

**Irish Fiscal  
Advisory Council**

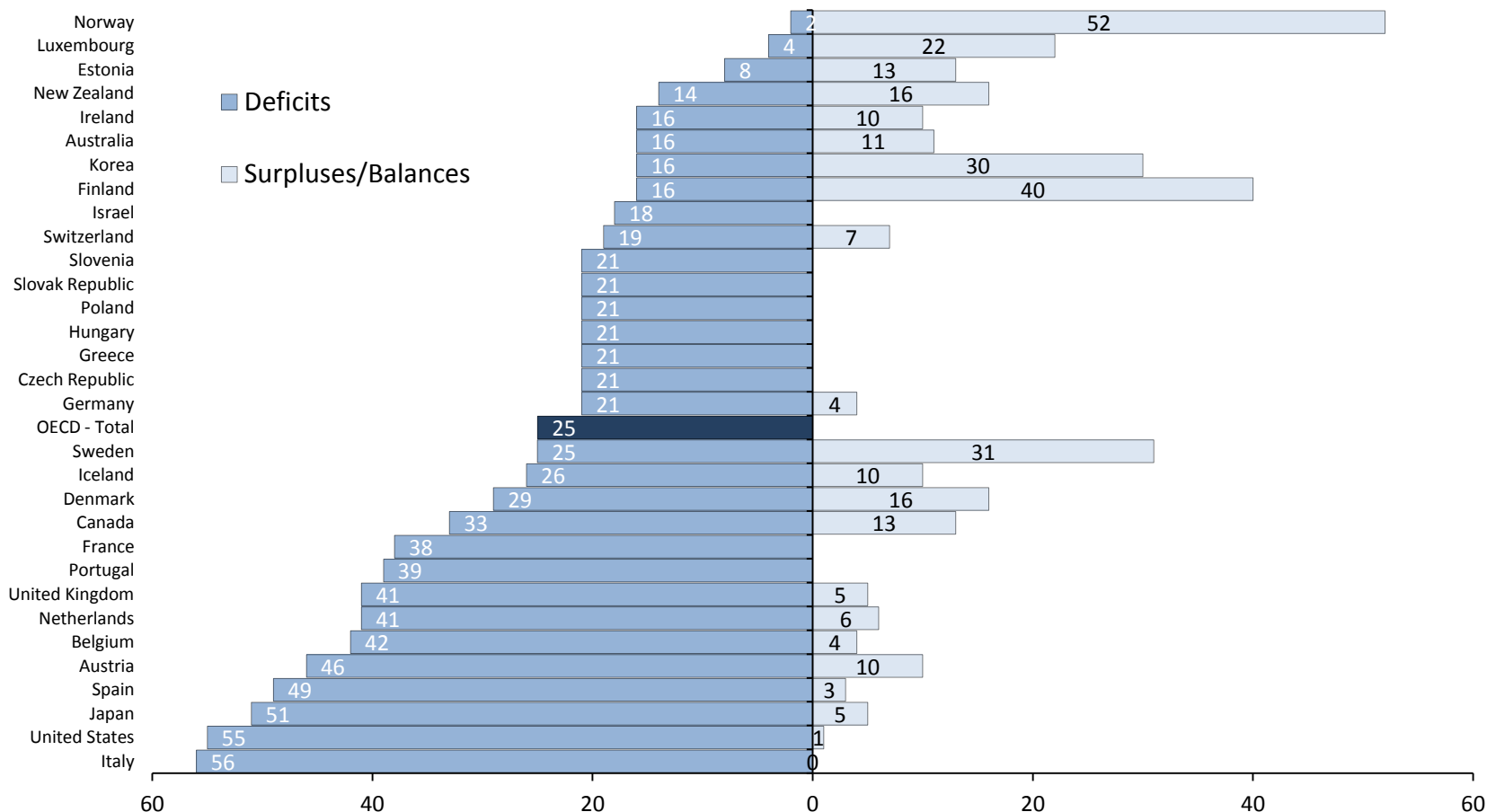
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# **IFAC's Approach to Assessing Fiscal Risks in Ireland**

