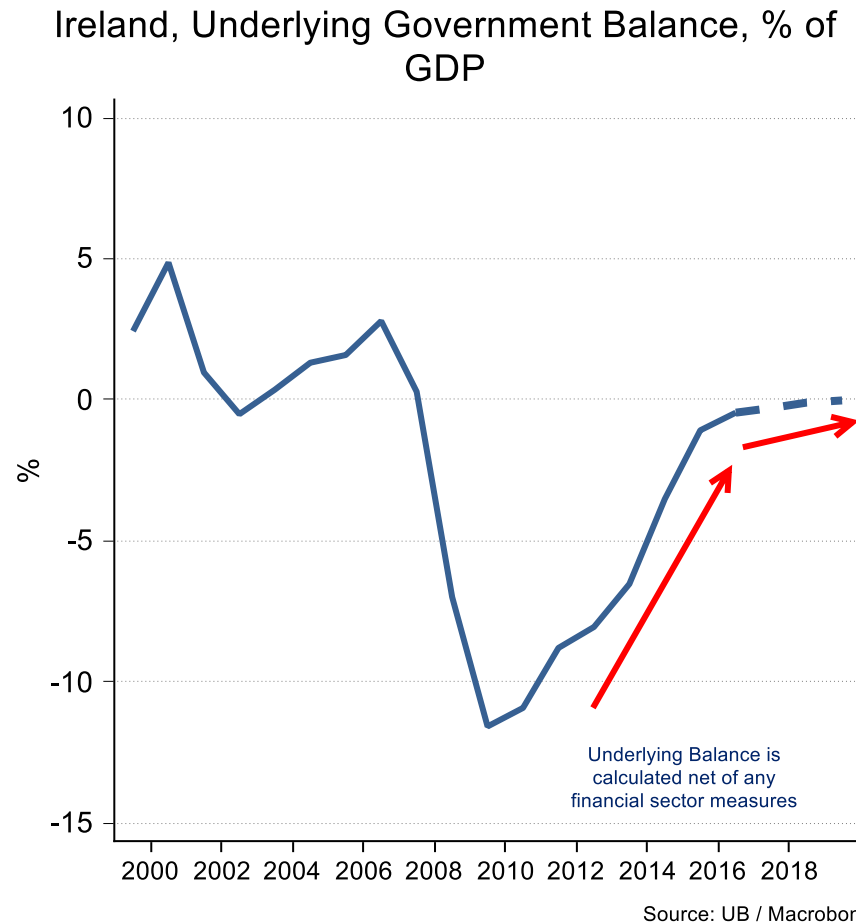


Source: UB / Macrobond

...while corporation tax receipts have more than doubled over the past 4 years



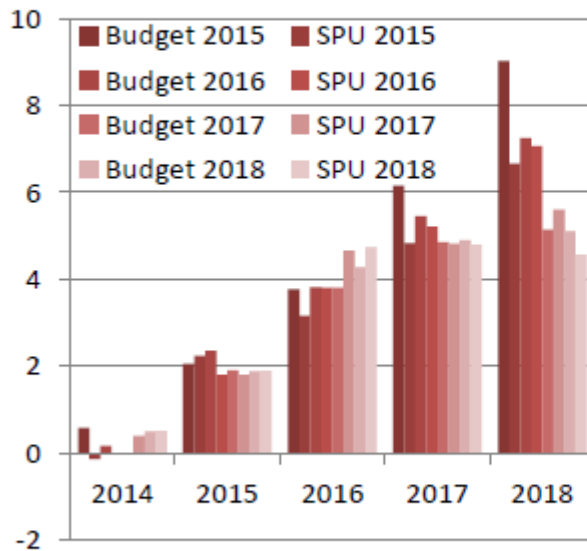
Despite these significant fiscal tailwinds, the pace of improvement in the budget balance has eased significantly since 2015



