Ulster Bank

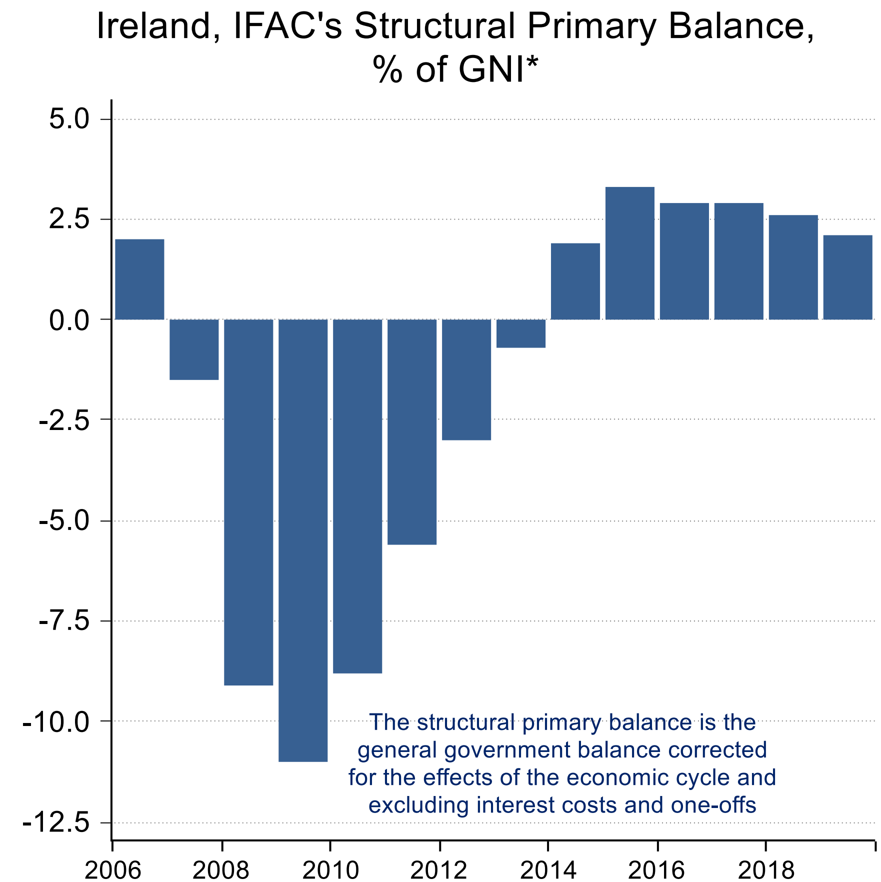
The Irish Public Finances: A Post-Budget 2021 Overview

Simon Barry
Chief Economist Republic of Ireland

October 2020

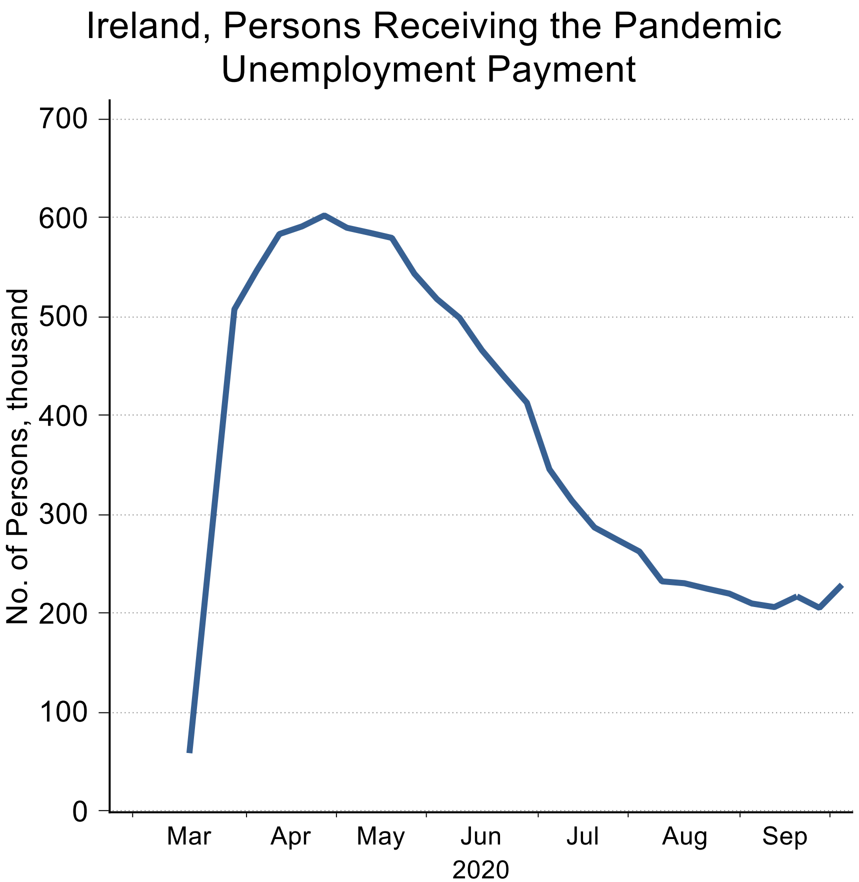
The Irish economy entered this episode in a position of strength and health: the labour market was at full employment and measures of the underlying budget balance had been in surplus for several years

Source: UB / Macrobond

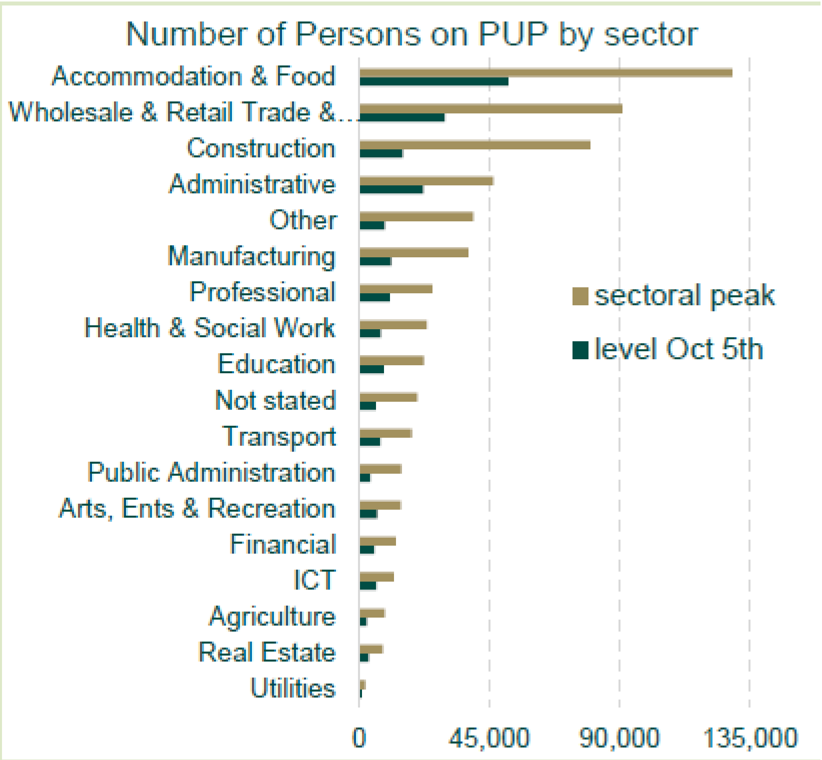


Source: IFAC

But the coronavirus outbreak and associated containment measures had a very sudden and severe impact on the economy; dislocation in the labour market was exceptionally abrupt and dramatic, though unevenly spread across sectors; PUP figures highlight the considerable improvement in economic conditions since the economy emerged from peak lockdown in May, though the recent tightening of restrictive measures is weighing on the very latest trends

