Irish Fiscal Advisory Council

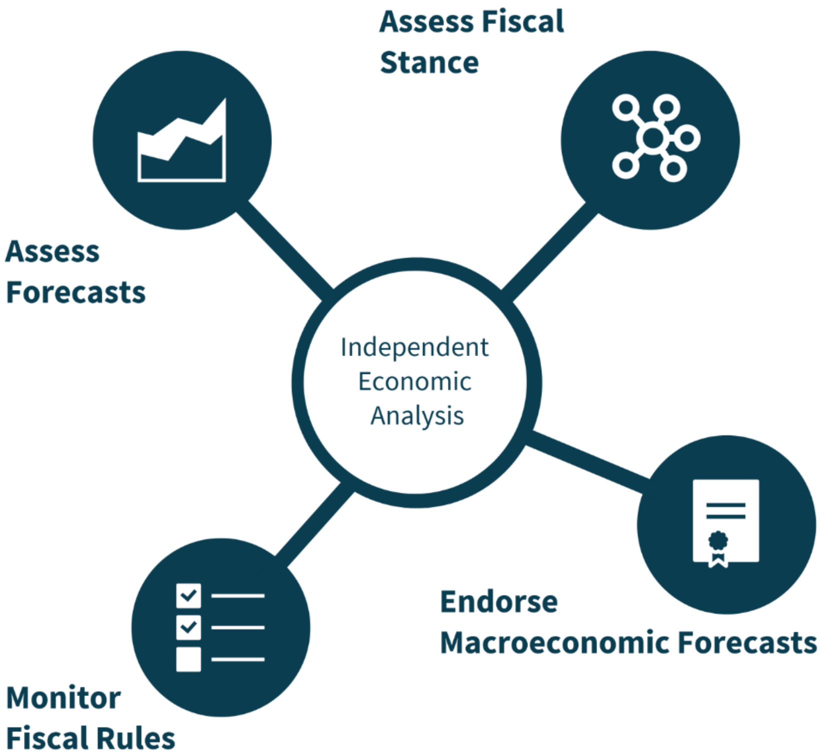
FISCAL ASSESSMENT REPORT

The Fiscal Impact of Covid-19

26 May 2020

Fiscal Assessment Report

- The Fiscal Council is an official independent body with a mandate to assess the public finances
- The Fiscal Assessment Report (FAR) assesses official forecasts, compliance with fiscal rules and appropriateness of fiscal stance
- **This FAR develops 3 scenarios to 2025** to help assess today's fiscal decisions
- It assesses SPU 2020
- We are also publishing today the annual *Assessment of Compliance with the Domestic Budgetary Rule*



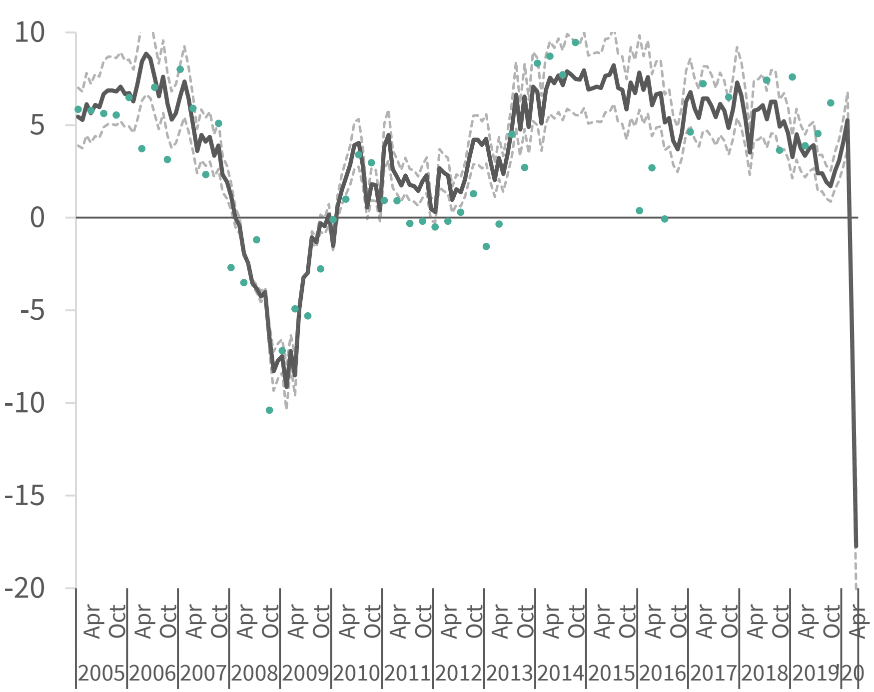
Key messages

- Covid-19 crisis will result in a deep economic downturn in 2020H1 with a lasting effect
- Uncertainty is exceptionally high
- Large-scale policy supports so far are appropriate to tackle the immediate crisis
- During the recovery phase, fiscal stimulus would be warranted
- Some fiscal adjustment is likely to be needed in the new steady-state, but severe austerity can be avoided
- Decisions will need to be made about tax and spending priorities
- Strengthening the fiscal framework would help

Covid-19 has had a major negative impact on activity and employment

Implied real GDP growth

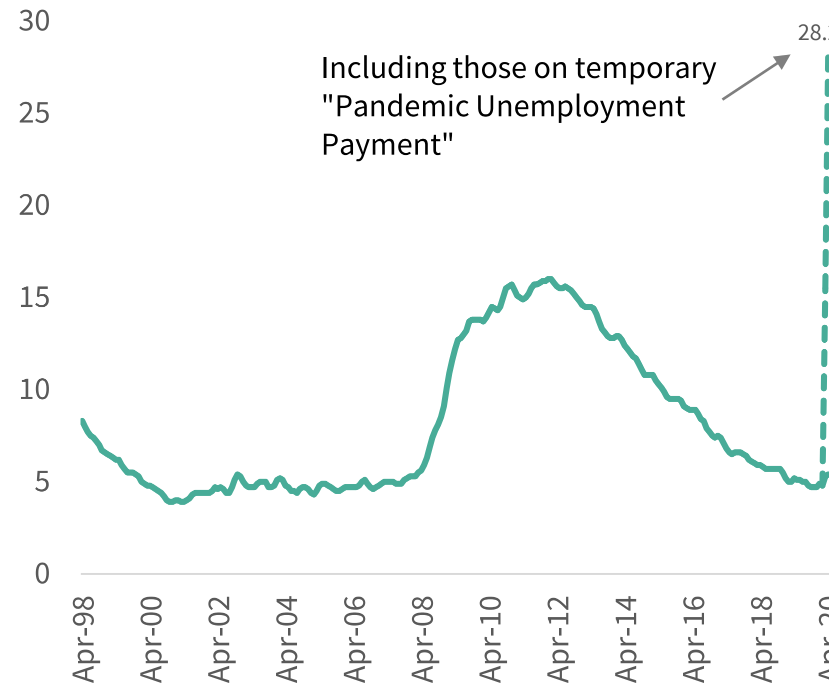
% y/y



Sources: IHS Markit; and Fiscal Council workings.
Notes: Notes: Based on historical relationship between real GDP growth and composite PMI data for Ireland. 95% confidence interval shown. Historical real GDP growth for quarters shown by green dots.