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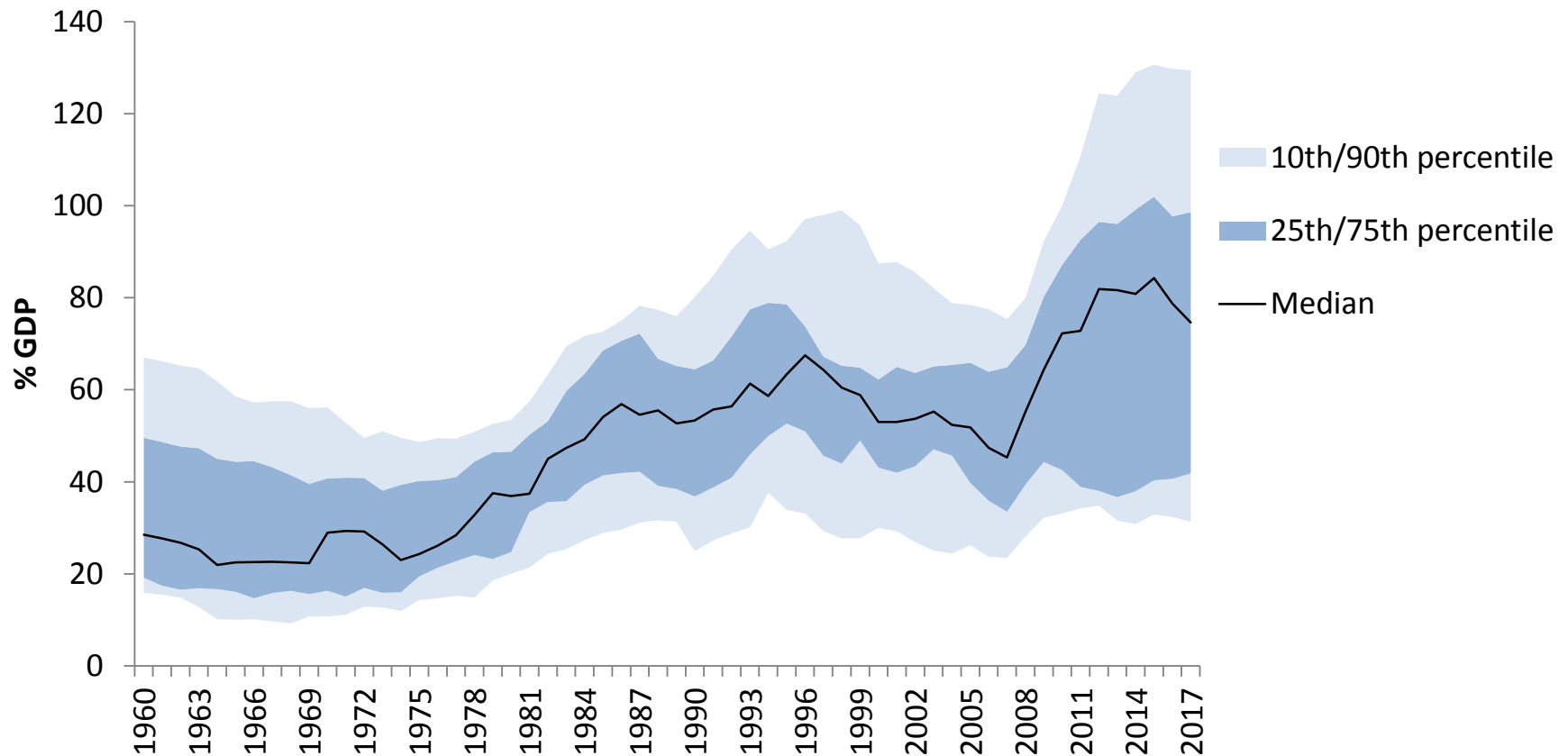
## OECD MEMBERS: FREQUENCY OF GENERAL GOVERNMENT SURPLUSES/BALANCES AND DEFICITS



Source: OECD.

Note: Data cover available observations for 1960-2015 and are expressed as % GDP.

