Irish Fiscal Advisory Council

The Macroeconomic and Fiscal Outlook for Budget 2019

Seamus Coffey

10th July 2018

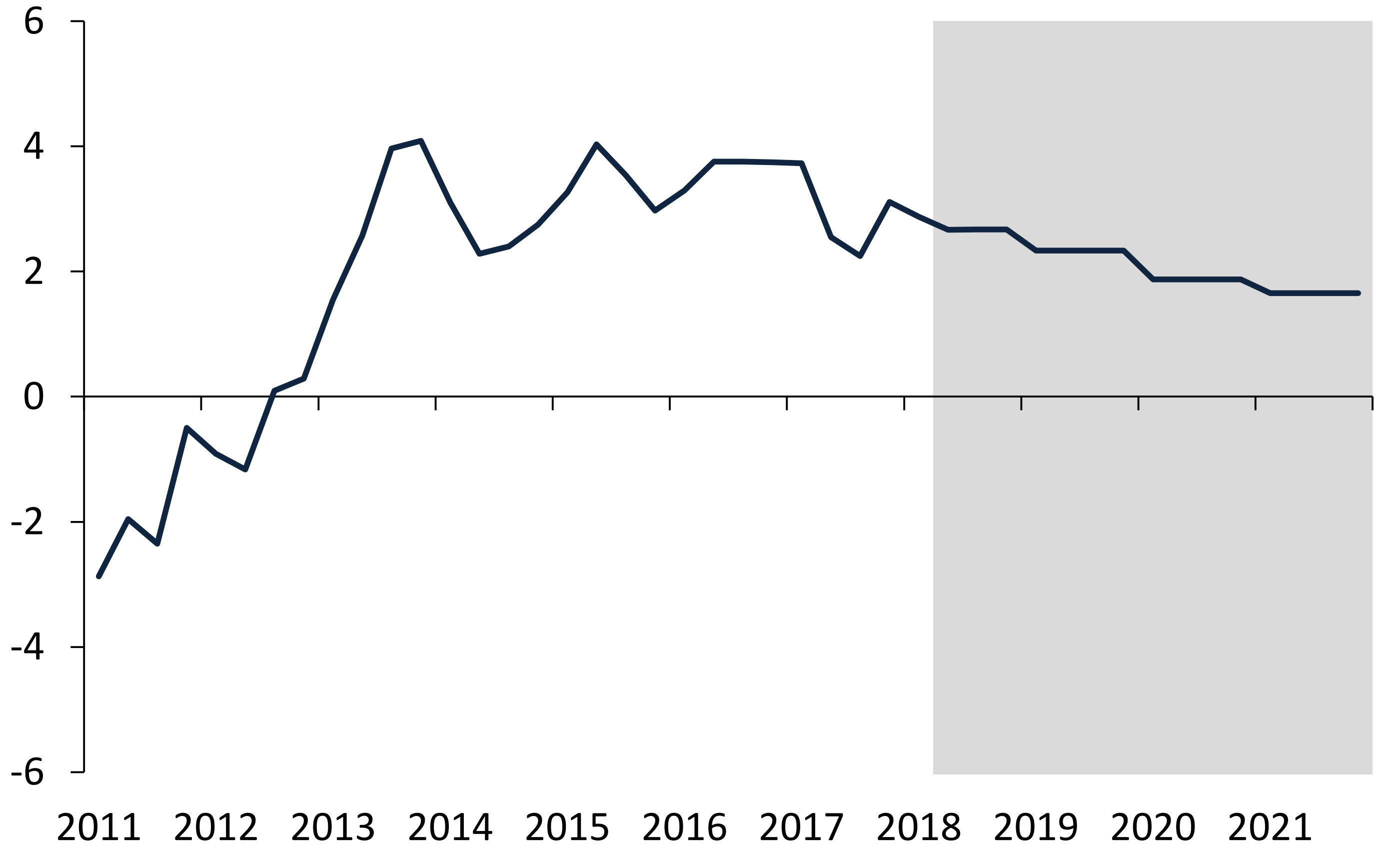
The Macro Context:

- A rapid cyclical recovery has taken place since at least 2014 and this is continuing at a strong pace.
- There is much uncertainty, yet most coherent estimates suggest that the domestic economy has been growing faster than its potential growth rate since 2014.
- Estimates suggest that the economy is producing close to its medium-term potential in 2018 and will move beyond it next year and after.
- Little evidence of overheating pressures at present, but given the nature of the Irish economy this can change rapidly.

Macro Context:

Employment

% change y/y, volumes



Sources: CSO (outturn data) and SPU 2018 (forecasts).

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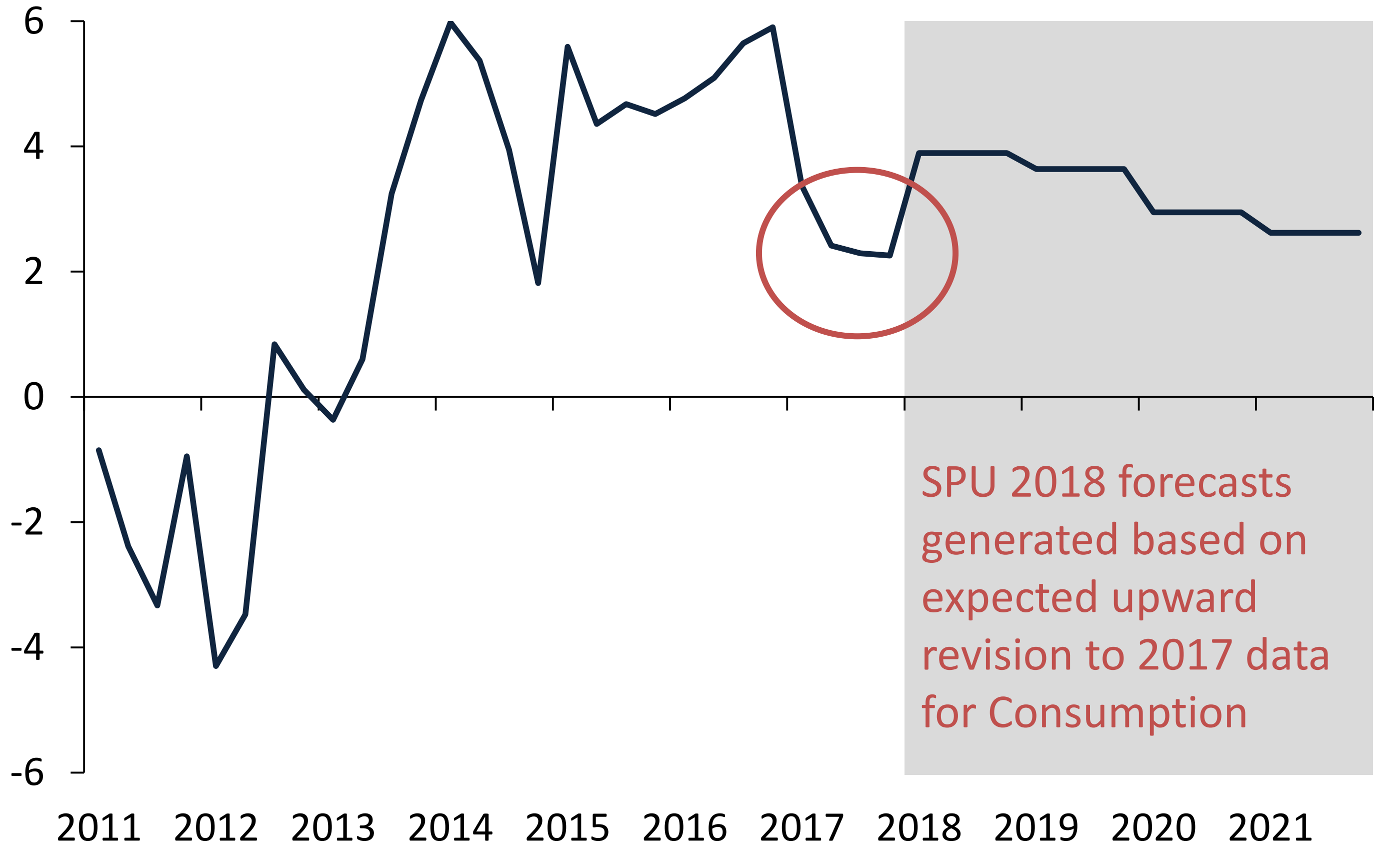
Underlying Domestic Demand

% change y/y, volumes



Sources: CSO (outturn data) and SPU 2018 (forecasts).
Note: Underlying domestic demand is domestic demand excluding stocks net of aircraft (other transport equipment) and intangibles.

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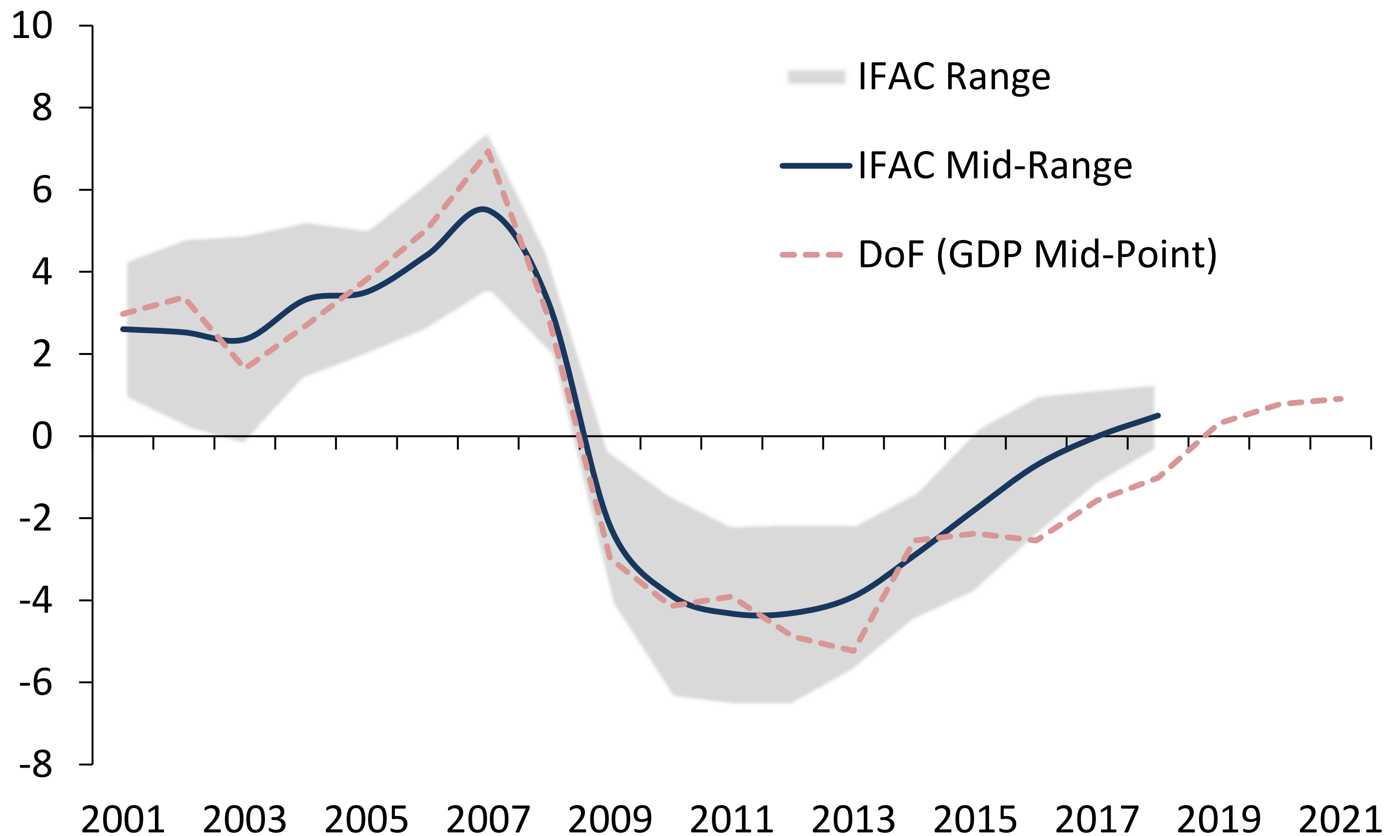
Ireland's Cyclical Recovery

Output gap estimates (% potential output)



Sources: IFAC (June 2018 FAR) and SPU 2018.

