SUMMARY ASSESSMENT

Significant progress has been achieved in resolving Ireland's fiscal crisis, though challenges remain.

Ireland's debt-to-GDP ratio should now be on a declining path, underpinned by nominal GDP growth, record low interest rates and the move to a planned balanced budget between 2013 and 2018. The borrowing capacity of the State has been restored, with secondary-market bond yields falling to low levels. However, fragilities remain, with debt levels likely to remain extremely high and growth prospects uncertain.

The planned €2 billion adjustment for Budget 2015 should be implemented.

The Government should follow through on commitments to implement €2 billion of additional measures in *Budget 2015*. There are three main reasons for this recommendation: (i) to reduce risks to debt sustainability by putting the debt-to-GDP ratio on a firm downward path; (ii) to provide a reasonable probability that the requirement of a deficit of below 3 per cent of GDP is achieved in 2015 to facilitate an exit from the Excessive Deficit Procedure (EDP); and (iii) to protect the hard-won credibility of Ireland's capacity to follow through on adjustment commitments.

While the Council assesses the Government's fiscal stance to be prudent and compliant with the fiscal rules, the commitment to target a balanced budget in structural terms by 2018 has costs.

Two separate fiscal objectives frame the 2014 Stability Programme Update (*SPU 2014*) projections. The first is the requirement to achieve a General Government deficit of less than 3 per cent of GDP in 2015 under the EDP. The second is to meet the Medium-Term Budgetary Objective (MTO) of a balanced budget in structural terms by 2018. This deadline is ambitious and exceeds minimum requirements under the rules. A clear rationale should be provided for this deadline.

While the Government's medium-term fiscal stance is assessed to be within the range of appropriate policies, it implies a stronger drag on demand and even greater pressures on spending than meeting the minimum requirements under the rules. Recognising the trade-off between supporting domestic demand and improving creditworthiness/debt sustainability, there is a case for a less ambitious medium-term fiscal stance that more closely follows these minimum requirements.

Ireland's fiscal framework has been strengthened and the Government has made a strong commitment to respect this new framework.

An important positive legacy of the economic crisis has been the strengthening of Ireland's fiscal framework and Government plans in the *SPU 2014* are consistent with this new framework. Post-2015, the Government is committed to meeting the requirements of the national Budgetary Rule and the requirements of the preventive arm of the *Stability and Growth Pact*. Adhering to the complementary national and European elements of the new fiscal framework should help to smooth future boom-bust cycles, guide Government debt to safer levels, and underpin borrowing capacity during the period when debt will remain unavoidably high.

Medium-term fiscal adjustment plans imply a sustained fall in non-interest Government spending as a share of GDP.

The *SPU 2014* projects Government non-interest spending to fall by approximately 8 percentage points of GDP by 2018, reaching a very low level historically (Figure A). These plans imply considerable pressures on government services, public investment and social payments (Figure B).

The planned spending squeeze raises questions about its viability.

The prolonged tight spending plans will be difficult to achieve given demand pressures and rigidities in certain areas of expenditure. The forthcoming *Comprehensive Review of Expenditure* needs to be used to identify appropriately detailed expenditure plans. This would help to promote informed public debate and enhance the credibility of budgetary projections over the medium term.

The Council has endorsed the macroeconomic forecasts underlying SPU 2014.

