Irish Fiscal Advisory Council

Fiscal Assessment Report

September 2012

Irish Fiscal Advisory Council

Proposed mandate in Fiscal Responsibility Bill

- Assessment of official (macroeconomic and budgetary) forecasts
- Assessment of fiscal stance
- Assessment of compliance with certain fiscal rules

Irish Fiscal Advisory Council

Assessment of macroeconomic forecasts

Irish Fiscal Advisory Council

Elements of assessment

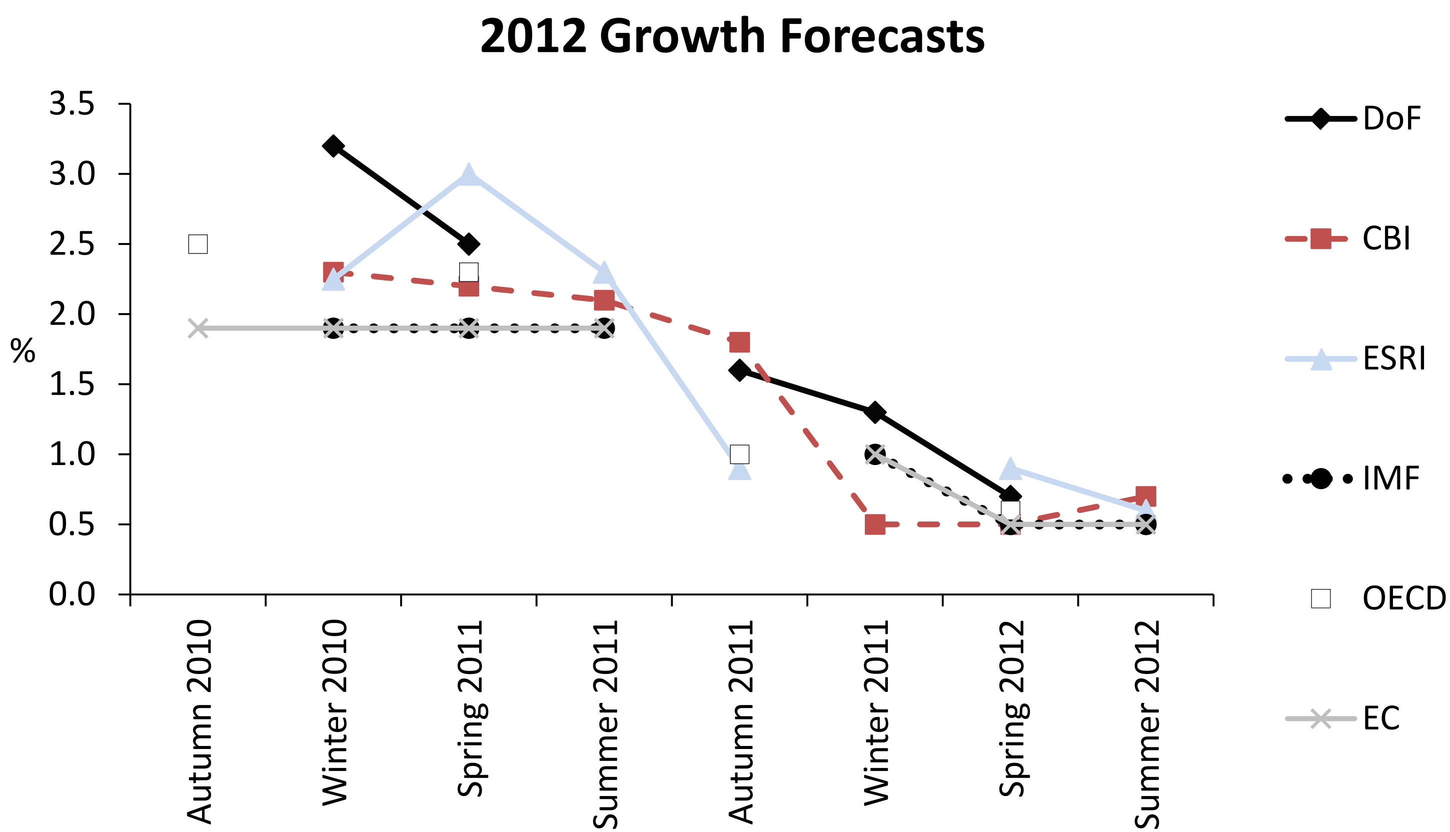
- Review of past forecast performance
- Comparison with contemporaneous forecasts from other agencies
- Examination of pattern of forecast revisions
- Explicit treatment of uncertainty

Irish Fiscal Advisory Council

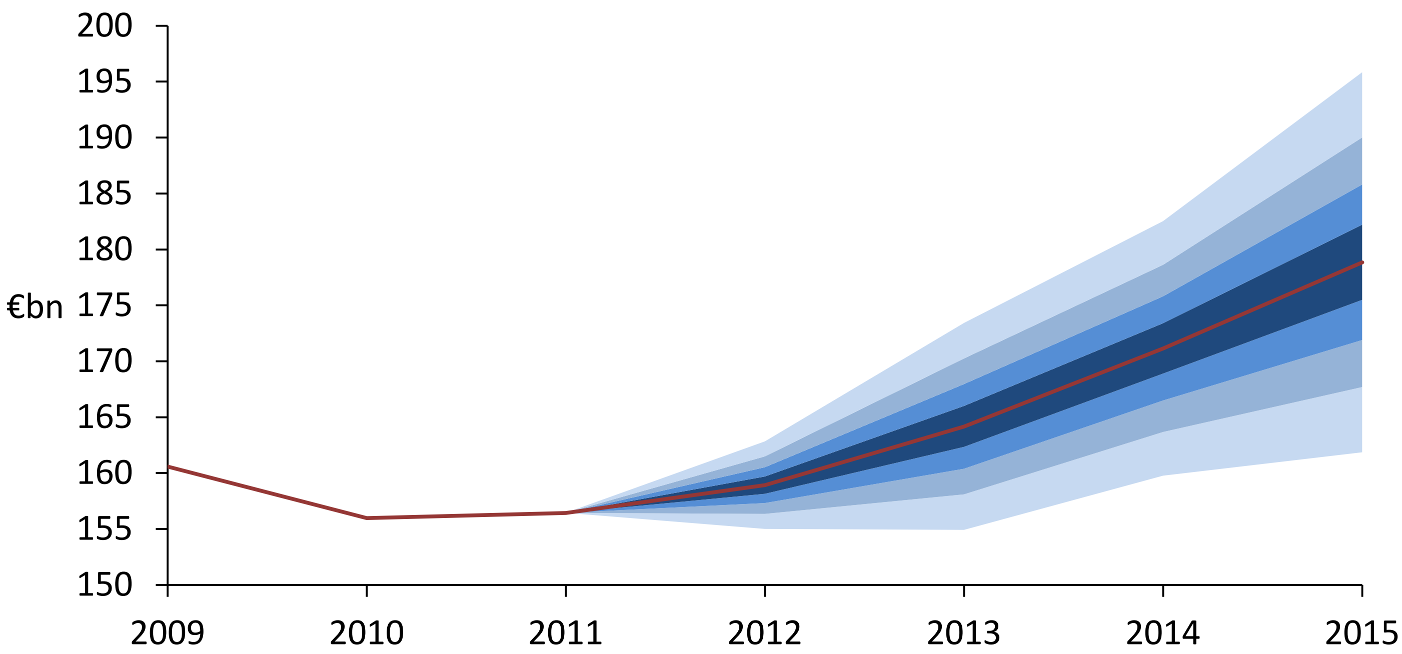
Overview of assessment of macroeconomic forecasts