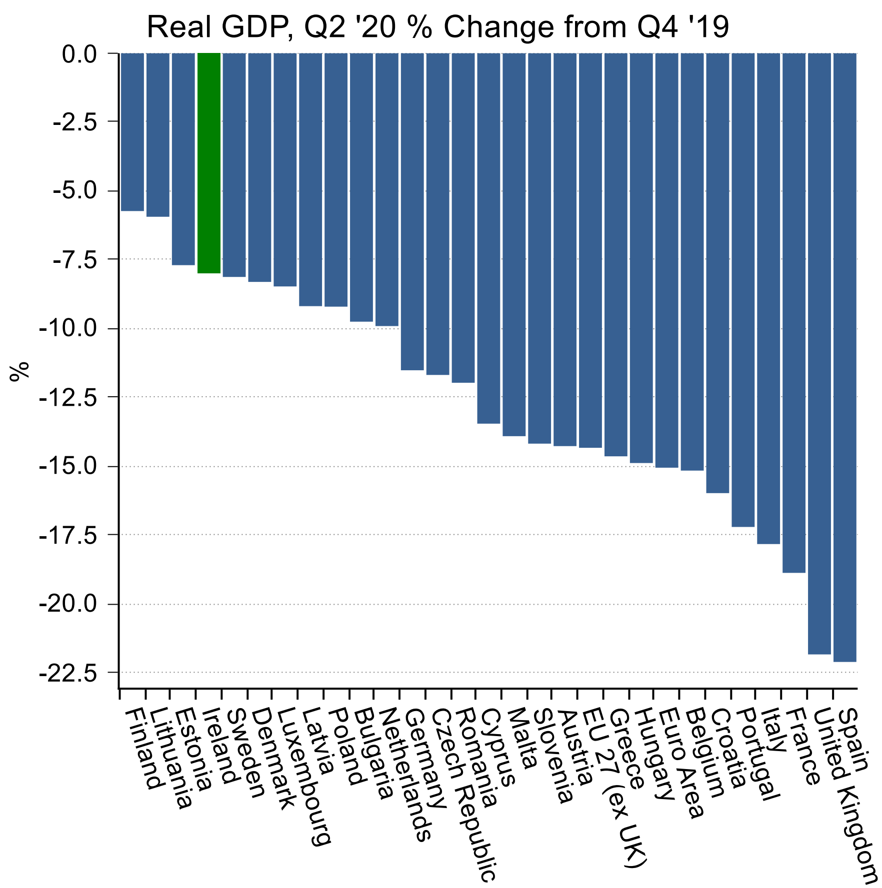


Source: UB / Macrobond

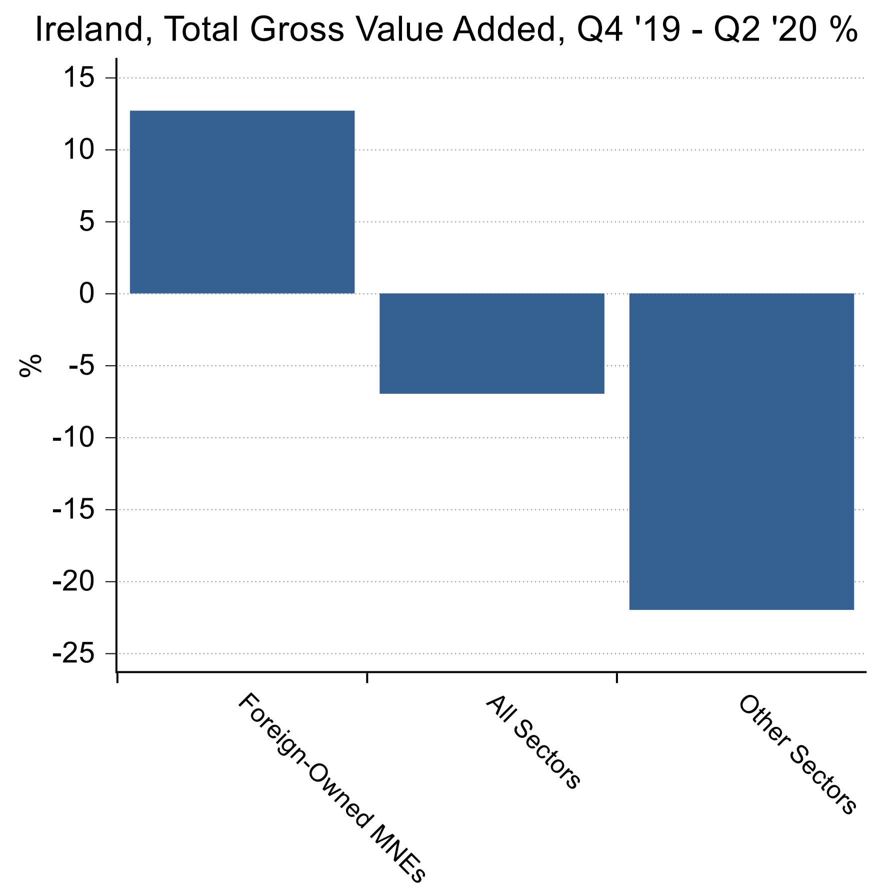


Source: Department of Finance

Overall economic activity took a huge hit in H1, with real GDP recording a combined drop of 8%, which was the largest 2-quarter decline on record; however, that left Irish output among the least-impacted in Europe, as the shock to aggregate output was importantly cushioned by strength in some key multi-national dominated sectors, including pharma/chem and ICT; non-MNE dominated sectors suffered a much larger drop of about 22% in H1 '20…