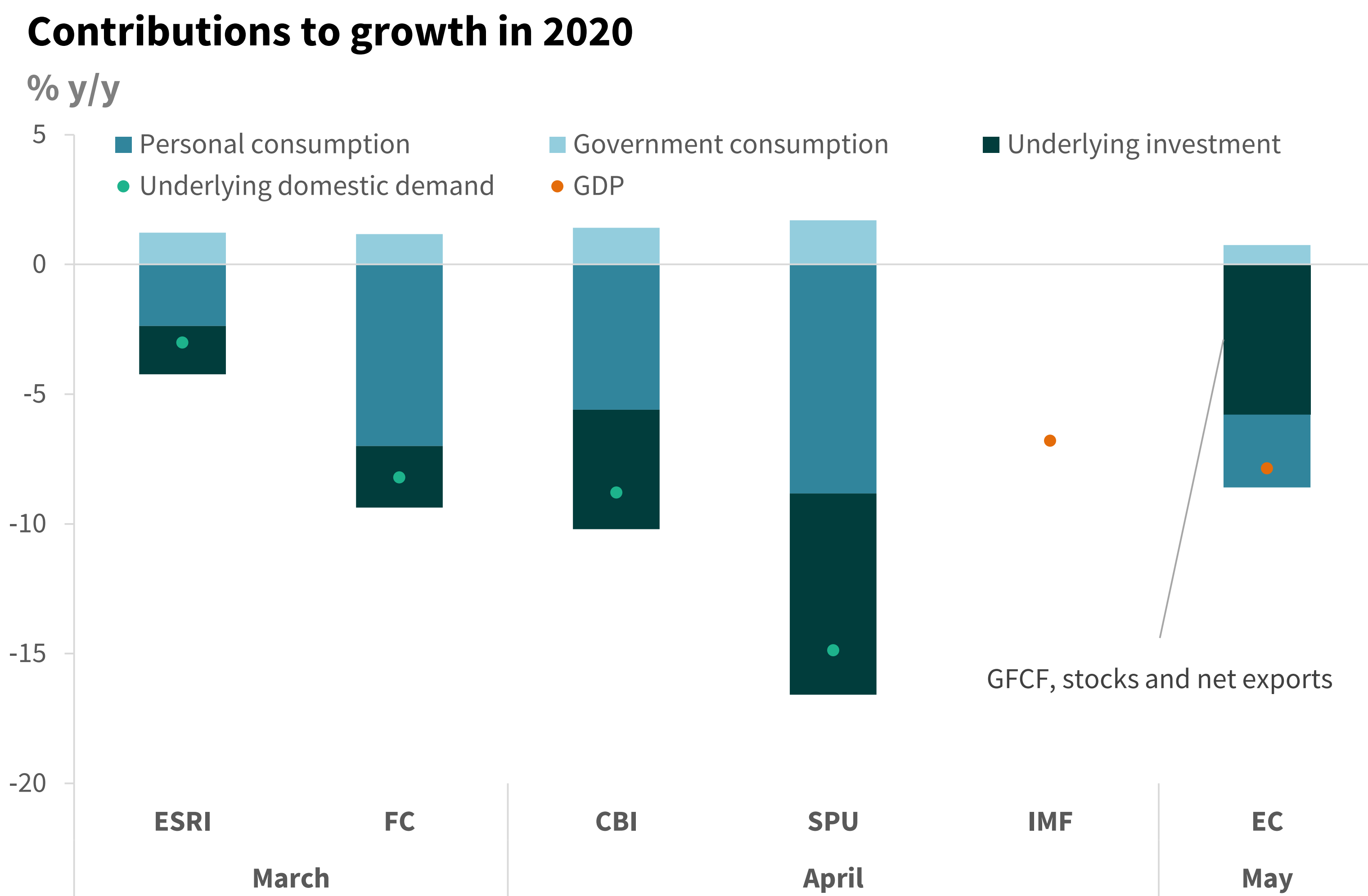
Unemployment

% labour force



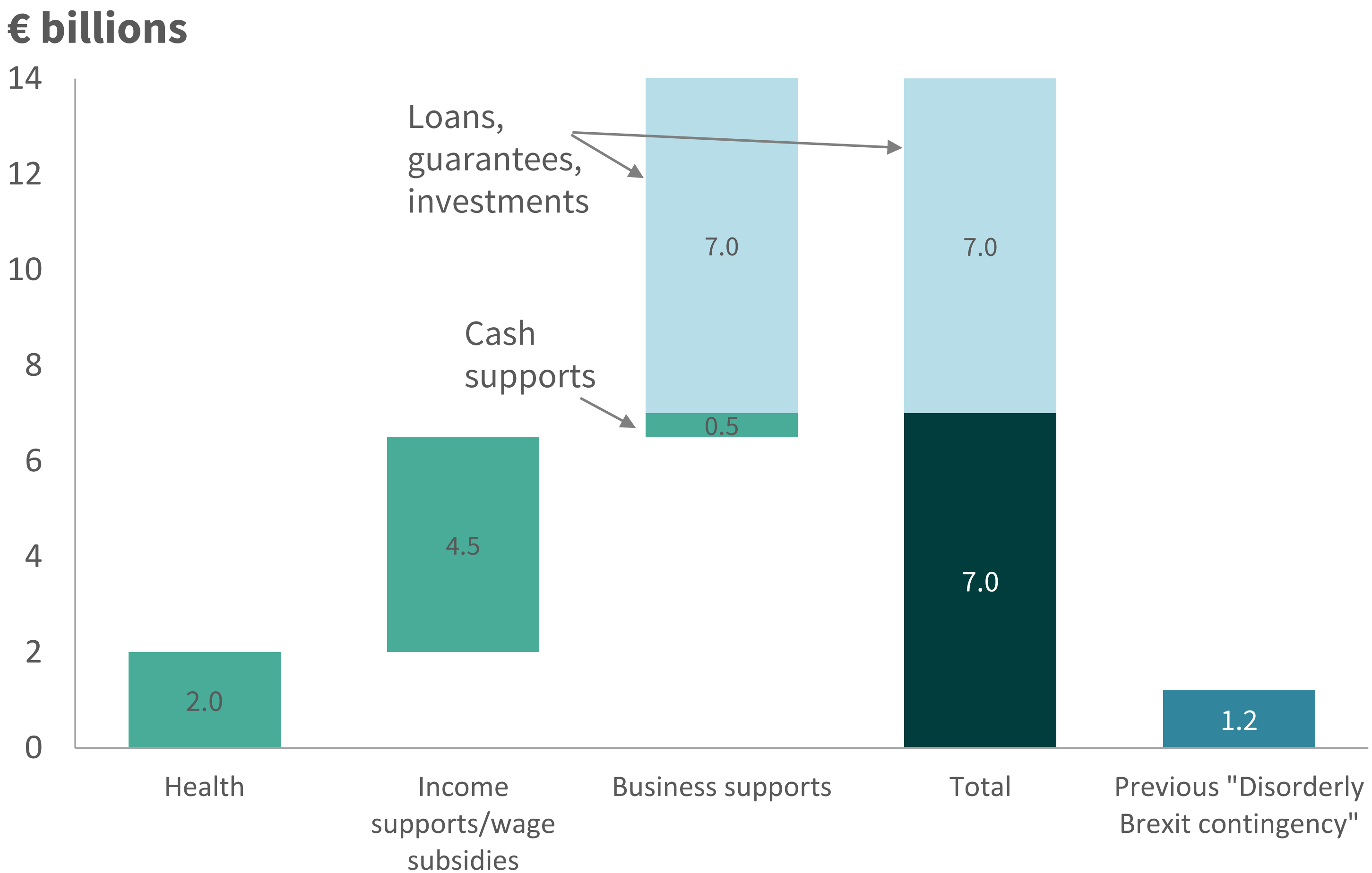
Sources: CSO.

Consumption, investment and trade will be sharply lower



Sources: Economic and Social Research Institute (ESRI), *Quarterly Economic Commentary, Spring 2020*; Central Bank of Ireland (CBI), *Quarterly Bulletin No 2 2020*; Department of Finance (SPU), *SPU 2020*; International Monetary Fund (IMF), *World Economic Outlook, April 2020*; European Commission (EC), *European Economic Forecast, Spring 2020*; and Fiscal Council (FC) workings.
Note: For the *Spring 2020* QEC, the forecast change in modified investment for 2020 is taken as equal to the change in underlying investment.

Large-scale policy measures have been deployed

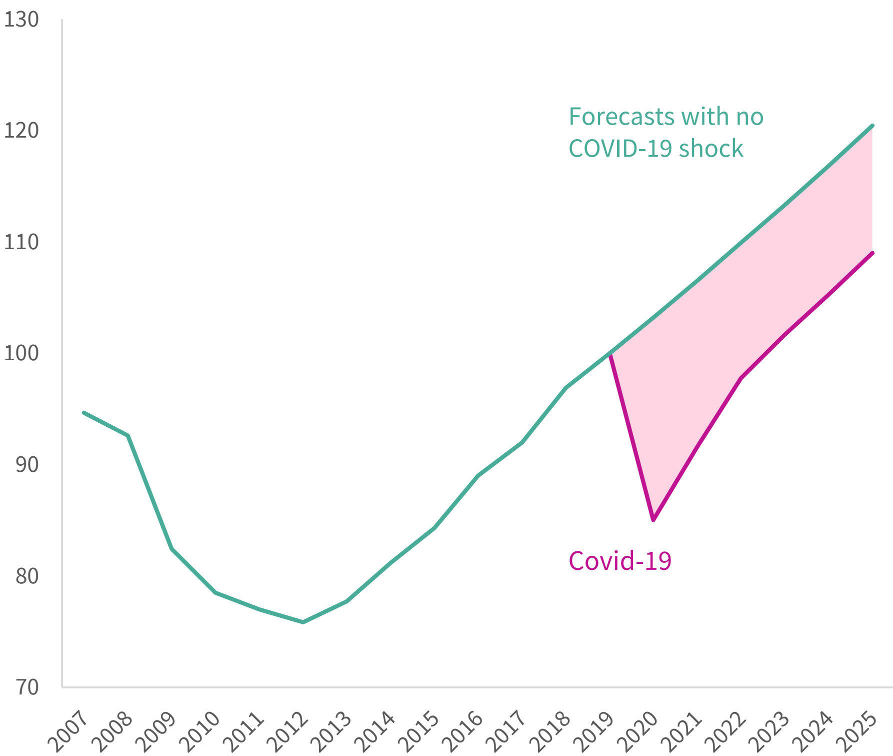


Sources: Department of Finance; and Fiscal Council workings.
Note: The previously planned "Disorderly Brexit Contingency" for 2020 was set out in Budget 2020, when the official forecasts assumed a disorderly Brexit for this year. It comprised about €650 million for the worst-hit sectors; about €450 million for employment supports; and the remainder for compliance checks and infrastructure costs (Box H, November 2019 Fiscal Assessment Report). Note that €0.75 billion of the €14 billion shown is repurposed expenditure previously outlined for 2020 so that the total new supports equate to €13.3 billion.