Macro Context:

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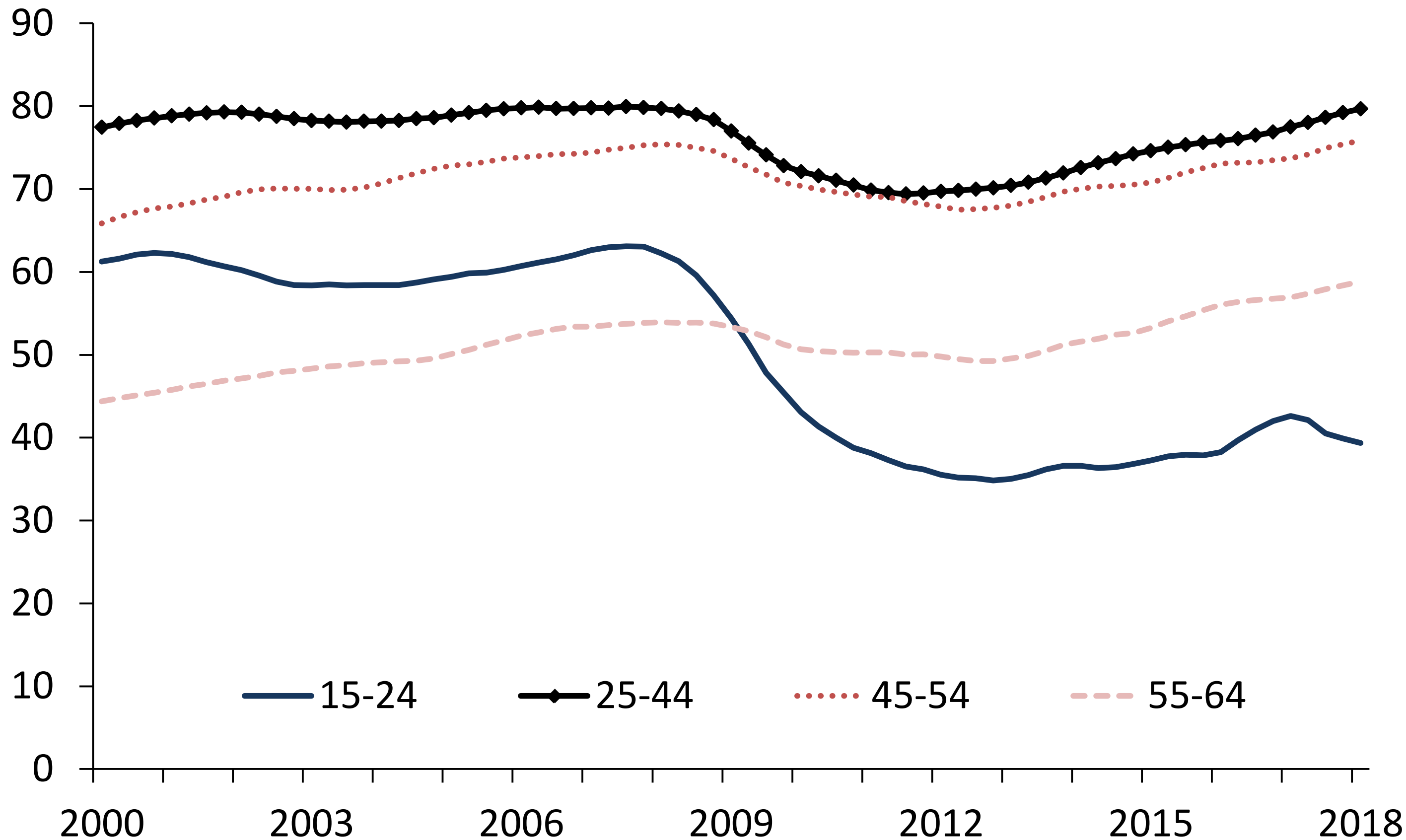
Employment Rates by Age Group

% population



Source: CSO.
Note: Employment rates by age grouping for 15-24 years, 25-44 years and 55-64 years are calculated as an average of quarterly employment rates weighted by annual population estimates.

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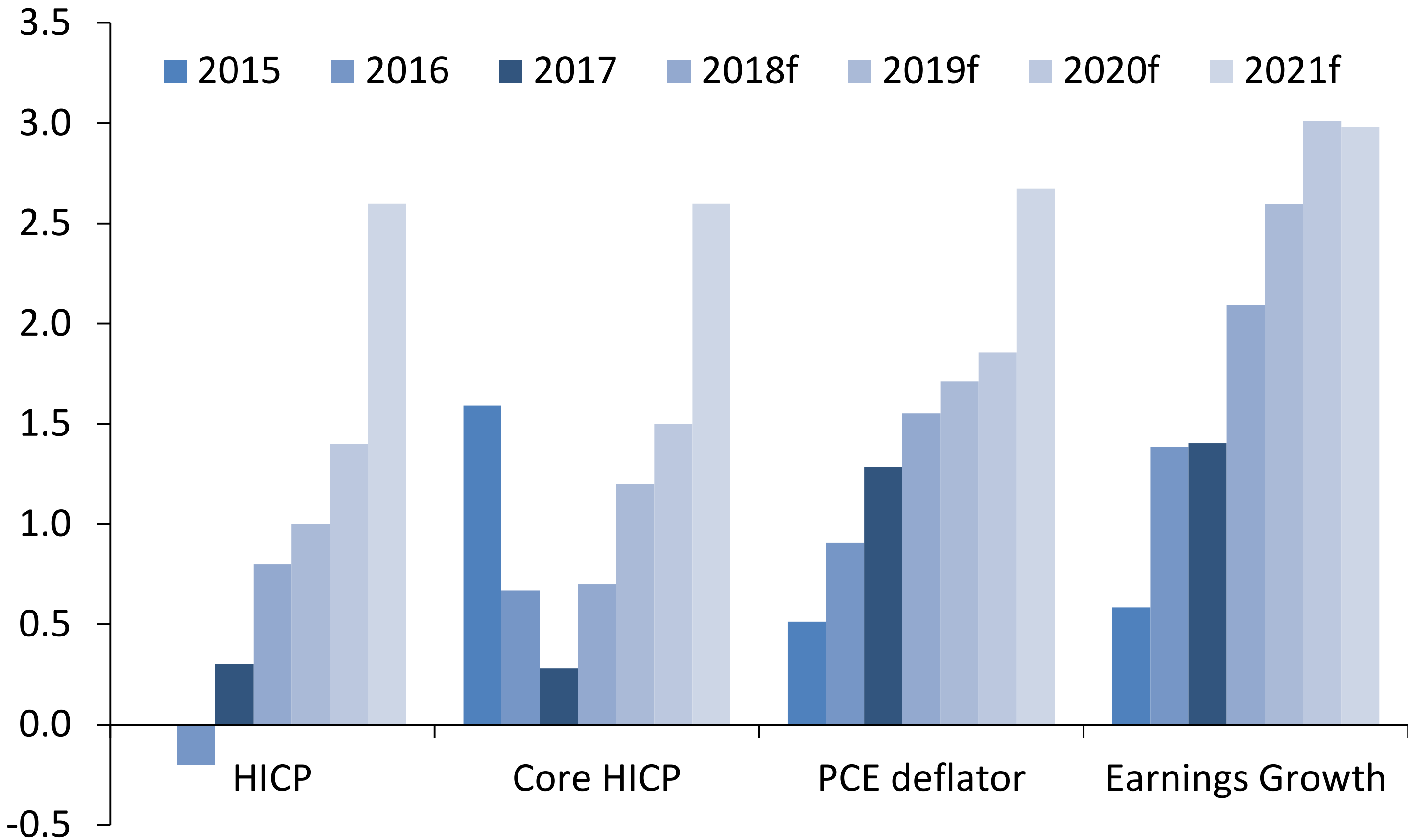
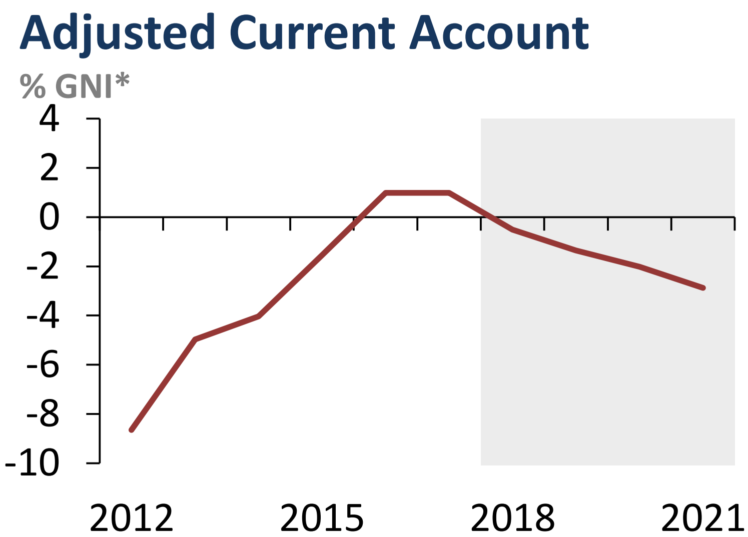
Prices and Earnings Growth

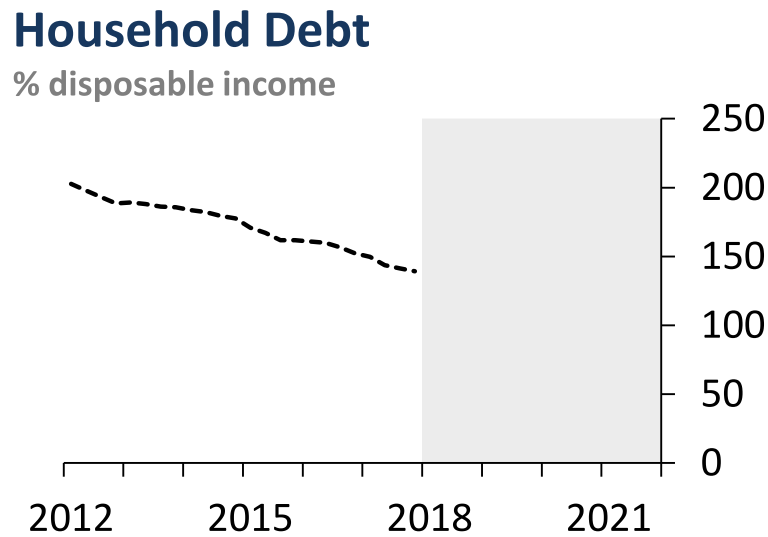
% change y/y

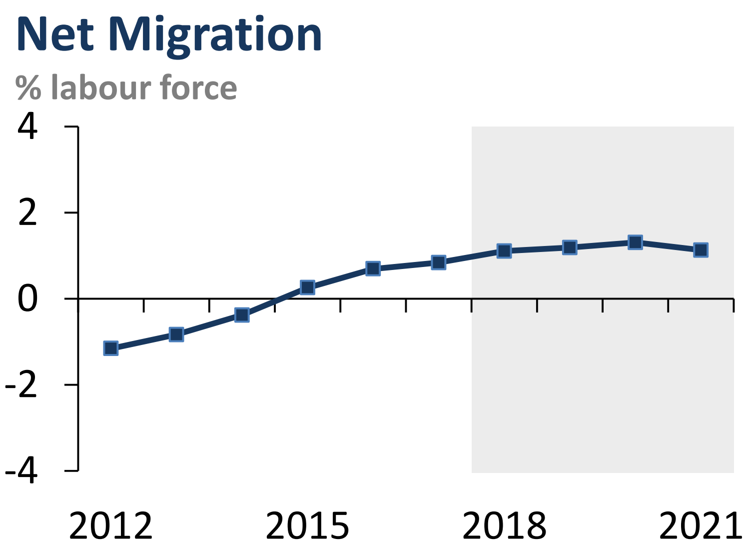


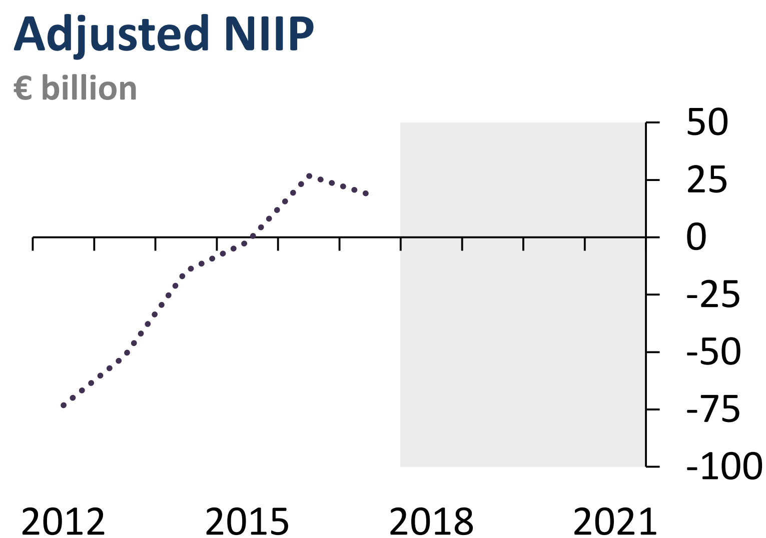
Sources: CSO (outturn data) and SPU 2018 (forecasts).
Notes: Core HICP excludes energy and food items. Earnings growth is a national accounts measure based on compensation of employees and annualised employee hours.