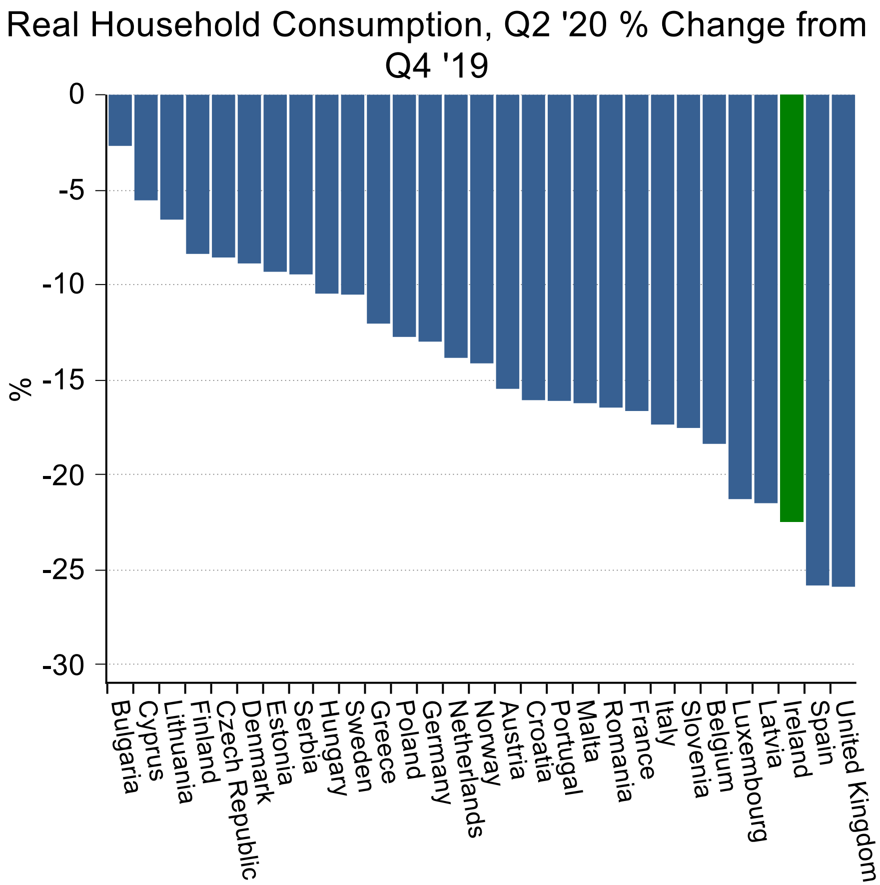


Source: UB / Macrobond

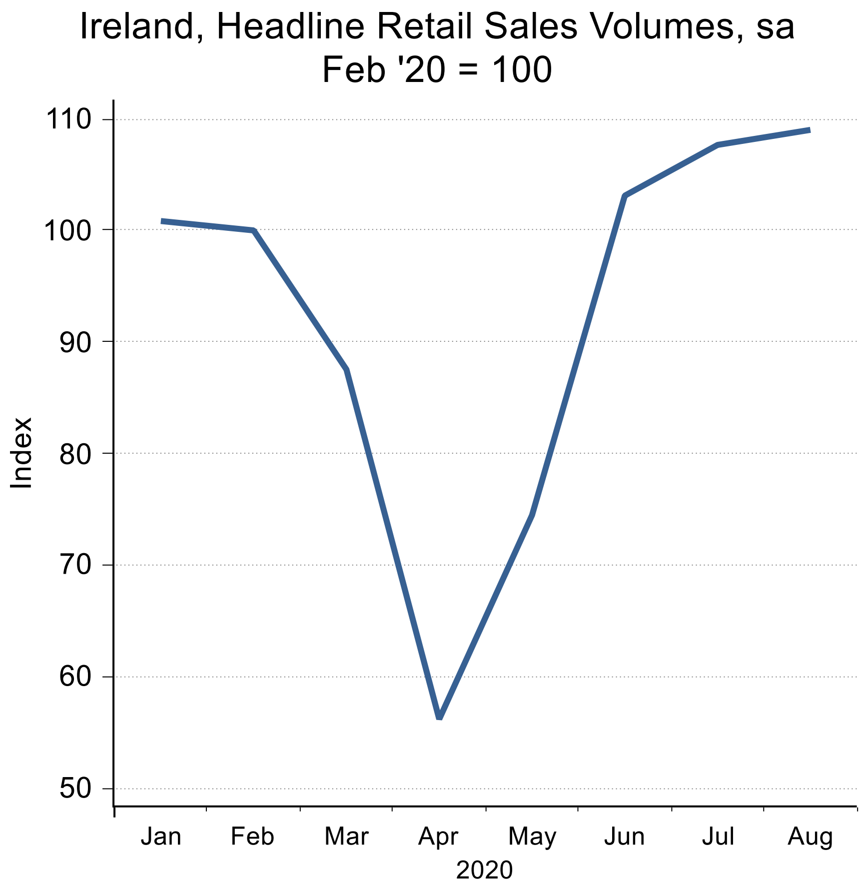


Source: UB / Macrobond

…as the hit to many areas of the domestic economy has been much more severe than to exports and overall GDP; indeed, Irish consumer spending was among the most-impacted in Europe reflecting extreme declines in March and April as opportunities to consume were significantly restricted; but spending has since staged a strong post-lockdown rebound with retail sales volumes in August running 9% higher than pre-coronavirus (February) levels, albeit that the pace of improvement is (unsurprisingly) showing signs of moderating, after an initial snap-back



Source: UB / Macrobond



Source: UB / Macrobond

The dramatic change in economic circumstances has brought equally dramatic changes to the DoF forecasts for the Irish economy, though the economy has held up much better than feared in April; the DoF has a cautious view on 2021 growth as it assumes that the UK and the EU will revert to WTO rules at the end of this year and that the economy will have to continue to cope with Covid over next year as it assumes a vaccine wont be available

Evolution of the DoF forecasts for the Irish Economy, Average Annual Growth, %

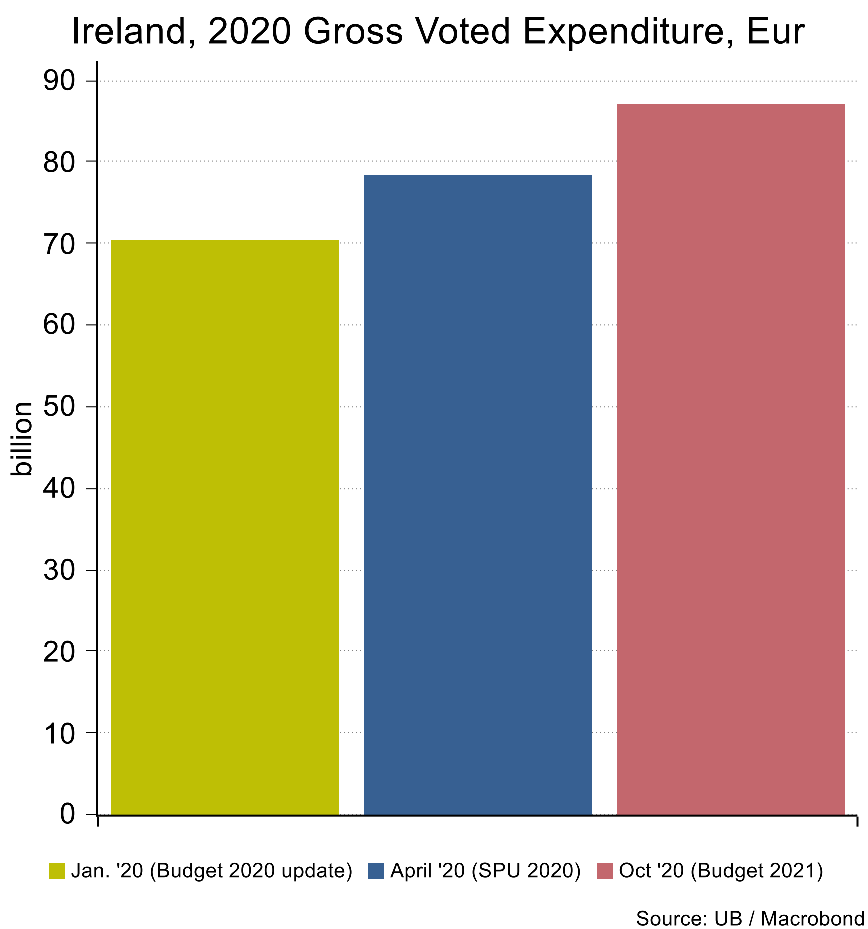
	Budget 2020 (Updated)	**SPU 2020**	**Budget 2021**
	January 2020	April 2020	October 2020
2020			
Real GDP	3.9	-10.5	-2.4
Consumer Spending	2.5*	-14.2	-7.5
2021			
Real GDP	3.9	6.0	1.7
Consumer Spending	2.1*	8.7	7.0