Covid-19 will nevertheless have a lasting impact, but Ireland is in better shape than in 2008

Underlying domestic demand

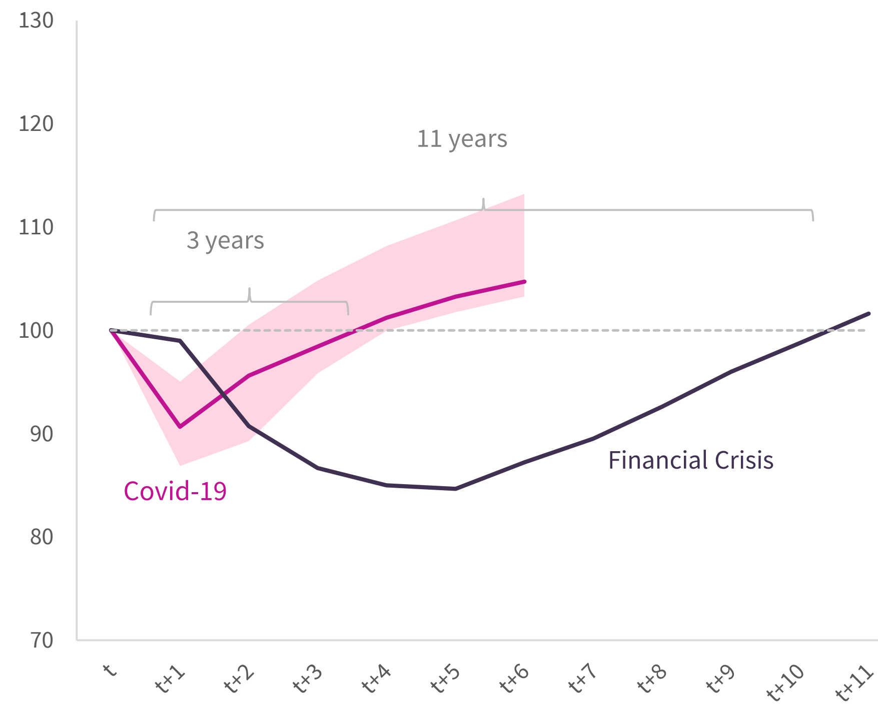
Index: 2019 = 100



Sources: Department of Finance; and Fiscal Council workings.
Note: Underlying domestic demand comprises consumer spending, government consumption, and investment spending (excluding planes and intangibles). The Covid-19 scenario is the Central scenario outlined in Box D. It is based on an extended version of the official SPU 2020 forecasts.

Employment

Index: 2019 = 100; 2007 = 100



Sources: Department of Finance; and Fiscal Council workings.
Note: We set t = 2007 for the financial crisis and t=2019 for the Covid-19 shock. The Covid-19 scenario is the Central scenario outlined in Box D. It is based on an extended version of the official SPU 2020 forecasts.

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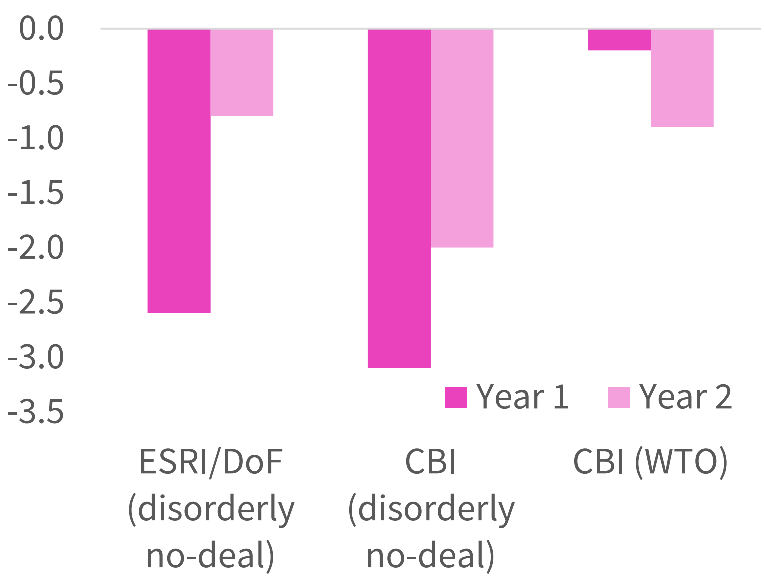
Uncertainty is high

The main risks are around Covid-19 health outcomes and their economic impact

Other risks include hard Brexit, changes in international tax

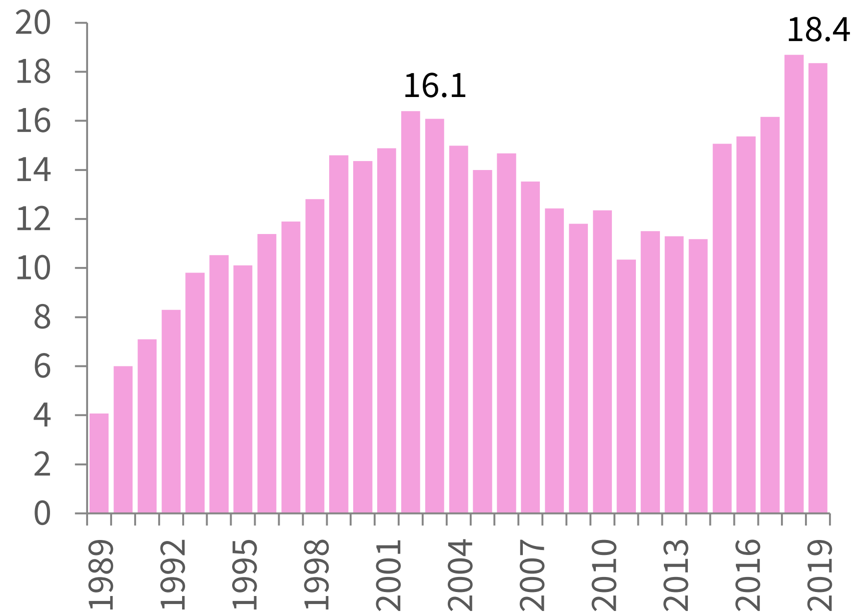
Real GDP growth

Percentage point impact on annual growth rates



Corporation tax

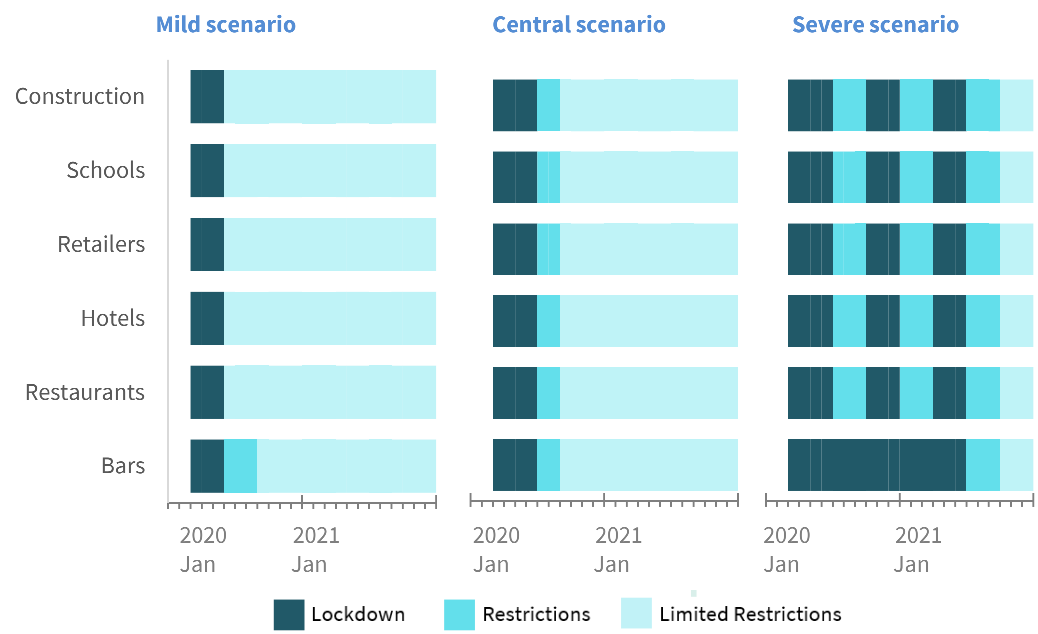
% of total Exchequer tax revenue



Sources: Department of Finance; ESRI; and Central Bank.
Note: Impacts are approximate and are based on difference between a “no Brexit” scenario and respective scenario shown.

