



06 October 2016

Dear Secretary General Moran,

The Council has an obligation under the Fiscal Responsibility Act to endorse, as appropriate, the macroeconomic forecasts prepared by the Department of Finance on which *Budget 2017* will be based.<sup>1</sup> The *Budget 2017* forecasts were provided to the Council on 22 September 2016 and discussed by the Council with Department of Finance staff on 04 October 2016, ahead of the Council's endorsement meeting.

The Council's approach to endorsement of the macroeconomic forecasts has three elements: a comparison of the Department of Finance's macroeconomic forecasts to IFAC's Benchmark forecasts; consideration of the methodology used to produce the forecasts; and a review of past forecast errors for evidence of systematic bias.

**The Irish Fiscal Advisory Council (IFAC) endorses as within the range of appropriate projections the set of macroeconomic forecasts prepared by the Department of Finance for *Budget 2017* for the years 2016 and 2017.**

The Council's endorsement refers only to the actual demand-side projections. The data published by the CSO in the 2015 National Accounts create particular challenges for the estimation of supply-side variables such as potential output and the output gap. These measures have a major influence on the operation of the fiscal rules. A mechanical application of the Commonly Agreed Methodology (CAM) could have seriously distorted the measures used to assess compliance with the fiscal rules, thereby potentially also distorting budgetary policy over the medium term. The Council has reviewed the technical adjustments to the CAM applied by the Department of Finance following engagement with the European Commission. The Council is satisfied that they reflect an appropriate response to the challenges caused by the revised National Accounts data.

In a number of recent reports, the Council has argued that it is essential that the Department of Finance develops a fuller picture of the supply side complementary to the Commonly Agreed Methodology, which is used primarily for fiscal surveillance by the European Commission. While the Council recognises that the scale of the challenges created by the revised National Accounts data has interrupted this work, further progress on developing and reporting alternatives to the CAM is necessary to improve the quality of the Department's supply-side forecasts.

A detailed discussion of the endorsement process and an assessment of the macroeconomic projections will be provided in the Council's forthcoming *Fiscal Assessment Report*, which is scheduled for publication in November.

Yours sincerely,

John McHale, Chair.

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<sup>1</sup> The Fiscal Responsibility Act 2012, as amended by the Ministers and Secretaries (Amendment) Act 2013, states that: "The Fiscal Council shall— (a) endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the Budget and stability programme will be based".