Macro Context:









Sources: Central Bank of Ireland and CSO (outturn data); SPU 2018 (forecasts).
Notes: Adjusted Current Account excludes re-domiciled PLCs, depreciation on R&D-related IP imports and aircraft leasing, and acquisitions of IP assets and aircraft for leasing. Adjusted NIIP excludes IFSC and NFC activities.

Near-term: upside risks from housing

- There are also burgeoning pressures in the housing sector, where persistent undersupply has been evident.
- Faster-than-assumed growth in housing output – although needed – could prompt overheating pressures unless offsetting measures are taken elsewhere.
- New dwellings in 2017: 14,446 (+45.7%)
  - 4,738 fewer than the number of connections

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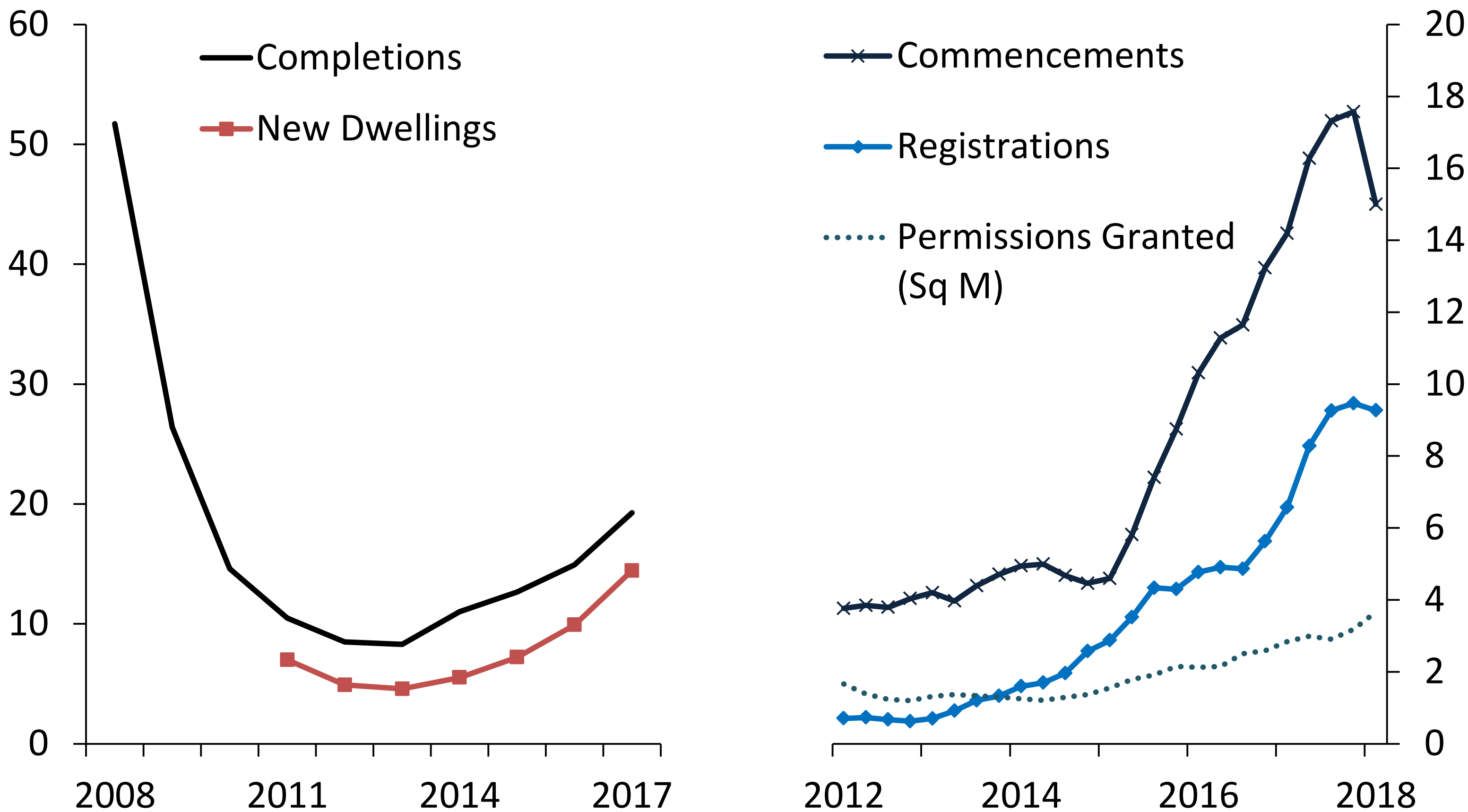
Supply Indicators

Thousands



Sources: DoEHLG and CSO.
Notes: Commencements, Registrations and Permissions data are presented as four-quarter sums.

Medium-term: numerous downside risks

- Negative shocks will inevitably occur in future years.
- There are clear downside risks over medium term:
  - Brexit;
  - US trade policy;
  - International tax environment.
- Other events that are currently unknown or unseen:
  - Regardless of sequencing or timing of these risks, the appropriate fiscal response now is the same.

The Fiscal Context:

- Debt remains high and improvements on the budgetary front have stalled since 2015
- Ireland’s debt burden is still among the highest in the OECD and is understated by standard GDP comparisons.
  - Set against a comparable measure of national income like GNI*, the net debt burden is equivalent to 87 per cent, the sixth highest in the OECD behind only Italy, Portugal, Belgium, France and Japan.
- A strong cyclical recovery has taken place – one reinforced by a number of favourable tailwinds. Despite this, the Government’s primary balance has not improved.

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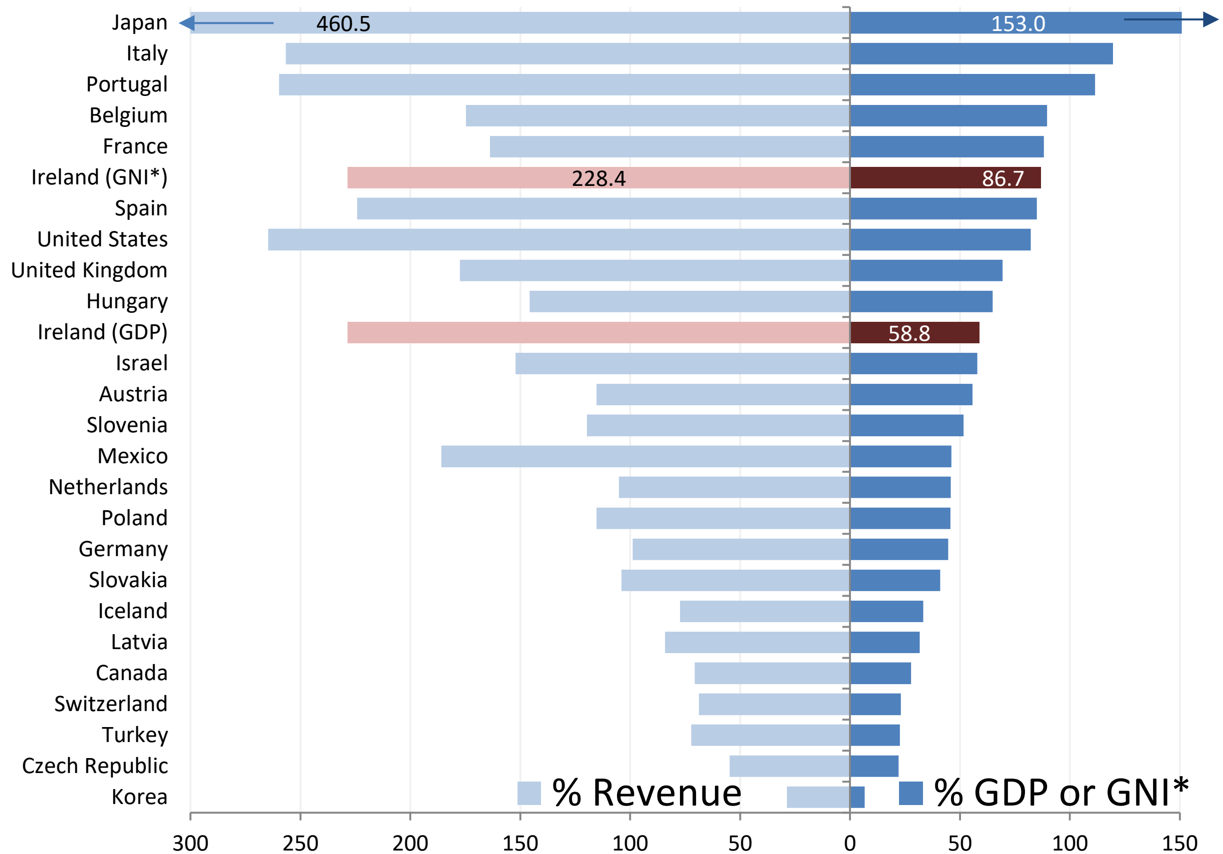
OECD Countries' Net Government Debt

