Irish Fiscal Advisory Council

# Endorsement of Budget 2024 macroeconomic forecasts

December 2023

The Fiscal Council has a mandate to endorse the macroeconomic forecasts underpinning each Budget and stability programme.[1]

To set out how each endorsement process is carried out, the Council and the Department of Finance have an agreed Memorandum of Understanding.[2]

This document gives an overview of some of the key aspects and discussions that took place during the course of the latest endorsement process. It replaces the section that would previously have appeared in the Macroeconomic Assessment chapter of the Council's Fiscal Assessment Reports. The Council felt it would make for a more coherent discussion in the Fiscal Assessment Report to keep this part of the discussion separate so that the Fiscal Assessment Report could focus on more timely assessments of the macroeconomic environment.

[1] This follows the agreement at European level on the Regulation on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (EU Regulation No 473/2013), Ireland is required under Article 4.4 to have its national medium-term fiscal plans and draft budgets based on independent macroeconomic forecasts, which means macroeconomic forecasts produced or endorsed by an independent body. In Ireland's case, this endorsement function is set out in the Fiscal Responsibility Acts 2012 and 2013 that entered into force on 23 July 2013. Under the Act, the Council as an independent body (as defined in Article 2.1.a of Regulation No 473/2013) has been assigned the endorsement function, and shall "endorse, as it considers appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the Budget and stability programme will be based".

[2] This sets out the timelines, data, and nature of interactions. It is available online at: https://www.fiscalcouncil.ie/about-the-council/

## This exercise

The Council's most recent endorsement exercise of the Department of Finance's macroeconomic forecasts was undertaken in September 2023.

The Department's provisional macroeconomic forecasts were completed on 15 September 2023 and shared with the Council. The Council and Secretariat then met with Department staff to discuss its forecasts on 26 September ahead of making its endorsement decision.

The key dates underpinning the Council's endorsement of the Department of Finance's macroeconomic projections for Budget 2024 are set out in Appendix 1.

# Approach

The Council's approach to endorsement has three main aspects: assessing the methodologies employed; detecting potential patterns of forecasting bias; and comparing to other forecasts. The comparison with other forecasts includes an assessment against the Council's own Benchmark projections. These projections are developed and finalised before assessing the Department's forecasts.

# Overall endorsement decision

Taking account of the plausibility of the judgements made, the Council assessed that the Department's macroeconomic forecasts were within an endorsable range. The Council's assessment of the Department's macroeconomic forecasts was favourable regarding the processes and methodologies used.

In *SPU 2023*, the Department expanded its macroeconomic forecast horizon to seven years ahead. This addressed the Council's concern that macroeconomic forecasts should always be made to at least five years ahead. For *Budget 2024*, the Department has continued to forecast key macroeconomic variables out to 2030. However, most of the economic variables covered by the endorsement exercise, and also the fiscal variables outside of the endorsement process, are out to 2026 — just three years ahead.

