Rialtas na hÉireann
Government of Ireland

Draft Stability Programme Update

Incorporating the Department of Finance's Spring Forecasts

APRIL 2023

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Department of Finance
www.gov.ie/finance

Stability Programme

April 2023 Update

(Incorporating the Department of Finance’s Spring Forecasts)

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1. Legal basis

EU Regulation 1175/11 (part of the so-called 'six pack' of legislative reforms adopted in 2011) requires all Member States to submit an annual update of their Stability Programme (Convergence Programme in the case of non-euro area Member States) to the European Commission by end-April each year.

This document is Ireland's annual update, and it constitutes Ireland's national medium-term fiscal plan. It has been prepared in line with the May 2017 guidelines on the format and content of Stability and Convergence Programmes – the 'Code of Conduct'. This document should be read in conjunction with Ireland's *National Reform Programme 2022*.

2. Endorsement

The Department produces, and publishes, two set of macroeconomic projections each year – its spring forecasts (set out in the annual *Stability Programme*) and its autumn forecasts (set out in the *Economic and Fiscal Outlook* that accompanies the annual budget).

Under European Union law (set out in the so-called 'two-pack'), both sets of forecasts are subject to independent endorsement, a function that, in an Irish context and under the *Fiscal Responsibility Act 2012*, is assigned to the *Irish Fiscal Advisory Council* (the Council). A Memorandum of Understanding between the two institutions codifies the process, and is available at:
https://www.gov.ie/en/publication/caca92-memorandum-of-understanding-between-the-irish-fiscal-advisory-counci/

For comparison purposes, the main macroeconomic variables from each set of forecasts that has been subject to the endorsement process (which began in 2013) is set out on the Department's website, and available at: https://www.gov.ie/en/publication/51dfd-database-of-past-forecasts/

The macroeconomic forecasts were endorsed by the Council on 6th April 2023 (**annex 1**). To operationalise this, staff in the Economics Division of the Department provided an initial set of projections to the Council on 27th March. Following an iterative process, a formal presentation was made by Departmental staff to the Council on 31st March.

The presentation provided to the Council is available on the Department's website at:
https://www.gov.ie/en/publication/026eb-spu-2023-presentation-to-ifac-31-march-2023/

3. Draft and final versions

The Government publishes each annual update of the Stability Programme in draft form, before submitting the final version to the European authorities at end-April.

4. Date stamp

The macroeconomic analysis and forecasts contained in this document are based on data available to end-March 2023.

5. Availability of chart data

In line with the Government's *Open Data Initiative,* the data underpinning charts in this document are available on the Department's website, available at:
https://www.gov.ie/en/publication/e7e35-spu-2023-chartpack/

6. Rounding

Rounding can affect totals in all tables in this document.

7. Boxes

The document contains several boxes. These are short, self-contained pieces of analysis, the objective of which is to delve a little deeper into some topical economic and fiscal issues.

8. Corrections policy

The data and analysis set out in this document are compiled by Department of Finance staff; every effort is made to ensure accuracy and completeness. If errors are discovered, subsequent corrections and revisions are incorporated into the digital version available on the Department's website. Any substantive change is detailed in the online version.

9. Presentation before parliament

The document was laid before (formally presented to) the Oireachtas on 18th April 2023.

Chapter 1
Overview and General Policy Strategy

1.1 Policy strategy

Three inter-related headwinds have weighed on economic activity in Ireland over the past year or so. First, and foremost, has been the energy price shock triggered by the Russian invasion of Ukraine. Because Ireland is a (net) energy importer, higher oil and natural gas prices involve a transfer of purchasing power abroad. The second drag on activity relates to the broadening of price pressures to non-energy goods and services, and the more generalised pick-up of inflation, which has further eroded real incomes. In part, this reflects higher energy costs being passed on to consumers; but it is also a reflection of the wider imbalance between demand and supply in the economy, including in the labour market. Finally, the pick-up in non-energy inflation has triggered a synchronised, front-loaded monetary policy response across advanced economies: in the euro area, policy interest rates have increased by 350 basis points since last summer, dampening demand in Ireland.

Despite these powerful headwinds, the Irish economy has proven to be remarkably resilient. This is most apparent in the labour market, where the rate of unemployment remains close to historical lows, and is broadly consistent with any reasonable estimate of ‘full employment’.

Moreover, evidence is now mounting to suggest that the worst of the energy price shock may have passed. Wholesale prices for oil and natural gas have fallen from their highs of last summer although, especially in the case of gas, the pass-through to retail prices is slowed by the hedging strategies of suppliers. Lower energy prices mean that headline inflation is now on a downward trajectory; as inflation loosens its grip on the economy, the erosion of purchasing power will be curtailed and real income growth should strengthen as the year progresses.