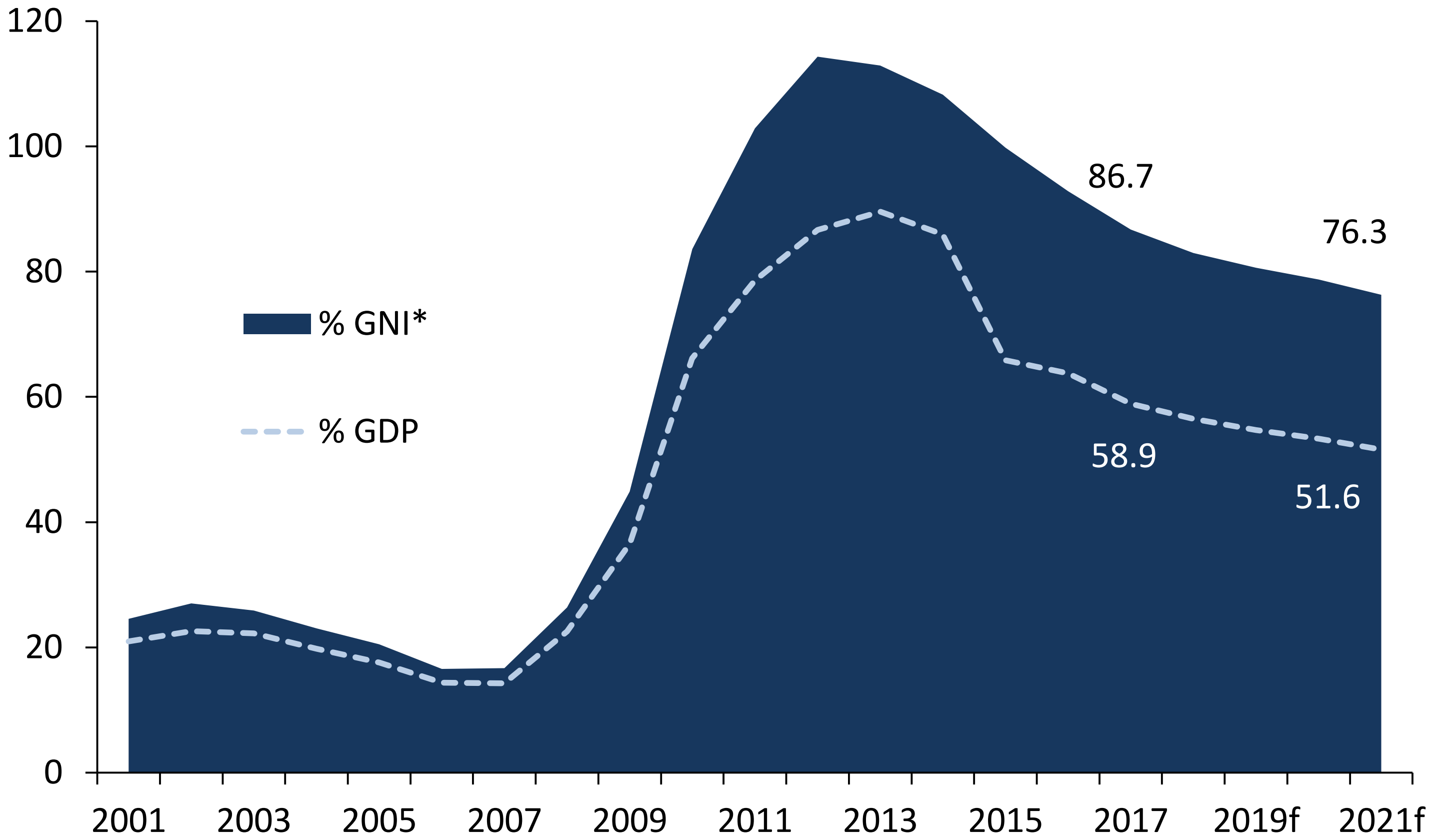
End-2017 net general government debt as % revenue (LHS); and as % GDP or GNI* (RHS)



Sources: OECD; and internal IFAC calculations.

Ireland's Net Government Debt

% GNI* and % GDP, General Government basis



Sources: CSO; and internal IFAC calculations.

Fiscal Context:

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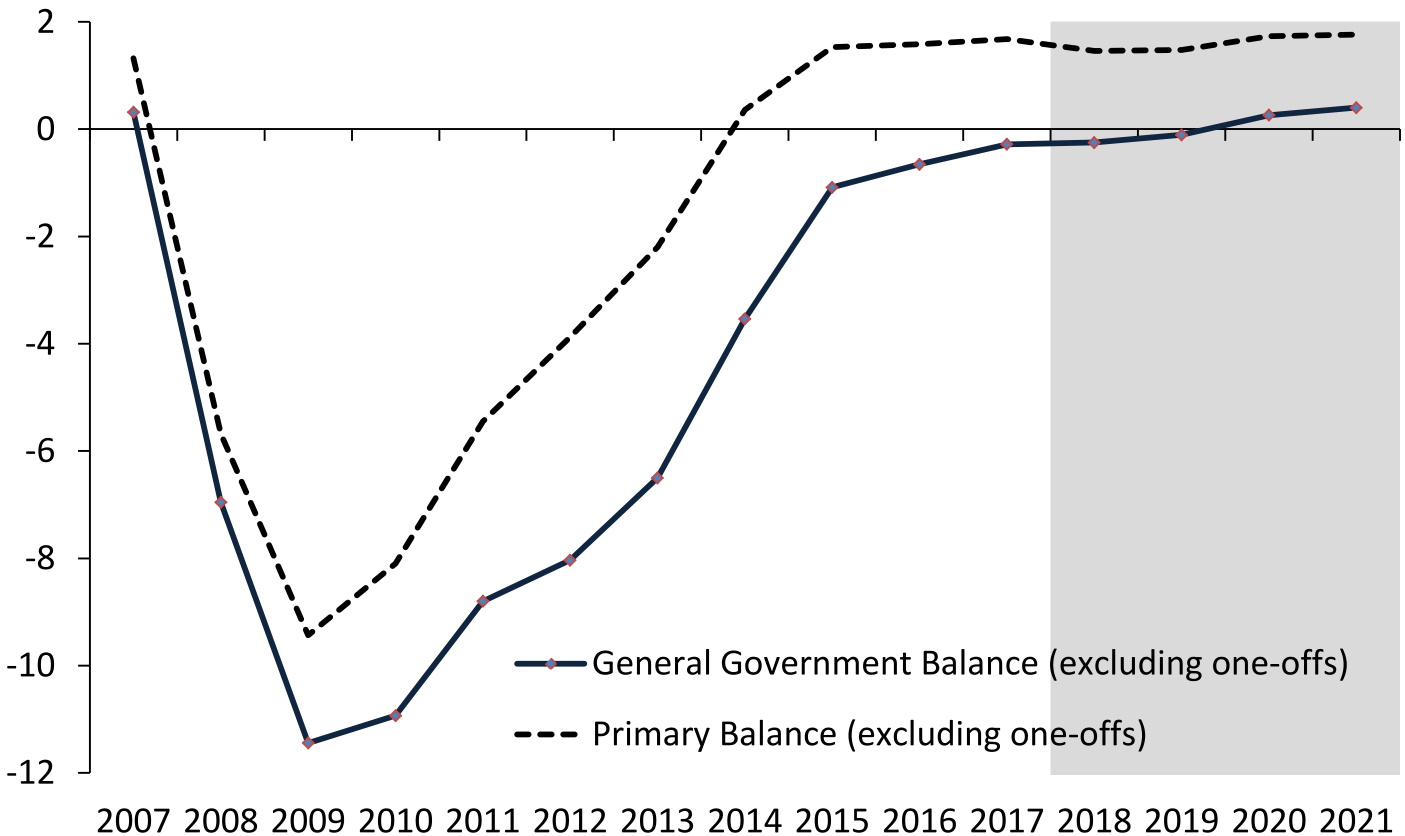
General Government Balance & Primary Balance

% GDP, General Government basis (excluding one-off items)



Sources: CSO (outturn data); and SPU 2018 (forecasts).

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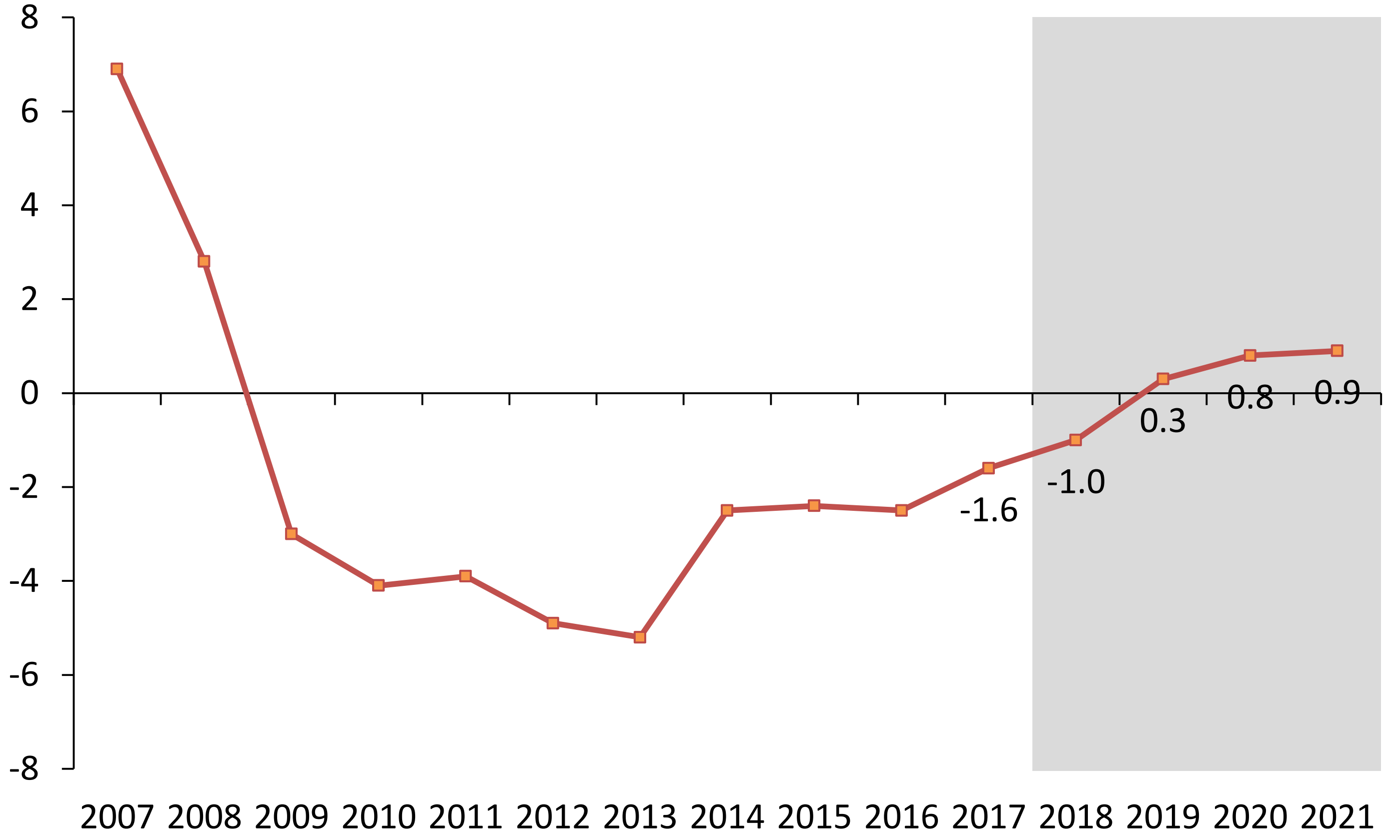
DoF Output Gap (Preferred Estimate)

% potential GDP



Source: SPU 2018.