- 2011
  - Under-prediction of real GDP growth: 0.8% (SPU 2011) v 1.4% (NIE)
  - Over-prediction of real GNP growth: 0.3% (SPU 2011) v -2.5% (NIE)
- Longer-term review: No evidence of absolute or relative "optimism bias" in Department of Finance forecasts
- 2012-2015
  - In line with contemporaneous forecasts from other agencies
- Worrying pattern of downward revisions to forecasts as the horizon shortens
  - Downside risk of a more prolonged "L-shaped" recovery pattern

Pattern of downward revisions



Fan chart for nominal GDP



Irish Fiscal Advisory Council

Assessment of budgetary forecasts

Elements of assessment

- Review of past forecast performance with examination of reasons for deviations of outturns from forecasts
- Comparison with contemporaneous forecasts from other agencies
- Examination of emerging performance of Budget 2012 and SPU 2012 projections using the most recent Exchequer returns
- Explicit treatment of uncertainty using fiscal fan charts and scenario analysis

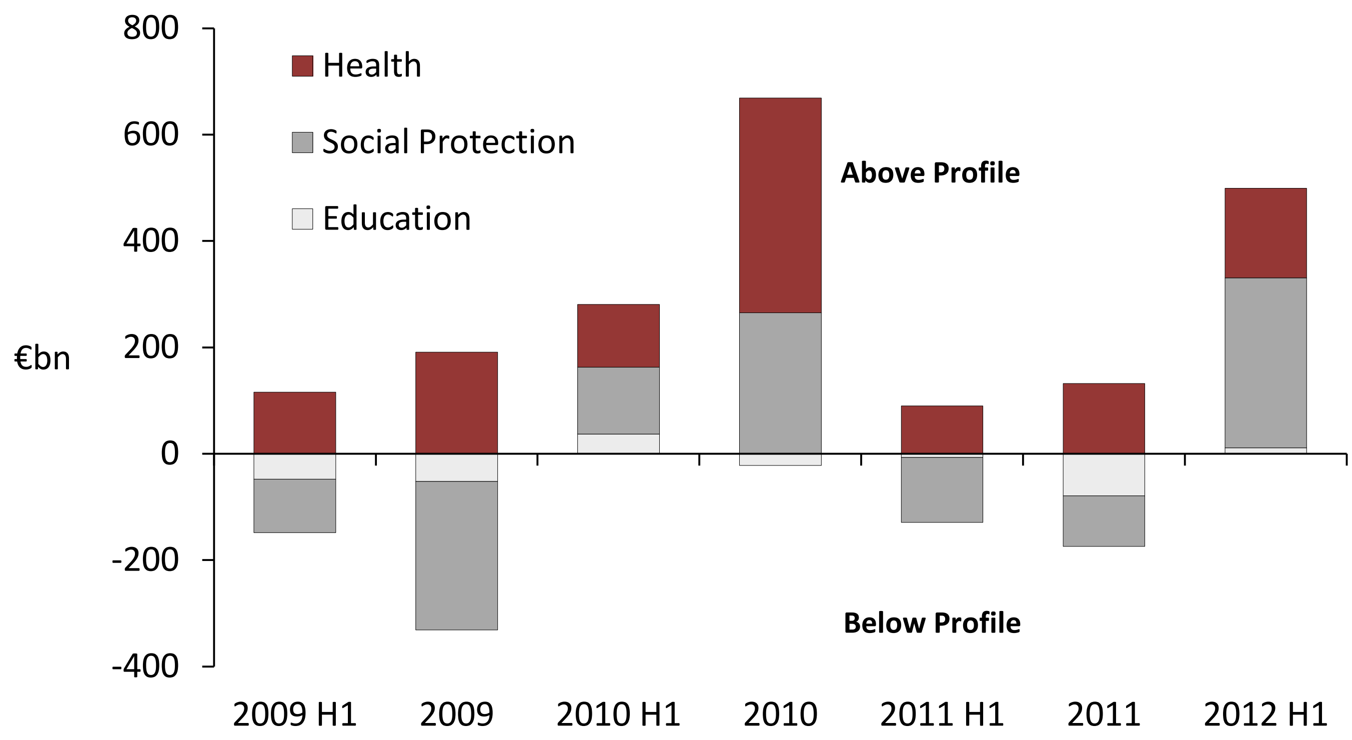
Irish Fiscal Advisory Council

On track to meet 2012 deficit limit

- On track to meet 8.6 percent limit agreed to under the Excessive Deficit Procedure
  - Downward revisions to near-term growth outlook
  - But better than projected 2011 outturn
  - Exchequer tax revenues to end-August 1.7% above profile
  - Increasing Importance of “non-tax” revenues
  - But first-half overruns in health and social protection
    - Pattern of half-year and full-year overruns in health in recent years