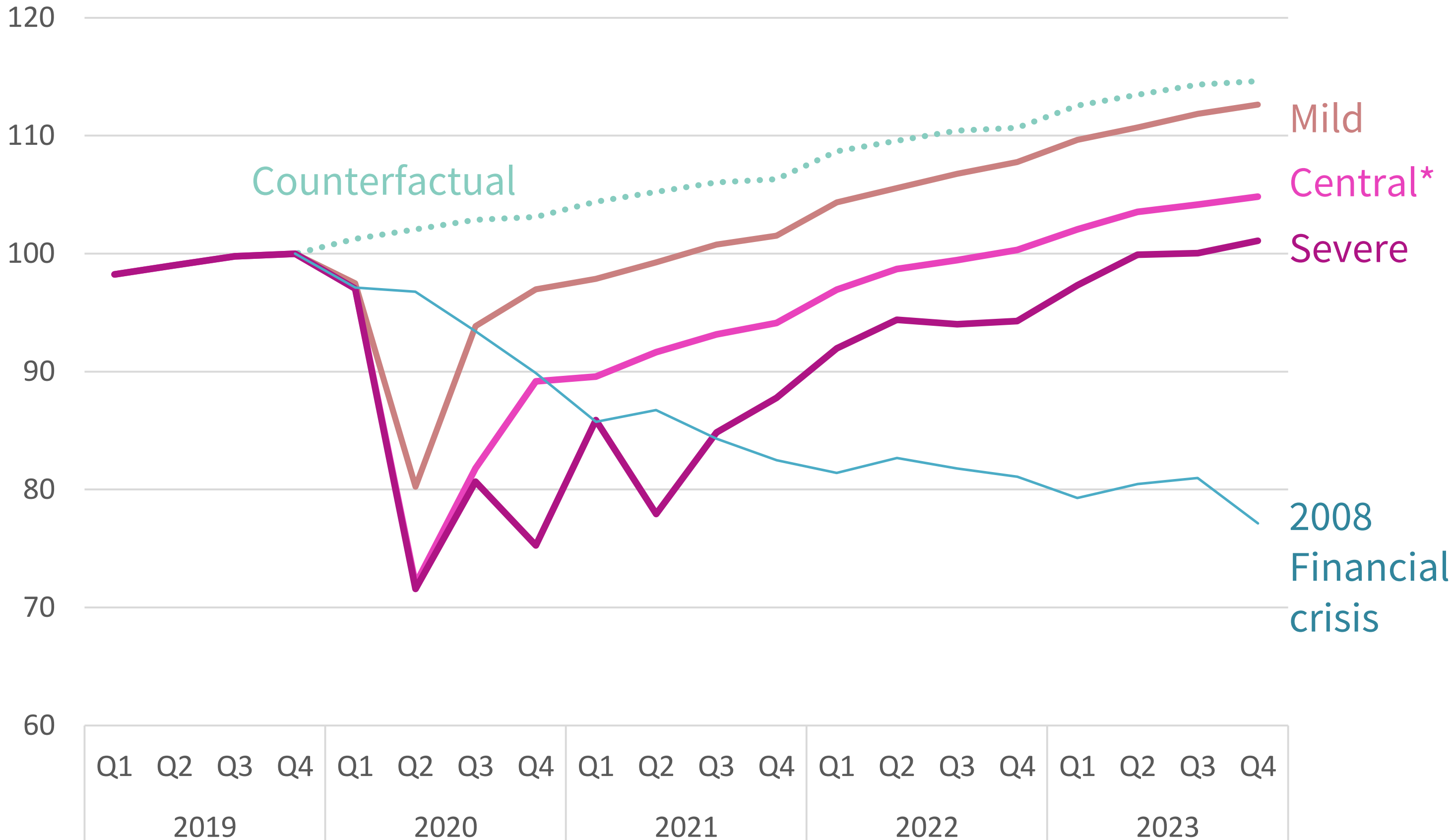
Three scenarios to 2025

Scenario	Description
Mild	Faster recovery. More successful containment measures, economic supports, and progress on treatments.
Central	Extended *SPU 2020* forecasts. Assume a sharp contraction in Q2 2020, followed by a very protracted recovery.
Severe	Protracted recovery marred by repeat lockdowns and wider financial distress.



The range of economic paths to 2025 is very wide

Underlying domestic demand (Index: Q4 2019 = 100)



Sources: Department of Finance; and Fiscal Council workings.
Note: * The Central forecasts are a replica of the official Department of Finance projections published in SPU 2020 (see Box D of the FAR).

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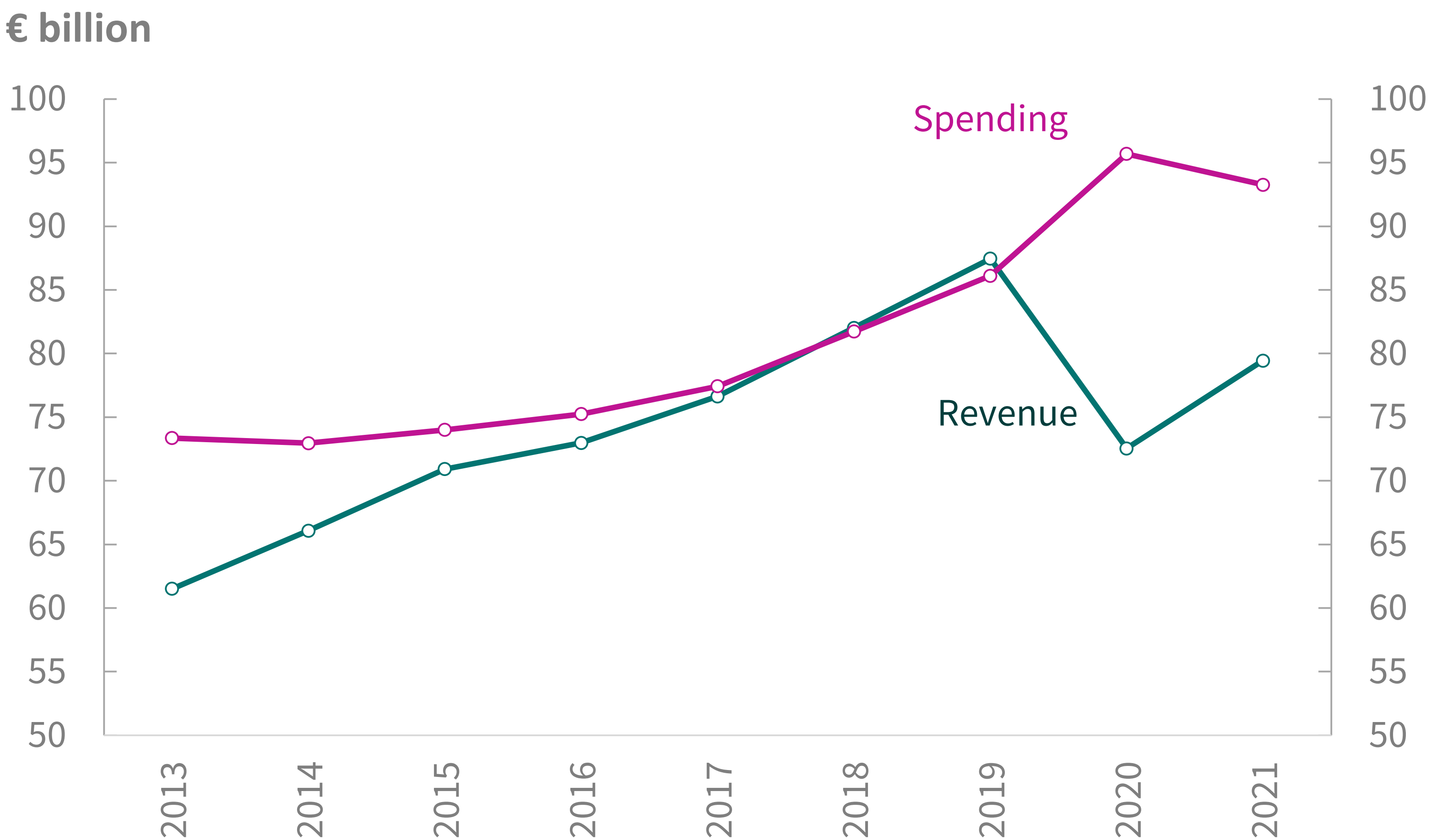
Spending will increase significantly and revenue will fall sharply