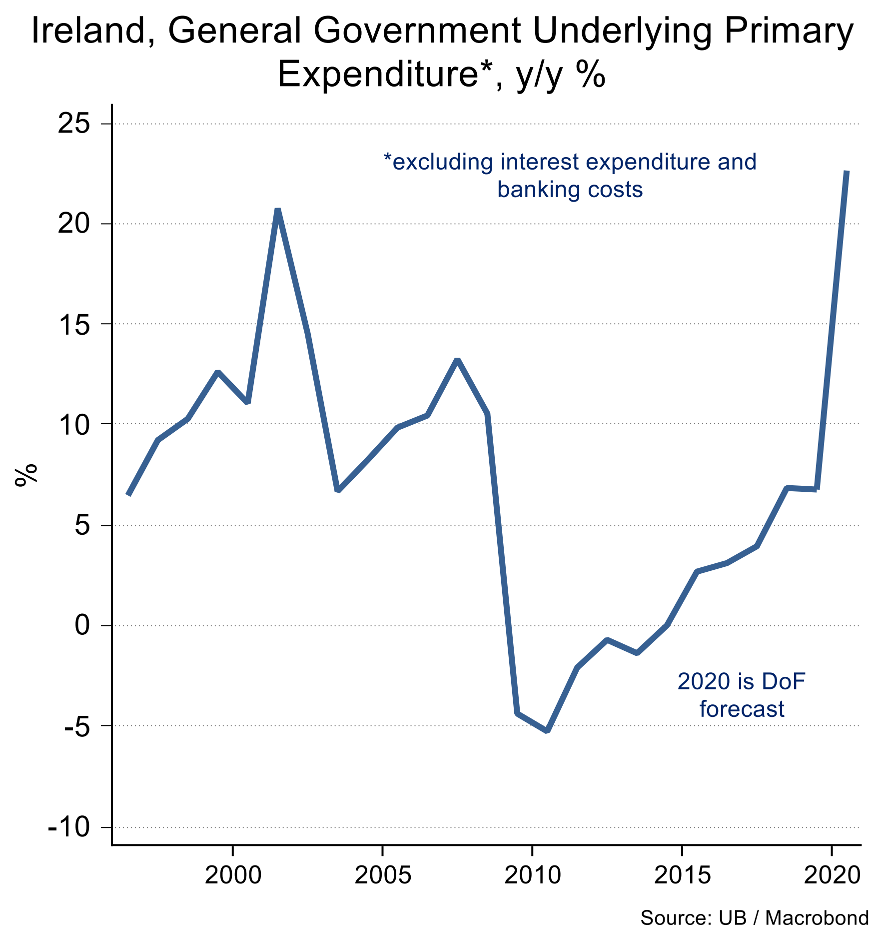
*This forecast is from the SPU 2019 from April '19, w hich is the most recent pre-coronavirus DoF forecast for consumer spending w hich does not assume a disorderly Brexit

- The decision to base Budget 2021 on the assumption that the UK leaves the transition in a disorderly fashion and that a vaccine won't be available next year is perhaps on the conservative side but certainly justifiable given the circumstances and ongoing uncertainty on both fronts

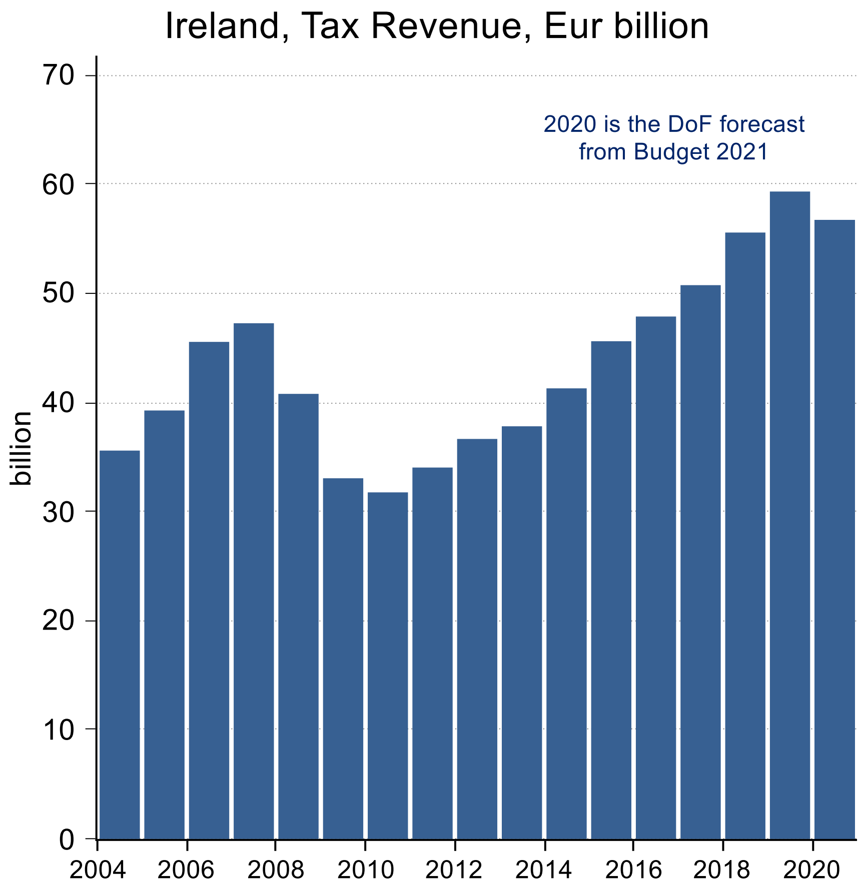
- On Brexit, while the risk of a WTO-type Brexit remains elevated, other outcomes (including a EU-UK trade deal) remain possible ; the Department of Finance estimates that a EU-UK deal could improve Irish growth by just under 3 percentage points in 2021

The pandemic has triggered an appropriately aggressive and unprecedented counter-cyclical fiscal policy response as Government spending measures aimed at supporting service provision (notably in health care capacity), protecting household incomes and supporting employment have added more than €16½ billion to planned departmental expenditure for 2020