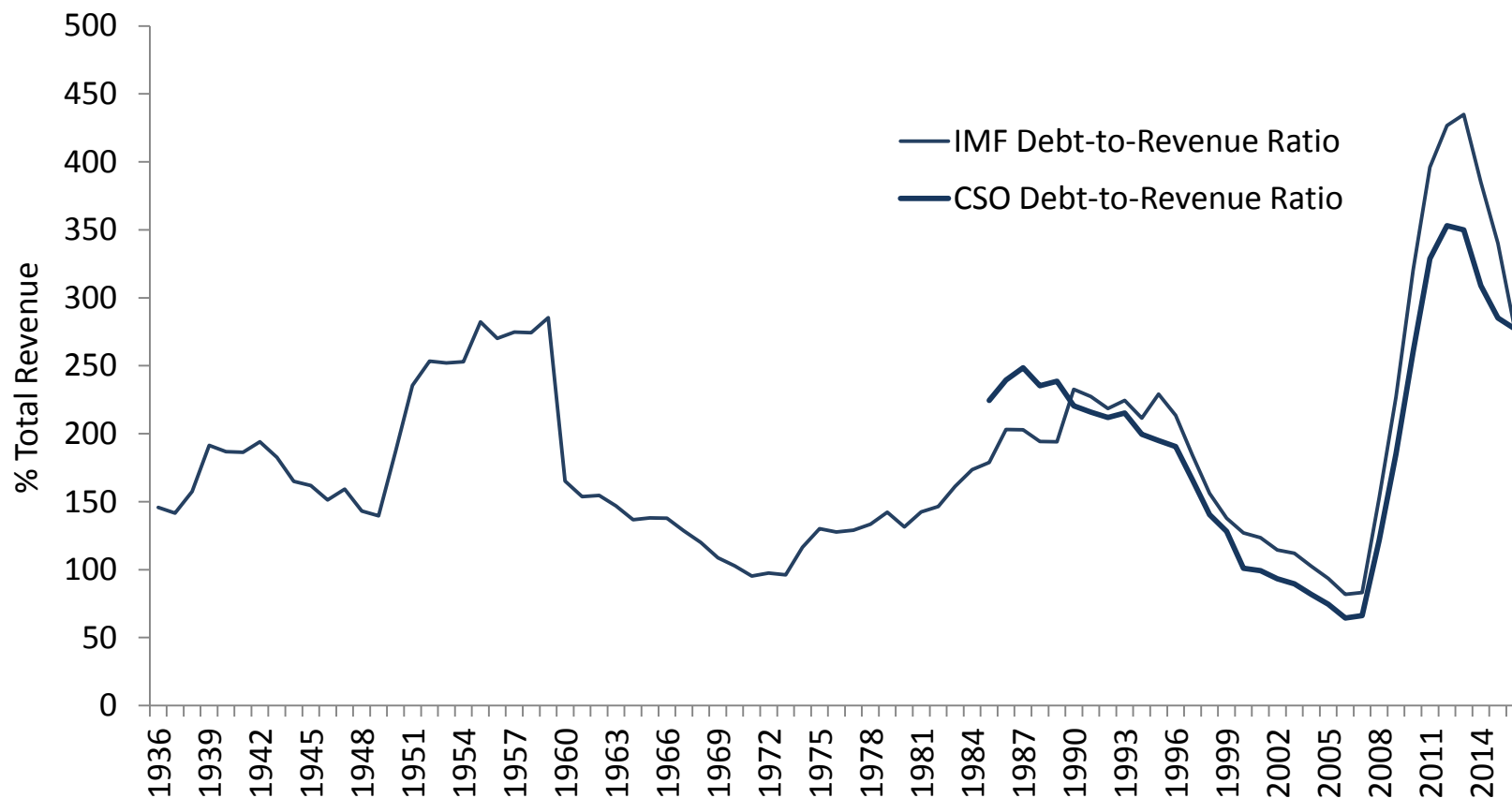
## OECD MEMBERS: EVOLUTION OF DEBT-GDP RATIOS (%)



Source: OECD.