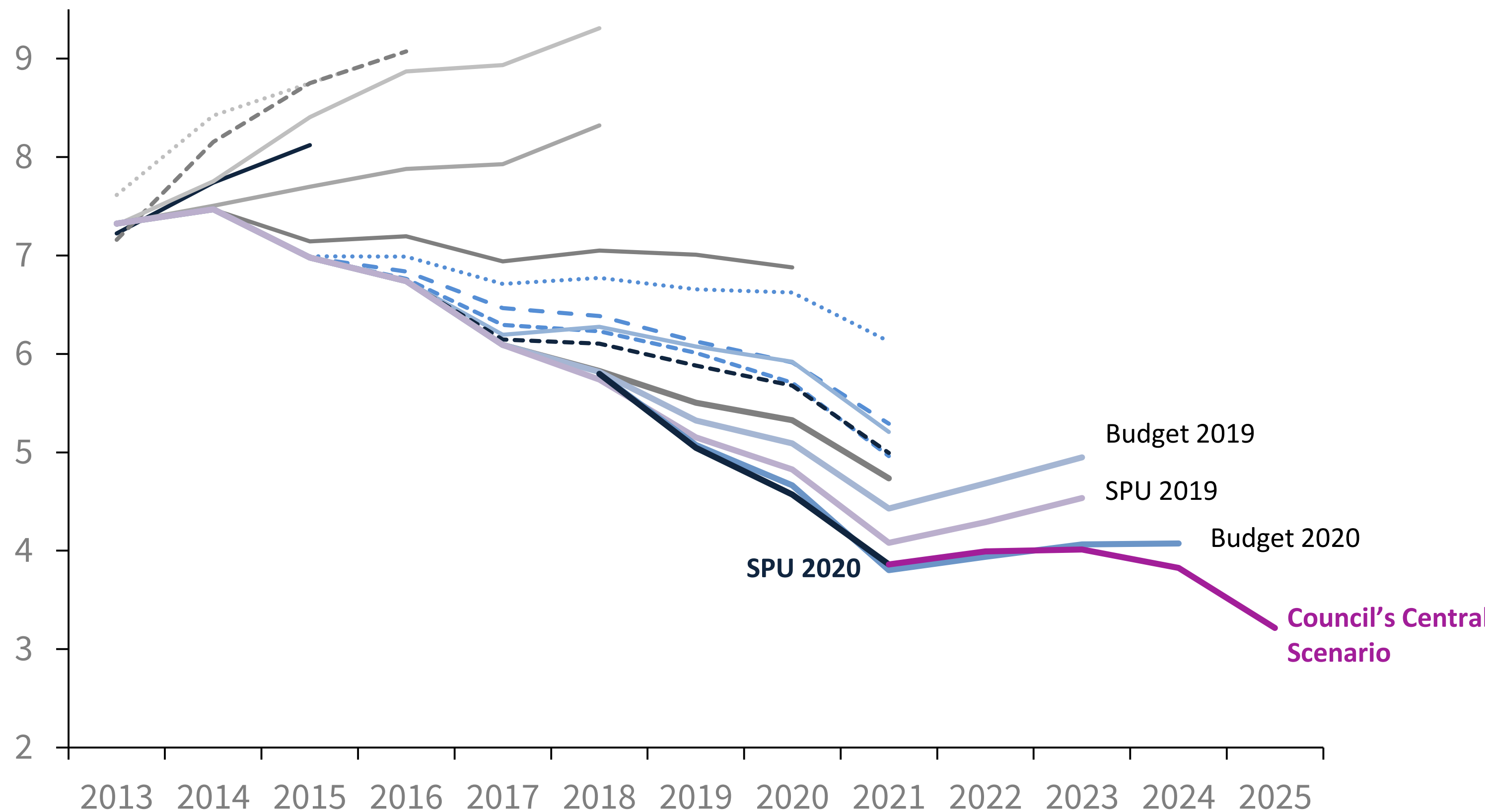


Sources: Department of Finance; and Fiscal Council workings.
Note: Figures exclude one-offs and are on a general government basis.

But, falling interest rates will help to finance higher debt

Interest payments

€ billions, general government basis



Sources: Department of Finance.

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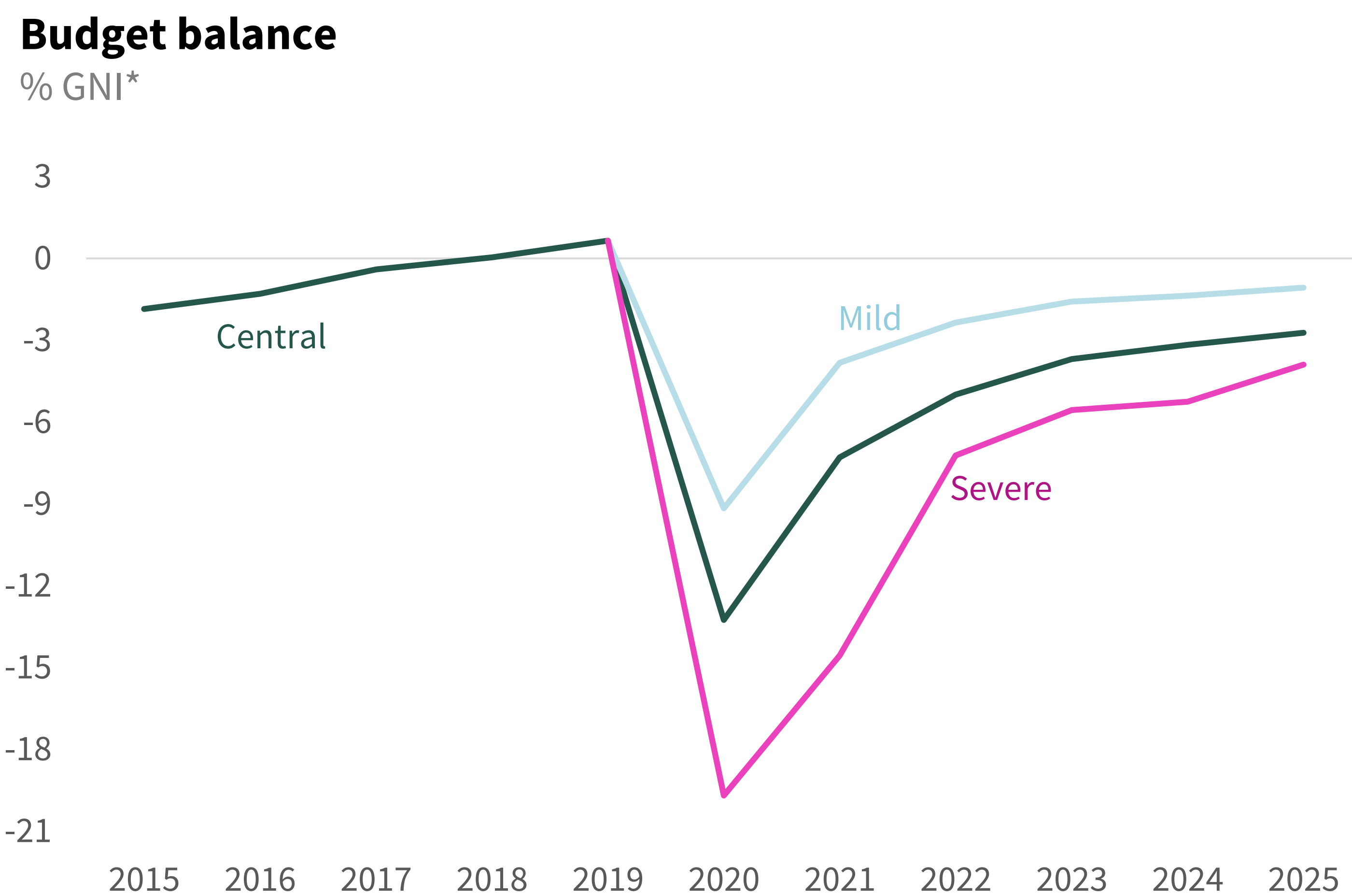
In all scenarios, the deficit will widen and would remain significant by 2025



Sources: *SPU 2020* and Fiscal Council workings.

