Economic Research

Irish Budget 2015: Modest stimulus, but structural deficit still constraint   Oct 15 2014

Following the release of the pre-Budget Exchequer estimates for 2015 it was clear that the Minister for Finance had the option of ending the 7-year period of fiscal adjustments , having the leeway to introduce a modest stimulus to the economy. We envisaged a €1bn package and in the event the figure was just over that, resulting in a planned General Government Deficit (GGD) of 2.7% of GDP in 2015, against a 2.4% figure in the absence of any policy change.

The Budget will provide a modest boost to activity (the Department of Finance has raised its growth forecast to 3.9% from an initial 3.6%) which is an extraordinary turn of events given that only six months ago the Government was still anticipating the need for further fiscal contraction in the form of a €2bn adjustment. Indeed, the EU and the Fiscal Advisory Council were still advocating such a course pre-Budget, advice the Government chose to ignore.

The catalyst for the change in policy was simple-economic growth. Irish nominal GDP in 2015 is now expected to be some €19bn higher than the Department projected in April, real growth has been much stronger than expected in the first half of 2014 and tax revenue is running well above profile. As a result the Government has chosen to borrow more than originally planned, to introduce some tax cuts and to allow some overspend relative to target this year, with more resources than originally projected allocated to spending in 2015 .

The Government has also made a significant amendment to the corporate tax code in that companies registered in Ireland now have to be tax resident as well , which will eliminate the 'Double Irish' tax arrangement .

Ireland's debt ratio is projected to fall to under 109% next year from over 123% in 2013 but the size of the structural fiscal deficit is still an issue. The structural balance adjusts the actual fiscal balance for the economic cycle and is projected at 3.3% of GDP in 2015. Under EU rules. Ireland is required to reduce that by more than 0.5% per annum until a balance is reached, which implies that the Irish Government will still need to take difficult fiscal decisions over the next three or four years even if the economy performs well. Moreover, Ireland is also required to keep any growth in public expenditure below that of GDP until the deficit is eliminated, so gross current spending will have to continue to fall relative to national output for some time to come, regardless of who is in power, absent a revision of the existing euro fiscal rules. .

' ...the Irish Government will still have to make difficult fiscal decisions even if the economy performs well'

The Irish Budget 2015

The Budget was predicated on 3.6% real growth.. The Department of Finance raised its Irish growth projections ahead of the Budget, forecasting a 3.6% rise in real GDP , with 2014 expected to have seen growth of 4.7% . Nominal growth in both years is put at around 5%. Export growth is expected to slow in 2015 and growth is largely driven by domestic demand; investment is forecast to rise at a double digit pace for the second consecutive year and consumer spending continues to recover, growing at 2.2% from 1.7% in 2014. Post-Budget, growth is now projected to be stronger still, at 3.9%, with upward revisions to consumer spending (now 2.7%) and government spending. Employment growth picks up, rising by 2.4% from 1.8% this year, reflecting the stronger contribution from domestic spending, with the unemployment rate continuing to fall, averaging 10.2%. The Department expects wage growth to pick up to 2.4% (which seems optimistic given the recent data) and to outpace price inflation (1.1%) so boosting real incomes. Ireland is also expected to continue to run a strong Balance of Payments surplus, exceeding 4% of GDP.

...**and the Minster announced a €1bn stimulus package....T**he Pre-Budget Exchequer Estimates for 2015 had projected a GGD of 2.4% of GDP, implying that the Minister for Finance had the option of increasing borrowing while still complying with the EU requirement to bring the deficit below 3% of GDP. In the event he chose a package worth just over €1bn, including tax cuts worth €400mn with the balance mainly in higher current spending, largely paid for by higher borrowing although partially offset by tax buoyancy and higher dividends from semi-State companies. The net result was a projected GGD of €5.2bn, or 2.7% of forecast GDP, against a pre-budget deficit figure of €4.6bn.

The Budget Arithmetic

Opening Deficit (€bn)	-4.6
Revenue measures	-0.4
Spending measures	-0.6
Other	0.2
Total	-5.4
fiscal buoyancy	0.2
Closing deficit	-5.2