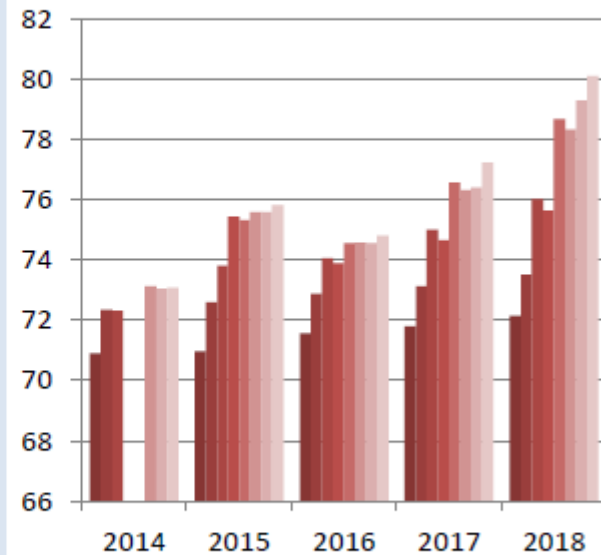
...as higher-than-expected revenues have been matched by higher-than-anticipated non-interest spending

Figure E.1: Vintages of Primary balance and expenditure

A: Primary Balance
€ billion



B: Expenditure
€ billion



Sources: CSO; Department of Finance; and internal IFAC calculations.

Note: Darker bars indicate older vintages; lighter bars indicate more recent vintages.

Note the extent of the spending drift relative to more realistic plans is overestimated as prior to Budget 2017 the Department did not include expenditure increases that would have been allowable under the fiscal rules as part of their initial forecasts.

In particular, the ongoing reliance on upside surprises in corporation tax receipts to compensate for health spending overshoots is not a sustainable basis on which to plan the public finances

Exchequer Tax Revenue Projections for 2018, €m

	Budget 2019	Budget 2018	Variance
Income Tax	21,455	21,444	11
VAT	14,090	14,090	0
Corporation Tax	9,605	8,504	1,101
Excise duties	5,620	5,820	-200
Other Taxes	4,300	4,317	-17
Total	55,070	54,175	895

Source: Department of Finance

Gross Current Expenditure Projections for 2018, €m

	Budget 2019	2018 Estimates	Variance
Total Current	56,900	55,941	959
Health Current	15,464	14,839	625
Total Current (Excl. health)	41,436	41,102	334

Source: Department of Finance

Importantly, Ireland reached its MTO in 2017, though may deviate in 2018 & 2019

- The Medium-Term Objective (MTO) is the key anchor for fiscal policy and is defined in Structural Budget Balance (SBB) terms: the balance adjusted for the cyclical position of the economy and the impact of any one-offs; in other words the balance that would prevail if the economy was operating at its full capacity;
- Ireland's MTO is a SBB of no less than -0.5% of GDP and was reached in 2017 i.e. the books were balanced in structural terms last year (and a year earlier than expected) – a major milestone given that the MTO takes centre stage in the EU fiscal framework;
- It looks like Ireland's SBB may temporarily deteriorate below the MTO in 2018 & 2019 (the Budget sets out a projected SBB of -1.0% and -0.7% in 2018 and 2019 respectively)
- But the plans set out in Budget 2019 confirm the government's intention to return the SBB to the MTO from 2020, thereby fulfilling the MTO in the years ahead, as it is required to do under the rules;

Projected spending growth for next year is within permitted limits under the Expenditure Benchmark...