That said, non-energy inflation has been more persistent, suggesting that the journey back to price stability is unlikely to be smooth. An additional complication relates to the transition from a prolonged period of exceptionally low interest rates to much higher rates, and the global financial stability implications of this rapid change. Vulnerabilities have been exposed in parts of the US and Swiss banking sectors, as well as in other financial market segments.[1] While severe risk-aversion and contagion have been avoided, at least thus far, previous experience highlights the potential real economy damage from a deterioration in global credit conditions.

Looking ahead, the baseline scenario set out in this document involves a gradual increase in Modified Domestic Demand (MDD) over the course of this year and into next, with only limited fall-out, at least in aggregate terms, from the terms-of-trade shock. Four key factors underpin this assessment.

First is the resilience of the labour market where, at least in aggregate terms, the demand for labour continues to exceed supply. Employment is now at its highest level ever while, on the supply-side, the participation rate has jumped by around 2 percentage points relative to its pre-pandemic trend, mainly due to higher female participation. This contrasts sharply with the situation in some other jurisdictions, where the evidence of a post-pandemic ‘big quit’ is compelling.

[1] The rapid jump in long-term borrowing costs triggered stress in part of the UK pensions funds sector (Liability-Driven Investment) last September, necessitating intervention by the monetary authorities.

The second factor relates to the domestic banking sector, which was an amplifier of the last economic cycle. Reforms introduced in the intervening period *inter alia* mean that the banking sector now operates in a more counter-cyclical manner.

Third is the strength of private sector balance sheets. Leverage within the household and Irish-owned enterprise sector has been reduced significantly since the sovereign debt crisis a decade-and-a-half ago. The household sector, for instance, accumulated an estimated €10-20 billion by way of 'forced' savings during the pandemic, equivalent to over 10 per cent of household disposable income.[2] While not evenly distributed across the income spectrum, these savings constitute an important buffer, allowing some households to maintain spending levels in the face of higher prices.

Finally, and perhaps most importantly, has been the stance of budgetary policy. Pro-active budgetary policy has helped to partly shield the private sector from the most severe impact of the price shock. Taking into account the measures introduced in February this year, the Department has estimated[3] that the Government mobilised a total of €12 billion (almost 4½ per cent GNI*), over the course of this year and last, to help absorb the impact of higher inflation on households and firms. With wholesale energy prices now in retreat, Government has communicated that the next fiscal intervention will be *Budget 2024*.

Cushioning the impact of economic shocks using tax and spending policy highlights the important role that counter-cyclical budgetary policy can play. Allowing public debt to rise in response to an adverse economic shock is an important shock absorber. But this is only the case if applied symmetrically across the economic cycle: public debt must be allowed to fall during 'good' times. The Government's (net) expenditure rule provides for this counter-cyclical approach.

In addition to helping households and firms navigate the pandemic and price shocks, the Government's main economic priority in recent years has been to address the demand-supply imbalance in the housing market. The origins of this imbalance are clearly on the supply-side, with annual output falling below estimated demand for each year for the past decade or so. The primary policy objective, therefore, is to boost the supply of new and affordable housing, with the Government's response set out in *Housing for All.*[4]

Turning to the fiscal strategy, the Government set out its medium-term framework for the public finances in the *Summer Economic Statement* in July 2021.[5] This framework, which anchors net spending growth to the trend growth rate of the economy, set core expenditure growth at 5 per cent over the period to 2025. This approach ensures the sustainable funding of incremental improvements in public services. This approach is calibrated in order to minimise the possibility that windfall revenues are used to finance permanent increases in expenditure; it also allows Government to maintain very high levels of public capital spending – at an annual average rate of around 4½ per cent of national income over 2021-2030 – as set out in the *National Development Plan*.[6]

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[2] Forced savings are deposits in excess of the pre-pandemic savings share of household income, calculated by the Department of Finance in line with IMF methodology, available at: https://www.imf.org/en/Publications/WEO/Issues/2021/10/12/world-economic-outlook-october-2021

[3] *The fiscal response to the cost of living challenge*, Department of Finance (April 2023), available at: https://www.gov.ie/en/publication/20374-fiscal-response-to-the-cost-of-living-challenge/

[4] Available at: https://www.gov.ie/en/publication/ef5ec-housing-for-all-a-new-housing-plan-for-ireland/

[5] See *Summer Economic Statement,* Department of Finance (July 2021), available at: https://www.gov.ie/en/publication/4d84e-summer-economic-statement-2021/

[6] https://www.gov.ie/en/publication/774e2-national-development-plan-2021-2030/

For *Budget 2023*, Government adjusted the annual expenditure growth rate to take account of higher-than-anticipated inflation. The revised growth rates aimed to strike a balance between protecting public services while also minimising the risk of adding to inflationary pressures. The fiscal projections, for the period 2024 to 2026, set out in this document assume a reversion to the 5 per cent (net) expenditure growth rate. For *Budget 2024*, the appropriate fiscal policy will be considered as part of the *Summer Economic Statement*.