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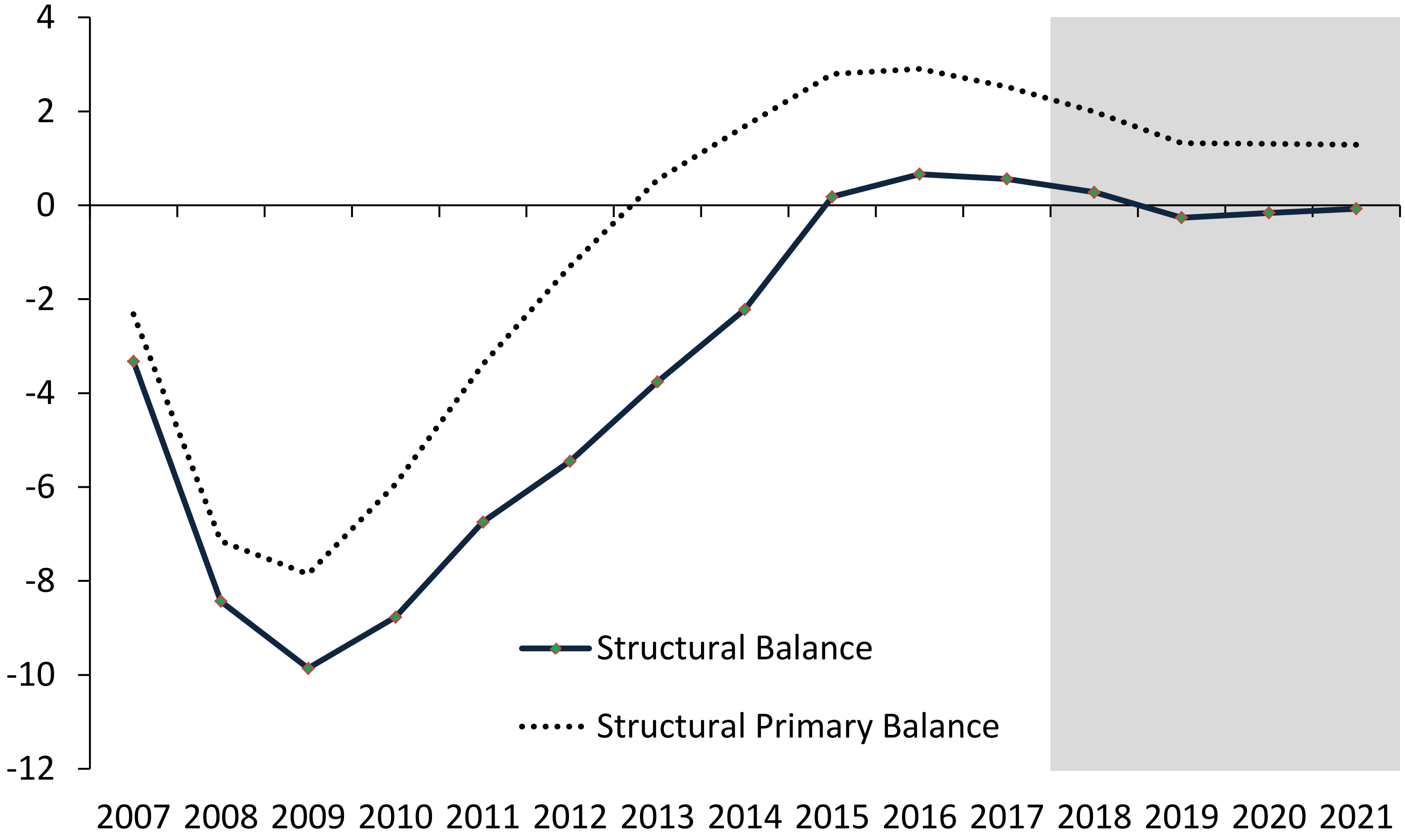
Structural Primary Balance: Deteriorating since 2015

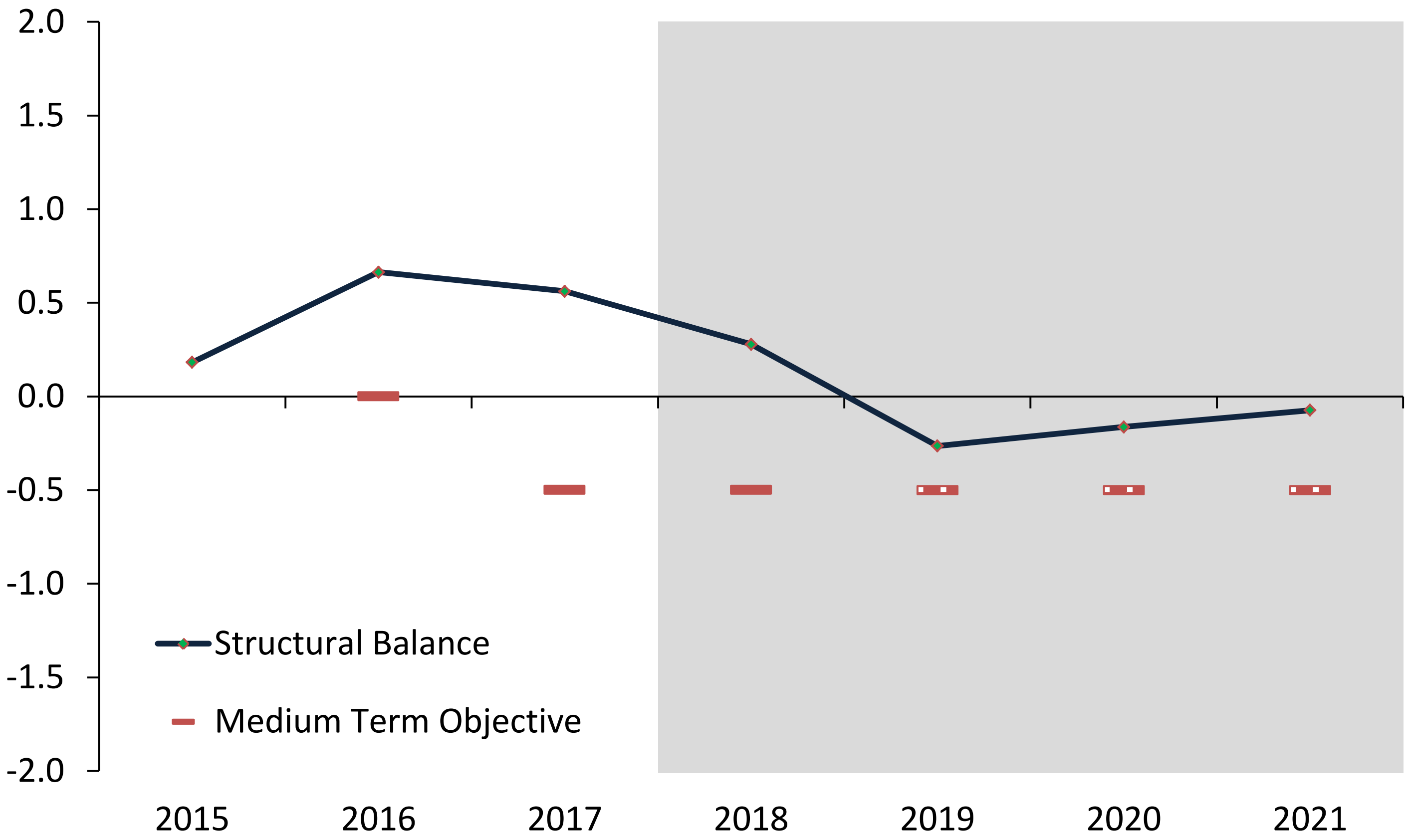
% potential GDP, General Government basis, DoF preferred output gap estimates



Sources: CSO (outturn data); SPU 2018 (forecasts); and internal IFAC calculations.

Structural Balance and the Medium Term Objective

% potential GDP, General Government basis, DoF preferred output gap estimates



Sources: CSO (outturn data); SPU 2018 (forecasts); and internal IFAC calculations.

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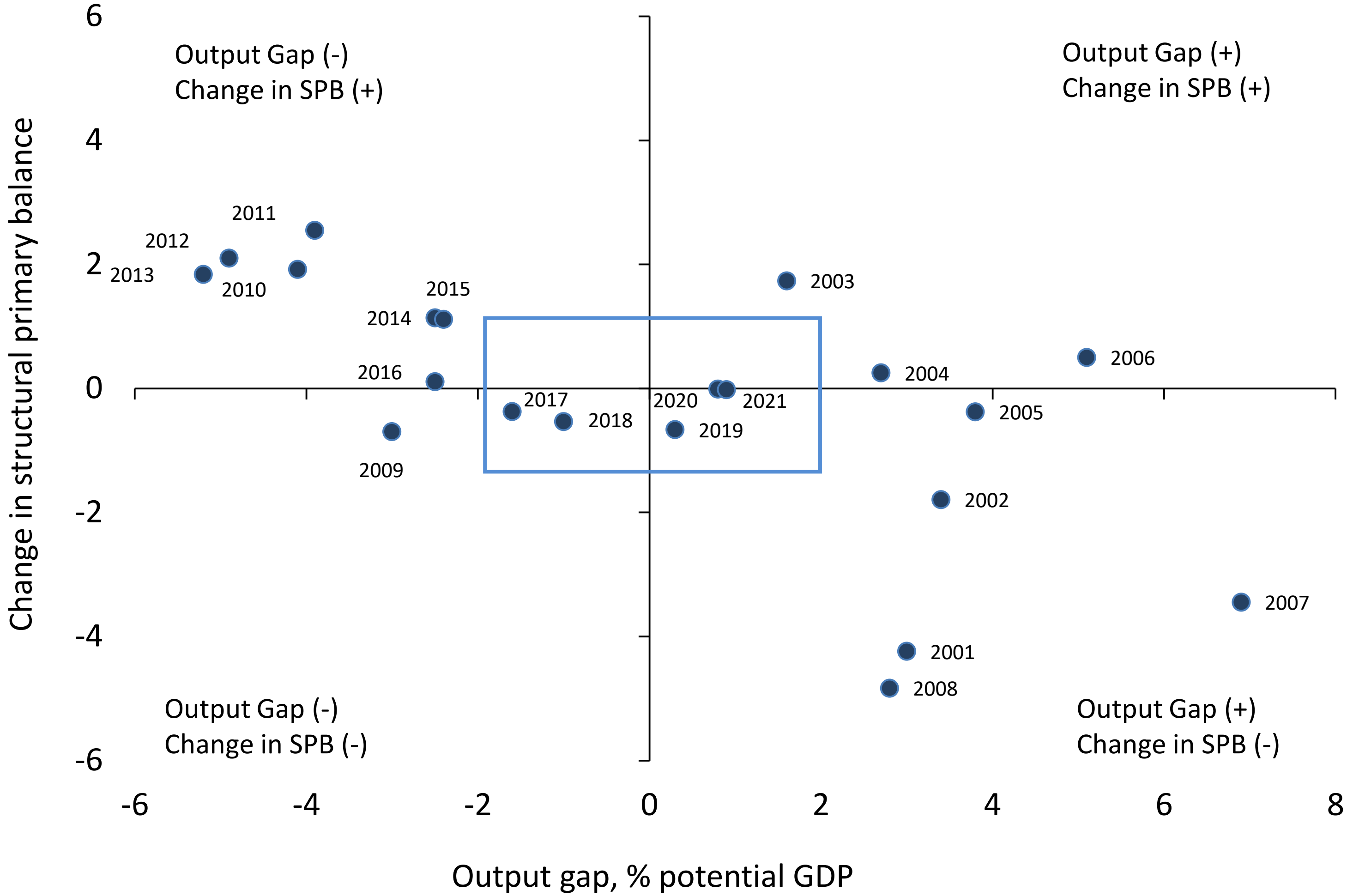
Fiscal Stance and Output Gap 2001-2021

Output gap (% potential GDP) and change in structural primary balance (percentage points) using DoF preferred output gap estimates



Sources: CSO; SPU 2018; and internal IFAC calculations.