- The Expenditure Benchmark (EB) is a complementary pillar of the framework - which operates by explicitly limiting the growth of government spending to the economy's estimated long-run potential growth rate. If not at the MTO, there is a further reduction in allowed spending growth to ensure that the SBB will adjust back to the MTO;
- The planned rate of growth in nominal spending revealed in the Budget for next year is 4.2% which is lower than the permissible rate under the EB of 5.3%, meaning Ireland is set to be EB-compliant in 2019;
- This is consistent with the Minister's messaging that his priority is to pursue the "right budgetary stance" given the economy's circumstances rather than making full use of all available fiscal space under the rules;
- and in fairness his confirmation that he will be transferring €500mn per year from next year from the Exchequer to the new Rainy Day Fund also represents an important step in the direction of a prudential approach

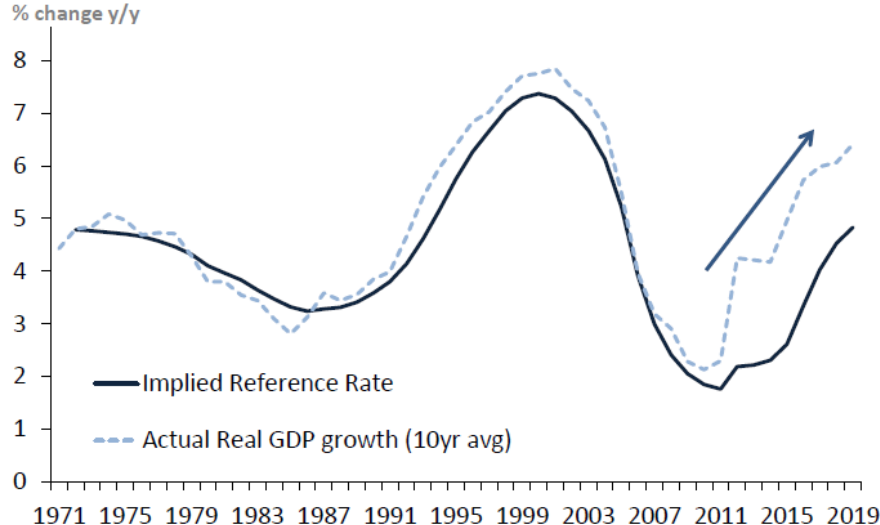
...but IFAC may again highlight a minimalist approach to rule compliance

- However, the estimates in the Budget also highlight non-compliance with the EB in 2017 and 2018 (i.e. spending growth has been faster than permitted by the EB in 2017 & 2018, based on currently available information);
- It may well be the case that these possible deviations from both MTO (for 2018 & 2019) and EB (for 2017 & 2018) are not deemed to be significant by the European Commission (as the rules do provide for leeway given estimation complexities and uncertainties);
- However, the Government may again come in for further criticism from the Irish Fiscal Advisory Council regarding a minimalist approach to compliance with the rules of the new fiscal framework; IFAC are also likely to once again be critical of the extra within-year spending revealed for 2018.

The known procyclical bias of the EB spending rule means that getting fiscal policy right in the coming years is going to require greater prudence and self-discipline than prescribed by the EB

The speed limits for government spending are rising as the economy grows fast

Procyclicality of Allowed Real Spending Growth (Reference Rates) under the Fiscal Rules