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The appropriate fiscal stance for the coming years will depend on how the crisis evolves

Phase 1
- Immediate crisis

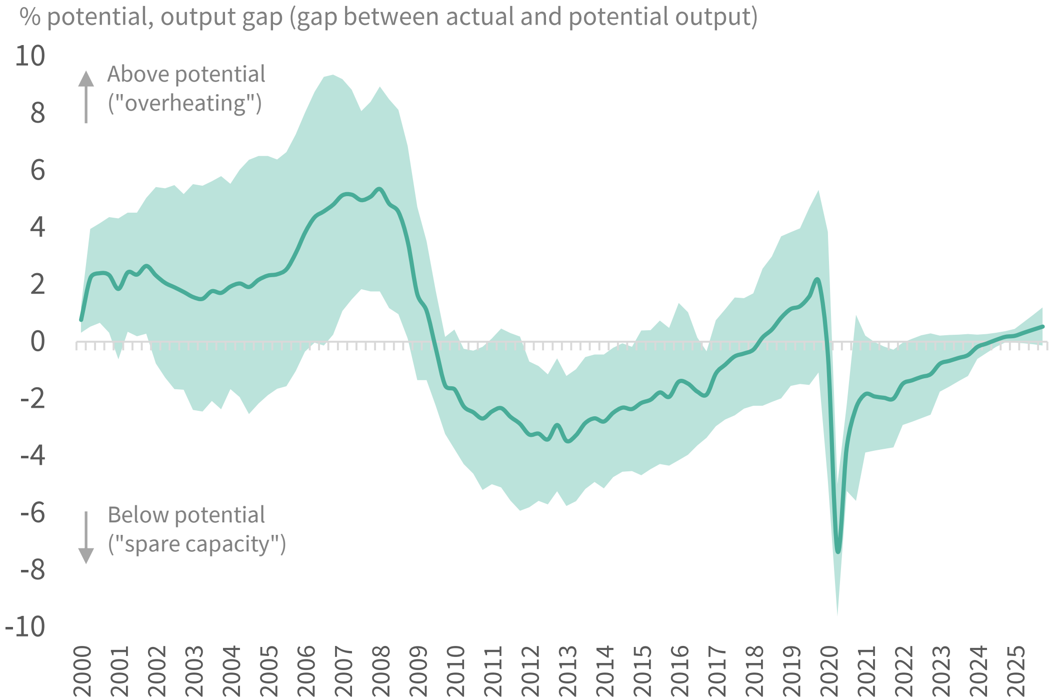
Phase 2
- Recovery

Phase 3
- New steady state

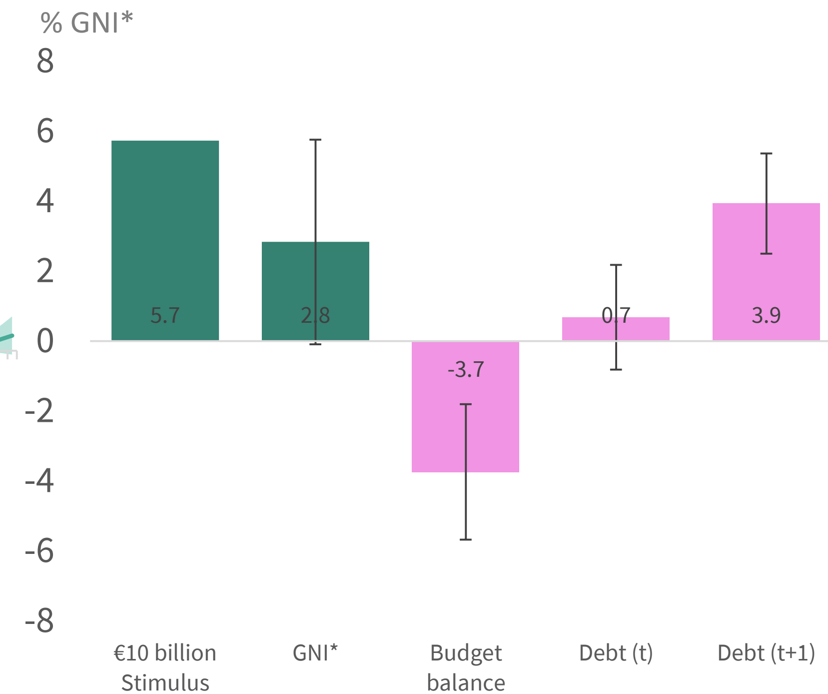
Actions so far to tackle the immediate economic crisis has been appropriate

Support should remain in place as long as needed, although measures may need to evolve

During the recovery phase, a sizeable fiscal stimulus would help support activity



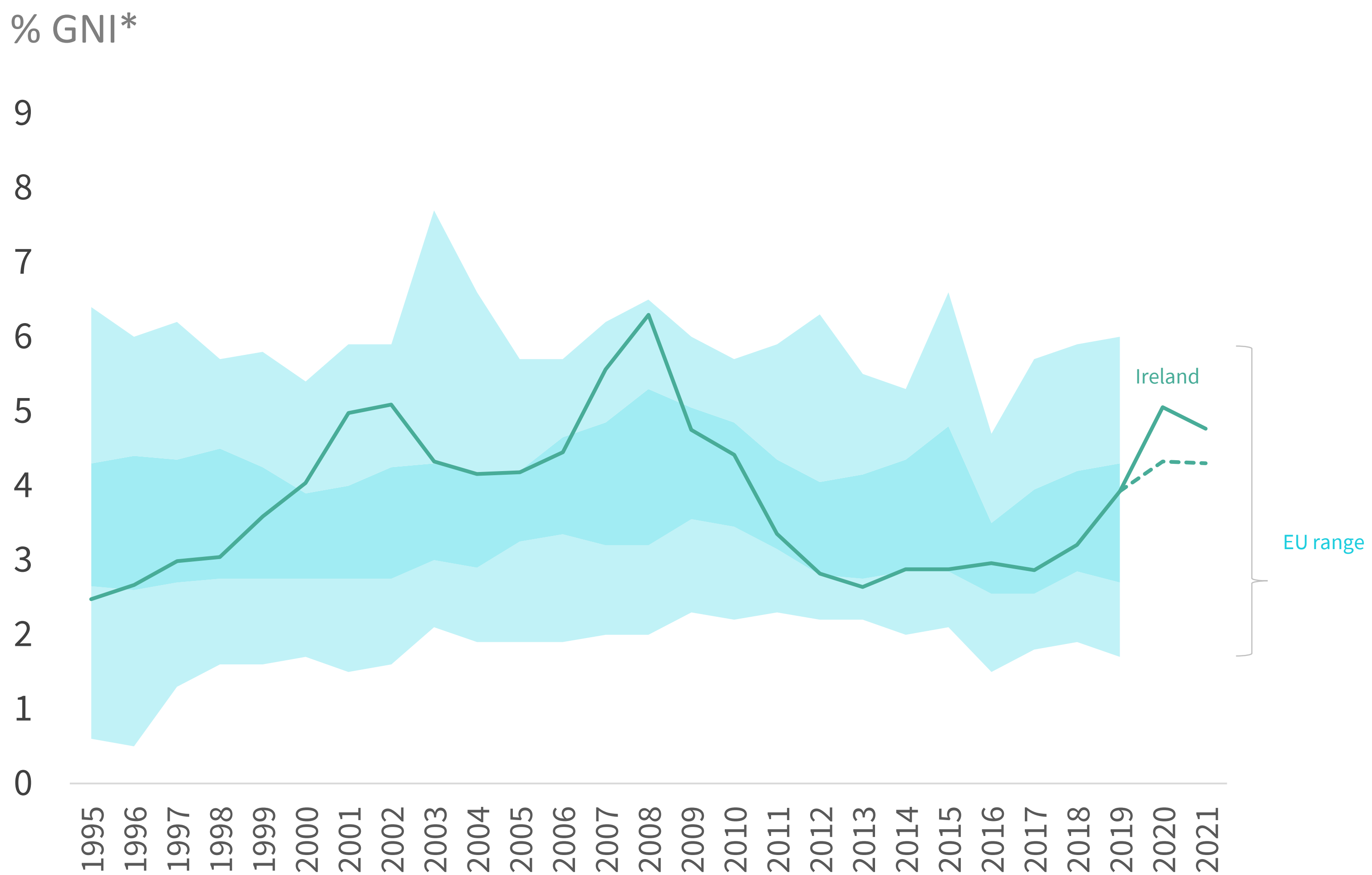
Sources: *SPU 2020* and Fiscal Council workings.
Note: The figure shows a range of output gap estimates (the shading) and the mid-range estimates (the line). Estimates are produced using a variety of methods based on the Council's models and Department forecasts (extended to 2025 — see Box D). Given the distortions to standard measures like GDP and GNP and the relative importance of domestic activity to fiscal outcomes, the range focuses on domestic economic activity, including quarterly Domestic GVA (see Casey, 2019).