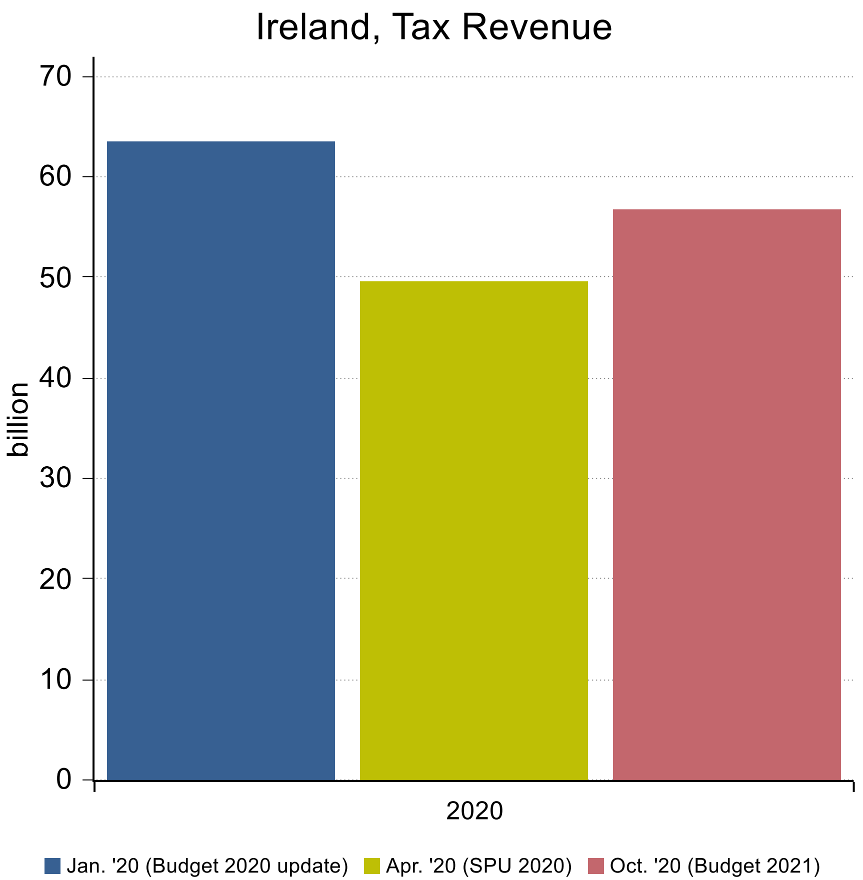




The coronavirus has led to a sharp fall in tax revenue, which is now estimated to fall by over €2 billion in 2020 to stand at below €57 billion; however, notably, tax revenue has performed much better than projected in April when an annual decline of nearly €10 billion in 2020 was projected



Source: UB / Macrobond



Source: UB / Macrobond

Budget 2021 remained very much focussed on continuing to provide further sizeable support to the economy, prioritising management of the C-19 crisis and Brexit

Budget 2021 Package, € billion

Total Package	17.75
Comprised of:	
Expenditure Measures	17.5
Tax Reductions	0.27

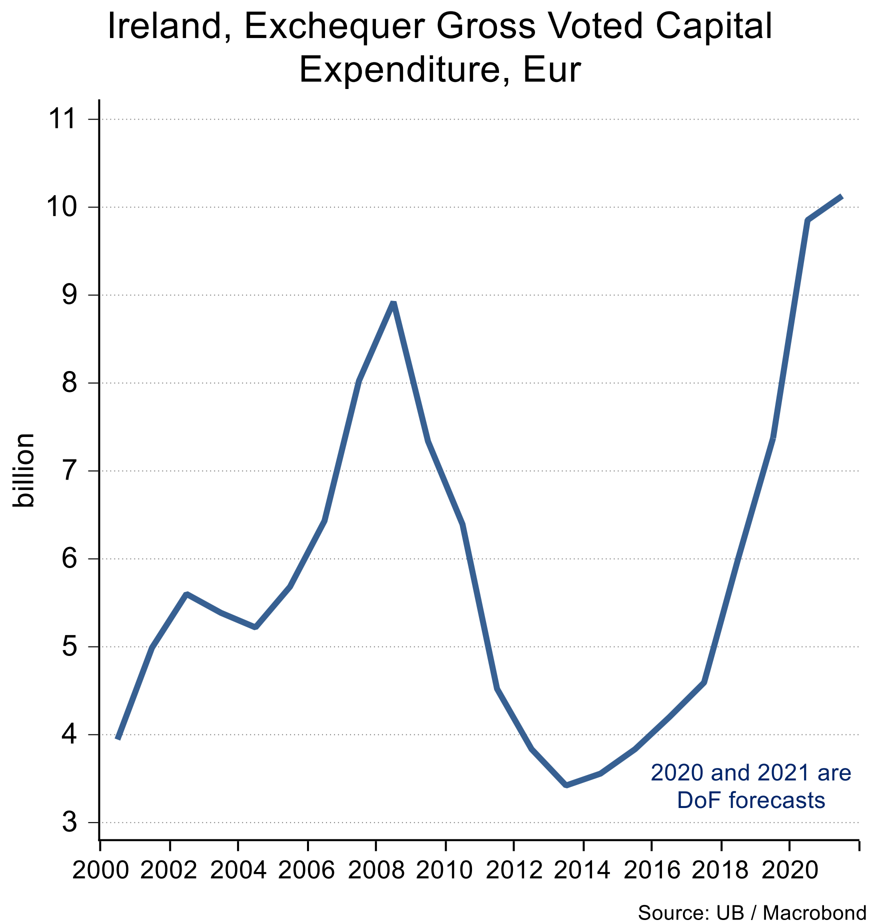
Source: Department of Finance

Main elements of additional expenditure provided for in Budget 2021

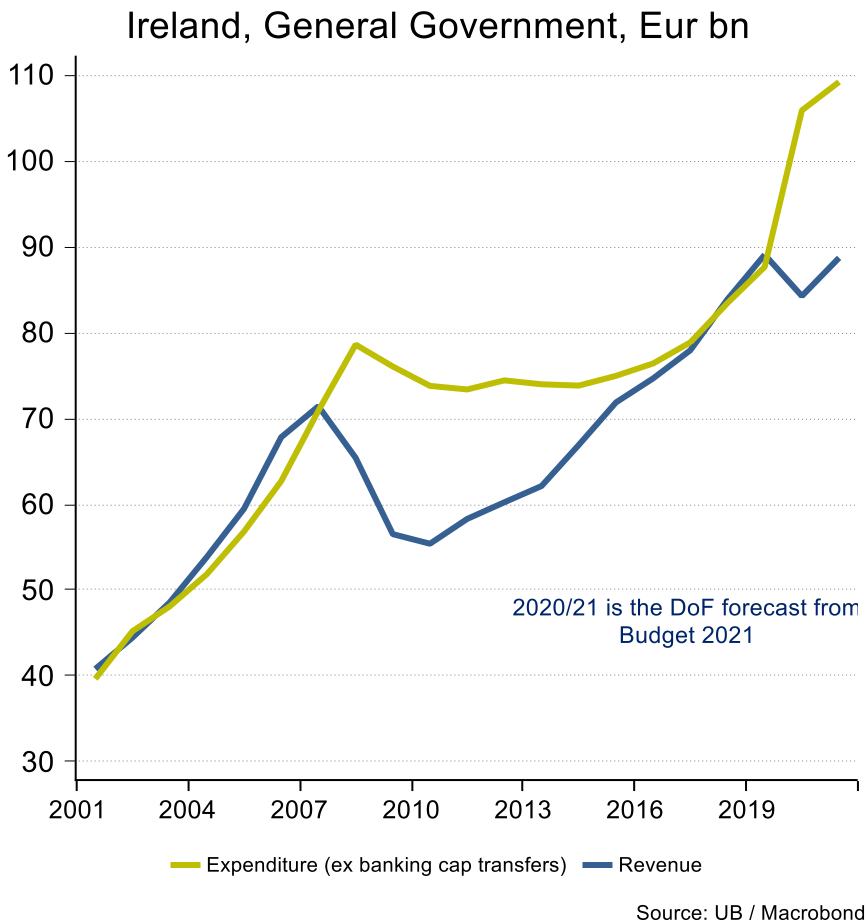
Funding to address Covid-19 challenges		8.5
of which: contingency funding	2.1	
Supporting existing services, incl in Health		3.8
Core capital programmes uplift		1.6
Recovery Fund		3.4
Total		**17.3**