## Key issues this endorsement

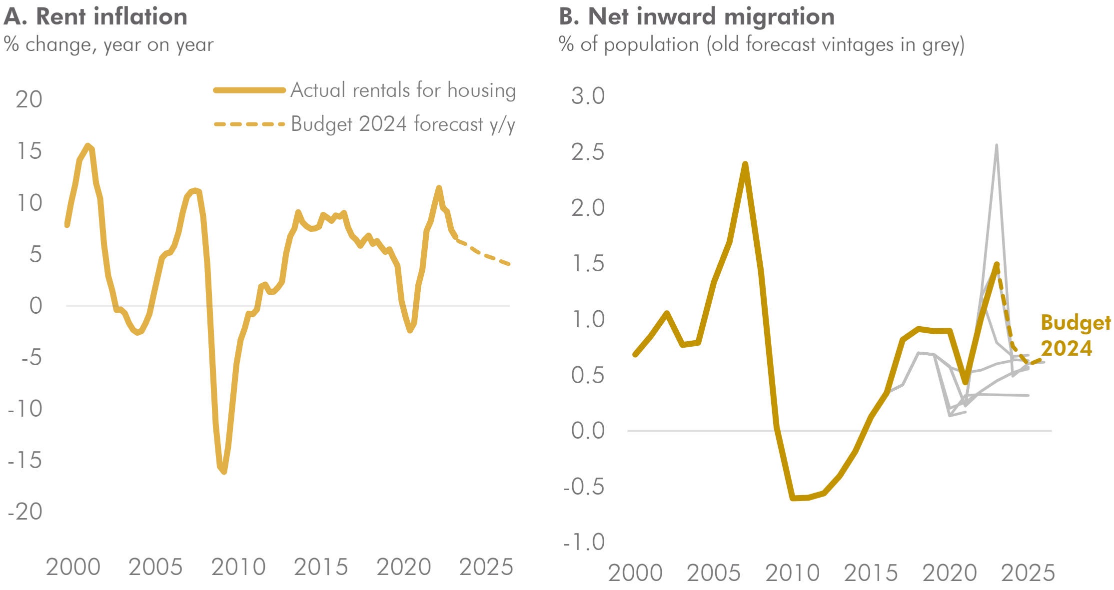
This section describes the key issues that arose in the latest endorsement process. A key focus related to how consistent the forecasts were, in the context of the economic cycle. This included the consistency of inflation, migration, wages, productivity, and supply-side estimates of the output gap in the context of the cyclical strength of the Irish economy.

### The relationship between rents and migration

Rental inflation and net inward migration have been high in recent years. Typically, these changes are likely to be linked, as discussed by Tyrcha (2020).[3] Young, highly educated workers have been migrating to Ireland in net terms of late. Of the cumulative net inward flow between 2015 and 2022, nearly all (96%) of individuals were educated to third level. The recent arrivals are likely to end up renting for some period and it is possible that rent pressures will remain high.

*Budget 2024* forecasts assume rent pressures moderate further from recent highs (Figure 1). However, the ongoing limited availability of properties to rent could see higher rent inflation continue. Furthermore, if net inward migration does not decline from recent highs as forecast, this would likely exacerbate the situation for rent inflation — which remains high at 6.7% in Q3 2023.

**Figure 1: Rent inflation and migration expected to moderate**




Sources: Department of Finance, CSO and Fiscal Council workings.

[3] Saiz (2003) showed that a large exogenous shock to migration in Miami due to the 1980 Mariel Boatlift resulted in an additional 8-11% increase in rents; Saiz (2007) later concluded that a 1% increase in a city's population increased rents by 0.6%.

A complication in forecasting population and migration for *Budget 2024* is that close to when the forecasts were finalised, the CSO released the *Annual Population and Migration Estimates* for the year up to April 2023. These estimates included large revisions for 2017–2022 driven by *Census 2022* data, with net inward migration revised up by a cumulative 57.1 thousand for this period.

Two factors behind the Department's forecast is that housing completions will struggle to rise sufficiently to accommodate further inward migration, and that prospective immigrants would be discouraged from coming to Ireland by expensive rents. However, there are long-standing shortages of Ireland's housing stock, and the share renting has increased considerably. Rents have also been high for some time, but this has not stopped high inward migration. There is uncertainty over how high rents would have to go to deter further significant inward migration.

If migration continues to exceed expectations, this is likely to imply a higher rate of inflation for rents over the coming years relative to the *Budget 2024* projections.

## Real hourly wage growth and labour productivity

The Council also had questions about how the projections for continued rent pressures and inward migration flows related to wage growth, particularly in the context of expected labour productivity advances.