Sources: Fiscal Council workings.
Notes: The stimulus of €10 billion is assumed to unwind in one year. The ratios are based on nominal GNI* for 2020. An overall deficit multiplier of 0.5 is the central estimate, while error bars examine multipliers ranging from zero to one.

Stimulus measures should be Timely, Targeted and Temporary

Public investment can be a key tool in stimulus



Sources: Fiscal Council workings.
Notes: The range is for all EU countries. Inner band is the middle 50 per cent of countries. Outer band is the full (max to min) range. The dashed green line for Ireland represents the ratio of public investment to modified GNI* based on the Budget 2020 forecasts for nominal GNI* (nominal investment amounts are unchanged).

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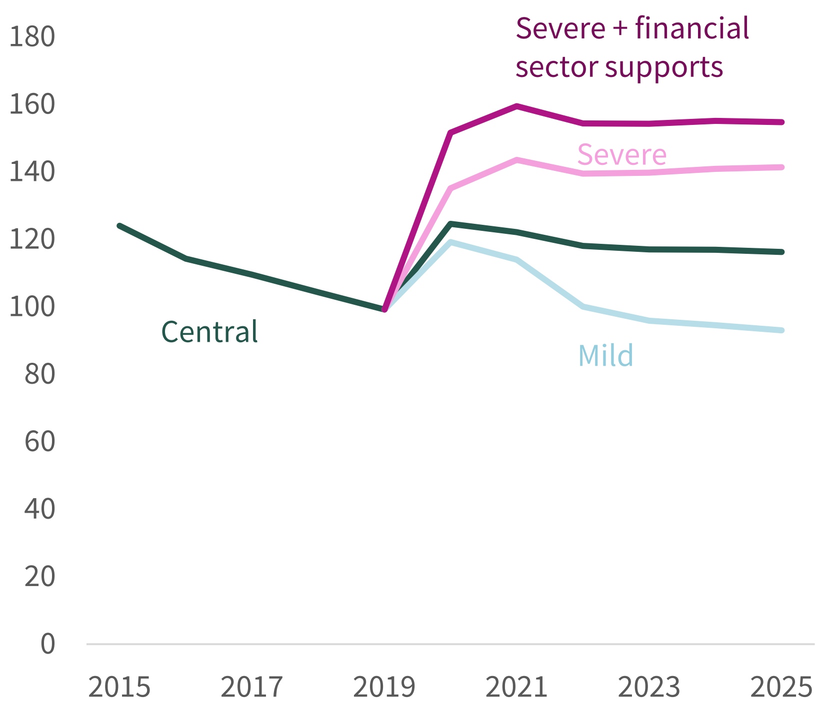
By 2021, the government debt GNI* ratio could be in the range of 114 to 160 per cent

Debt ratios

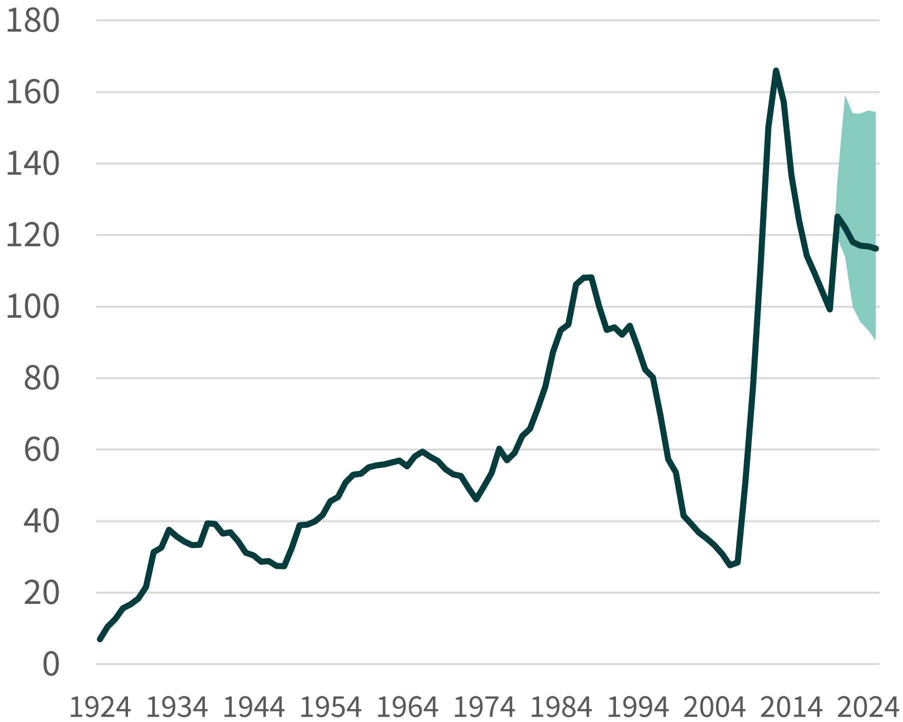
% GNI*



Sources: CSO; Department of Finance; and Fiscal Council workings.
Note: Scenarios are consistent with the macroeconomic and fiscal assumptions set out in Boxes D and I. The Severe + scenario includes a financial sector shock that assumes a recapitalisation of domestic banks equivalent to 10 per cent of the value of their assets (€27.8 billion) in 2021.