Government is also conscious of the need to ensure that the public finances can absorb any shock to corporation tax receipts. The direct revenue-at-risk is estimated at almost €12 billion (over 4 per cent of GNI*) this year; indirect effects could potentially be larger, with income and corporation taxes increasingly inter-twined.

In relation to corporation tax, work continues to finalise the OECD *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*.[7] In relation to the first pillar, discussions remain on-going on a number of key aspects; this work is expected to be completed in the coming months with a view to finalising a Multilateral Convention to be opened for signature later this year. Regarding the second pillar, the EU *Minimum Tax Directive* was agreed in December and will give effect to Pillar Two of the agreement across the EU. For Ireland, legislation to transpose the Directive is being brought forward in *Finance Bill 2023*, ahead of the transposition deadline of 31st December 2023.

A first estimate of the potential cost of implementation of the OECD agreement was published in 2020 – corporation tax receipts were tentatively assumed to decline by €2 billion (approximately 20 per cent of corporation tax revenue at that time). Corporation tax receipts have increased substantially since the pandemic; accordingly, the proportional cost of implementing the agreement is expected to rise. However, material uncertainty remains in relation to the final design of the rules across both pillars and estimates of the revenue-at-risk will be revised once there is further clarity on the final design and implementation of the rules globally.

In recognition of these vulnerabilities to corporation tax revenue, *Budget 2023* provided for the transfer of €6 billion from the budgetary surplus to the *National Reserve Fund*. This was operationalised via the transfer of €2 billion in September last year, followed by the transfer of €4 billion in February of this year. Recognising significant fiscal challenges beyond the short-term, Government is also considering options for establishing a longer-term public sector savings vehicle.

During the pandemic, the application of the European Union's fiscal rules was temporarily suspended, to allow governments of the Member States ramp-up income and other supports for households and firms; in legal terms, this involved activating the *General Escape Clause* (GEC). The suspension was extended last year, in response to the outbreak of war in Ukraine and its transmission to the European economy *inter alia* via the energy price shock. In March of this year, the European Commission indicated that the GEC would be de-activated in 2024, meaning that the application of the *Stability and Growth Pact* governs the preparation of budgets for next year.

Finally, it is worth stressing that, in calibrating budgetary policy, Government is cognisant of the sea-change in monetary conditions. Policy interest rates have increased sharply and central banks in most advanced economies are reducing their footprint in sovereign debt markets; the upshot is a higher cost of borrowing. Importantly, Irish sovereign borrowing costs have moved in-line with other 'semi-core'

[7] Pillar One seeks to reallocate a portion of taxing rights to market jurisdictions, while Pillar Two seeks to introduce a minimum effective tax rate of 15 per cent for Multinational Enterprises with annual revenue over €750 million.

euro area economies, reflecting the credibility of the Government's framework and strategy. It is important that this credibility is retained as the normalisation of monetary policy proceeds.

1.2 Short-term economic and budgetary outlook

Notwithstanding powerful headwinds, incoming data confirm that, in the round, economic activity surprised on the upside in the second half of last year. Employment growth, for instance, continued to expand, as did consumer spending. High frequency data relating to the first quarter of this year also paint a somewhat more positive picture than that foreseen in the Department's autumn 2022 forecasts.

On the external front, the economic fall-out from the energy price shock has been milder than anticipated. As a result of successful demand management strategies and a relatively mild European winter, energy prices – especially those for natural gas – have fallen from their highs last autumn and, accordingly, there is now strong evidence that headline inflation in most regions has peaked.

That said, non-energy price inflation has proved somewhat 'sticky', prompting aggressive tightening of monetary policy in the euro area (+350 bps relative to its low-point), UK (+415 bps) and US (+475 bps).[8] As monetary policy operates with a lag, the tightening cycle will be a powerful headwind for many of Ireland's export markets in the months ahead. Higher frequency real-economy data have weakened of late in several regions, while some important forward-looking financial indicators have moved in the wrong direction. All told, notwithstanding the relatively contained fall-out from the energy price shock in Ireland's main export markets, the external economic situation remains fragile.