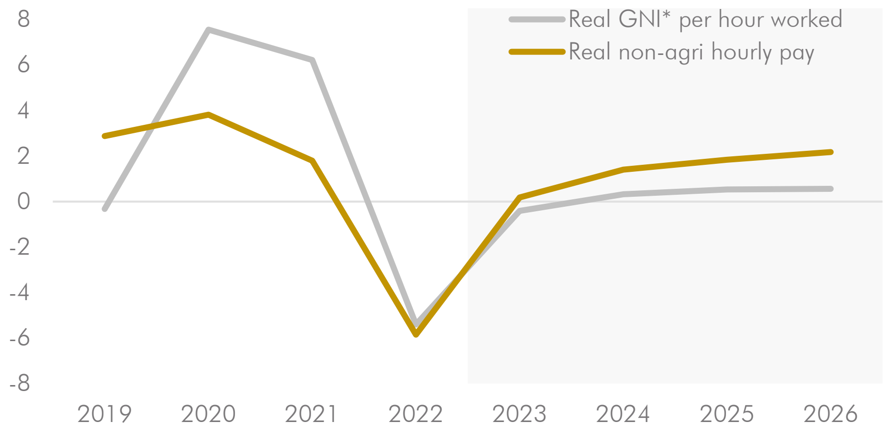
A standard assumption for long-run forecasting is that real wages and productivity growth would tend to align. However, an issue considered by the Council during this endorsement was the Department's projection for stronger real wage growth relative to labour productivity.

This is mainly visible in growth rates. The Department forecasts a slight fall in labour productivity as measured by real GNI* per hour worked in 2023 (–0.4%), followed by a slow recovery of 0.5% a year on average for 2024–2026. As shown in Figure 2, real hourly non-agricultural pay growth is expected to recover more rapidly, by close to 2% a year.

The Department anticipates a slower growth trajectory for real GNI* over the forecast horizon, with an average of just 2.1% growth expected for 2023–2030. This would be lower than the growth rates achieved in 19 of the previous 27 years, and well below median growth at just the 30$^{th}$ percentile of historical outcomes since 1996. This would be consistent with a maturing economy with lower growth from labour supply. If net inward migration is higher than forecast however, this could maintain higher GNI* growth rates for longer than the Department expects.

**Figure 2: Pay forecast to grow faster than labour productivity**

% change, year on year

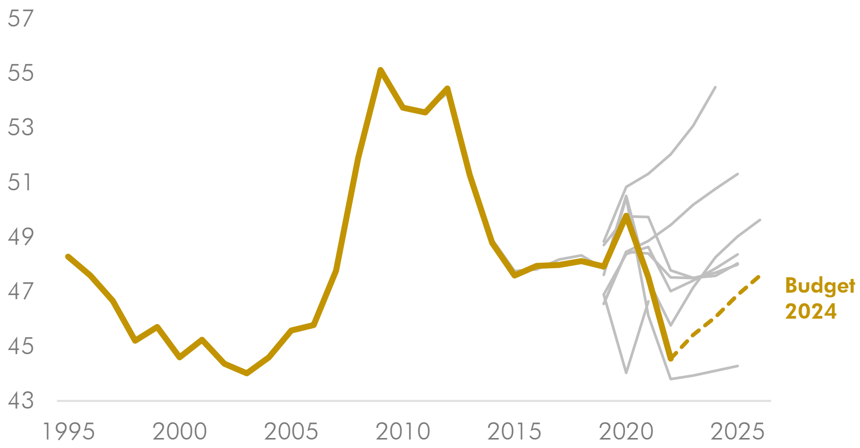



Sources: Department of Finance, CSO and Fiscal Council workings.

Faster growth in hourly wages relative to real-GNI*-based labour productivity implies an increase in unit labour costs over the *Budget 2024* forecast horizon. The rapid growth in corporation tax receipts from foreign companies in recent years has contributed to a decline in the share of employee wages in GNI*, as shown in Figure 3. In 2022, wages as a share of GNI* fell to the lowest percentage since 2004. However, the Department's forecasts imply a recovery in this share close to pre-pandemic levels by 2026.

**Figure 3: Wages are expected to increase relatively quickly**

% of GNI*, compensation of employees (old forecast vintages in grey)




Sources: Department of Finance, CSO and Fiscal Council workings.