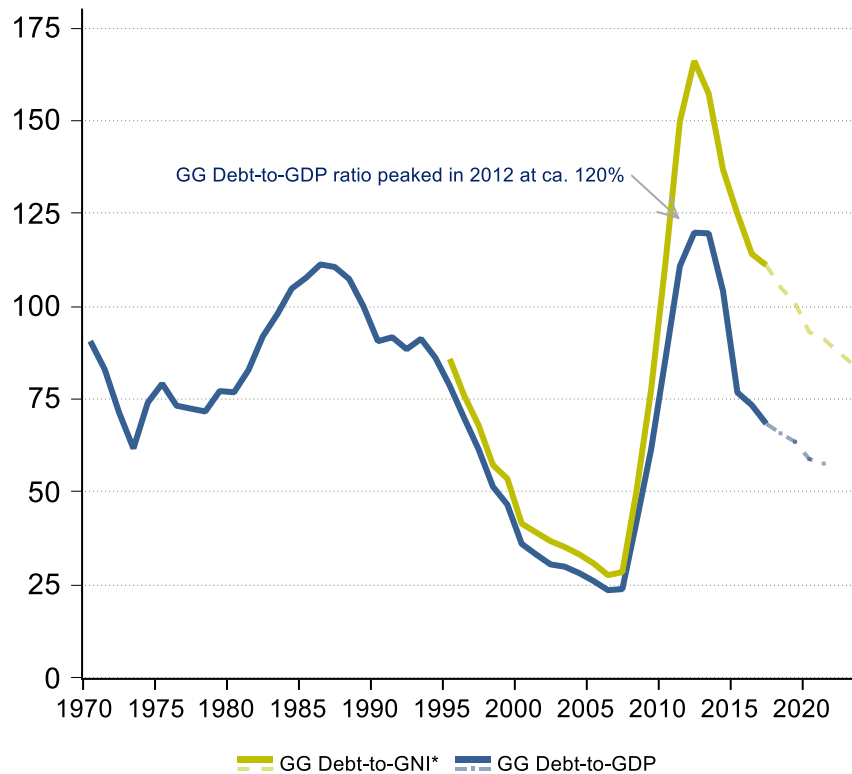
Sources: European Commission (Autumn 2017 estimates); own workings.

Note: Data show the implied Reference Rates based on ten-year averages of the estimated potential output growth rates, which are derived using the commonly agreed methodology.

- As highlighted by IFAC, because of measurement issues related to recent volatility in the Irish growth cycle, allowed spending growth under the rules tends to exhibit an excessively procyclical pattern. That is, spending is allowed to grow too fast in good times, but is restricted to an overly slow pace in bad times. This means too much spending in expansions, potentially leading to forced retrenchments in downturns, thus potentially amplifying, rather than leaning against, the cycle.
- One solution, again as suggested by IFAC, is to base planned spending growth on plausible estimates of the economy's medium-term potential growth rate rather than on the pro-cyclical (rising in good times) reference rate used in the EB.
- This, more prudent approach, would see Irish spending growth limited to ca. 4 to 5% (on the basis of medium-term growth potential in real terms of ca 3% and inflation of 1 to 2%).

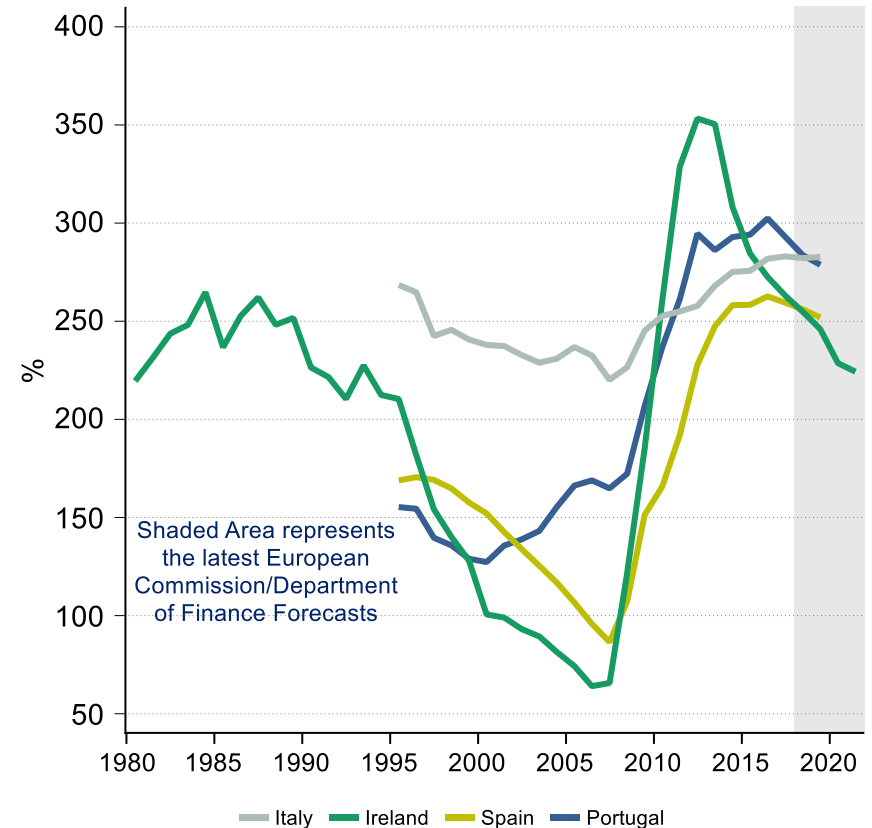
A further reason to prioritise a prudent approach to the conduct of fiscal policy is that Ireland's sovereign debt levels remain uncomfortably high, albeit rapidly declining

