Economic Research

Irish Budget 2014 scales back on pace of debt reduction 15 Oct 2013

The 2014 Budget was expected to deliver the first primary surplus since 2007 and hence put significant downward pressure on the General Government Debt ratio , which is now projected to exceed 124% of GDP in 2013. In the event the 2014 primary budget balance is projected at zero, and although the debt ratio is still forecast to fall from here, the projected pace of decline is slower than previously envisaged.

The planned General Government deficit ratio of 4.8% from an anticipated outturn of 7.3% this year is also higher than the 4.3% envisaged in April. In effect, the Minister for Finance has utilized some of the savings from the Promissory note deal (€1bn per annum in the near term) to soften the fiscal adjustment against a backdrop of weaker than forecast growth in 2013. The result is a Budget deficit target which meets the limit imposed by the EU (5.1% of GDP) while doing less damage to the economy than in recent years.

The Budget will dampen domestic spending, of course, but the €3.1bn adjustment total includes €2.5bn in tax and spending changes and of that some €1.9bn was in the form of new measures, with a strong carryover from changes announced last year accounting for the balance. The Department of Finance believes the measures will dampen activity but the estimated reduction in tax revenue (negative buoyancy) amounts to €400mn and as such less than in previous budgets..

Indeed, the Department of Finance has actually revised up its growth forecast post-Budget from the initial 1.8% on the basis that the measures were not as negative as originally flagged, including the decision to keep the reduced Vat rate of 9% on personal services. The tax changes were confined to excise duty , higher rates on pensions and deposit interest and a Bank levy, so leaving wage income unaffected. Current government spending was cut, by €1.5bn, but real GDP is now expected to rise by 2% in 2014, driven by a 1.8% increase in personal consumption, in turn supported by a 1.9% increase in average pay and a 1.5% rise in employment. The GDP forecast is above the consensus (1.7%) but is not overly dependent on an export recovery as domestic demand accounts for 70% of the growth.

Ireland is due to exit the bailout in December and the Minister has designed the Budget to do the least damage to the economy while still keeping the deficit on a downward trend and hence placating bond investors. The absence of a primary surplus may disappoint the latter, however, although this may not prove very significant if the broader euro backdrop remains supportive. The main risk to the Budget lies in the assumption that the consumer will now start to spend..

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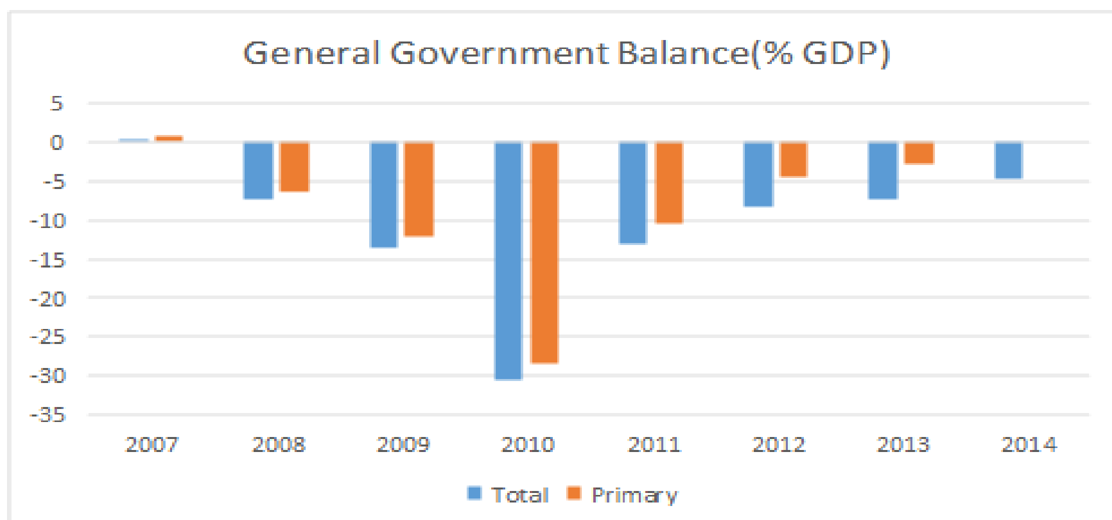
Budget 2014

The pre-Budget deficit was projected at 5.8% of GDP… The Department of Finance expect this year's Exchequer deficit to emerge at €11.3bn, in line with the revised projection following the Promissory note deal and unbudgeted capital revenue, with a substantial shortfall in Vat receipts offset by stronger revenue and savings elsewhere. That translates into a General Government deficit of €12.1bn or 7.3% of GDP, slightly below the original target of 7.5% despite weaker economic growth than expected, both in nominal and real terms (real growth is now estimated at only 0.2% against an initial 1.5%). The Department had also trimmed its 2014 outlook (real growth of 1.8% from 2.4%) and on unchanged policies projected an Exchequer shortfall of €11bn and a General Government deficit of €9.8bn or 5.8% of GDP