The central scenario set out in this document is calibrated on the assumption that the rate of headline inflation in Ireland eases from the second quarter of this year, in part due to the moderation in wholesale energy prices. As inflation loses its grip, real disposable income is set to recover, supporting consumer spending. Partly offsetting this tailwind is the impact of monetary policy tightening, which will weigh on disposable income of some households and dampen investment spending by some firms.

Against this backdrop, MDD is projected to increase by 2.1 per cent this year (**table 1**), a 0.9 percentage point upward revision relative to the Departments autumn forecasts. A key building block of this projection is the positive impact on activity of Government supports to households and firms announced in February of this year (c. 0.5 per cent of GNI*). For next year, MDD growth of 2.5 per cent is currently anticipated.

The resilience of the labour market has been a notable feature of the post-pandemic economy. The level of employment in the final quarter of last year was just under 2.6 million, its highest level ever and 9 per cent above its level immediately before the pandemic. On the supply-side of the market, participation rates are notably higher than would have been suggested by the pre-pandemic trend, while inward migration continues to be an important source of additional labour.

The tight labour market at present could potentially have a bearing on inflation dynamics: while the labour market was not the origin of the price shock, a key risk is that imbalances between demand and supply of labour may propagate, or prolong, the shock to 'core' inflation. In this type of situation, the price shock could morph from an external, supply-side shock to one where domestically-generated inflationary pressures are dominant.

[8] Change from low-point relative to the data cut-off point for inclusion in this document.

Turning to the budgetary situation, the projections contained in this document are highly conditional on the assumption of no major shock to corporation tax receipts. The concentration of these receipts in a handful of multinational firms means that it is impossible to predict any turning point; it also means that the Irish public finances are exposed to firm- and sector-specific shocks. Depending on the scale and timing of any such shock, the trajectory for tax revenue and, accordingly, the headline budgetary position, could be very different to that set out.

Table 1: Summary – main economic and fiscal variables

	2022	2023	2024	2025	2026
Economic activity			*per cent change*		
Real GDP	12.0	5.6	4.1	4.9	4.4
Real GNP	6.6	5.1	3.6	4.4	3.8
Modified domestic demand	8.2	2.1	2.5	3.2	3.4
Real GNI*	9.3	1.6	2.1	2.5	2.3
Prices			*per cent change*		
HICP	8.1	4.9	2.5	2.0	2.0
Core HICP^	5.0	4.4	3.2	2.6	2.5
GDP deflator	5.3	4.0	2.3	2.2	2.2
External trade			*per cent GNI* (unless stated)*		
Modified current account	9.7	9.1	8.7	8.0	7.2
Current account (per cent GDP)	8.8	11.1	11.6	12.3	12.5
Labour market			*per cent change (unless stated)*		
Total Employment ('000)	2,547	2,588	2,624	2,662	2,704
Employment	6.6	1.6	1.4	1.5	1.6
Unemployment (per cent)	4.5	4.4	4.5	4.5	4.5
Public finances			*per cent GNI* (unless stated)*		
General government balance (€ million)	8,035	10,010	16,215	18,115	20,840
General government balance	3.0	3.5	5.4	5.8	6.3
General government balance, exc. windfall CT~	-1.0	-0.6	1.5	2.1	2.6
Structural budget balance^^	1.4	0.8	1.1	1.6	1.9
General government debt (€ billion)	224.8	223.5	224.4	220.2	215.0
Net debt position (year-end, € billion)^^^	185.4	183.6	173.8	163.6	151.3
Debt ratio	83.3	78.8	75.4	70.4	65.4
Net debt ratio	68.7	64.7	58.4	52.3	46.0

Notes:
^ core inflation is the headline figure excluding unprocessed food and energy.
^^ estimates of the structural balance exclude estimates of windfall corporation tax receipts.
^^^ net debt from 2022 onwards estimated by mechanical extrapolation of financial assets.
~ the general government balance excluding the Department's estimate of corporation tax receipts that may be 'windfall' in nature.
Source: CSO for 2022; Department of Finance for 2023-2026.

For this year, excluding the impact of excess corporation tax receipts – estimated at almost €12 billion – the estimated underlying fiscal position (GGB*) is a deficit of €1.8 billion. When these excess corporation tax receipts are included, a headline general government surplus of €10 billion is projected for this year, equivalent to 3.5 per cent of GNI*. This is calibrated on the assumption of tax revenue amounting to €88.9 billion, a growth rate of almost 7 per cent.