Ireland, General Government Debt,
% of GDP and GNI*



Source: UB / Macrobond

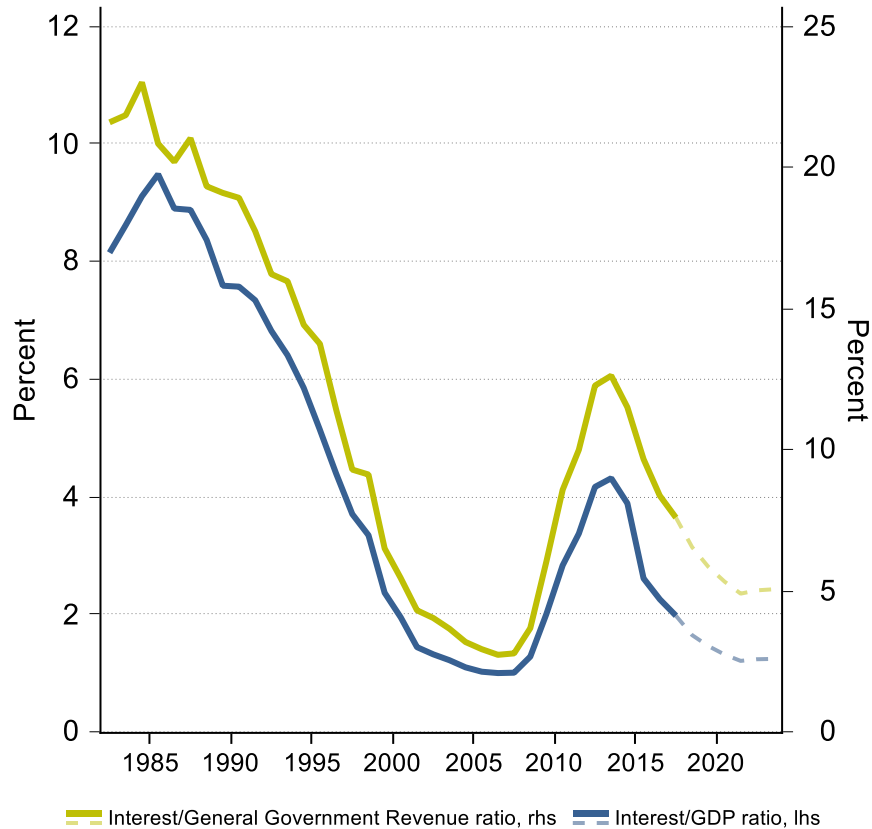
General Government Debt to Total Revenue Ratio