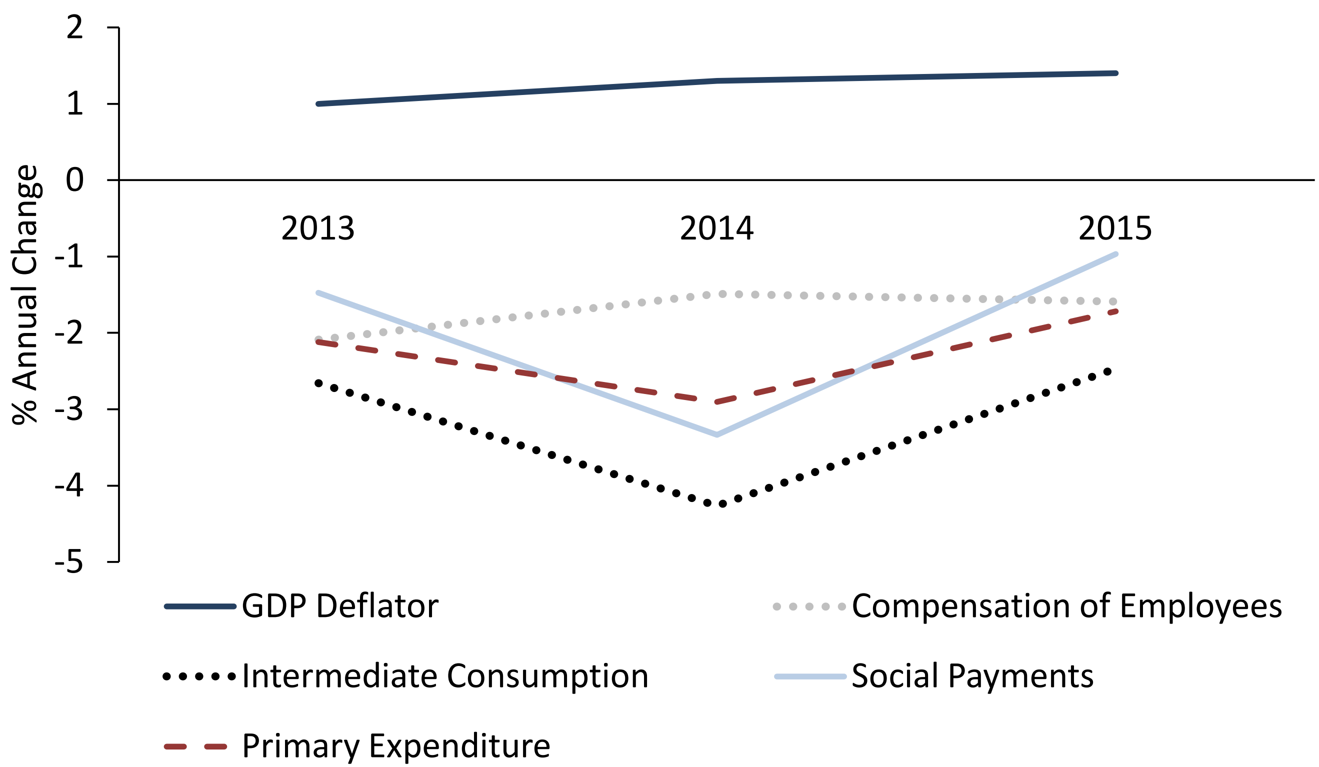
Irish Fiscal Advisory Council

Pattern of health spending overruns



Irish Fiscal Advisory Council

Large planned reductions in real expenditure

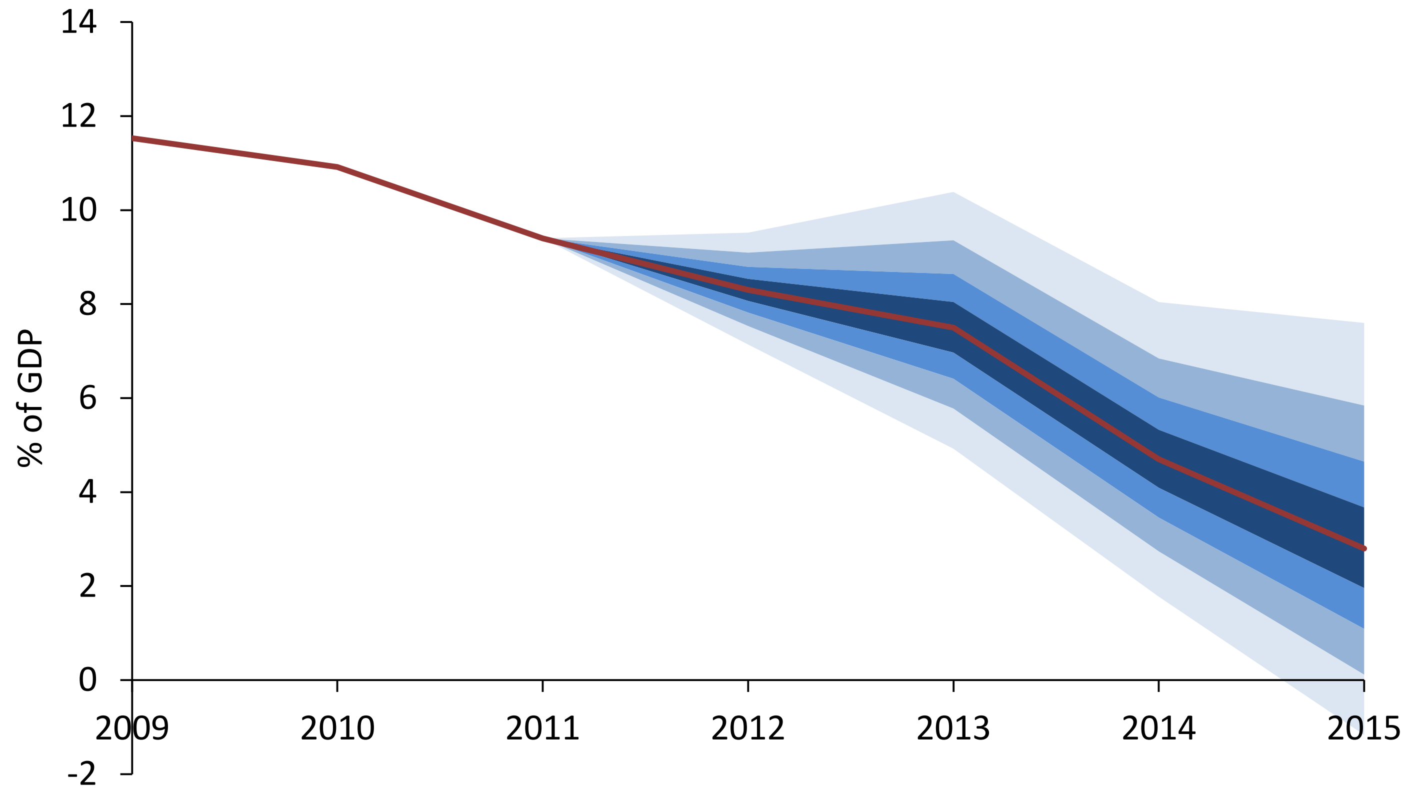


Very challenging expenditure reduction targets

- Importance of keeping all adjustment margins – including tax rates, public-sector pay/pension rates and welfare rates – under review