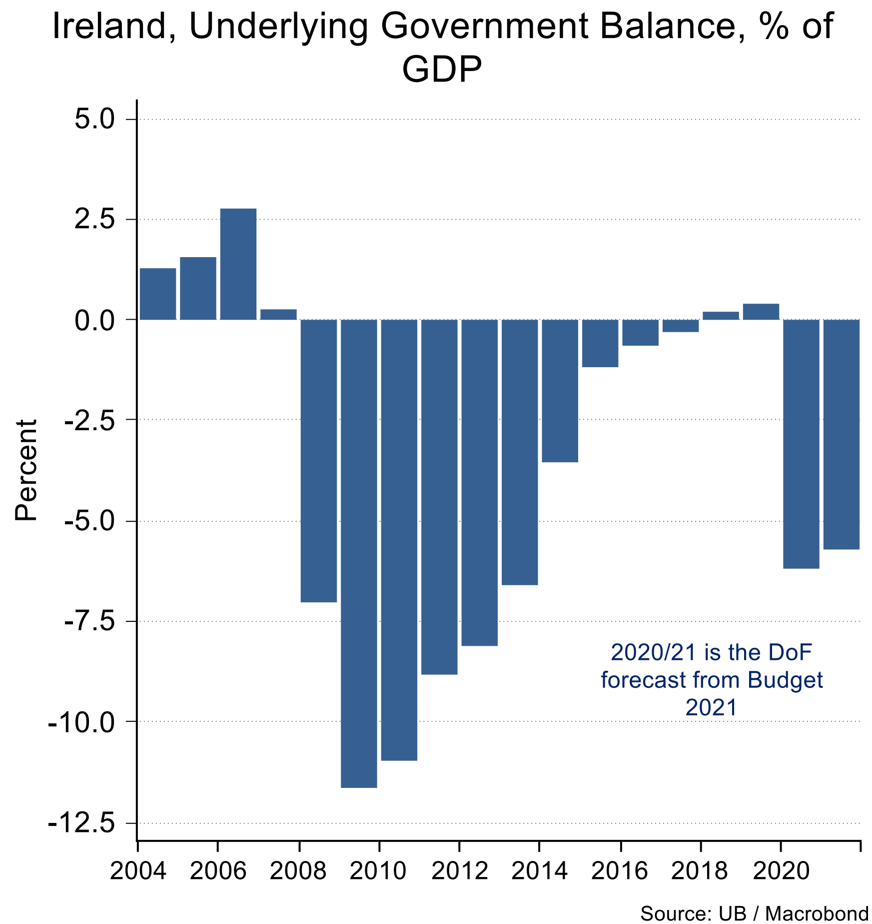
- Ministers Donohoe and McGrath announced today that they are unveiling a package of over €17¾ billion, more than €17 billion of which relates to expenditure and €270 million in taxation measures
- But in reality, there is significant carryover (of ca. €10bn) from previously announced measures to cope with Covid impacts; it looks like Budget 2021 brought "new new" spending measures worth around €7 billion

Exchequer capital spending is set to increase in 2021 to over € 10 billion for the first time on record, more than doubling over the past 4 years; the commitment to a counter-cyclical approach to public investment is a very welcome point of difference from previous crises where capital spending was slashed

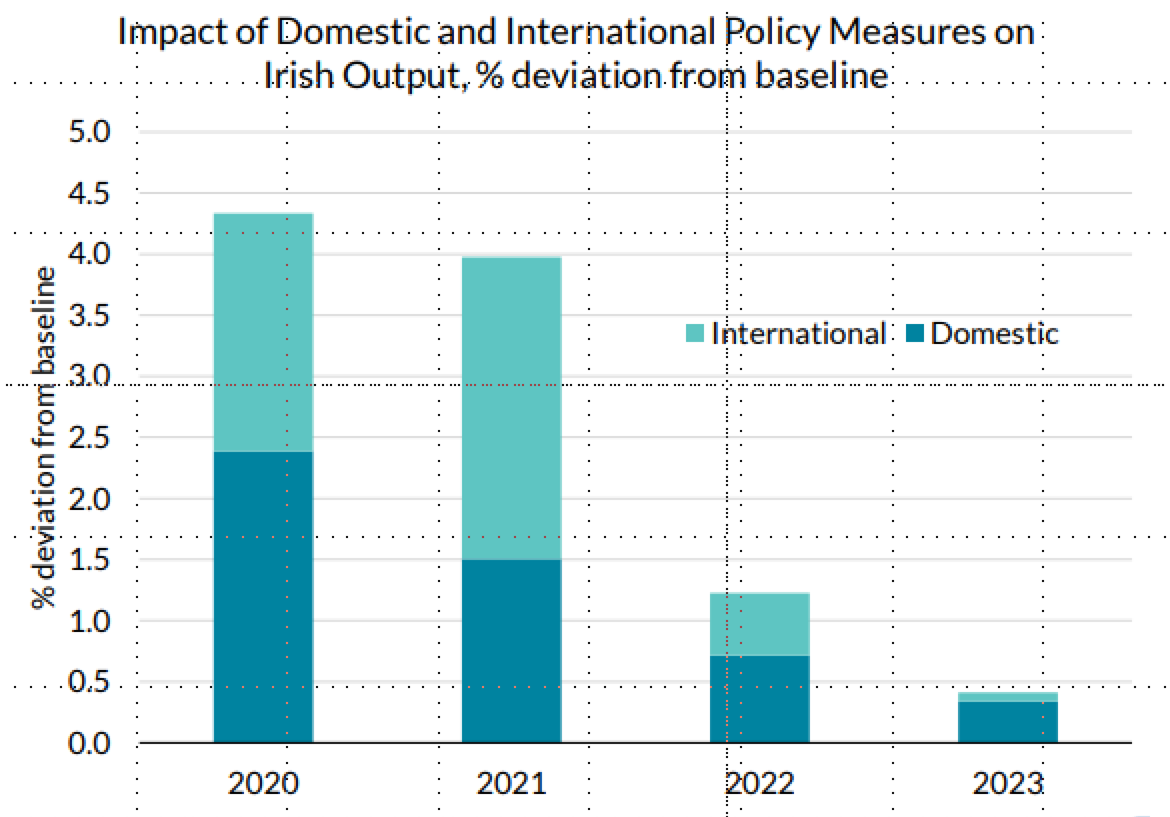


Overall, the ramping up of spending combined with the hit to revenue means that following two years of headline surpluses, Budget 2021 is planning for two substantial deficits this year and next (of around 6% of GDP or 10% of GNI* each year), albeit that next year's is projected to be a little smaller than this year's