Source: UB / Macrobond

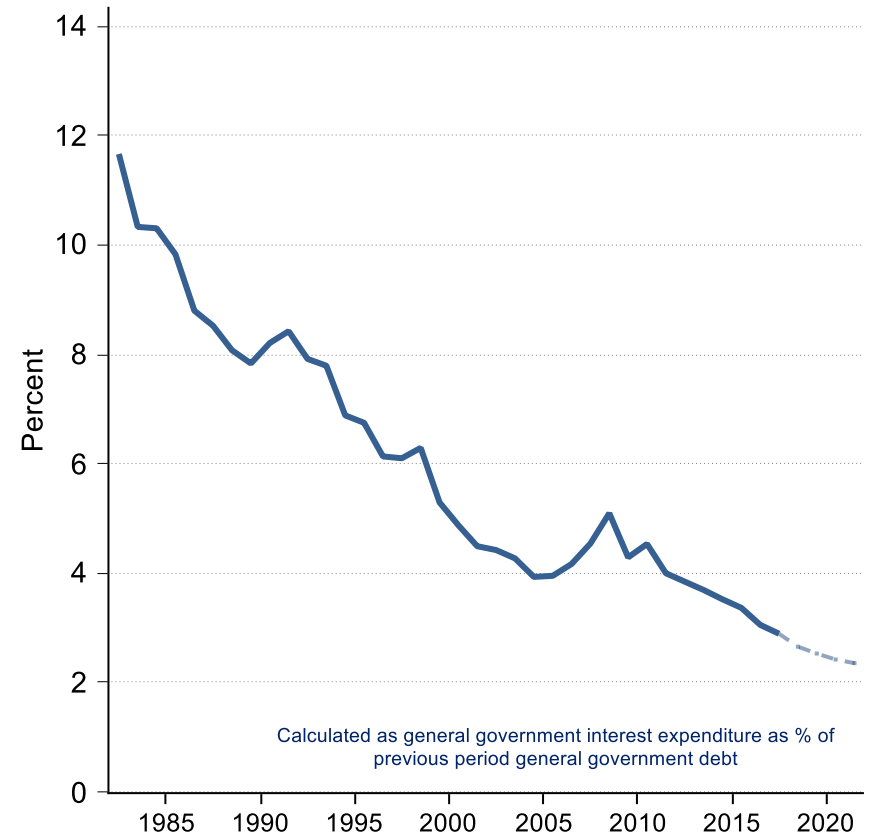
Crucially, the debt servicing burden also continues to decline, helped by the ongoing improvement in growth and revenue trends, while lower interest rates also help greatly to cushion the impact of higher debt, and are a critical source of difference between now and the 1980s

Ireland, Debt Interest Burden



Source: UB / Macrobond / Department of Finance / NTMA / EC

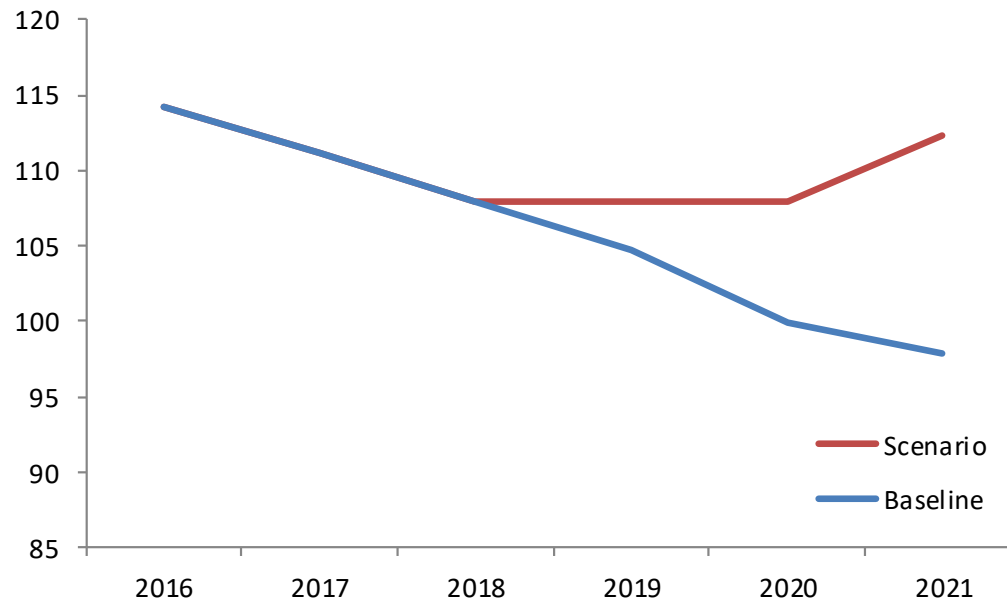
Avg Interest rate on Gen Govt Debt



Source: UB / Macrobond / Department of Finance / NTMA / EC / IMF

Debt levels look set to continue to decline into the medium-term, but sustainability remains vulnerable to shocks...