On the spending side, *Budget 2023* set an expenditure ceiling of €90.9 billion for next year, providing for an increase in core voted expenditure of 5 per cent. With tax revenue growth projected at over 6 per cent, this would equate to a surplus of 5.4 per cent of GNI* next year. Excluding estimates of 'windfall' corporation tax, this would be consistent with an underlying (GGB*) surplus of €4.4 billion (1.5 per cent of GNI*).

The *Summer Economic Statement 2021* set out a fiscal framework to meet the objectives set out in the Programme for Government: investing in the economy and society to deliver improvements in infrastructure and public services, while reducing the deficit as the pandemic faded. This fiscal framework – the *Medium Term Expenditure Strategy (MTES)* – set out planned 'core' (non-temporary) expenditure ceilings for the period 2021 to 2025. The strategy was formulated on the basis of inflation averaging 2 per cent per annum.

The MTES set out overall core (net) spending growing at c.5 per cent per annum over the period, broadly in line with the estimated trend growth rate of the economy. Linking expenditure growth to the trend growth rate of the economy provides for a counter-cyclical budgetary approach and a reduction in the debt-income ratio over time.

Government adapted this strategy in response to the higher-than-anticipated inflation last year; the growth rate for core expenditure in both 2022 and 2023 was increased in the *Summer Economic Statement 2022.* The revised growth rates aimed to strike a balance between protecting public services while also minimising the risk of further adding to inflationary pressures. In addition, higher levels of non-core expenditure were provided for in the *Stability Programme Update 2022;* this was in response to the outbreak of war in Ukraine and the associated need to provide humanitarian assistance.

Non-core expenditure has proved a useful mechanism to effectively respond to externally driven challenges facing the Irish economy and wider society. It provides funding for temporary, or one-off, supports which do not become part of the core expenditure base. Substantial resources have been provided to respond to the pandemic, to provide humanitarian assistance arising from the war in Ukraine, to mitigate the domestic impact of the UK's exit from the European Union, and to ease the cost of living pressures facing households and businesses. The phased withdrawal of these supports, once no longer required, is essential to ensure fiscal sustainability.

The MTES is subject to ongoing analysis and review particularly in the context of economic developments and need to continue providing support for persons fleeing the war in Ukraine. Core and non-core expenditure requirements will be reviewed as part of *Summer Economic Statement 2023*.

Public indebtedness this year is projected at €223.5 billion, the equivalent of 78.8 per cent of GNI*. For next year, public indebtedness is projected at €224.4 billion, 75.4 per cent of GNI*. As central banks across advanced economies reduce their market footprint, sovereign borrowing costs are now on a rising trajectory. This means that fiscal trade-offs must, once again, feature in decision-making.

1.3 Medium-term economic prospects

The next stage in the budgetary cycle – the *National Economic Dialogue* – will take place in mid-June. The Government has decided that the theme of this year's Dialogue will be *The economy in 2030*. The objective will be to discuss some of the key challenges facing the economy in the coming years, including the economic impact of the '4Ds' (demographics, de-carbonisation, digitalisation and de-globalisation).

To prepare the ground, the Department has prepared a set of medium-term macro-economic forecasts covering the remainder of this decade.

Another reason for a longer forecast horizon lies in recommendations of the *Irish Fiscal Advisory Council*: in its recent Fiscal Assessment Report,[9] the Council recommended that the Department expand its forecast horizon *inter alia* to enhance the medium-term orientation of budgetary policy.

Finally, the production of longer-range forecasts is also motivated by reforms to the European Union's fiscal rules that are in the pipeline.[10]

Table 2: Potential growth rate of the Irish economy, per cent change (unless stated)

	2016-2020	2021-2025	2026-2030
Contribution of labour supply	1.2	2.3	0.6
: participation rate	61.8	64.0	63.1
: migration (000's)	27	53	32
Contribution of capital	0.6	0.6	0.9
Contribution of TFP	0.6	3.0	0.8
Potential growth (real)	**2.4^**	**5.9^**	**2.3**

^ the very large fall (and subsequent recovery) in GNI*/employment during 2020/2021 affect these calculations.
Source: Department of Finance calculations.

Accordingly, this document sets out forecasts for key macro-economic variables for 2023-2030 (**table 2**). Medium-term macro-economic projections are grounded in estimates of 'potential' growth – the pace at which an economy can expand without generating inflation if all factors of production are fully employed. For Ireland, technical work – endorsed by the IFAC – confirms that the potential growth rate is slowing: annual average potential GNI* growth will be an estimated 2.3 per cent in 2026-2030. The Department has been highlighting this downward trajectory of trend growth for a number of years. Demand-side projections consistent with the supply-side numbers are set out later in this document.

