Appendix A: Fiscal Council Benchmark Projections 22 September

As part of the endorsement process, the Council's Secretariat produced a set of Benchmark projections in advance of its meetings with the Department of Finance. The Benchmark projections were finalised on 22 September 2014 and are summarised in Appendix Table A.1.

Appendix Table A.1: Benchmark Projections for 2014 and 2015

% change unless otherwise stated	2014	2015
Real GDP	4.8	3.7
Consumption	1.1	1.3
Investment	13.8	12.5
Government	-0.9	0.0
Stock change (% of GDP)	0.5	0.4
Exports	9.0	4.4
Imports	8.5	4.3
Net Exports (p.p. contribution)	2.3	1.0
Domestic Demand (p.p. contribution)	2.5	2.7
Stock Changes (p.p. contribution)	0.0	0.0
Current Account (% GDP)	4.5	4.9
Employment	1.6	1.9
Unemployment Rate (%)	11.4	10.3
HICP	0.4	0.9
GDP Deflator	0.2	1.3
Nominal GDP (€ billions)	183.6	192.8
Nominal GDP	5.0	5.0

The Council's "endorsable range" is informed by, but not mechanically linked to, the uncertainty captured in fan chart analysis. Note that this time around, the Council has applied the fan chart approach retrospectively also so that uncertainty around outturn revisions can also be graphically represented (Figure 2.8).

The fan chart bands for the historical period effectively show the typical scale of revisions applying to historical estimates of real GDP growth over a five year period.[1] As can be seen these are quite wide for the most recent yearly outturns, but gradually pare off over time.

The construction of the fan chart for the historical period can also vary depending on the number of iterations already released (i.e., the number of releases published with estimates of the yearly

[1] Quill (2008) notes that in practice CSO data beyond five years rarely changes materially except for methodological reasons.

outturn in question). As detailed in Casey and Smyth (*forthcoming*), typical confidence intervals surrounding estimates for the latest annual outturn are not especially narrower than that for the current forecast year.[2] While this source of uncertainty narrows after the *NIE* release in Summer, large uncertainties around the most recent annual outturns can still remain.[3]

It is important to note that the fan chart for the forecast period is symmetric by construction even though the Council may interpret the balance of risks to be weighted in a certain direction at a given point in time.

[2] Revisions for the latest full-year of data are typically large, especially when it comes to the first estimate of real GDP growth (i.e., with the release of the fourth quarter QNA results). A typical root mean squared error (RMSE) value of 1.6 for the previous full year of data compares to a RMSR of 1.8 for the current year's forecast. This means that the uncertainty surrounding the current forecast year is a little less than that of the previous year for which four quarters of data are available. The RMSR for the previous year narrows to 0.9 after the release of the NIE in the Summer of each year, but remains relatively large.

[3] The fan chart shown here is based on the typical scale of revisions that can be expected after the NIE release (i.e. after the second vintage of estimates for the previous annual outturn) and is, therefore, more aligned with the information available at the time of the budgetary endorsement exercise.

APPENDIX B: HOUSE PRICE RISKS UPDATE

The Council continues to monitor various indicators with respect to housing market trends given the attendant risks to both economic activity and to the public finances. This section updates previous analyses (IFAC, 2014a) using the latest available data.

The summary analysis in Figure AB.1 highlights the upturn in valuations from low levels as well as the recent reductions in user costs.[4] Such pressures appear to be fuelled by supply issues in particular.[5] In the absence of an appropriate supply response, there is a risk that price rises become entrenched in expectations and consequently self-reinforcing. The Central Bank (2014) proposed macroprudential measures to enhance the resilience of the banking sector and households to housing market developments.

Policy measures in *Budget 2015* that increase social housing provision are a useful means of tackling housing stock shortages, but are unlikely to be sufficient in the absence of increased private sector provision also. More sustainable solutions to shortages might seek to address barriers to construction responses in the form of regulations and associated costs as highlighted by Lyons (2014).

As noted in the previous *FAR*, risk assessment of the housing market would be well served if more regional analyses were routinely produced as migration and other assumptions evolve. Data availability with respect to regional household numbers and current and projected housing stocks could also be improved on. This would further help to limit risks of price growth expectations becoming dislodged from fundamentals.

[4] The recent four-quarter average is used here and assumes price growth of 9.6 per cent over the next twelve months. Third quarter survey price expectations by Daft.ie are for a 12 per cent rise in Dublin and 6 per cent outside of Dublin.

