# Economic Research

## Irish Budget 2019 — 9 Oct 2018

It is clear that the Irish economy is growing very strongly and the Department of Finance now expect real GDP growth of 7.5% this year, followed by 4.2% in 2019. Against that backdrop some have cautioned the Government against an expansionary budget , although capturing the actual fiscal stance of policy is not straightforward as it requires some measure of where Ireland currently sits in the economic cycle. The EU believes the economy is currently operating well above capacity which will continue into 2019 and that is important because it determines some of the fiscal rules underlying the Stability and Growth pact. In contrast, , the Department of Finance argues that the economy is currently operating with some spare capacity, although that will close in the coming year. That view is reflected in the economic outlook, which envisages the unemployment rate bottoming out at 5% over the next few years.

That EU assumption explains why the 2019 Budget is still running a structural deficit of 0.7% of GDP ( i.e. adjusted for the economic cycle) even though the actual deficit falls to zero. That compares with an estimated structural deficit of 1% of GDP in 2018, so on that basis one could argue the fiscal stance is marginally contractionary despite the fact that General Government spending increases by €4.2bn. That said, to comply with EU fiscal rules the structural deficit is required to fall by 0.5% of GDP and so on the face of it Ireland breaches that rule.

Indeed, Ireland has breached The Expenditure Benchmark for two consecutive years. This constraint limits any increase in government spending (net of any tax increases) and Ireland breached it in 2017, by €1.2bn, with a similar figure projected for this year. That explains why Ireland chose not to use all the available fiscal space in 2019, underspending by €0.8bn. Of course it is debatable whether the political will exists in the EU to actually fully enforce the fiscal rules and the fact that Ireland's debt burden is falling steadily is probably of more significance to bond investors.

| **Fiscal Indicators (% of GDP)** | **2018(e)** | **2019(f)** |
|---|---|---|
| General Government Balance | -0.1% | 0.0% |
| Structural Balance | -1.0% | -0.7% |
| Debt ratio | 64.0 | 61.4 |
| Debt/GNI* | 105.2 | 101.0 |

The debt dynamics remain on a very favourable path. The average interest rate on the debt is falling , to an estimated 2.4% in 2019 from 2.6% this year, and both are well below the growth in GDP. If one adds in a primary surplus that should result is steadily falling ratio, which is forecast at 61.4% in 2019 and then a sub-60% reading in 2020 (56.5%). We had anticipated a sub-60% reading in 2019 but the debt level was inflated by overfunding this year

Turning to the detail of the 2019 Budget, the Minister had already announced substantial expenditure increases, notably on the capital side, and that was complemented by an additional €1.4bn current expenditure , including social welfare increases . To fund this and a €365m package of income and USC cuts the Minister raised over €700m by restoring the 9% VAT rate on tourism related services to 13.5% and by increasing excise duties and betting tax. These Indirect tax changes will boost inflation, which Finance now estimate at 1.5% in 2019 from a pre-Budget 1.2% but income tax payers will benefit from the USC changes , an increase in the 20% tax rate band and a rise in the minimum wage. Finance estimate the latter changes will boost the income of a single person earning €35,000 a year by about €3 a week.

In fact virtually all of the fiscal space used went on the expenditure side and as a result voted current spending is set to rise by €2bn or 4.5%, with capital spending set to increase by around €1,5bn, or over 20%. The impact on the current budget balance will be offset to some degree by a €0.5bn fall in debt interest, and that alongside a projected €3bn (5.2%) rise in tax revenue generates a current budget surplus of €5.5bn. This is offset by a capital deficit of €7.8bn, meaning that the Exchequer will have to borrow €2.3bn, although this translates into a General Government balance when adjusting for items such as the large surplus in the Social Insurance Fund and the Exchequer contribution to the rainy day fund..

| Exchequer Statement (€bn) | 2018 (e) | 2019 (f) | % change |
|---|---|---|---|
| **Current Expenditure** | 53.5 | 55.0 | 2.8 |
| Voted | 44.5 | 46.5 | 4.5 |
| Non-Voted | 8.9 | 8.4 | |
| **Current Revenue** | 57.9 | 60.5 | 4.5 |
| Tax receipts | 55.1 | 58.0 | 5.2 |
| Other | 2.8 | 2.5 | |
| **Current Budget Balance** | 4.4 | 5.5 | |
| **Capital Budget Balance** | -5.1 | -7.8 | |
| **Exchequer Balance** | -0.7 | -2.3 | |
| **General Government Balance** | -0.3 | -0.1 | |
| (% of GDP) | (-0.1%) | (-0.0%) | |