The Government's fiscal framework covers the period 2021-2025; the fiscal framework for 2026-2030 will be a matter for the next Government, subject to binding rules to be set out in the revised *Stability and Growth Pact*.

[9] *Fiscal Assessment Report*, November 2022, available at: https://www.fiscalcouncil.ie/wp-content/uploads/2022/11/Fiscal-Assessment-Report-November-2022.pdf
[10] The European Commission published orientations for reform of the EU economic governance framework in November 2022. Since then, technical discussions have been ongoing, leading to the adoption of Council Conclusions on the proposed reforms at the March ECOFIN meeting. Technical discussions will continue, while the Commission considers the areas of consensus agreed by the Council, with a view to concluding the legislative work by end-2023.

Chapter 2
Economic Outlook

2.1 Summary

While not yet out of the woods, the outlook for the Irish economy has improved relative to the situation envisaged at the time of the Department's autumn forecasts. At the global level, supply chain bottlenecks have eased with, for instance, shipping costs now back at pre-pandemic norms. Crucially, wholesale energy prices have fallen markedly since the autumn. Against this slightly more favourable backdrop, prospects for demand have improved in Ireland's main export markets. Worst-case scenarios that were on the horizon last autumn – such as a potential rationing of energy in continental Europe – have not materialised. That said, uncertainty remains high, and any escalation of geopolitical tensions could derail the global economy once again.

On the domestic front, households and firms are still faced with high energy bills, which continue to affect consumer and investment spending decisions. However, the mobilisation of Government financial support has helped to mitigate the impact of high prices over the winter and into the spring. Headline inflation peaked in the second half of last year and, subject to no further energy price shock, is now on a downward trajectory. An average inflation rate of 4.9 per cent for this year is currently projected, with the annual rate easing to 3.6 per cent by the final quarter of the year. By supporting a recovery in real incomes, more moderate inflation should underpin a further expansion of consumer spending this year and next. By reducing (though not eliminating) uncertainty regarding future profitability, the fading of the energy price shock should also support higher capital spending by firms.

Working in the opposite direction is the interest rate cycle, with policy rates now 350 basis points higher than this time last year. The persistence of 'core' inflation in the euro area means that financial markets are pricing in additional tightening of monetary policy this year. By raising borrowing costs, this is, and will continue to be, an important headwind for both households and firms.

Against this backdrop, Modified Domestic Demand (MDD) is projected to increase by 2.1 per cent this year, a 0.9 percentage point upward revision relative to the Department's autumn forecasts. For next year, an increase of 2.5 per cent is currently forecast. Relatively strong activity should pay dividends in the labour market, where further additions to employment are anticipated; indeed, the main barrier to employment growth is likely to be the availability of workers rather than insufficient demand for labour.

Risks to the near-term baseline outlook are judged to be tilted to the downside. While the likelihood of some of severe ('tail') risks has abated somewhat (energy outages in Europe), other tail risks have come to the fore, most notably the possibility that global financial stress spills over to the real economy.

This document also sets out longer-range economic forecasts. These confirm an easing in the trend growth rate of the Irish economy in the second half of this decade, as demographic change begins to take hold.

2.2 Macroeconomic developments in 2022

Higher energy prices were the main channel through which war in Ukraine was transmitted to the Irish economy last year. This supply-side shock compounded the more generalised pick-up in price inflation that pre-dated the war, the origins of which lay in a broader mis-match between demand and supply as the pandemic came to an end.

Domestic economic conditions last year were heavily influenced by the price shock. A pick-up in risk aversion was also a factor with, for instance, households continuing to save around 20 per cent of their disposable income. In addition, higher rates of 'core' (non-energy) inflation in the wider euro area triggered an aggressive tightening of monetary conditions in the second half of the year. Against this general backdrop, consumer spending increased by 6½ per cent last year (note that this full-year annual comparison is affected by the stringent lockdown in place during early-2021).

In terms of capital spending, just under 30,000 housing units were completed last year. Non-residential building and construction investment benefited from outlays of €10.2 billion under the *National Development Plan*, while there is some evidence that investment in commercial real estate may have peaked.

Elsewhere there was a significant boost to spending on machinery and equipment by the multinational sector, with several large projects contributing to record investment levels in this category (in time, this investment will generate additional exports). After reaching its highest level ever in the second quarter, spending on machinery and equipment retreated somewhat in the second half of the year, albeit remaining at relatively high levels.