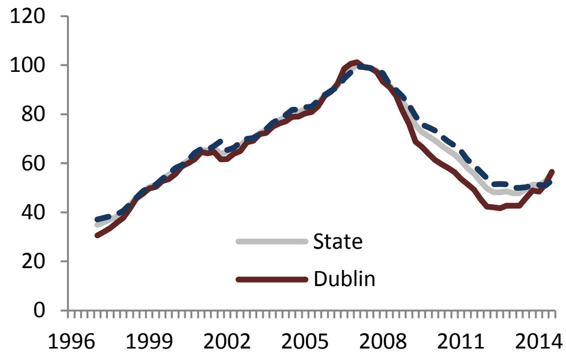
[5] A recent report commissioned by the Society of Chartered Surveyors Ireland (SCSI, 2014) examines the capacity of Dublin's zoned residential sites to meet projected demand over 2014-2018.

FIGURE AB.1: IRELAND: HOUSING DEVELOPMENTS

Even with recent increases, real prices are more than 40 per cent below peak levels on average

Real Residential Property Prices (HICP adj.)

Index: Q1 2007=100

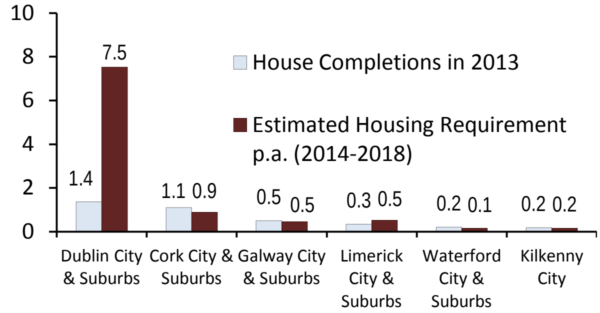


Sources: ESRI/PTSB; CSO.

...and supply issues remain a concern, particularly in Dublin.

Estimated housing requirements/completions

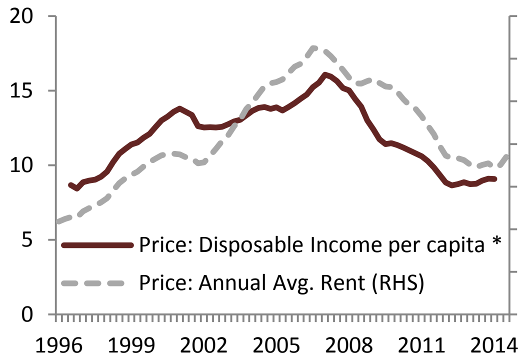
Units (000s)



Sources: Housing Agency; DoECLG.
Note: Completions cover rural + urban settlements; requirements only cover urban settlements of 1,000+ persons

Valuations have begun to pick up from low levels partly due to supply pressures in certain areas

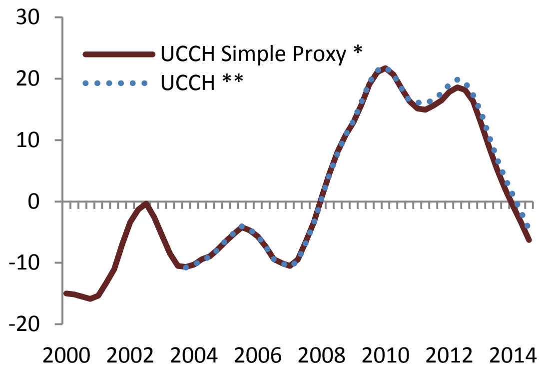
Housing Valuation Ratios



Sources: ESRI/PTSB; CSO.
*Average house prices divided by moving 4-quarter sum of adjusted personal disposable income per capita.

...and rising price expectations are fuelling a return to negative user costs.

User Cost of Capital for Housing (UCCH)

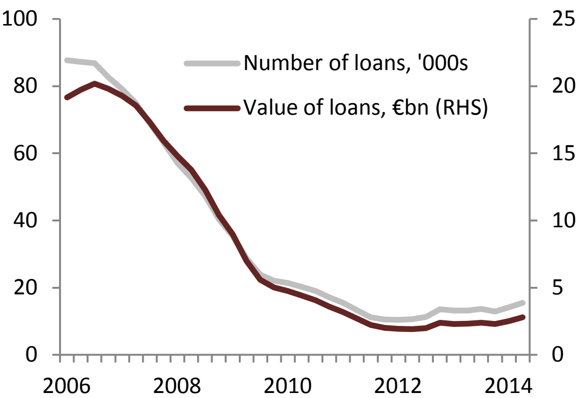


Sources: Central Bank of Ireland; CSO; ESRI/PTSB.
* New mortgage rates less annual price change for past 4Qs.
**Includes first-time buyer taxes/subsidies; down-payments; depreciation / maintenance.