Historical Debt ratios

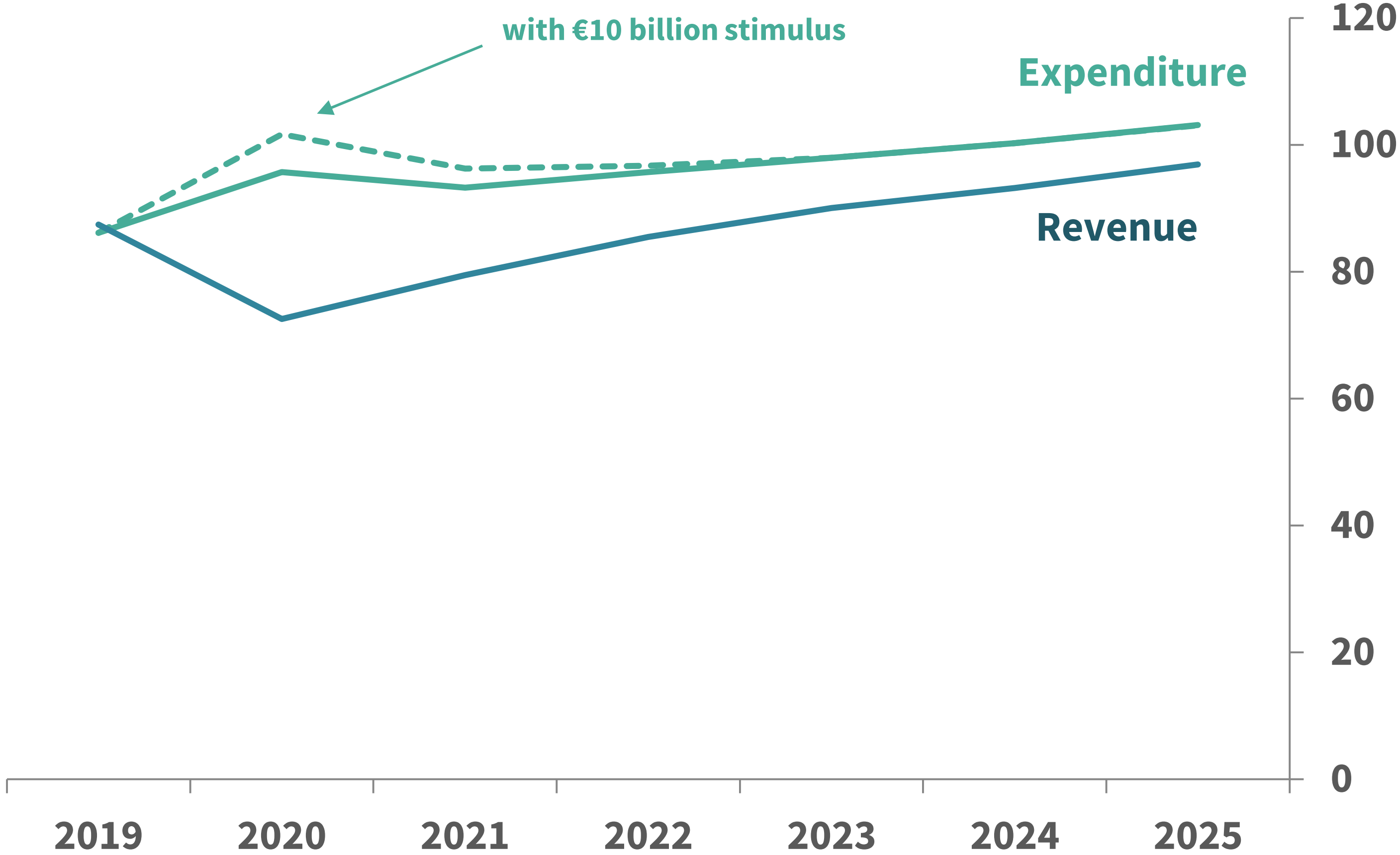
% GNI*



Sources: CSO; FitzGerald and Kenny (2018); Department of Finance; and Fiscal Council workings.
Note: Modified GNI* is linked to GNI for the historical period. The range depicts the debt ratios consistent with the Council's Mild and Severe scenarios (including potential costs of recapitalising the banking system).

Measures will be needed to close the gap between revenue and spending

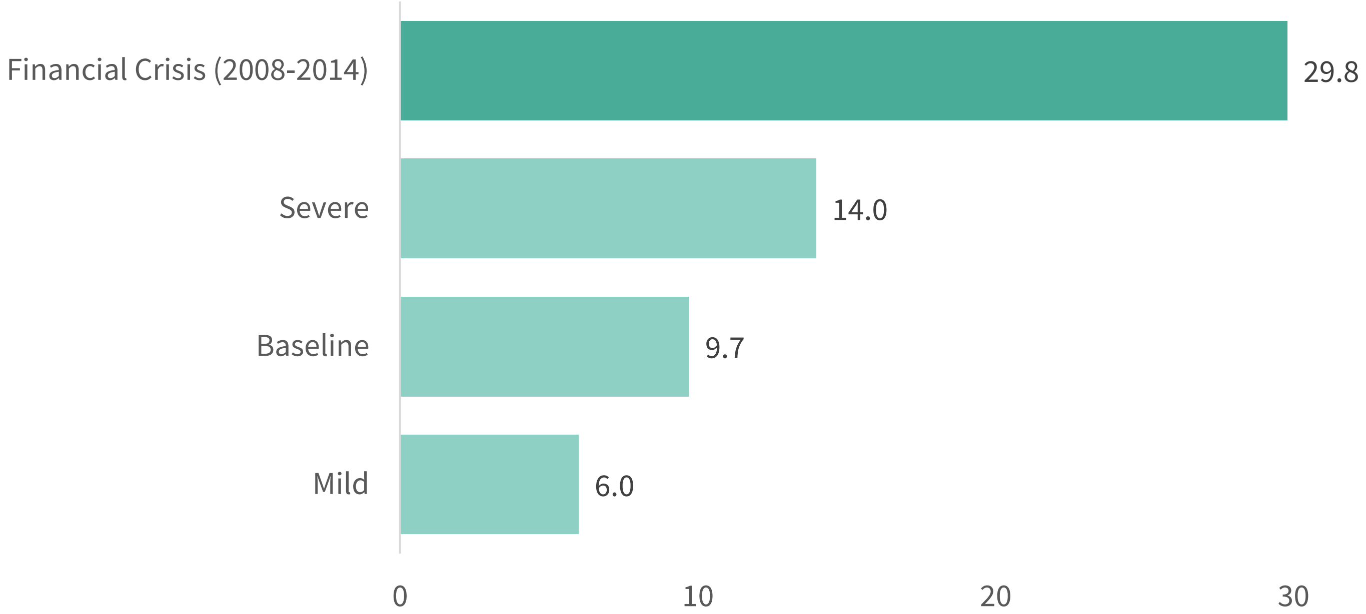
€ billion



Sources: CSO; Department of Finance; and Fiscal Council workings.
Note: The figure shows general government spending and revenue under the Central scenario, and an illustrative stimulus assumed at €10 billion and phased over three years (as in Table 1.2).

Some fiscal adjustment is likely to be needed in time to put debt-to-GNI* on a downward path

Fiscal adjustment relative to business as usual needed to achieve 3pp GNI* annual debt reduction by 2025
€ billion total



Sources: NTMA; Department of Finance; and Fiscal Council workings.
Note: Unlike the consolidation amounts during the financial crisis, the amounts set out for scenarios are relative to a situation where public sector wages and welfare payments are assumed to rise in line with general wages. The adjustments also take place over a shorter time period (three years as compared to seven years). And they take place at a stage when the economy is assumed to be growing relatively fast again.

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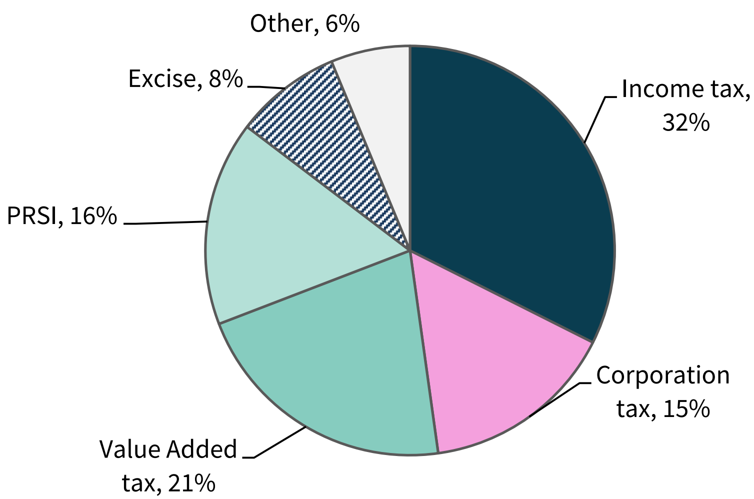
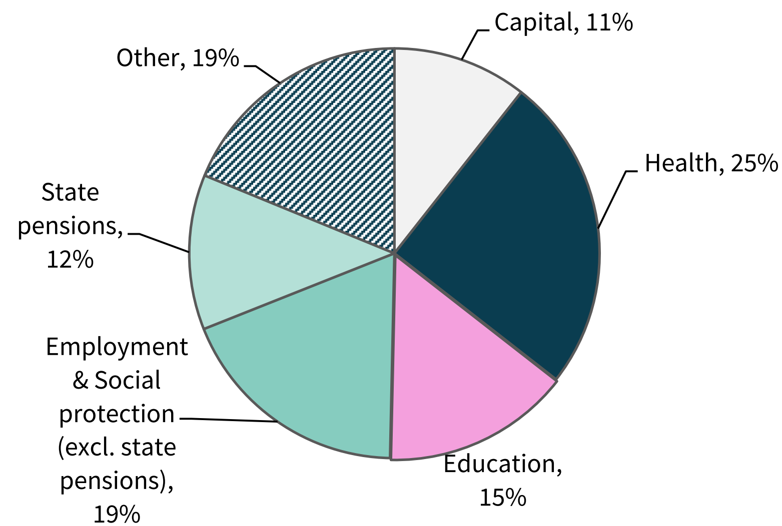
Decisions will need to be made about competing spending and tax objectives

Exchequer tax and PRSI revenue 2019



Gross voted current & capital expenditure 2019



- With fiscal adjustment, any new initiatives will need to be financed by spending less in other areas or raising taxes
- Sláintecare, investing in housing, and climate change measures are feasible, but must be funded sustainably

Medium-term stability should be supported by the fiscal framework

- Rules complied with in 2019
- Domestic and EU rules allow flexibility for exceptional circumstances in 2020
- This could be extended to 2021

Measures to strengthen the fiscal framework

Key messages

- Covid-19 crisis will result in a deep economic downturn in 2020H1 with a lasting effect
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- During the recovery phase, fiscal stimulus would be warranted
- Some fiscal adjustment is likely to be needed in the new steady-state, but severe austerity can be avoided
- Decisions will need to be made about tax and spending priorities
- Strengthening the fiscal framework would help