Bringing all this together, MDD increased by 8.2 per cent in 2022. While figures for GNI* are not published until the summer, the Department estimates an increase of 9.3 per cent last year driven by the robust growth in MDD but also due to a strong contribution to domestic value-added from the multinational sector (via wages and corporation taxes).

On the external front, a robust export performance was recorded once again last year, despite the slowdown of demand in key export markets from the summer onwards. On a national accounts basis, exports were up 15 per cent (goods by 23 per cent, services by 7 per cent), with continued strong growth in pharma and ICT exports. In addition, the national accounts classification of exports includes the exports of certain goods produced in third countries under contract to Irish-resident firms; a very strong increase in these exports was logged last year. Imports of goods and services increased by 19 per cent, broadly in line with the change in final demand so that, in overall terms, GDP expanded by 12 per cent last year.

2.3 Macroeconomic projections for 2023 and 2024

The projections set out in this document incorporate the estimated economic impact of several key inter-related developments since the Department's autumn projections.[11] Firstly, demand in Ireland's main export markets has improved, *inter alia* reflecting the retreat of global oil and natural gas prices to mid-2021 levels. An additional impulse to world demand arises from the ending of the 'zero-Covid' policy and the associated re-opening of the Chinese economy. Second is the additional fiscal support provided by Government in mid-February, which will boost domestic demand this year. Lastly, the recent Windsor Framework between the EU and the UK provides greater certainty around post-Brexit arrangements for Northern Ireland. The EU-UK Trade and Cooperation Agreement continues to provide for tariff-free and quota-free trade between Ireland and the UK. The outworkings of Brexit will continue to be felt as the UK moves to introduce further import controls later this year, with particular implications for the Irish agri-food sector.[12]

[11] Published in *Economic and Fiscal Outlook*, Department of Finance (September 2022), available at: https://www.gov.ie/en/publication/7599a-budget-publications/
[12] The underpinning this forecast are that further UK import controls will be phased in and will apply to east-west trade from October 2023.

Box 1: Forecast vintages – comparison of spring forecast with autumn forecast

The Department produces two sets of forecasts each year, both of which are aligned with Ireland's legal obligations as a Member State of the euro area. Standard macro-economic indicators are provided but, as has been well documented, the information-content of GDP, balance of payments, etc. for Ireland is limited. Instead, modified macroeconomic metrics now published by the Central Statistics Office provide a better insight.

The shift to modified metrics as a means of deepening the understanding of the Irish economy has prompted some important innovations in the Department's approach to calibrating, and publishing, macro-economic forecasts.

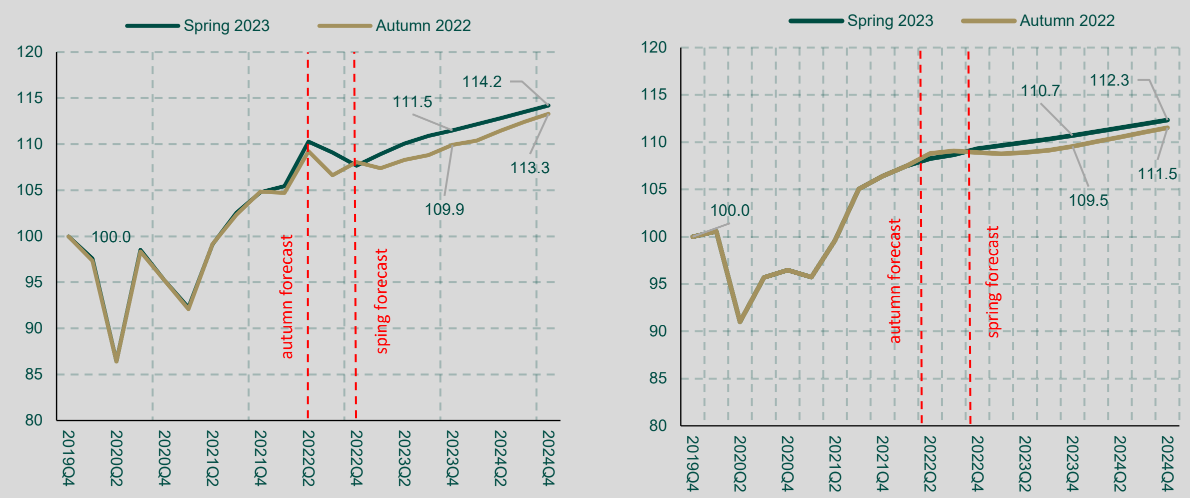
In particular, more meaningful metrics – such as MDD, modified investment – are now projected on a quarterly basis. Such an exercise made little sense for headline GDP and GNP figures, given the exceptional volatility of these variables in an Irish context.