Debt as % of GNI*: Illustrative Growth Shock Scenario from 2019 onwards

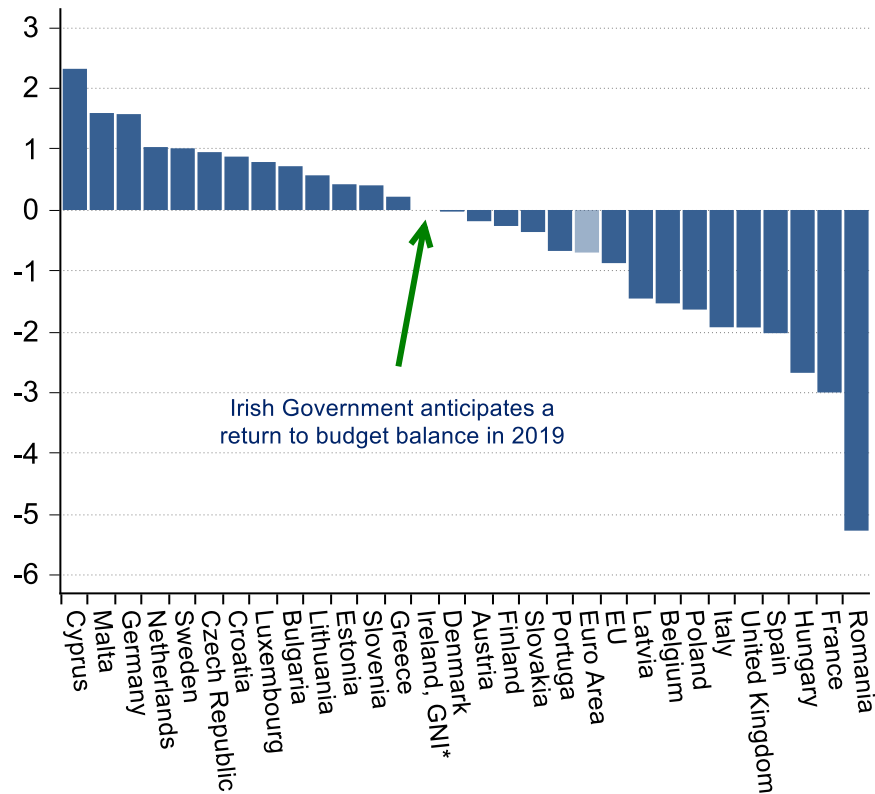


Source: IFAC, UB Economics

Note: The scenario shows the debt ratio path for an illustrative shock equivalent to a typical forecast error on nominal GDP growth (-2pp relative to baseline growth rates) in each of the years 2019, 2020 and 2021

With the budget set to return to balance next year, the challenge beyond 2019 will likely be to run policy with sufficient prudence to take the budget into (potentially meaningful) surplus territory

General Government Balance to GNI*/GDP, 2019
European Commission and DoF



Source: UB / Macrobond

Running surpluses:

- Can help contain domestic overheating pressures;
- Will build fiscal buffers to help accommodate counter-cyclical deficits in the event of the crystallisation of downside risks, and help avoid a repeat of past experience in which downturns have been amplified by pro-cyclical fiscal tightening;
- Is a prudent response to the risk that some current tailwinds (e.g. corporation tax buoyancy and extremely low borrowing costs) may prove temporary;
- Is also appropriate in recognition of the still very-high levels of national debt.

Thank You!

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