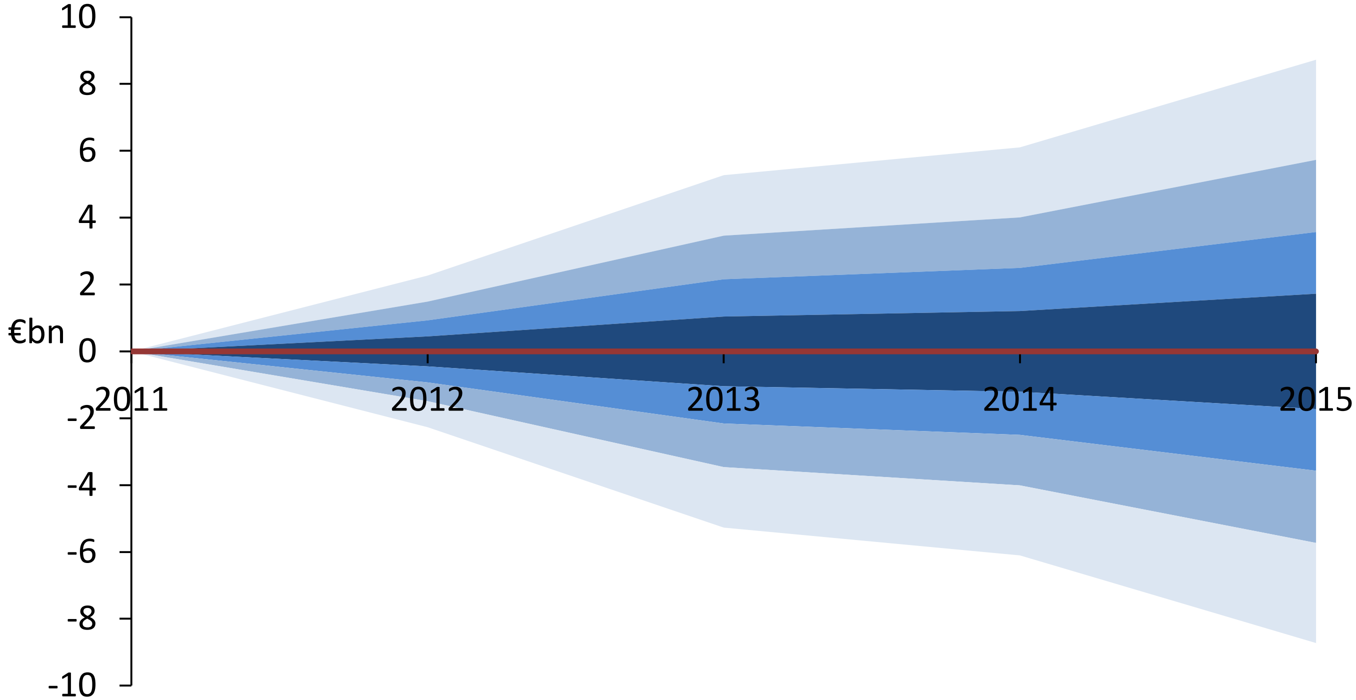
Irish Fiscal Advisory Council

Macroeconomic uncertainty → uncertainty around deficit projections



Irish Fiscal Advisory Council

Uncertainty around discretionary adjustments needed to meet deficit targets



Irish Fiscal Advisory Council

Assessment of the fiscal stance

Irish Fiscal Advisory Council

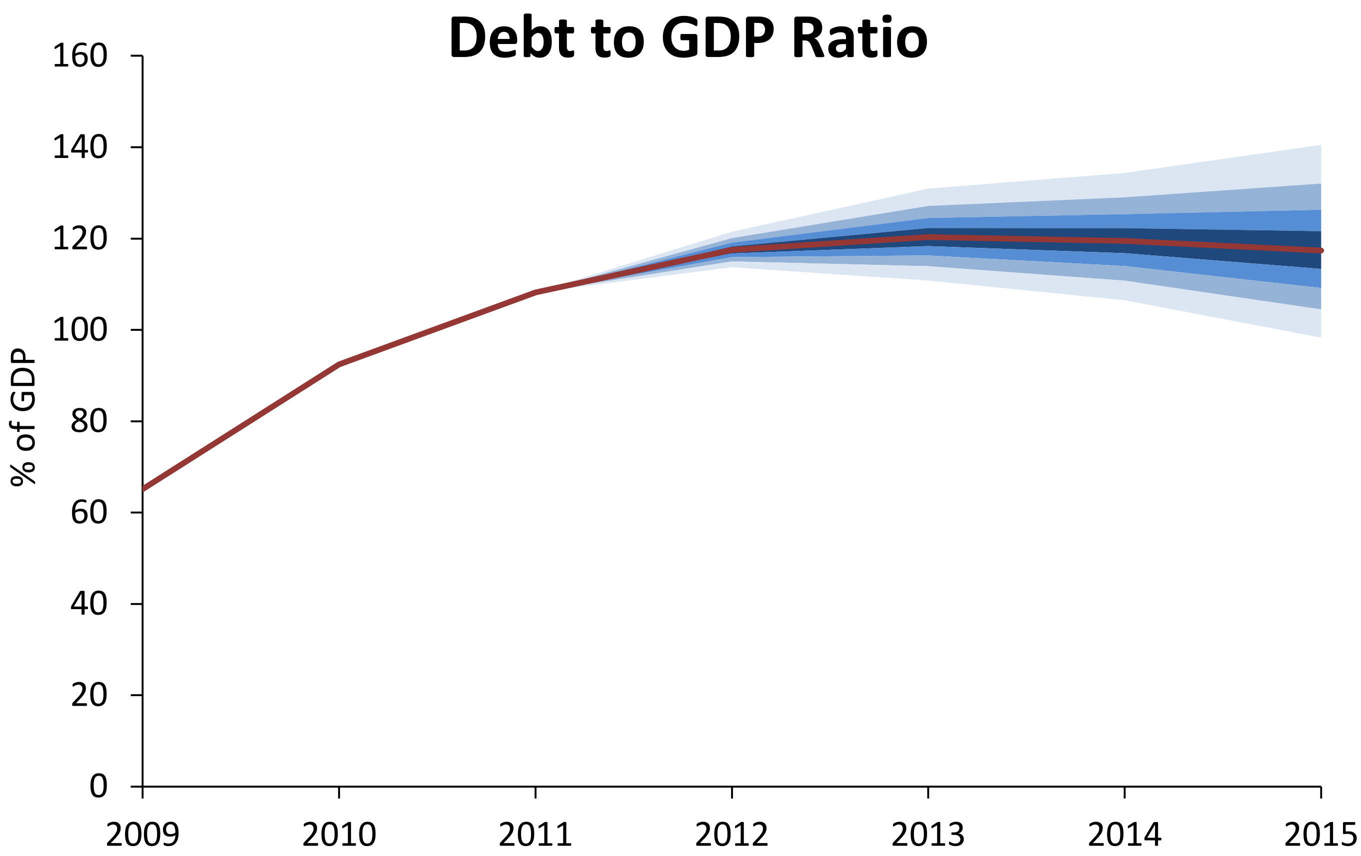
Basic framework

- Trade off
  - Supporting domestic demand versus securing sustainability/creditworthiness

- Key considerations
  - Fragility of debt sustainability
  - Market assessments of creditworthiness
  - State of aggregate demand