Loan volumes and amounts have begun to pick up from a very low base

Annualised Residential Mortgage Lending

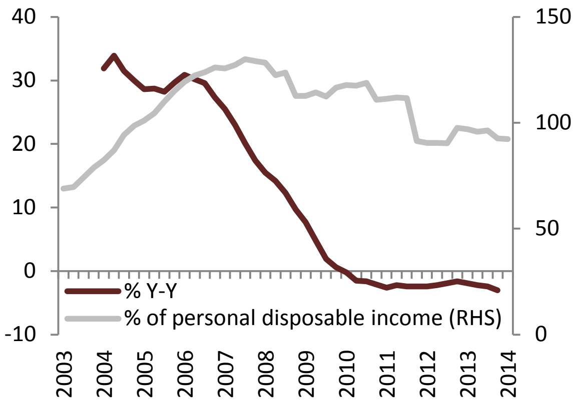
First-time buyer and mover purchaser loans



Source: IBF/PwC Mortgage Market Profile.

...although – in net terms – negative loan growth continues to reflect household deleveraging.

Loans to Irish Households for House Purchase



Sources: Central Bank of Ireland; CSO.

Appendix C: Timeline for Endorsement of *Budget 2015* Projections

Date	
18 September	CSO release *Quarterly National Accounts* estimates for Q2 2014.
19 September	The Secretariat received Department of Finance technical assumptions underpinning *Budget 2015* forecasts.[6]
24 September	Benchmark projections were discussed by the Council and finalised by the Secretariat prior to receiving preliminary forecasts from the Department of Finance.
	The Secretariat and Department of Finance met the CSO to clarify technical details of latest *Quarterly National Accounts* estimates.
	The Council received preliminary forecasts from the Department in line with *Memorandum of Understanding* requirements.
25 September	The first endorsement meeting took place with the Department of Finance presenting their forecasts to the Secretariat. A number of clarifications of a factual nature were requested.
26 September	The Secretariat submitted a number of queries to the Department in relation to the forecast set.[7]
29 September	The Department provided more details to IFAC in response to the queries received.
	The Council received a set of provisional final forecasts from the Department. Changes to several components were included and the forecast level of nominal GDP was slightly higher for 2015 in the newer forecast set reflecting higher public consumption estimates.
30 September	The Department provided additional details to IFAC in response to previous queries received.
2 October	The Council met to discuss the Department of Finance forecasts. Following this, Department of Finance staff met with the full Council and Secretariat to present their latest forecasts and to answer questions. The Council sought additional information regarding a number of forecast components.[8]
3 October	The Council met to discuss the Department of Finance forecasts in detail and to finalise a decision on the endorsement.
6 October	The Chair of the Council wrote a letter to the Secretary General of the Department of Finance endorsing the set of macroeconomic forecasts underlying *Budget 2015*.
7 October	The endorsement decision is announced at a presentation of the Department's forecasts at an Oireachtas Committee meeting. Subsequent to this, the endorsement letter is published.
14 October	*Budget 2015* published a reconciliation exercise between final and endorsed forecasts provided by the Department with qualitative explanations of changes to estimates.
15 October	Draft *2015 Budgetary Plan* for 2015 was formally submitted to the EC.

[6] These included assumptions related to oil prices, interest rates, exchange rates and sources of forecasts for major trading partners.

[7] Mainly covering quarterly profiles, income assumptions and the breakdown of investment forecasts.

[8] Primarily concerning the composition and expected profile of net exports, but also assumptions for incomes, the evolution of contract manufacturing activities, savings rates, building and construction assumptions, the neutral budget assumption underpinning fiscal assumptions and the employment growth slowdown in early 2014.

GLOSSARY[9]

Automatic stabilisers: Features of the tax and spending regime which react automatically to the economic cycle and reduce its fluctuations. As a result, the budget balance in per cent of GDP tends to improve in years of high growth, and deteriorate during economic slowdowns.

Budget balance: The balance between total public expenditure and revenue in a specific year, with a positive balance indicating a surplus and a negative balance indicating a deficit. For the monitoring of Member State budgetary positions, the EU uses general government aggregates.

Cyclical component of budget balance: That part of the change in the budget balance that follows automatically from the cyclical conditions of the economy, due to the reaction of public revenue and expenditure to changes in the output gap.