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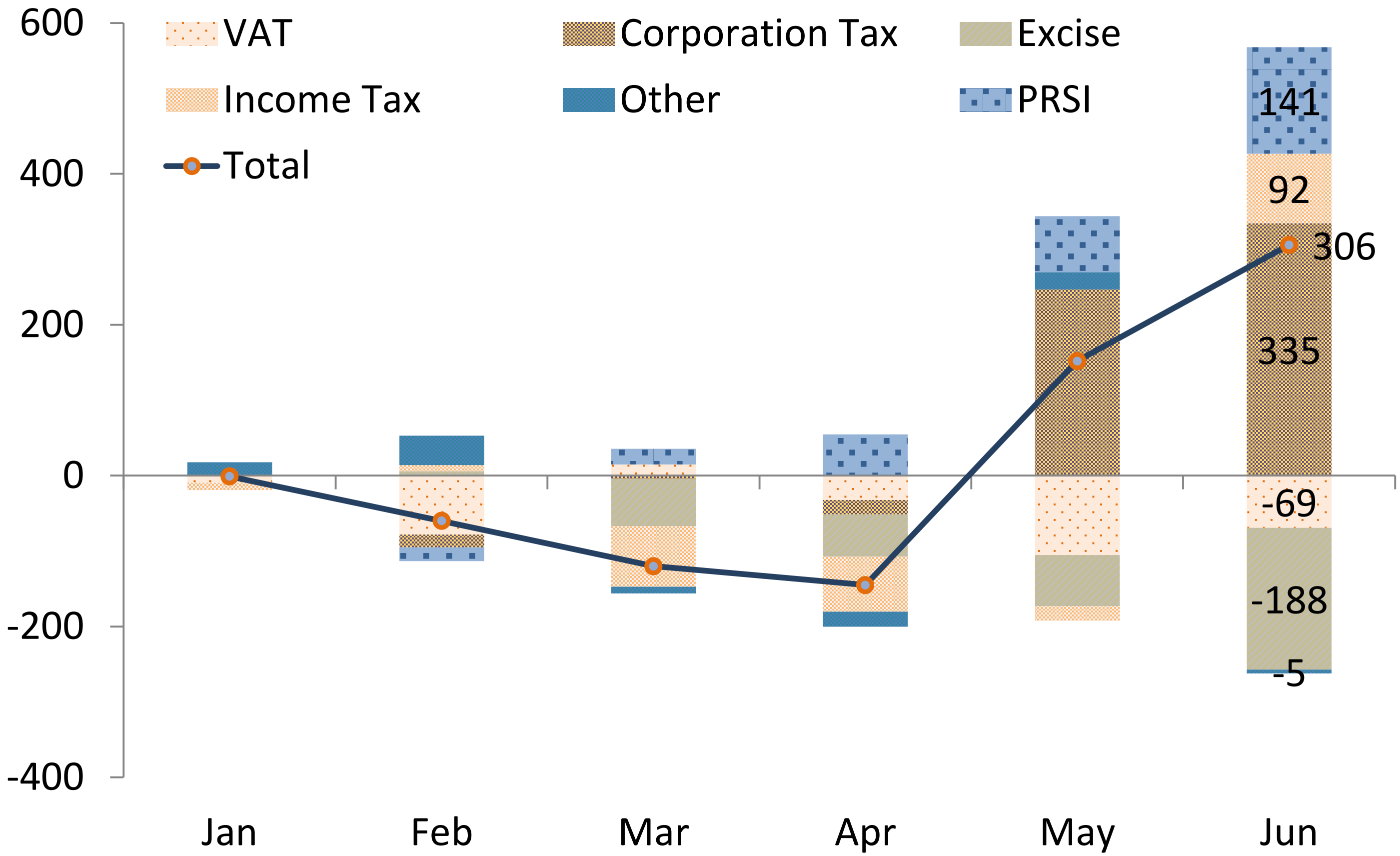
Revenue over-performance in first half of 2018

Performance relative to profile, €million



Sources: Department of Finance; and internal IFAC calculations.
Note: Other Taxes include Stamps, Capital Taxes, Motor Tax and Other.

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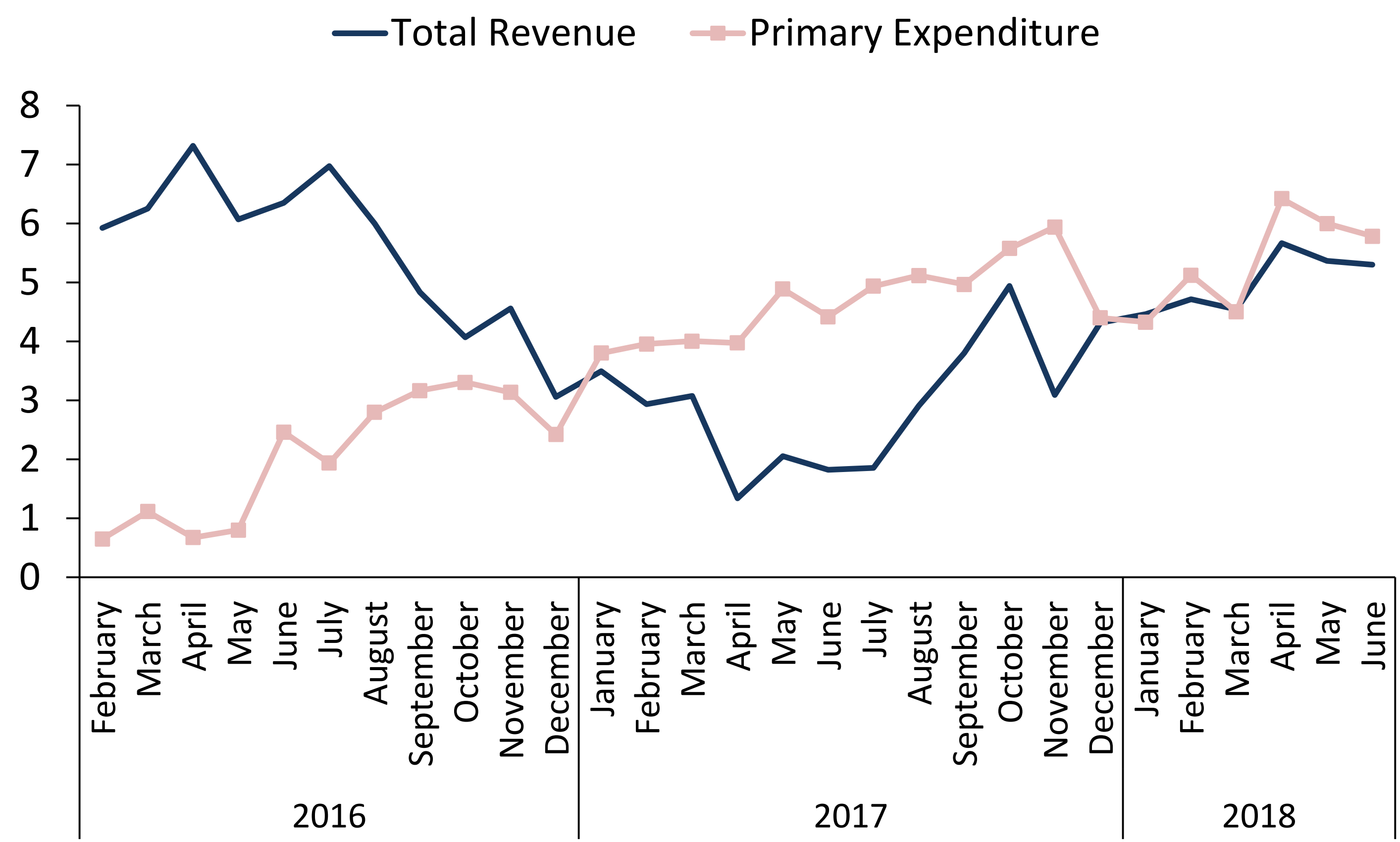
Primary Expenditure and Central Gov't Revenue

% change y/y, 12 month moving sum



Sources: Department of Finance; and internal IFAC calculations.

Fiscal Risks

- Corporation tax concentration risks
- EU climate change and renewable energy targets
- Budgetary pressures (public expectations)
- Spending drift
- Reliance on transient revenues; tax-rich sector activity
- EU Budget contributions

Appropriate Fiscal Stance in 2019

- A sustainable real growth rate for the economy could be the Department's estimate of potential growth for 2019–2021 in SPU 2018, close to 3 per cent per annum.
- Including expected economy-wide inflation of 1.3 per cent for 2019 implies a maximum sustainable growth rate for spending net of tax measures of 4½ per cent.
- This translates into an approximate limit of €3½ billion for spending increases or discretionary tax cuts for Budget 2019.

Appropriate Fiscal Stance in 2019

Estimates of Average Potential Growth 2019-2021 (%)	
IFAC	3.25
ESRI	3.3
DoF (GDP-based alternative)	3.0
Forecasts of Inflation for 2019 (%)	
GDP Deflator	1.3
Core HICP	1.2
HICP	1.0
Reference Rate (%)	
Potential Growth Rate + Inflation	c.4.5

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Appropriate Fiscal Stance in 2019

Expenditure Calculations (€ billion)	
Total General Government Expenditure in 2018	**80.1**
Less Interest Expenditure	-5.3
Less EU co-financed current spending	-0.5
Less Public Gross Fixed Capital Formation	-6.8
Plus four-year average of Public GFCF	+5.5
Less Cyclical Unemployment Expenditure	-0.2
Less One-Off Expenditure Items	-0.0
Corrected Expenditure Aggregate	**73.2**
Multiplied by Reference Rate of 4.5%	3.4

The appropriate fiscal stance for 2019 would allow for net budgetary measures of up to €3.5 billion to be introduced.

Commitments have already been made for measures that sum to approximately two-thirds of this amount.

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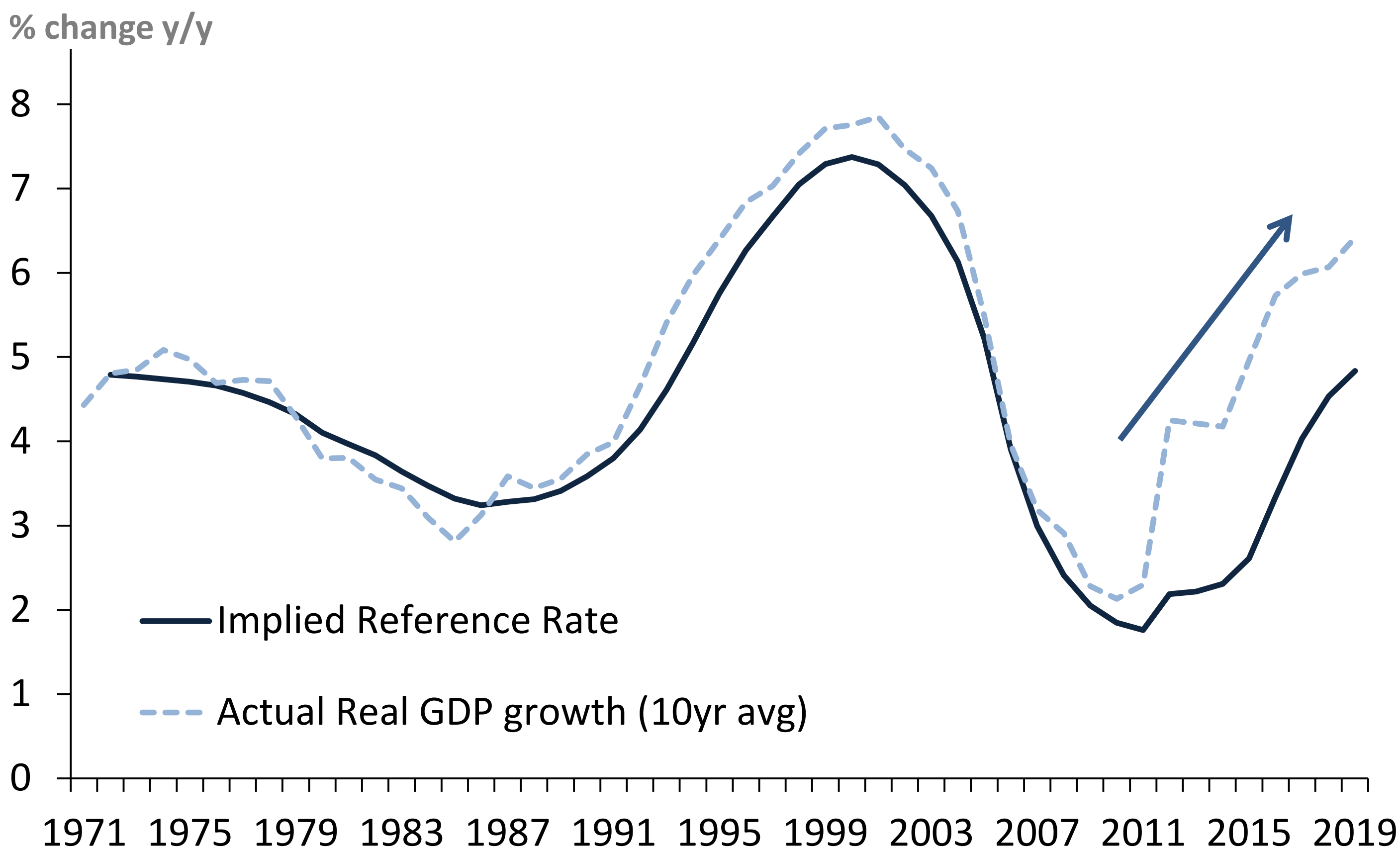
Rainy Day Fund

- A recent working paper by members of the IFAC secretariat shows how a truly countercyclical Rainy Day Fund could work with modest changes to the fiscal rules.
- It explores how such funds can be used
  - (i) to address procyclical bias in measurements of the cycle, which underpin the EU fiscal rules; and
  - (ii) to enhance the scope for fiscal stimulus in future downturns while also making it more desirable to set aside savings in good times.