Such large-scale domestic fiscal support, combined with international fiscal and monetary policy responses which have also been unprecedented, are playing a very important role in ensuring that even more negative outcomes for the Irish economy are avoided

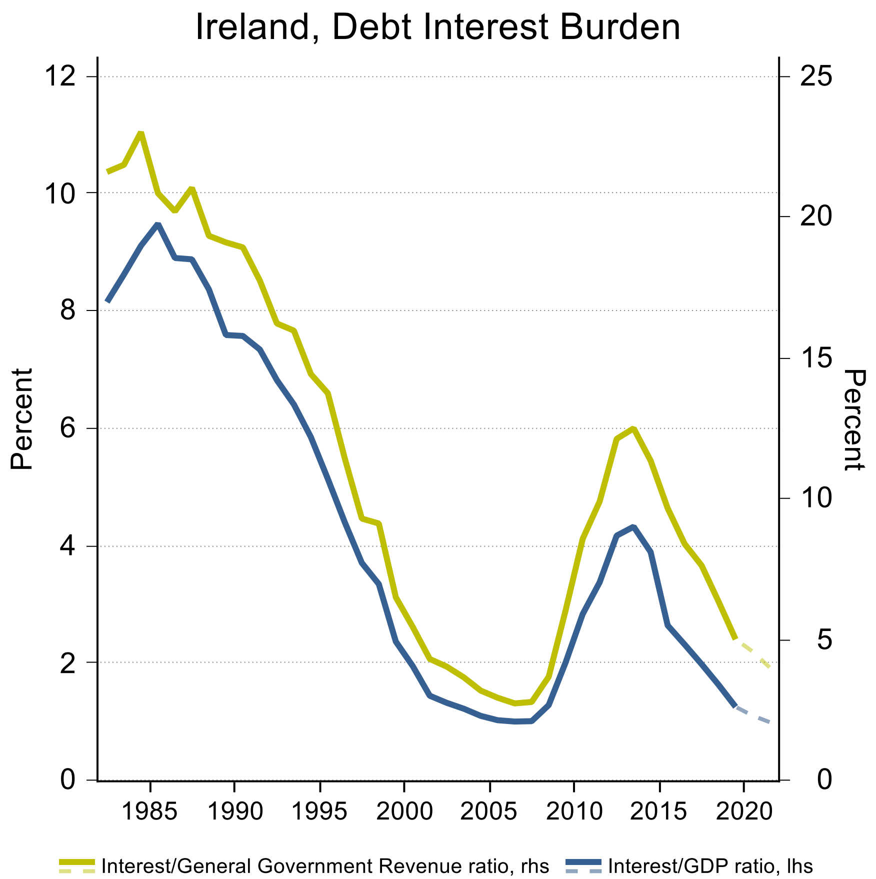


Source: Updated from Conefrey. T., McInerney. N., O'Reilly. G. & G. Walsh, "Recovery Paths from COVID-19 and the Impact of Policy Interventions", Central Bank of Ireland, Signed Article, Quarterly Bulletin No.3 (2020).

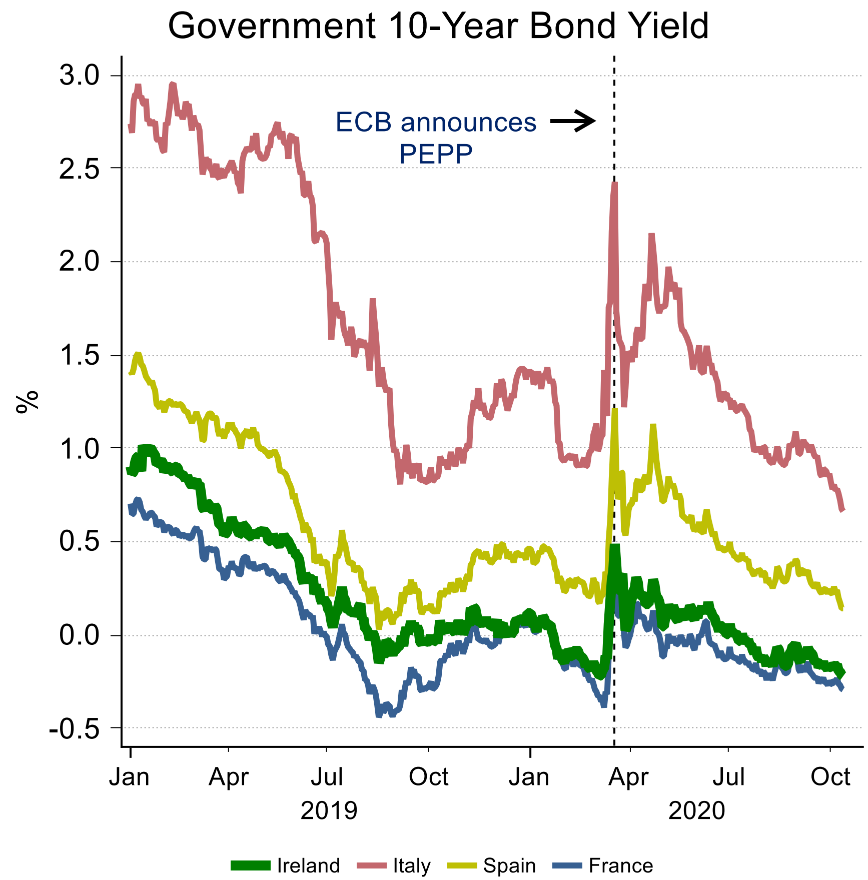
A consequence of the deficits arising from the (merited) high levels of stimulus provision is that, following the large declines of recent years, Ireland's debt levels face renewed upward pressure in the short term from what was an already-elevated starting position

Source: UB / Macrobond

However, the affordability of Ireland's debt is underpinned by a comparatively low debt-servicing burden, supported by a sustained drop in borrowing costs which, remarkably, remain near historic lows – helped greatly by huge ECB policy support

