Economic Research

Irish Budget 2017 11 Oct 2016

Ireland is currently subject to a number of fiscal rules, by virtue of its euro membership, imposing constraints on Budgetary policy, leaving the Minister of Finance with far less of the discretion available to his predecessors. The main restriction now is the requirement to further reduce the cyclically adjusted budget deficit (not the actual deficit) and to that end the European Commission stipulate a limit to government expenditure (net of any tax changes) consistent with that deficit reduction. The Minister of the day can of course choose to go further and not avail of all the fiscal space (so implying a larger fall in the structural deficit) and can also decide whether to use the available resources to increase expenditure or reduce taxation.

For the 2017 Budget the fiscal space calculation threw up a permitted rise in spending of 2.4% , equivalent to €1.6bn. Spending is actually planned to increase by €1.9bn, so breaching the limit, with the Minister announcing a package of €1.2bn on the day, in addition to pre-committed expenditure reflecting pay agreements ,demographic pressures and higher payments to the EU. The Budget day changes included €0.9bn in higher spending, largely on current side, and a net tax package of €0.3bn. The structural deficit is forecast to fall from an estimated 1.9% in 2016 to 1.1%, so exceeding the minimum reduction (0.6%) required by the fiscal rules. The change in the structural deficit is also the standard used to measure the fiscal stance and so the Budget is essentially contractionary, although of course less so than would have been the case in the absence of the policy changes

The Budget arithmetic is predicated on real GDP growth of 3.5%, following an estimated 4.2% growth in 2016, with nominal GDP forecast to rise by 4.6%, taking it to €275bn.We believe that real growth this year and next may well be lower than that (although both have been revised down) with nominal GDP possibly much lower, although the Fiscal Council has deemed the forecasts acceptable. Tax receipts are projected to rise by 5.2% next year from a base of €48bn, and again one could point out that the data to end-September showed tax revenue running behind profile when corporation tax receipts are excluded, with Finance assuming that corrects itself by year end. We have argued before that the Irish Budget is much too early now, given the volatility of tax in the final quarter, and other countries produce the required draft by mid-October but wait till late November or December to deliver the final article. Uncertainty abounds, relating to Brexit, the US election, Fed policy and the next moves, if any, from the ECB. Some have argued for a more cautious approach but to put things in perspective the net changes announced by the Minister amount to 0.4% of GDP. A bigger issue is that day to day current spending is set to fall further relative to GDP , which does not look realistic, given changed demographics (a return to net immigration) and growing pay pressures in the public sector.

The Irish fiscal process is unusual in that the Government is obliged to publish tax and spending projections for the coming year on an unchanged policy basis, and that indicated that the Exchequer would run a cash deficit (known as the Exchequer Borrowing Requirement ,or EBR) of €1.3bn. The Minister announced additional spending of €1bn, comprising €0.8bn on the current side and €0.2bn in capital spending . He cut the Universal Social Charge ,at a cost of €450m, and announced some modest reductions in capital taxes, partly offset by higher excise duties on cigarettes and measures to tackle tax evasion. The package is deemed to boost activity and result in tax buoyancy of €285m , as well as boosting PRSI receipts and so reducing the net increase in spending. The overall effect was to raise the projected EBR for 2017 by €0.9bn to €2.2bn. The General Government deficit is projected at €1.2bn or 0.4% of GDP, as against the 0.9% now forecast for the 2016 outturn.

Exchequer Statement (€bn)	2016 (e)	2017 (f)	% change
Current Expenditure	50.4	51.2	2.0
Voted	40.4	41.7	3.0
Non-Voted	10.0	9.6	-2.1
Current Revenue	51.1	53.2	4.6
Tax receipts	48.1	50.6	5.2
Other	3.0	2.6	-4.6
Current Budget Balance	0.7	2.0	
Capital Budget Balance	-2.1	-4.2	
Exchequer Balance	-1.4	-2.2	
General Government Balance	-2.4	-1.2	
(% of GDP)	(-0.9%)	(-0.4%)	

As noted the main tax changes announced centred on the USC, with cuts in three of the rates. This will boost take home pay by between €3 and €5 a week for most workers, boosting net income by around 0.6%. Finance also expect pay per head to rise by 2.7% in 2017 and for employment to grow by 2.1%, so generating strong income growth, although inflation is forecast to rise , to 1.3%, so reducing real income gains. Another notable feature of this year's Budget was an attempt to support First-Time house buyers , who can claim up to 5% of the value of a newly built property back from income tax paid over the previous four years in order to supplement the deposit. This will boost demand, presumably, in a market already characterised by insufficient supply but the Minister argues that by limiting the measure to new builds it will prompt a supply response.

The Irish Exchequer is now running a current budget surplus, so the overall deficit reflects a borrowing on the capital side. That is projected to rise by some €2bn in 2017, to €4.2bn, partly reflecting higher spending (€0.5bn) but largely due to a steep fall in capital receipts in the absence of any further sale of bank assets owned by the State. The Budget excluding interest payments (the primary balance) is also in surplus, rising from 1.4% of GDP to 1.8% in 2017. The average interest rate on the debt is also declining, to 3%, and is now below the projected rise in nominal GDP. Consequently the Debt/GDP ratio is forecast to fall to 74.3% in 2017 from an estimated 76% in 2016, although we are skeptical on the latter as we believe nominal GDP will be broadly unchanged. Interestingly, the Minister announced a medium term debt target of 45%, although how meaningful that will be for future governments is unclear.

Measuring the structural deficit requires an estimate of the output gap (where the economy is in relation to its potential growth rate) and Ireland's 26% growth surge in 2015 adds to the existing problems in that regard. In the event Finance have gone with the view that that the economy in 2016 is operating 1.6% above capacity, and that below potential growth in 2017 will reduce the gap to 1.1%. That implies a higher structural deficit than the actual figure of 0.4%, hence the 1.1% estimate that emerges. Others argue that Ireland's large Balance of Payments surplus is not consistent with an economy operating above potential and that Ireland actually has a negative output gap i.e. has a deal of spare capacity. The debate illustrates that this arcane and impossible to measure concept is unsuitable as a peg to hang a key EU fiscal rule.

Fiscal Indicators (% of GDP)	**2016**	**2017**
General Government Balance	-0.9%	-0.4%
Primary Balance	1.4%	1.8%
Structural Balance	-1.9%	-1.1%
Change in Structural Balance	-0.3%	-0.8%
General Government Debt	76.0%	74.3%