Irish Fiscal Advisory Council

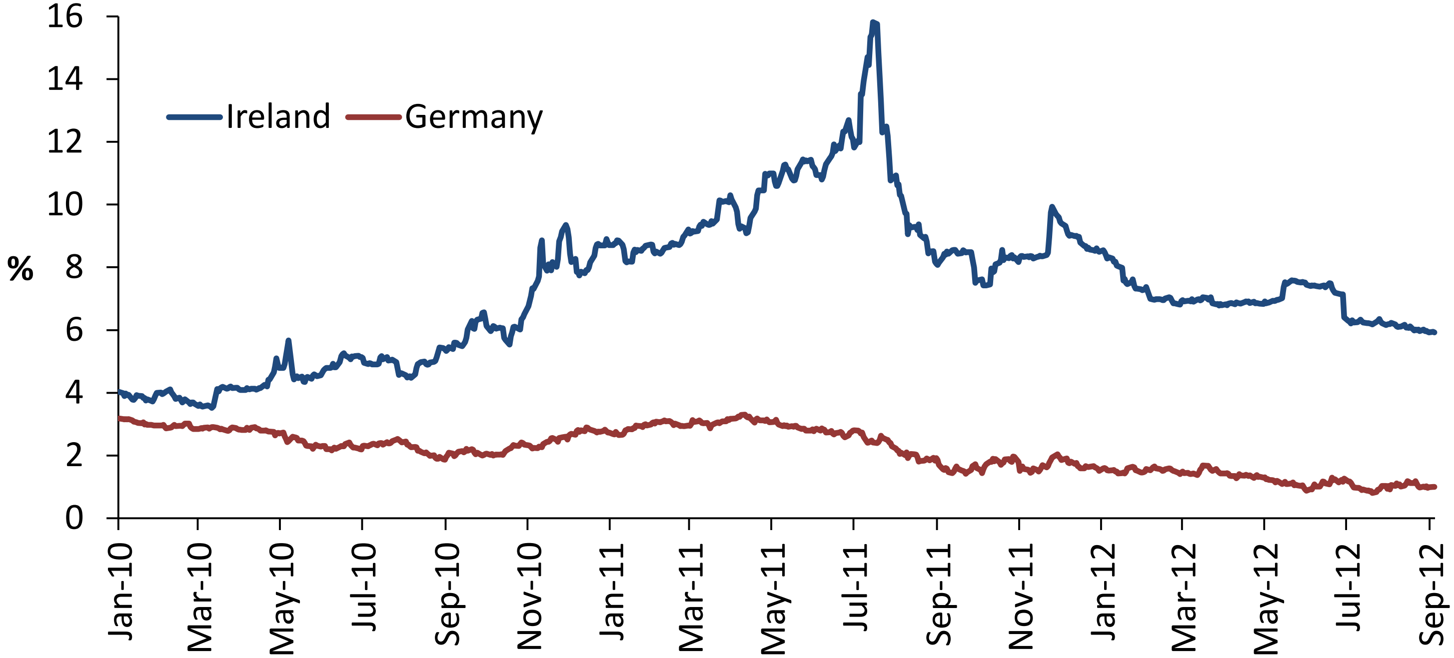
Debt sustainability remains fragile



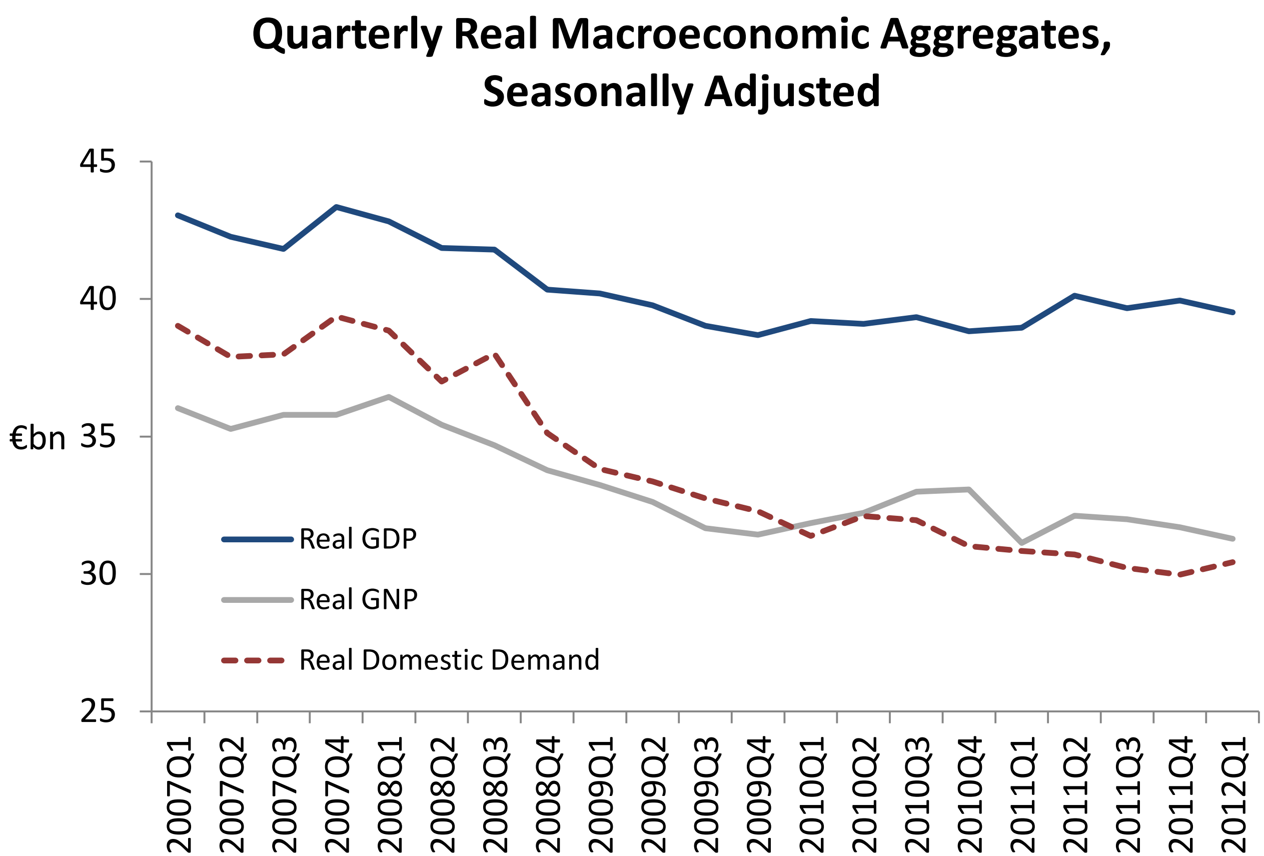
Irish Fiscal Advisory Council

Improvement in market assessments of creditworthiness

8-year Secondary Market Bond Yields



Demand conditions remain difficult



Current assessment

- Government's fiscal stance "conducive to prudent economic and budgetary management"
- The continued fragility of debt sustainability points to the value of a more ambitious adjustment path
- The Council has modestly scaled back the suggested additional adjustments due to improvements in secondary-market bond yields and continued weakness in growth
- Compared to the Government's baseline, the Council's alternative adjustment path involves a cumulative additional adjustment of €1.9 billion, with no additional adjustments beyond the planned €3.5 billion in 2013

Irish Fiscal Advisory Council

IFAC Assessment: September 2012

General Government Balance, % of GDP	2013	2014	2015	
IFAC April 2012 Alternative Adjustment Path	-7.4	-4.6	-1.7	
SPU (April 2012)	-7.5	-4.8	-2.8	
IFAC September 2012 Alternative Adjustment Path	-7.5	-4.5	-1.9	
Discretionary Adjustments, Billions of Euro	**2013**	**2014**	**2015**	**2013-2015**
IFAC October 2012 Alternative Adjustment Path	3.9	3.8	3.7	11.4
SPU (April 2012)	3.5	3.1	2.0	8.6
IFAC September 2012 Alternative Adjustment Path	3.5	3.5	3.5	10.5

Irish Fiscal Advisory Council

Proposed stimulus programme

- Possible rationales for “separate-stimulus” approach
  - Financing mechanisms that do not add to gross debt
  - Provides an instrument to improve demand/sustainability trade off

- Council does not support a separate stimulus under current conditions
  - Goals should be pursued in the context of main adjustment programme
  - Does not see case for relaxing the overall fiscal stance; any increases in expenditure should be matched by explicit revenue raising measures

Irish Fiscal Advisory Council

Compliance with fiscal rules: A preliminary examination

Irish Fiscal Advisory Council

Fiscal rules

- Fiscal rules already in place under the revised Stability and Growth Pact (SGP)

- The FRB will implement fiscal rules agreed to under the "Fiscal Compact"
  - Budgetary (or Structural Balance) Rule
  - Debt (or 1/20th) Rule

- Mandated role for IFAC in monitoring compliance with the Budgetary Rule as well as assessment of the fiscal stance with reference to the requirements of the SGP