## Supply-side estimates and the output gap

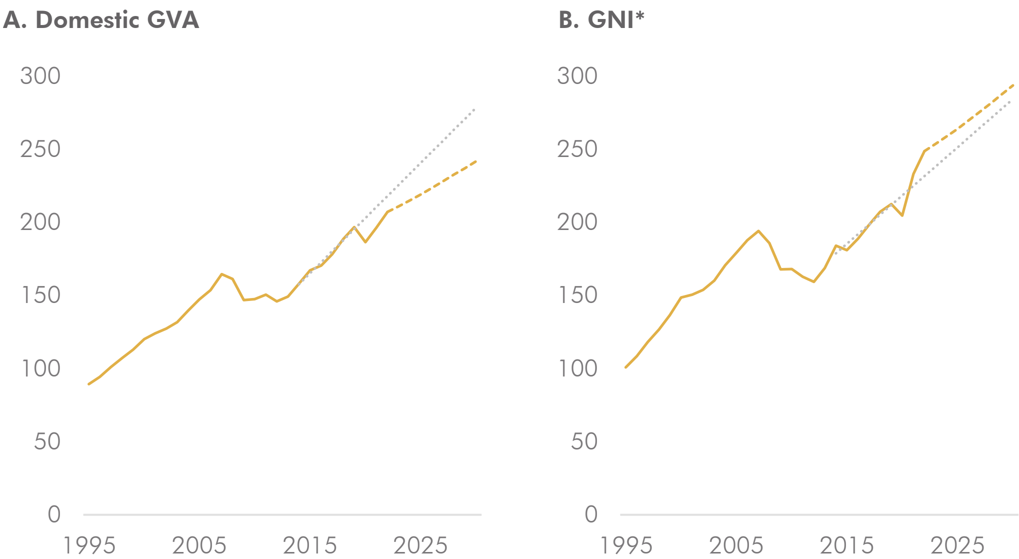
A final thread to the overarching theme the endorsement discussions focused on was how consistent the above two issues were with expectations for overheating in the economy. This is represented, at least in part, by the output gap and supply-side estimates.

The *Budget 2024* forecasts indicate that output in 2023 is 0.9% above potential, and that this will gradually close over the medium term. This is consistent with the Department's assumption that economic growth moderates over the medium term. If economic growth performs stronger than expected, this would increase the risk of a prolonged period of overheating for the Irish economy.

The output gap estimates produced by the Department rely on gross value added excluding sectors whose turnover is dominated by foreign-owned multinationals ("domestic GVA"). Figure 4 shows the recovery from the pandemic in domestic GVA was less complete than for GNI*. This is at odds with the recovery in the labour market and with the level of real GNI*. Based on the Department's forecasts, domestic GVA will further diverge below its pre-pandemic trend from this year onwards.

**Figure 4: A less complete recovery for domestic GVA than GNI***

€ billion, 2021 constant prices




Sources: Department of Finance, CSO and Fiscal Council workings.

As the Department's estimates are based on domestic GVA, there is a risk that output gaps are understated. To address these concerns, the Department provided the Council with alternative estimates of the output gap. Using GNI* as the output variable, rather than domestic GVA, a more positive output gap was estimated in 2022 and 2023. However, there was a similar path over the medium term, with the output gap closing by 2030. Furthermore, a bottom-up historical estimate of real GNI* (as described by [Timoney, 2023](#)) does not exceed its pre-pandemic trend in 2022 (see figure N°3 in the Council's December 2023 *Fiscal Assessment Report*). Using this bottom-up real GNI* in place of the official CSO series, the output gap would close far sooner by 2024. These issues complicate the assessment of the supply-side estimates included in *Budget 2024*.

# Appendix A

## Timeline for Endorsement of *Budget 2024* Projections

| | |
|---|---|
| 1 September | The CSO released its Quarterly National Accounts estimates for Q2 2023. |
| 5 September | The Council's Secretariat and Department staff met with the CSO to clarify technical details of latest Quarterly National Accounts estimates. |
| 15 September | The Department sent the Council preliminary forecasts in line with Memorandum of Understanding requirements. |
| 19 September | The Department presented its preliminary forecasts to the Council's Secretariat. |
| 22 September | The Department sent updated forecasts. |
| 26 September | The Department of Finance presented its latest forecasts to the Council and Secretariat and answered questions. After the meeting the Council had a preliminary discussion on its endorsement decision. |
| 28 September | The Council finalised a decision on the endorsement. The Acting Chairperson of the Council wrote a letter to the Secretary General of the Department of Finance endorsing the set of macroeconomic forecasts underlying *Budget 2024*. |
| 10 October | The Department's forecasts were published in *Budget 2024*. |