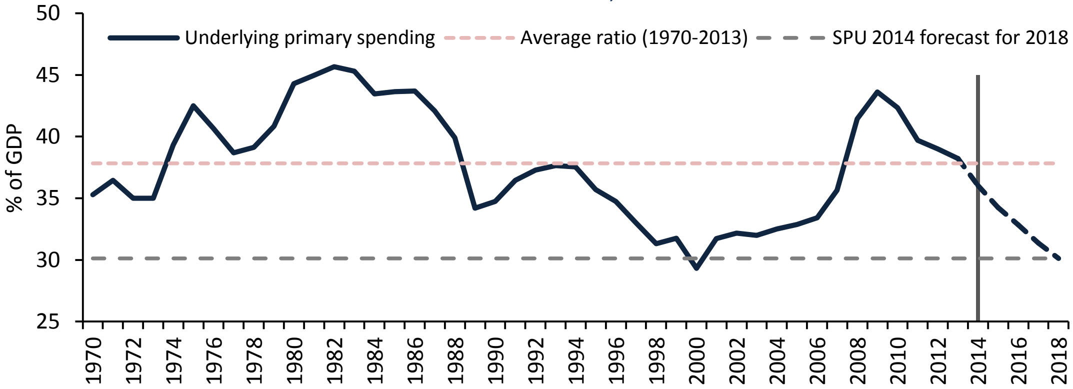
Under the *Fiscal Responsibility Act*, the Council is required to endorse as appropriate the macroeconomic forecasts underlying each Budget and stability programme. The *SPU 2014* forecasts are within an endorseable range, taking into account the methodology and the plausibility of the judgements involved, as well as the uncertainty surrounding any growth forecast. This is the first time the Council has endorsed medium-term projections.

The assumed shift to net-exports-driven growth in *SPU 2014* by 2017 may be difficult to achieve given the subdued productivity growth forecast. The forecast medium-term real GDP growth rate of 3½ per cent also appears to be at the relatively optimistic end of the range.

Budget projections are assessed to be appropriate.

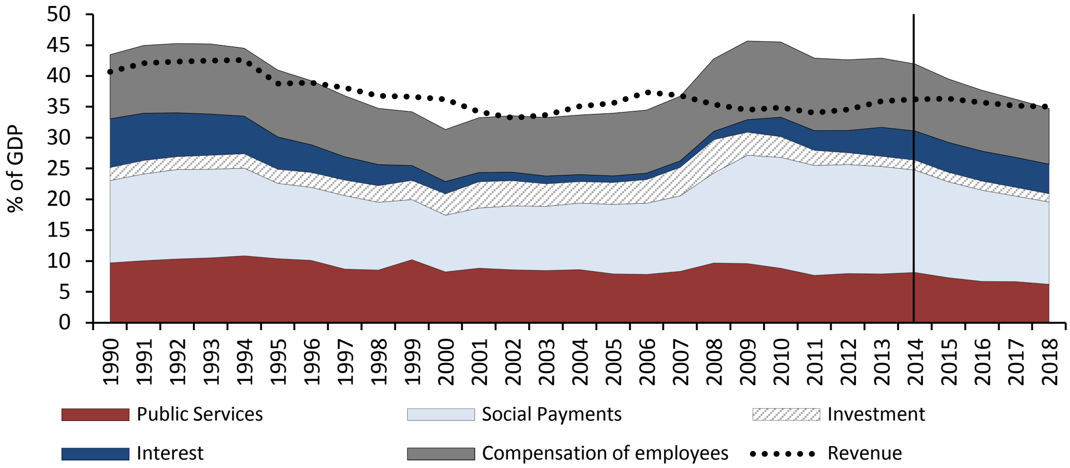
While considered appropriate, the budgetary projections in *SPU 2014* are contingent on the delivery of significant expenditure savings and achieving the projected acceleration in economic growth. Expenditure control problems in Health appear to be unresolved. Additional risks stem from interest rates, inflation and contingent liabilities.

FIGURE A: PRIMARY SPENDING, 1970 TO 2018



Source: Internal calculations based on CSO and Department of Finance data.
Note: Underlying primary expenditure excludes exceptional payments to the banking sector.

FIGURE B: COMPOSITION OF GOVERNMENT EXPENDITURE



Source: CSO; *SPU 2014.*

This Assessment Report includes an "Analytical Notes" series for the first time.

The "Analytical Notes" series provide more detail on specific areas related to the Assessment Report. There are five such notes in this report and the topics covered are: House Price Risks; A Sensitivity Analysis of the Department of Finance Approach to Potential Output Estimation under the European Commission (EC) Methodology; Tax Forecasting Error Decomposition; DIRT Forecast Methodology and Future Implications of the Debt Rule.