Illustrative extended scenario

2012-2015

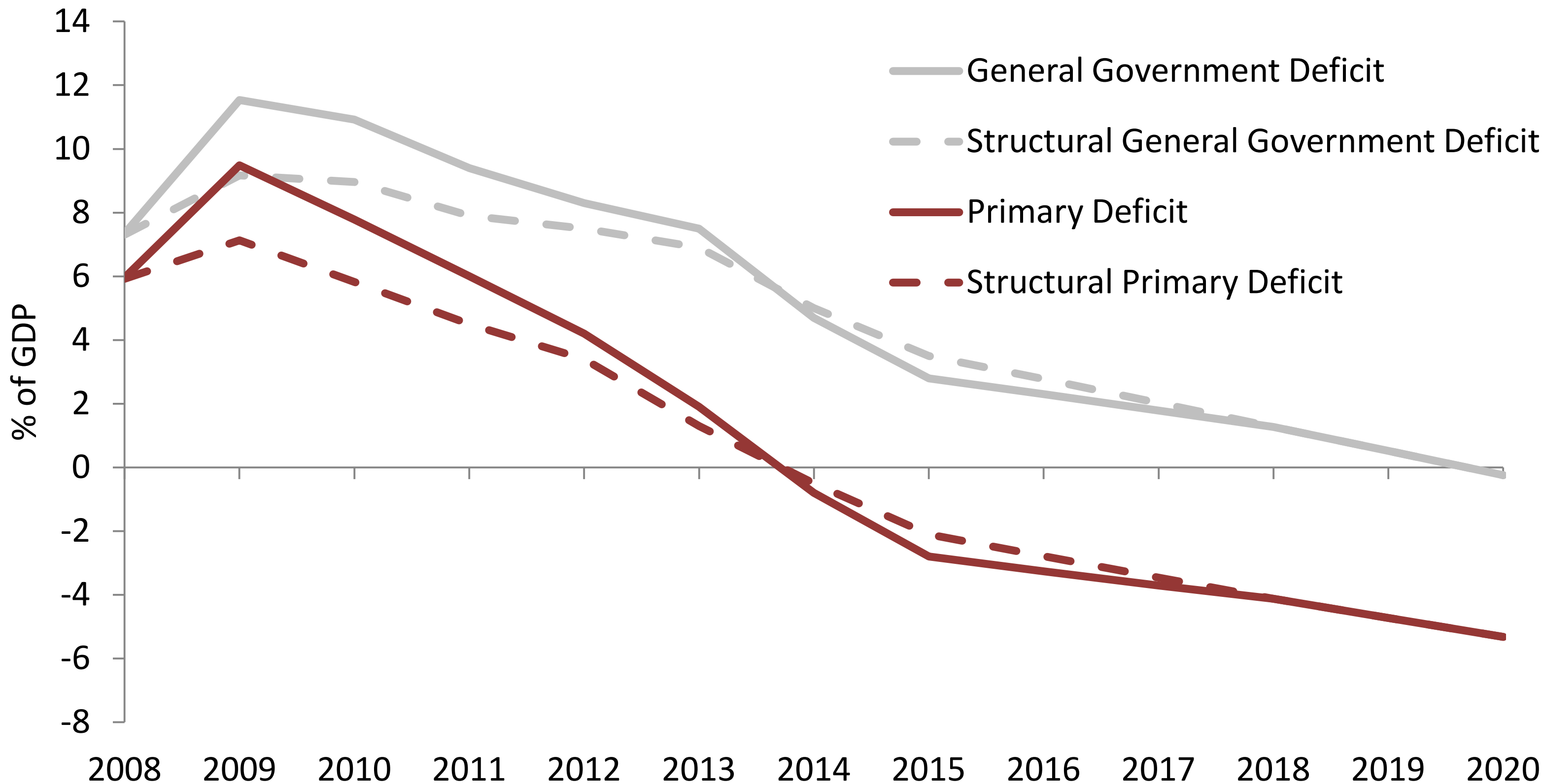
– All assumptions as in SPU 2012

2016-2020

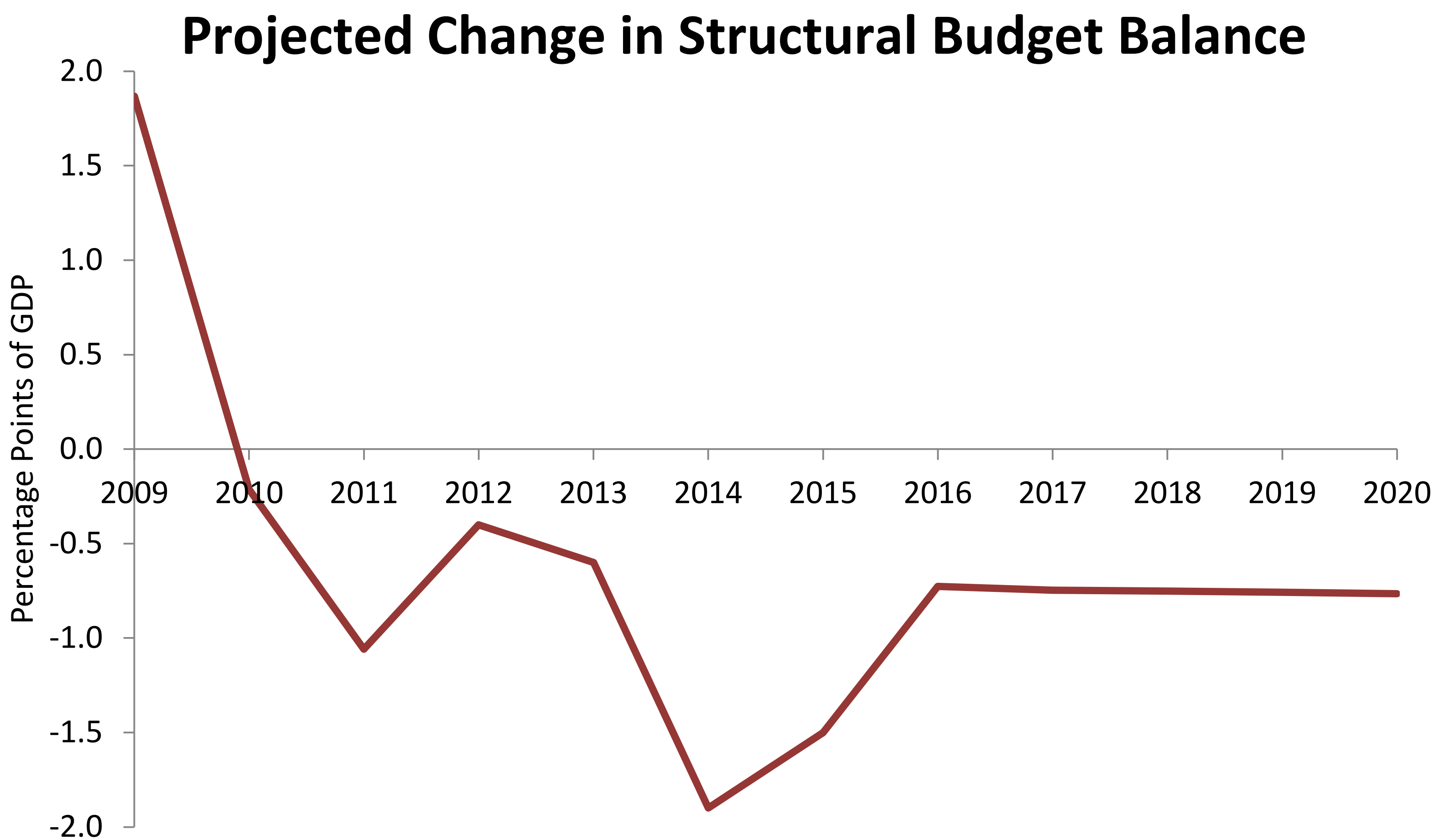
– Nominal potential GDP growth = 4 percent
– Output gap closes by 2018
– Nominal expenditure growth = 0.2 X Change in Nominal Potential GDP
– Average interest rate on outstanding debt = 4.9 percent