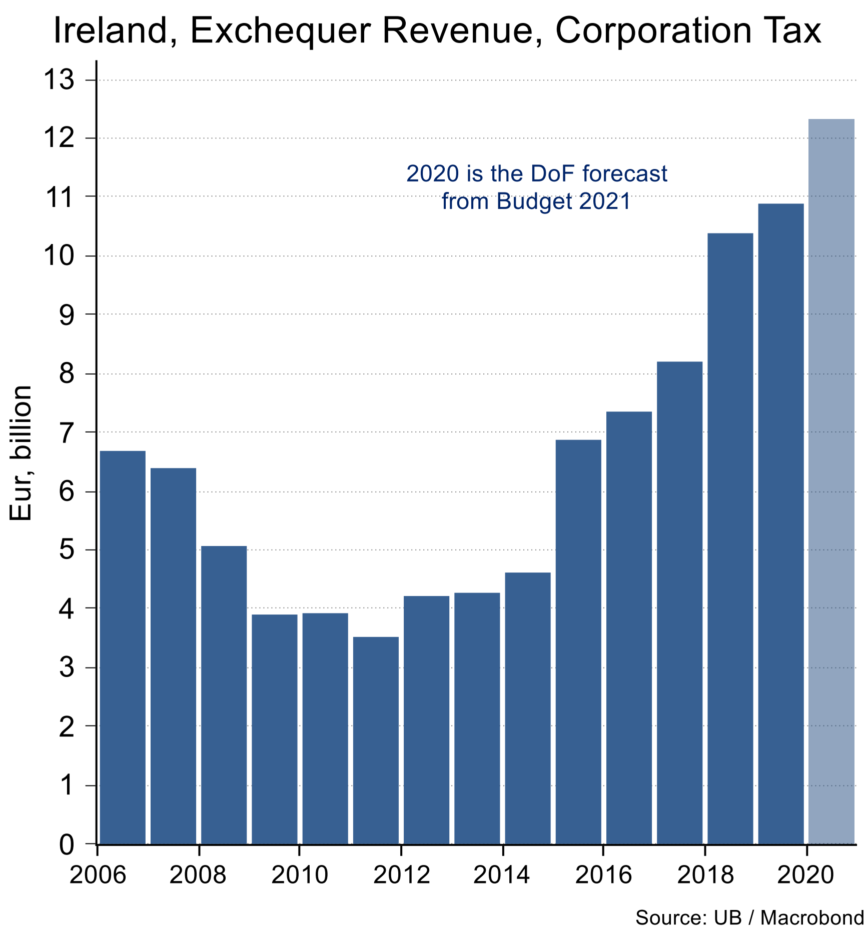


Source: UB / Macrobond / Department of Finance / NTMA / EC



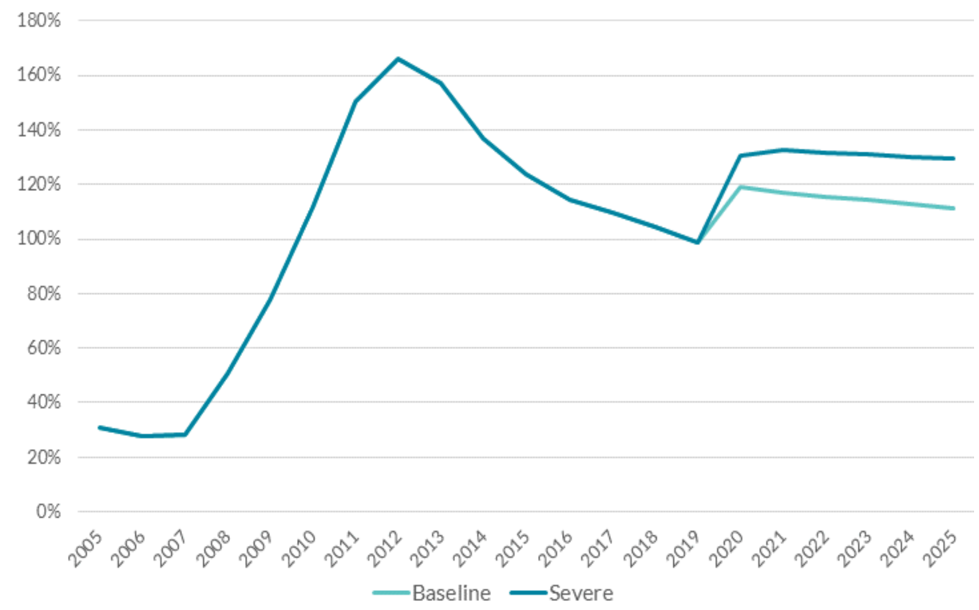
Source: UB / Macrobond

However, it would be imprudent to presume that borrowing costs will be at such extremely low levels over the longer term, especially when the public finances feature a number of points of vulnerability, including a reliance on potentially-unsustainable corporation tax receipts…



…and the fact that maintaining debt sustainability would become more challenging in the in the event of further downside shocks to the economy; it will be very important for the government to set out a credible multi-year fiscal strategy early next year that maps out a return to a more sustainable path over the medium term

Figure 1: General government debt as a percentage of GNI*



Source: ‘Managing the medium term debt challenge’, Blog post by Central Bank of Ireland Governor, Gabriel Makhlouf, July 2020

Summing up:

- The economy’s ability to weather - and the government’s ability to manage - the covid shock has been helped considerably by the relative health of pre-virus economic conditions and the major improvement in the fiscal position in recent years
- While the extent of the hit to the economy has been less drastic than earlier feared, the crisis has warranted an unprecedented amount of fiscal support which itself has played a crucial role in avoiding even more severe economic outcomes
- The provision of such large-scale counter-cyclical support in the near term (including via a commitment to increased capital spending) is the appropriate response given the nature, extent and scale of the economic challenges related not just to Covid but also to the heightened risk of an adverse Brexit outcome
- Exceptionally low borrowing costs at present underpin the affordability of the policy response for now. However, the combination of likely upward pressure on borrowing costs over the long term, a downside risk skew to the economic outlook and underlying vulnerabilities in the public finances (including a high starting-point debt position and a reliance on potentially unsustainable corporation tax revenues) means that as the economy moves past the acute phase of the crisis, policy attention will need to re-focus on the medium-term outlook
- The planning horizon of Budget 2021 in Ireland (as in other EU countries) does not extend past next year. So while sizeable elements of the fiscal supports currently in place are temporary in nature (meaning their deficit impact will reduce automatically as the economy recovers) it will be extremely important for the Stability Programme Update (due by next April) to set out a detailed multi-year fiscal strategy that maps out a credible path that will bring the public finances back to balance and re-establish debt sustainability over the medium term

Thank You!

You can sign up for our Weekly and other commentaries by contacting us at:

Ricardo.amaro@ulsterbank.com

Important Information

This document is intended for clients or potential clients of Ulster Bank Limited and Ulster Bank Ireland DAC (together and separately, "Ulster Bank") and is not intended for any other person. It does not constitute an offer or invitation to purchase or sell any instrument or to provide any service in any jurisdiction where the required authorisation is not held. Ulster Bank and/or its associates and/or its employees may have a position or engage in transactions in any instruments mentioned.

The information including any opinions expressed is indicative and may constitute our judgement at time of publication and are subject to change without notice. The information contained herein should not be construed as advice, and is not intended to be construed as such.

This publication provides only a brief review of the complex issues discussed and recipients should not rely on information contained here without seeking specific advice on matters that concern them. Ulster Bank make no representations or warranties with respect to the information and disclaim all liability for use the recipient or their advisors make of the information.

Ulster Bank Ireland DAC. A private company limited by shares, trading as Ulster Bank, Ulster Bank Group, Banc Uladh, Lombard and Ulster Bank Invoice Finance. Registered in Republic of Ireland. Registered No 25766. Registered Office: Ulster Bank Group Centre, George's Quay, Dublin 2, D02 VR98. Member of The Royal Bank of Scotland Group. Ulster Bank Ireland DAC is regulated by the Central Bank of Ireland. Calls may be recorded.

Ulster Bank Limited Registered Number: R733 Northern Ireland. Registered Office: 11-16 Donegal Square East, Belfast BT1 5UB. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, and entered on the Financial Services Register (Registration Number 122315). Calls may be recorded.