The speed limits for government spending are rising as the economy grows fast

Procyclicality of Allowed Real Spending Growth (Reference Rates) under the Fiscal Rules



Sources: European Commission (Autumn 2017 estimates); own workings.
Note: Data show the implied Reference Rates based on ten-year averages of the estimated potential output growth rates, which are derived using the commonly agreed methodology.

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Additional Slides

Impact of a large, foreign-owned multinational firm exiting Ireland

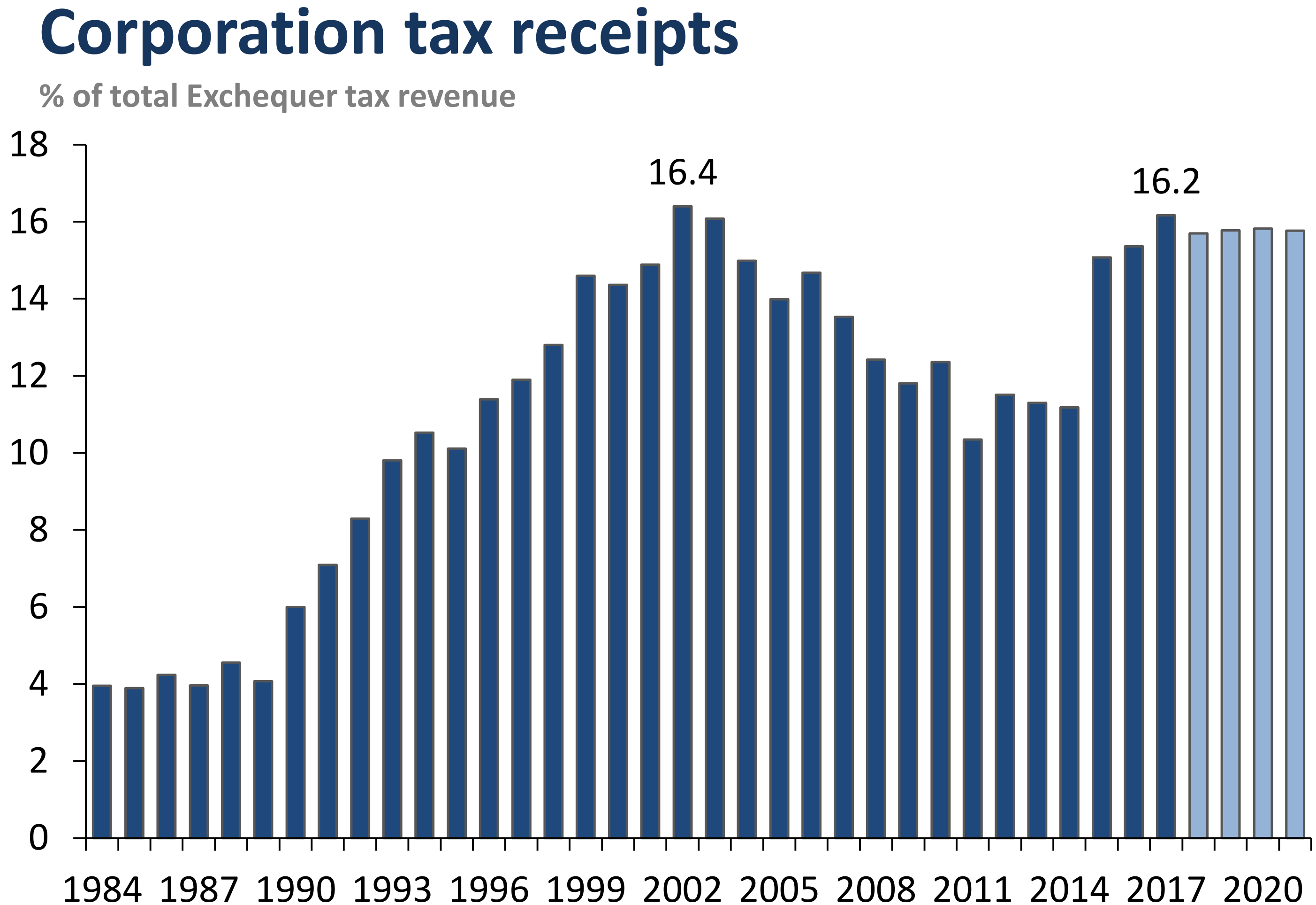
- IFAC's June Fiscal Assessment Report highlights how corporation tax receipts would be particularly vulnerable to an exit of a large, foreign-owned multinational firm.
- This reflects the high concentration of payments among the top ten contributing firms.
- Corporation tax receipts are forecast to remain at record high levels and near their peak share of Exchequer taxes.

Taxes, Earnings and Economic Activity

€ million unless stated

	Total in 2016	Stylised Large Firm[a]	Large Firm Share (per cent of Total)
Taxes and Earnings			
Corporation Tax	7,353	276	3.7
Employee Taxes/PRSI	15,997	62	0.4
Employee Net Earnings	30,419	79	0.3
Economic Activity			
Gross Value Added	255,294	4,975	1.9
Employment (thousands)	2,133	2	0.1

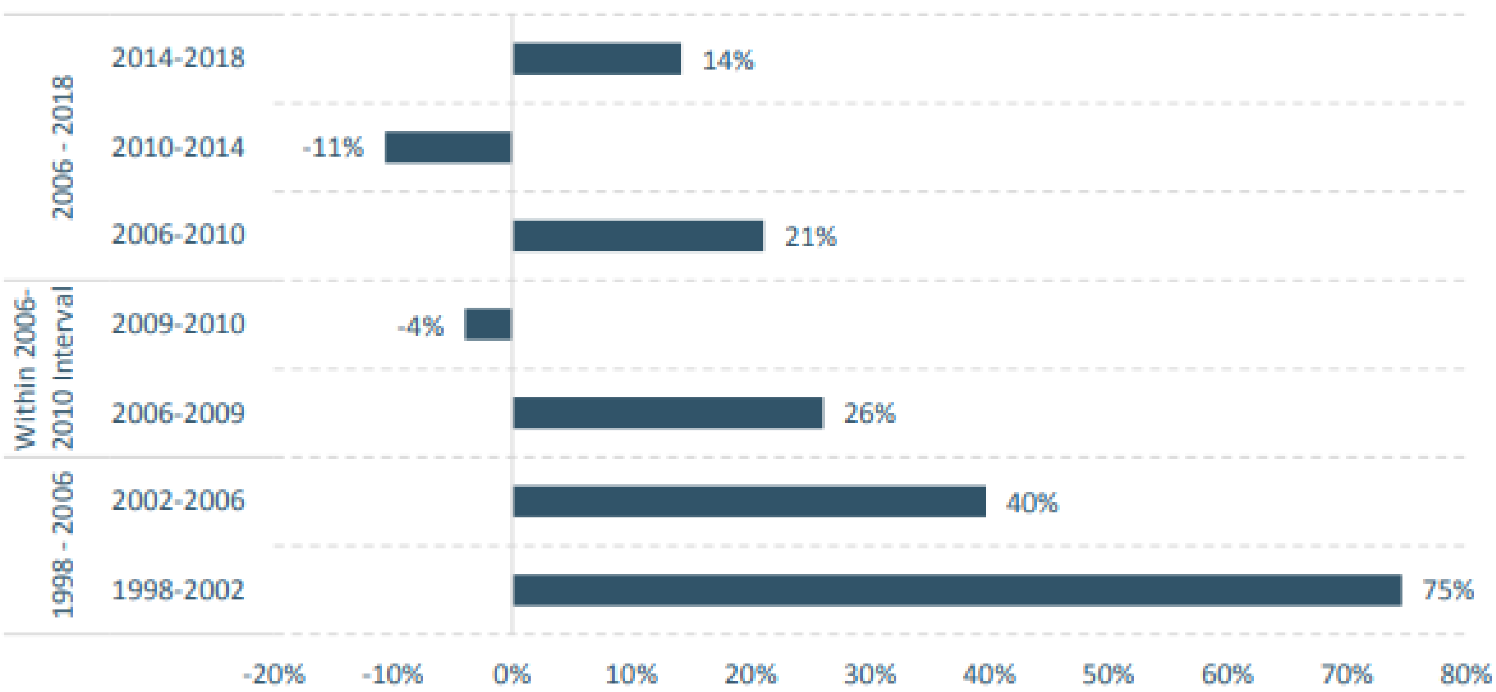
Sources: CSO; Revenue Commissioners; and internal IFAC calculations.
Notes: [a]The direct impacts of a typical large foreign-owned multinational firm on GVA, employment and employee taxes/PRSI and net earnings are estimated using the relative size of corporation tax payments for a top-ten firm compared to a top 96 foreign-owned firm ranked by corporate tax payments made in 2016.



Sources: Department of Finance; and internal IFAC calculations.
Notes: Dark bars show outturns for 1984–2017; light bars show *SPU 2018* forecasts for 2018–2021.

Fiscal Context:

Figure 7: expenditure growth 1998 - 2018 by interval

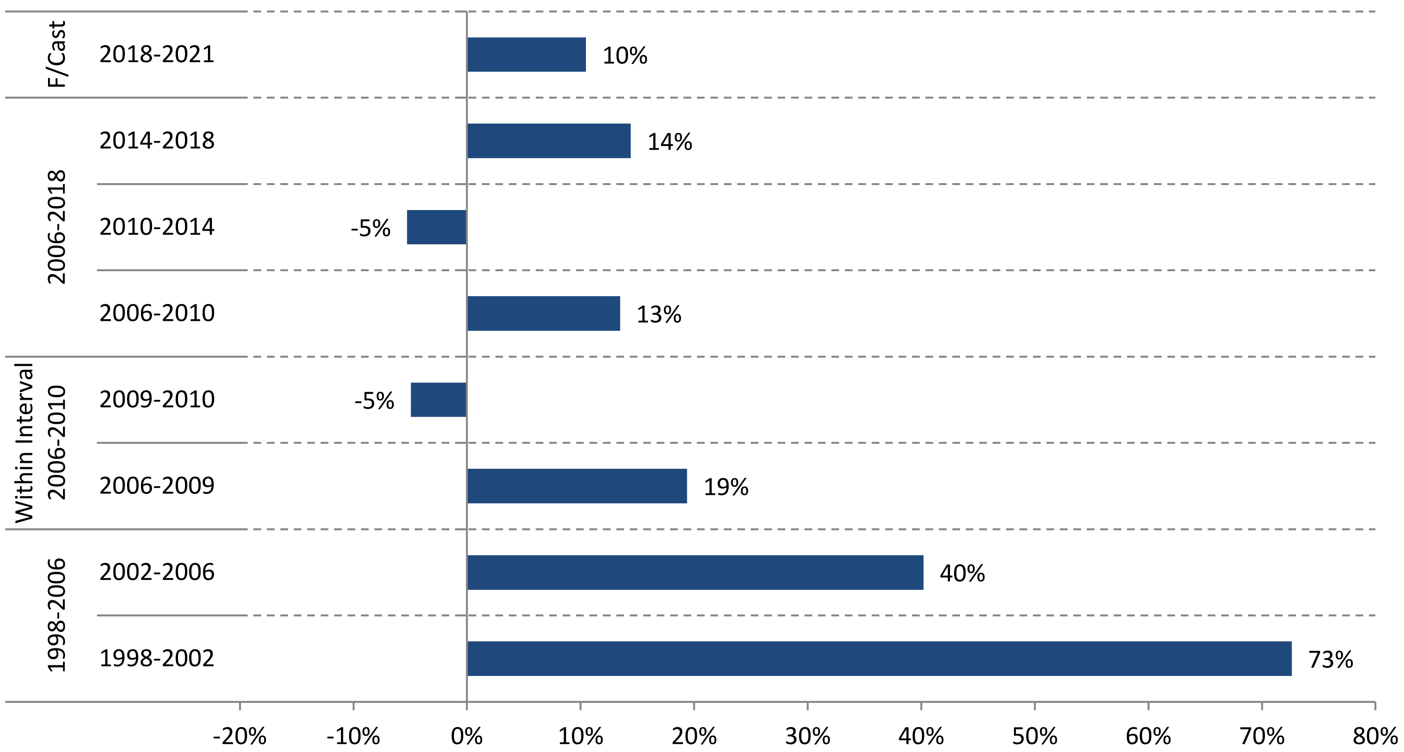


Source: DPER databank

Expenditure Growth

Total Expenditure net of one-offs less Interest

% change



Sources: CSO; SPU 2018; and internal IFAC calculations.
Notes: One-off items used are those assessed as applicable by IFAC.