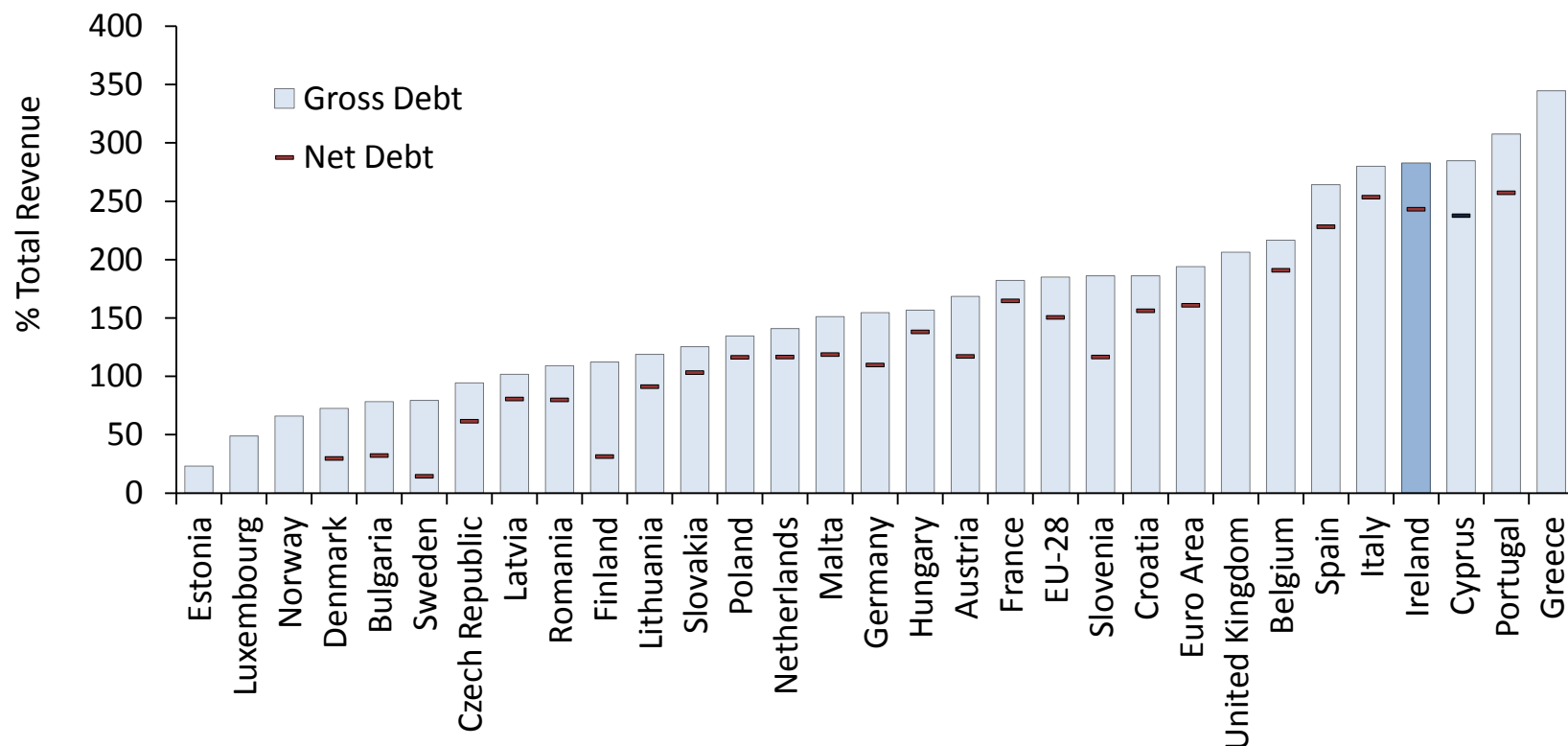
Note: Covers 19 Members for which data are consistently available.

IRELAND: GROSS GOVERNMENT DEBT-TO-REVENUE RATIO (%)



Source: IMF (Historical Public Debt Database); CSO; internal IFAC calculations.

## GROSS GOVERNMENT DEBT-TO-REVENUE RATIOS, 2016 Q3 (%)



Source: Eurostat; internal IFAC calculations.

Note: Net debt from Eurostat Government Finance Statistics calculated as Gross Consolidated Debt less EDP debt instrument assets (F2: Currency and Deposits; F3: Debt securities; and F4: Loan assets). Total General Government Revenue = 4 quarter sum.