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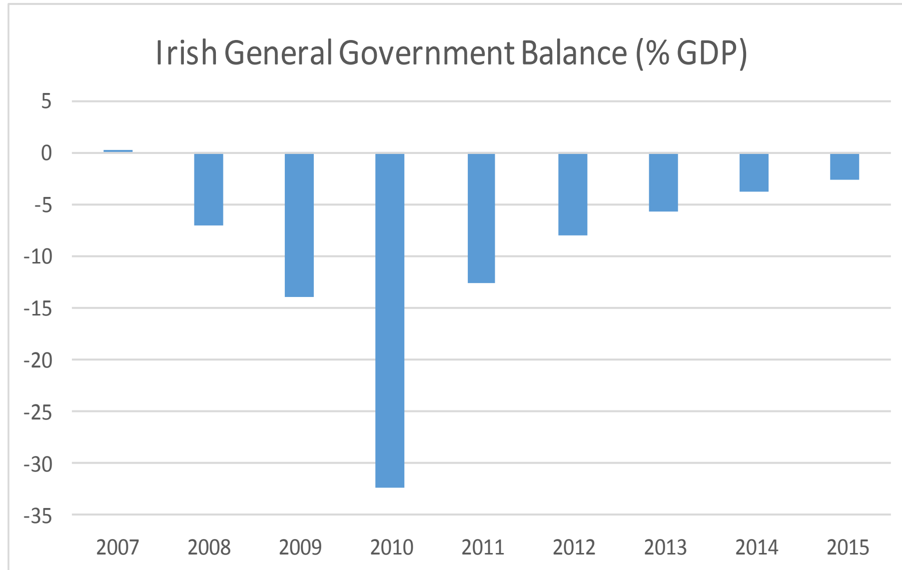
..**Current spending falls while revenue is set to rise**. The Government is using some of the expected overshoot in tax and other current revenue in 2014 to allow current voted spending to exceed the initial target (largely in Health) and expenditure in 2015 is also now higher than originally planned. Nevertheless Voted current spending is projected to fall by almost €1bn next year, with non-voted spending (largely debt servicing)set to rise marginally, leaving total net current spending at €49bn.On the revenue side, tax receipts are forecast to grow by €1.3bn or 3.1%, which appears low relative to the expected growth in GDP but this largely reflects a big fall in money from the pension levy relative to 2014. Non-tax receipts fall marginally , with the result that total revenue rises by €1.2bn to €45.3bn.Consequently the Current Budget deficit is projected at €3.7bn in 2015, against an expected deficit of €5.6bn in 2014.

Exchequer Finances (€bn)			
	2014	2015	% change
Current Spending	49.7	49.0	-1.4
Voted	38.9	38.0	-2.3
Non-voted	10.8	11.0	1.2
Revenue	44.1	45.3	2.6
Tax	41.0	42.3	3.2
Other	3.1	3.0	-3.1
Current Budget Balance	-5.6	-3.7	
Capital Budget Balance	-2.3	-2.8	
Exchequer Balance	-8.0	-6.5	
General Government Balance	-6.9	-5.3	
(% GDP)	(3.7)	(2.7)	

The Exchequer deficit is €6.5bn.. On the capital side the Government plans to spend €4.7bn, equivalent to 2.4% of GDP ,broadly unchanged from 2014, although a fall in capital resources means that the capital deficit rises €2.8bn from €2.3bn. The outcome is a projected Exchequer deficit of €6.5bn, down from the expected outturn of €7.9bn That is the actual cash sum required by the state to fund the deficit which alongside debt repayments next year of only €2.2bn implies a gross funding requirement of €8.7bn. In addition cash balances are expected to end this year at over €18bn so there is no compelling need to call on debt investors. Yields are unusually low, however, (the NTMA issued 10-year debt at 1.63% last week) and the Government has announced its intention to repay most of the IMF loan so issuance to fund that early repayment is likely.

..**the debt burden is now falling**...Ireland's General Government debt ratio has seen substantial revisions of late, with significant changes to both the denominator and the numerator , with the latter also inflated by the inclusion of IBRC liabilities. As a result the debt ratio in 2013 stood at over 123% of GDP. This year has seen a substantial fall, however, largely as a result of the sale of IBRC assets and hence the repayment of liabilities. The ratio is projected at 110.5% of GDP, with a modest fall to 108.5% expected in 2015. The average interest rate on Irish debt is now below 4%, which is lower than the forecast growth in nominal GDP over the next few years, and the government is now running a primary surplus, which will put downward pressure on the debt ratio.



..**but the Structural deficit is a constraint**.. According to the Department of Finance the economy in 2014 has no spare capacity (which is surprising given an unemployment rate of over 11%) and in 2015 will have a positive output gap of 1%. This would imply a 0.5% fiscal deficit on cyclical grounds so if the actual deficit is forecast at 2.7% this means that the structural deficit is 3.2% (they put it at 3.3%). That figure may seem arcane but is actually a significant constraint on any fiscal options over the next three or four years, for two reasons. First, Ireland has to eliminate that deficit by reducing it by at least 0.5% of GDP each year. Remember this is a structural deficit so stronger growth will not help. Second, until that time, Government spending is constrained to rise at a slower pace than GDP under the rules. Consequently, Irish governments, regardless of political hue, will have to oversee a further fall in the share of GDP going to exchequer spending at least in the absence of any change to the current euro fiscal rules..

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