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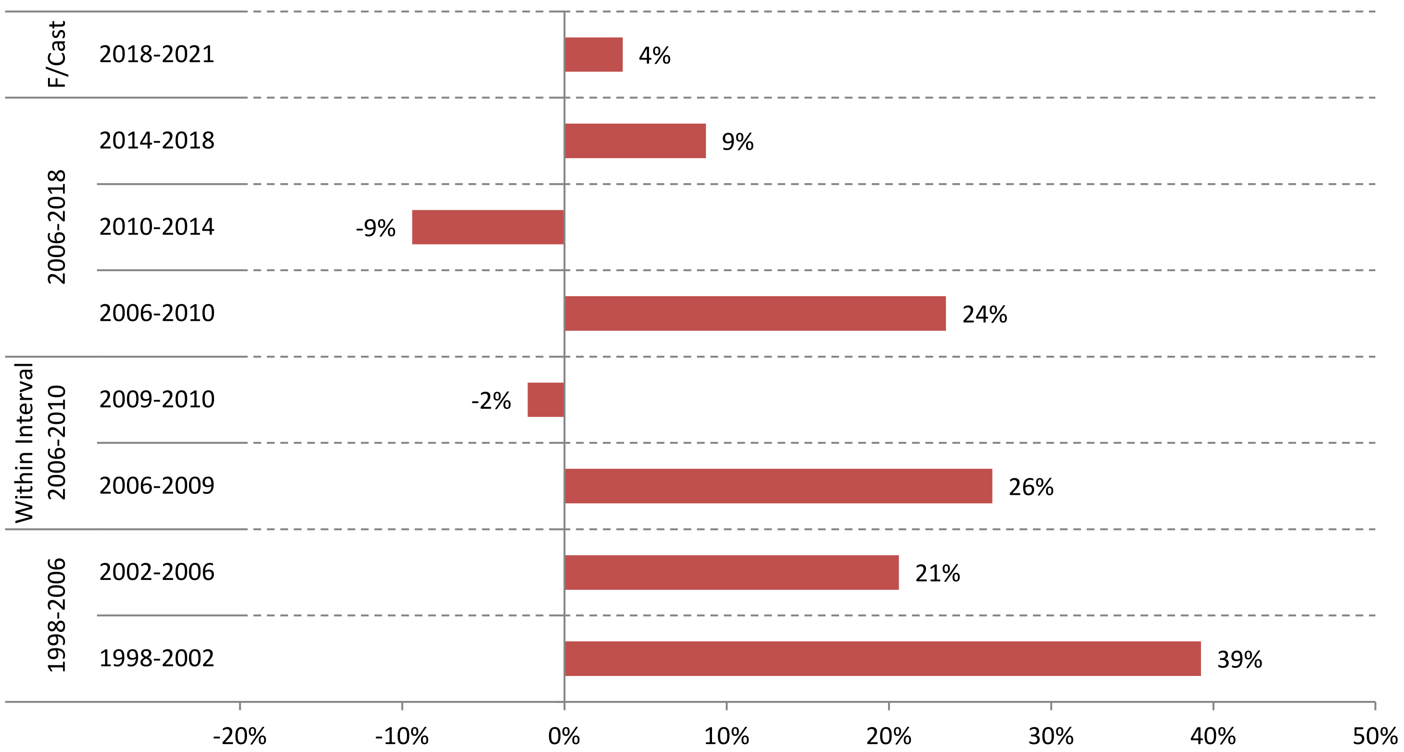
Real Total Expenditure net of one-offs less Interest

Using underlying domestic demand deflator, % change



Sources: CSO; SPU 2018; and internal IFAC calculations.
Notes: One-off items used are those assessed as applicable by IFAC.

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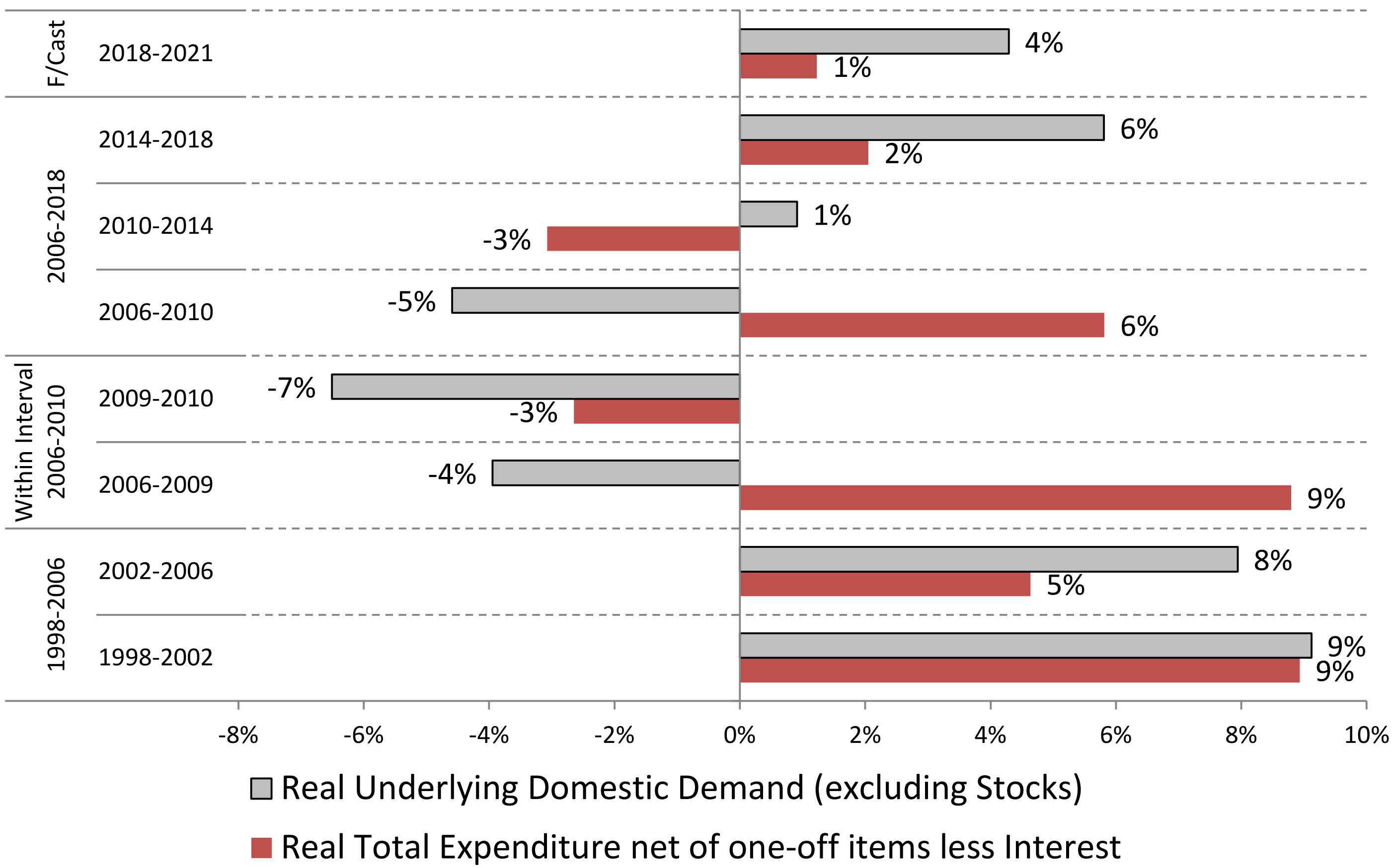
Comparing with Underlying Domestic Demand

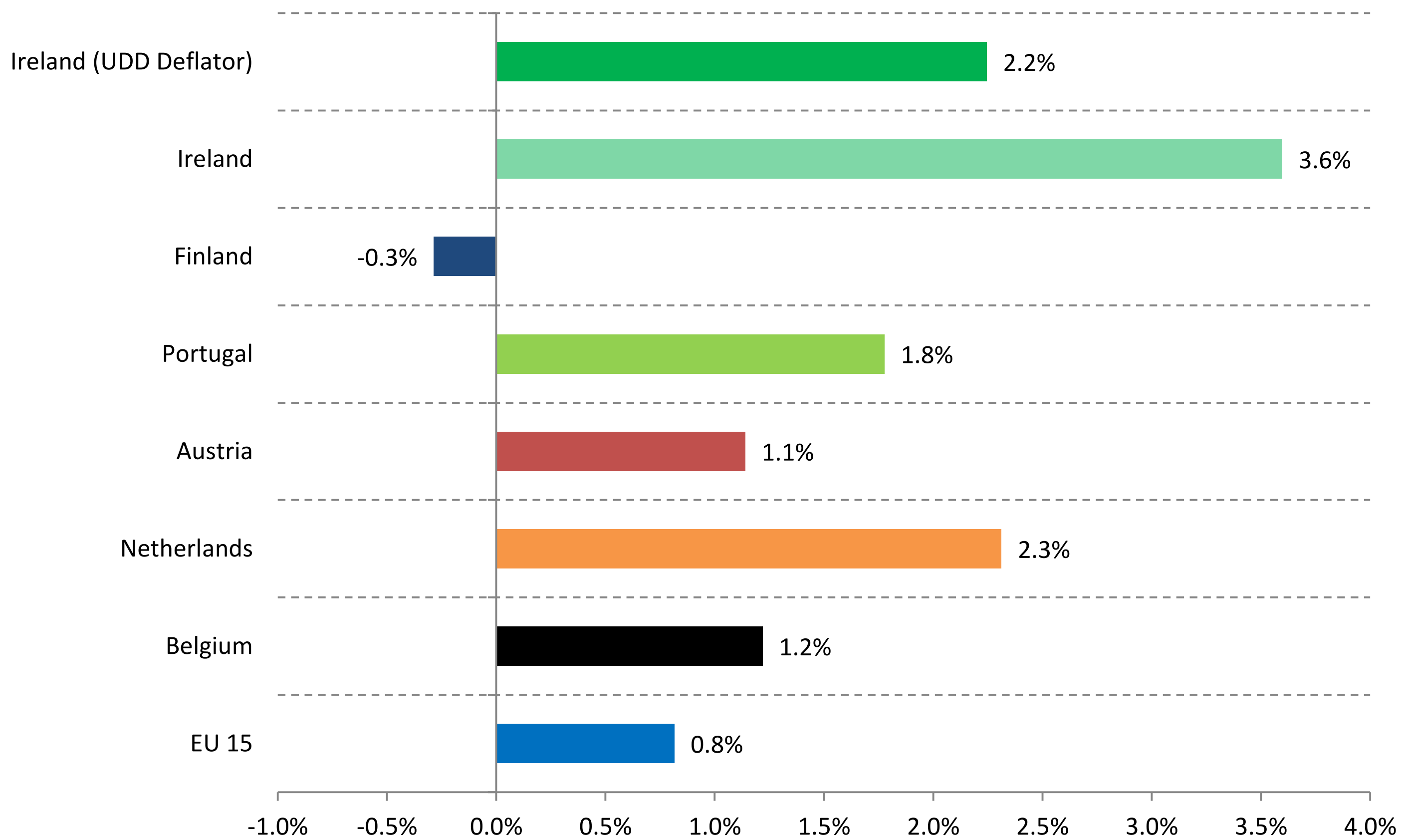
Average % change y/y



Sources: CSO; SPU 2018; and internal IFAC calculations.
Notes: One-off items used are those assessed as applicable by IFAC.

Real Primary Expenditure Growth, 2016-2019

Using GDP deflator (unless stated), average % change y/y



Sources: AMECO; CSO; and internal IFAC calculations.