Irish Fiscal Advisory Council

Projected evolution of key deficit measures

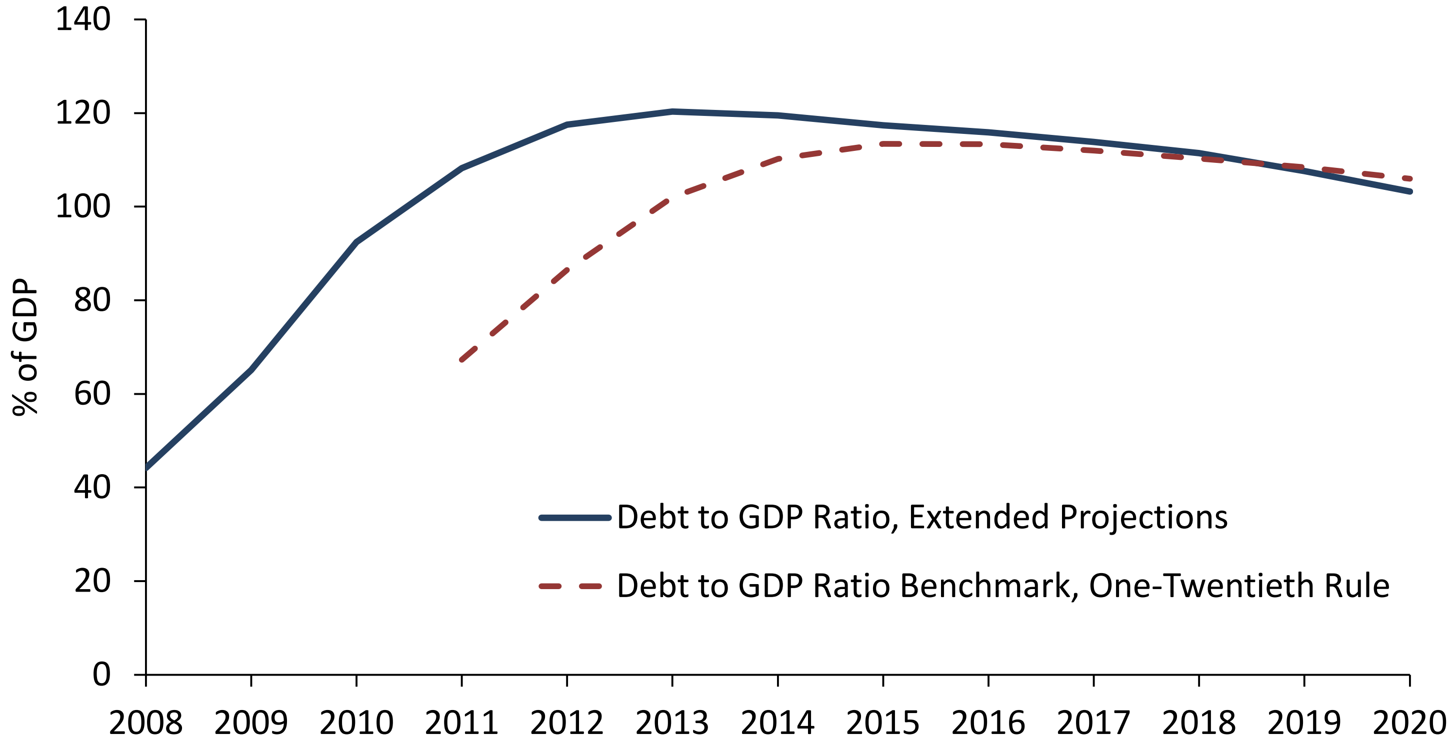


Compliance with Budgetary Rule



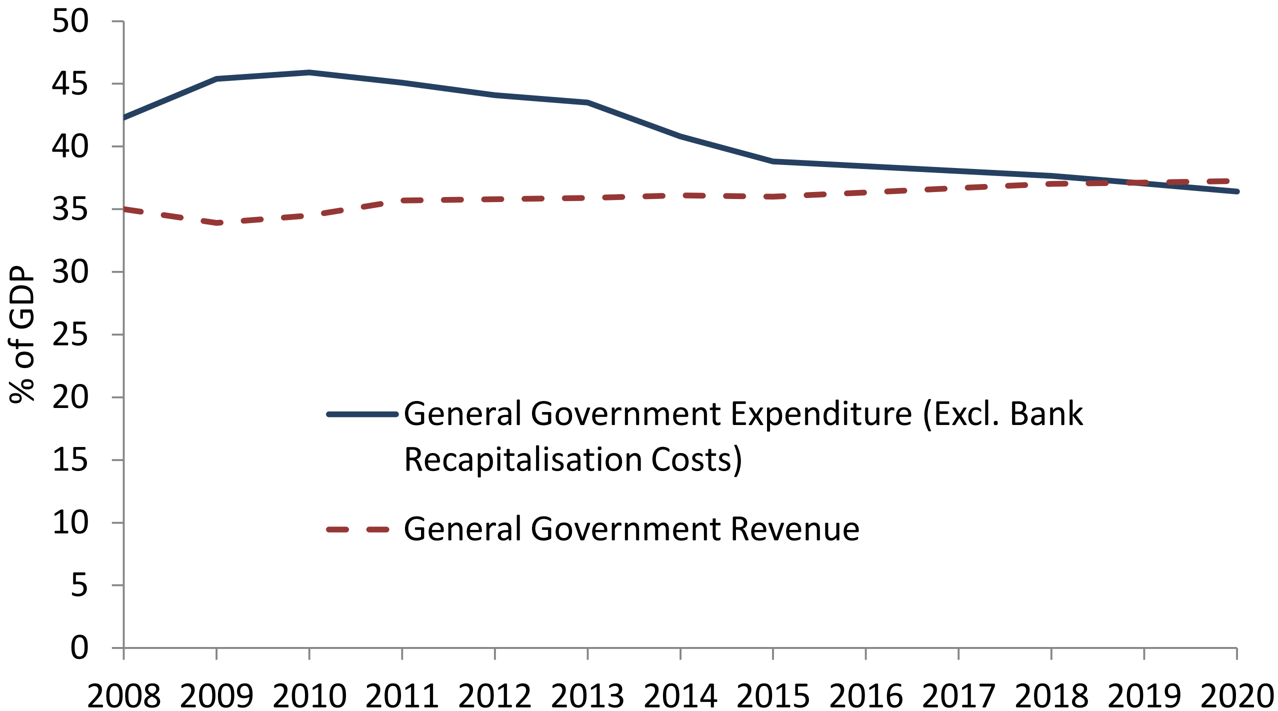
Irish Fiscal Advisory Council

Post-2018 compliance with Debt Rule



Irish Fiscal Advisory Council

Projected expenditure and revenue shares



Irish Fiscal Advisory Council

Summing up

- On track to meet programme targets
  - But significant *uncertainty* surrounds projections
- Fiscal stance is "conducive to sound economic and budgetary management"
  - But case for modest additional adjustments given the continued fragility of debt sustainability
- Very challenging remaining adjustment, particularly on the expenditure side
  - Importance of keeping all adjustment margins under close review
  - Value of relief on official debt – but will not be a panacea