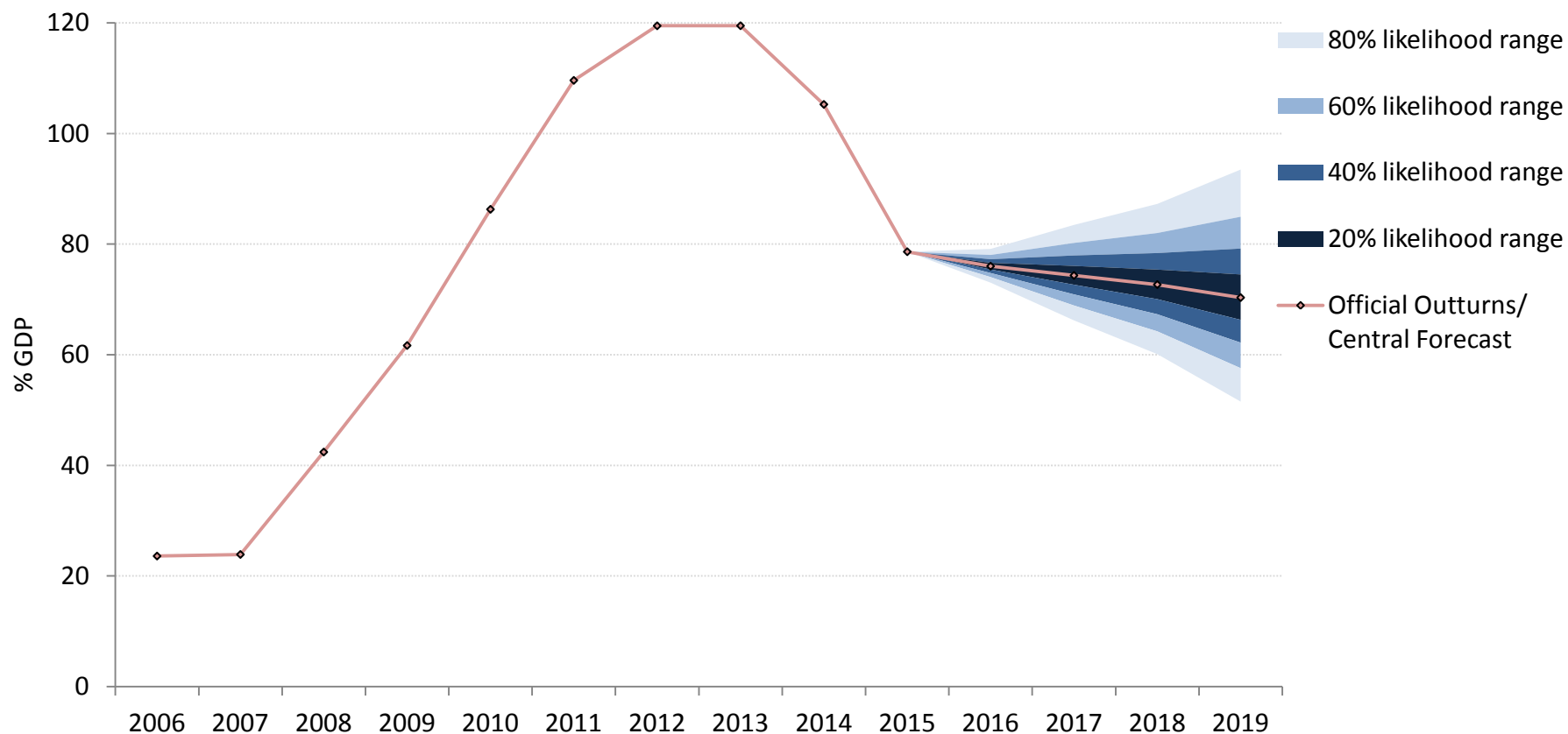
- Debt sustainability concerns can arise quickly
- They have undesirable impacts:
  - Increase interest costs, putting more pressure on rest of budget;
  - Limit flexibility to respond to unforeseen events;
  - May reduce total savings and income in the long term (diverting savings to debt costs rather than investment);
  - Increase likelihood of another fiscal crisis
- Avoiding repeats of past episodes requires an awareness of risks