2014 Budget (€bn)	
Opening Exchequer Balance	-11.0
Tax changes	0.4
Current spending	1.4
Capital spending	0.1
Carry over	0.6
Total tax and spending	2.5
Other	0.6
Total adjustments	3.1
Negative buoyancy	-0.4
Closing Exchequer Balance	-8.2

requiring another significant adjustment to meet EU targets... Under the EU excessive deficit procedure Ireland was set a deficit ceiling of 5.1% of GDP and hence a further fiscal adjustment was required, despite savings from the Promissory note deal, which reduced the projected General Government deficit by €1bn. The initial fiscal consolidation plan envisaged a €3.1bn adjustment in the 2014 budget and in effect that was delivered although the Minister found €0.6bn from savings elsewhere leaving a tax and spending adjustment of €2.5bn.That included some €0.6bn in carryover from measures introduced last year so requiring €1.9bn in new measures, which was lower than expected. Indeed, the Department of Finance actually revised up its post-budget growth forecast , by 0.2 percentage points to 2%, in part because the temporary cut in Vat on personal services (from 13% to 9%) , due to revert , was extended at a cost of €350mn.



..**which will dampen demand**….Current spending was cut by €1.5bn and taxes raised by €0.4bn, although wage income was left untouched, with the Minister raising excise duty and the withholding tax on deposit interest, now at the highest marginal rate of 41%. A bank levy was also introduced and the temporary levy on pension funds was raised for the coming year and will be permanent from 2015, albeit at a lower rate. The Budget is therefore clearly deflationary, with a €2.5bn adjustment equivalent to 1.5% of GDP. Consequently the Department of Finance adjusted its tax forecast to take account of that impact but their estimate of this 'negative buoyancy' was only €400mn,which is lower than in recent budgets, presumably reflecting the nature of the tax changes and the decision not to raise the 9% Vat rate..

…..**the deficit target is now €8.2bn**...The net result is that tax receipts are expected to increase strongly in 2014, by €2.2bn or 5.8%, boosted by stronger GDP growth and carryover effects. Non-tax revenue is forecast to fall back, largely due to the ending of the Bank Guarantee, leaving total current revenue at €42bn from an estimated €40.4bn this year. Current spending is projected to fall by €2.1bn to €49.1bn , resulting in a current budget deficit of €7.1bn from €10.8bn this year. The capital deficit is forecast to rise sharply, from €0.5bn to €2.5bn , reflecting the one-off impact of certain capital receipts this year, to yield an Exchequer deficit target of €9.6bn in 2014 from €11.3bn . That is the cash sum required to be funded but the EU standard definition of the fiscal stance is the General Government balance, a broader accruals based concept taking in all arms of government , and on that measure the deficit target is €8.2bn, some €4bn below the current estimate for 2013 and equivalent to 4.8% of projected GDP.

2014 Budget Projections(€bn)		
	2013	2014
Current Expenditure	51.2	49.1
Net voted	40.2	38.4
Central fund	11.0	10.8
Current Revenue	40.4	42.0
Tax	37.8	40.0
Other	2.6	2.0
Current Balance	-10.8	-7.1
Capital Balance	-0.5	-2.5
Exchequer Balance	-11.3	-9.6
General Government Balance	-12.1	-8.2
(% GDP)	(-7.3%)	(-4.8%)

..**but the promised primary surplus did not materialize..** Six months ago the Government produced a Stability Programme update which projected a 4.3% fiscal deficit in 2014, including a large primary surplus approaching €1bn, and the Minster for Finance had also flagged the importance of that surplus in the weeks running up to the Budget. Hence the absence of that surplus is a surprise, with the € 8.2bn interest on the debt just matching the overall deficit, giving a primary surplus of zero. That means that the debt ratio is still expected to peak this year, albeit at a figure now in excess of 124% of GDP, but the projected pace of decline is now slower than previously envisaged. The risk premium on Irish bonds relative to Germany is largely a function of the deficit and debt ratios and both are set to fall but investors may be disappointed at the slower pace of adjustment on the latter, although sentiment towards Ireland is likely to remain positive in the absence of another euro wide crisis.

.....**Overall, some austerity fatigue and an upbeat forecast**... From an economic perspective the overall conclusion on Budget 2014 is that it betrays signs of austerity fatigue in that the Minister has taken advantage of the leeway afforded by the savings on the promissory note and brought in a fiscal package designed to placate the EU by keeping within the deficit limit of 5.1% while seeking to do the least damage to the economy by eschewing a primary surplus and targeting a higher deficit than previously thought achievable. The Budget arithmetic is also predicated on a strong recovery in consumer spending, projected to increase by 1.8%, and it remains to be seen whether Irish household 's current predilection for deleveraging will change sufficiently to justify that forecast. What is also significant is that the risks to the outlook are not solely external, as domestic demand is forecast to account for 70% of the projected growth in GDP, so the days of an export-led recovery are behind us it would seem.