Discretionary fiscal policy: Change in the budget balance and in its components under the control of government. It is usually measured as the residual of the change in the balance after the exclusion of the budgetary impact of automatic stabilisers.

Excessive Deficit Procedure (EDP): A procedure according to which the Commission and the Council monitor the development of national budget balances and public debt in order to assess and/or correct the risk of an excessive deficit in each Member State.

Expenditure rules: A subset of fiscal rules that target (a subset of) public expenditure.

Fiscal consolidation: An improvement in the budget balance through measures of discretionary fiscal policy, either specified by the amount of the improvement or the period over which the improvement continues.

General Government: As used by the EU in its process of budgetary surveillance under the *Stability and Growth Pact* and the excessive deficit procedure, the general government sector covers national government, regional and local government, as well as social security funds. Public enterprises are excluded, as are transfers to and from the EU Budget.

[9] These definitions are taken directly from the European Commission. See European Economy, Occasional Papers 151, May 2013, *Vade Mecum* on the *Stability and Growth Pact*.

Maastricht reference values for public debt and deficits: Respectively, a 60 per cent General Government debt-to-GDP ratio and a 3 per cent General Government deficit-to-GDP ratio. These thresholds are defined in a protocol to the Maastricht Treaty on European Union.

Medium-term budgetary framework: An institutional fiscal device that lets policy-makers extend the horizon for fiscal policy making beyond the annual budgetary calendar (typically 3-5 years). Targets can be adjusted under medium-term budgetary frameworks (MTBF) either on an annual basis (flexible frameworks) or only at the end of the MTBF horizon (fixed frameworks).

Medium-term budgetary objective (MTO): According to the reformed *Stability and Growth Pact*, stability programmes and convergence programmes present a medium-term objective for the budgetary position. It is country-specific to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risks to the sustainability of public finances, and is defined in structural terms.

Minimum benchmarks: The lowest value of the structural budget balance that provides a safety margin against the risk of breaching the Maastricht reference value for the deficit during normal cyclical fluctuations. The minimum benchmarks are estimated by the European Commission. They do not cater for other risks such as unexpected budgetary developments and interest rate shocks. They are a lower bound for the medium-term budgetary objectives (MTO).

One-off and temporary measures: Government transactions having a transitory budgetary effect that does not lead to a sustained change in the budgetary position.

Output gap: The difference between actual output and estimated potential output at any particular point in time.

Potential GDP: The level of real GDP in a given year that is consistent with a stable rate of inflation. If actual output rises above its potential level, then constraints on capacity begin to bind and inflationary pressures build; if output falls below potential, then resources are lying idle and inflationary pressures abate.

Primary budget balance: The budget balance net of interest payments on general government debt.

Primary structural budget balance: The structural budget balance net of interest payments.

Pro-cyclical fiscal policy: A fiscal stance which amplifies the economic cycle by increasing the structural primary deficit during an economic upturn, or by decreasing it in a downturn. A neutral fiscal policy keeps the cyclically-adjusted budget balance unchanged over the economic cycle but lets the automatic stabilisers work.

Public debt: Consolidated gross debt for the general government sector. It includes the total nominal value of all debt owed by public institutions in the Member State, except that part of the debt which is owed to other public institutions in the same Member State.

Sovereign bond spread: The difference between risk premiums imposed by financial markets on sovereign bonds for different states. Higher risk premiums can largely stem from (i) the debt service ratio, also reflecting the countries' ability to raise their taxes for a given level of GDP, (ii) the fiscal track record, (iii) expected future deficits, and (iv) the degree of risk aversion.

Stability and Growth Pact (SGP)**:** Approved in 1997 and reformed in 2005 and 2011, the *SGP* clarifies the provisions of the Maastricht Treaty regarding the surveillance of Member State budgetary policies and the monitoring of budget deficits during the third phase of EMU. The *SGP* consists of two Council Regulations setting out legally binding provisions to be followed by the European Institutions and the Member States and two Resolutions of the European Council in Amsterdam (June 1997).

Stability programmes: Medium-term budgetary strategies presented by those Member States that have already adopted the euro. They are updated annually, according to the provisions of the *Stability and Growth Pact*.

Stock-flow adjustment: The stock-flow adjustment (also known as the debt-deficit adjustment) ensures consistency between the net borrowing (flow) and the variation in the stock of gross debt. It includes the accumulation of financial assets, changes in the value of debt denominated in foreign currency, and remaining statistical adjustments.

Structural budget balance: The actual budget balance net of the cyclical component and one-off and other temporary measures. The structural balance gives a measure of the underlying trend in the budget balance.

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