- Fiscal Stress Tests
- Value at Risk assessments
  - Distributional assumptions are critical
- Early Warning Systems
  - Leading indicators & Multivariate regressions
  - Danger that we assume causes of current crisis are the same as for past crises

- Fiscal Feedbacks Model
- Work on Macroeconomic data
  - Data revisions
  - Forecast errors
  - Fan charts
  - ST forecasting tools
- Risk Matrix
- Scenario Analyses



# Gross General Government Debt Fan Chart (% GDP)



Source: Department of Finance (Budget 2017 *ex-post* forecasts); and internal IFAC calculations.  
Note: Forecast errors based on 1999-05 sample of Department of Finance forecast errors.

# Risk Matrices

MACROECONOMIC RISK MATRIX

Risk	Likelihood	Impact
External Demand Shocks	M	H
Geopolitical Risks	M	H
Persistence of low inflation	M	M
Currency Developments	H	H
Rapid rebound in oil prices	L	M
Global financial market conditions	M	M
“Hard Brexit”	H	H
Concentrated industrial base	L	H
Loss of competitiveness	M	H
Private sector deleveraging	L	M
Housing supply pressures	H	M

FISCAL RISK MATRIX

Risk	Likelihood	Impact
Tax forecast and payment timeline asymmetry	M	M
Corporation tax concentration risks	H	M
Financial sector developments	L	M
Receipts from resolution of financial sector crisis	L	M
EU Budget Contributions	H	L
Contingent liabilities	L	M
Bond market conditions	L	M
Changes to tax ‘drivers’	M	M
EU-level climate change and energy developments	H	H

Source: IFAC Fiscal Assessment Report, November 2016.

# Upsides are typically factored into our thinking (asymmetric evaluation)

	Dec 2016 (€bn)
ISIF Directed Portfolio and Bank Assets	~14
IBRC Liquidation & NAMA Profit	~3
Total	~17
Total (% GDP)	6.6%

- A one standard deviation shock to growth (i.e., nominal GDP growth lower by 1.9pp p.a.) relative to Budget 2017 baseline over each of 2017, 2018 and 2019 would imply a debt ratio 10pp higher in 2019 (80% GDP vs 70% currently forecast).

*\*AIB shares were independently valued based on the estimated financial position of the bank, using publicly available information as of 31 December 2016.*

- New target debt-to-GDP ratio of 45% within the next decade
  - Is this a target or a maximum tolerable level?
  - If we assume nominal GDP growth in 2015 wasn't 32% but closer to NNP growth rates suggested by CSO, then debt ratio in 2015 would be ~15pp higher
- Countercyclical Buffer / Rainy Day Fund
  - Proposal that from 2019, €1bn p.a. set aside as a counter-cyclical buffer
- Commitment to minimum compliance with Fiscal Rules

- Long-term assessments
  - Expenditure scenarios
  - Debt sustainability
- Comprehensive adverse scenario (“Fiscal Stress Test”)
  - Bringing it all together
  - Systematically produce this
  - Focus on vulnerable areas
- Quantifying Contingent Liabilities
  - Quantifiable (existing banking sector support measures, PPPs, public sector pension liabilities...)
  - Unquantifiable (new commitments in respect of pension schemes in deficit, legal claims)

- CBI stress tests parameters
  - static balance sheet from end-2015
  - cumulative real GDP change in the adverse scenario was -10.4%, compared to -6.8% for both the UK and Euro Area
  - Irish house prices were set to fall by c.22%, and commercial property prices by c.28% in the Irish adverse scenario
- Available Macro Models for Ireland:
  - ESRI's COre Structural MOdel for Ireland (COSMO)
  - Central Bank's DSGE work

# Where Does this Leave us?

- Will results be useful?
  - An adverse scenario will as expected show adverse findings
  - Can we use what we learn to identify key areas and mitigate big risks?
- Will they be heeded?
  - Are the results easily dismissed (assumptions!)?
  - Does it inevitably become a Cassandra-like exercise?