Economic Research

Irish Budget 2018 10 Oct 2017

In the past , Irish Governments of differing political hues have been accused of pro-cyclical fiscal policy, meaning that they have used the annual Budget to inject additional spending to an economy which is already growing strongly, although politicians might argue that the electorate often rewards rather than punishes such behaviour. Moreover, estimates of where the economy actually sits in the economic cycle are difficult to pin down with the data often subject to revision. That said, it does seem reasonably clear that the Irish economy is growing very strongly and that we are at or approaching full employment. Indeed the Department of Finance estimates that real GDP in 2017 is 1.6% above the long term potential i.e. the output gap is positive. However, Finance also expect the economy to slow somewhat in 2018, with real growth now forecast at 3.5% from an estimated 4.3% this year. with the former well below the projected potential growth rate of 4.5%. Consequently the output gap falls to 0.6% and Finance now expect the economy to continue to grow below potential over the succeeding years, although that is not consistent with an unchanged unemployment rate, which they also forecast

Inflation remains very low, with sterling's slide since Brexit a key factor, so it would be interesting to see what fiscal stance the Minister for Finance might have adopted in the absence of any external constraints. There are such constraints of course, stemming from the EU's Stability and Growth pact. One stipulates that Ireland must meets its Medium Term Objective (MTO) in terms of the annual budget balance when adjusted for the economic cycle (the structural balance). That MTO is a deficit of 0.5% of GDP, and in the absence of any additional budgetary measures the structural deficit would have fallen to 0.3%, In the event the Minister chose the minimalist approach common to recent budgets and opted for a structural deficit target of 0.5%, so hitting the MTO despite a net injection of spending into the economy.

The Expenditure Benchmark is another (linked) constraint, which limits any increase in government spending to the long term potential growth rate of the economy, with an additional limit if not meeting the MTO. That available "Fiscal Space' for 2018 was €1.7bn or just €320mn on Budget day given spending decisions already taken. The latter is a net figure and the Minister chose to raise over €800mn in revenue measures to fund a €1.2bn package, which was well above initial estimates and slightly above speculation nearer the day. Rather disappointing, though, to see a lack of transparency in the Budget documentation on the Expenditure Benchmark relative to previous years.

The revenue raising measures centred on stamp duty, with an increase for Commercial property transactions from 2% to 6%, which is expected to generate €375mn. Excise duty was increased on cigarettes , raising €95mn, which was not unexpected , but one surprise was the introduction of an 80% limit on capital allowances on Intangibles, set to raise €175mn in Corporation tax. That, with a number of other smaller measures, including a Sugar tax, brought the total revenue increase to €830mn, and €335mn of that was used to fund some income tax and USC reductions. The former consisted of widening the 20% band by €750 (therefore worth €150mn a year to anyone in the top 40% rate) and the latter entailed a number of cuts to various USC rates although in percentage terms the biggest gainers were single people in the €35,000-€45,000 income bracket, with a 0.8% increase to net income.

Exchequer Statement (€bn)	**2017 (e)**	**2018 (f)**	**% change**
Current Expenditure	51.3	53.1	3.5
Voted	41.9	43.4	3.3
Non-Voted	9.3	9.7	
Current Revenue	53.4	56.0	4.8
Tax receipts	50.6	53.7	6.0
Other	2.8	2.3	
Current Budget Balance	2.2	2.9	
Capital Budget Balance	-0.7	-5.2	
Exchequer Balance	1.5	-2.3	
General Government Balance	-1.0	-0.5	
(% of GDP)	(-0.3%)	(-0.2%)	

The Minister was therefore left with a net revenue increase of around €500mn, and announced further spending increases on top of the pre-Budget rises. Current spending was allocated an additional €870mn net of savings on the social insurance fund (due to lower unemployment), including higher social welfare payments, while capital spending rose by a further €215mn . In sum them, the target General Government deficit for 2018 is now €535mn or 0.2% of GDP, instead of the €90mn figure that was projected in the absence of any budgetary changes.

On a cash basis the Exchequer deficit is projected at €2.3bn, which alongside some forecast overfunding will push up the national debt to €208bn from an estimated €203bn in 2017. The debt/GDP ratio continues to fall however: the primary budget is in surplus and the forecast nominal growth in GDP, at 4.4% ,is above the average interest rate on the debt, now down to only 2.9%. As a result the debt ratio is forecast to fall to 69% from 70%. The debt/tax revenue metric also declines, to 388% from 399%.

Most budgets impact tax payers or recipients of social transfers but what is important at the macro level is the overall fiscal stance. In 2018 the structural deficit is projected to continue to fall, to 0.5% of GDP from 1.1% in 2017, so continuing the deflationary pattern seen for many years now. The structural deficit would have fallen to 0.3% in the absence of any discretionary action by the Minister and he chose to raise the deficit target to 0.5%, by injecting a net €450mn into the economy, but that is too small to have any meaningful impact on output, employment or inflation.

Fiscal Indicators (% of GDP)	**2017**	**2018**
General Government Balance	-0.3%	-0.2%
Primary Balance	1.7%	1.7%
Structural Balance	-1.1%	-0.5%
Change in Structural Balance	0.6%	0.6%
General Government Debt	70.1%	69.0%