As well as providing more detail to the Minister and Government, quarterly projections for key metrics provide a useful benchmark against which incoming data can be assessed.

Figure 1: Comparison of current forecast with previous vintage

A: modified domestic demand, 2019Q4 =100

B: employment, 2019Q4=100



Note: data labels show position at end-23, end-24
Source: CSO and Department of Finance.

Note: data labels show position at end-23, end-24
Source: CSO and Department of Finance.

The Department's quarterly projection for the (constant price) level of MDD until end-2024 (Q+8)^ are set out above (**figure 1A**). The data show that at end-2022, the level of MDD was broadly in line with the autumn projections (although the quarterly trajectory within the second half of last year was somewhat different).

For this year, an upward revision to MDD has been incorporated into the projection, reflecting the stronger underlying momentum in the domestic economy, particularly from consumer spending, as well as the additional fiscal stimulus introduced in February.

Taking into account outturn data for the second half of last year, as well as the assumption of stronger momentum this year, it is now envisaged that the level of MDD at the end of this year will be 1.4 per cent higher than assumed in the autumn forecasts. Relative to the pre-pandemic peak (final quarter of 2019), MDD at end-2024 is projected to be 14.2 per cent higher; the equivalent figure in the autumn vintage was 13.3 per cent.

The Department's quarterly projection for the level of employment is also set out (**figure 1B**). The level of employment at end-2022 was marginally higher than foreseen in the autumn forecasts (2.57 million vs 2.56 million).

In line with the assumption for stronger MDD growth this year, an upward revision to within-year employment growth has also been incorporated into the current set of forecasts: employment at end-2023 is now projected at 2.6 million, an average quarterly growth rate of 0.3 per cent.

Relative to the pre-pandemic peak, total employment at end-2024 is projected to be 12.3 per cent higher; the equivalent figure in the autumn vintage was 11.5 per cent.

^ Q+8 refers to 8-quarter ahead from the latest outturn.

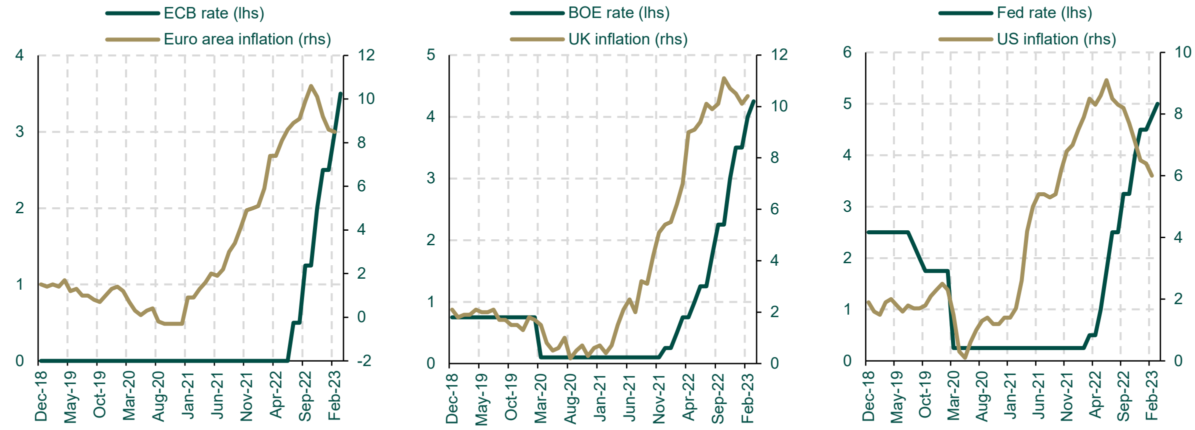
2.3.1 External economic environment

The broadening of inflationary pressures beyond energy prices remains the key factor shaping the economic situation in Ireland's key export markets. Incoming inflation data for the euro area, UK and US confirm that the pathway back to rates consistent with price stability is unlikely to be linear, with 'core' inflation expected to be somewhat persistent.

The associated shift in the stance of monetary policy (**figure 2**) represents a significant headwind in all regions, especially for interest-sensitive components of demand such as consumer and residential investment spending. Moreover, because the transmission of monetary policy to the real economy occurs with a lag, the impact on demand from aggressive policy tightening will take time to fully play out.

Figure 2: Monetary policy and inflation in key trading partners

A: euro area, per cent | **B: UK,** per cent | **C: US,** per cent



Source: Macrobond.
Note: inflation = HICP

Source: Macrobond.
Note: inflation = CPI

Source: Macrobond.
Note: inflation = CPI

That said, the macroeconomic data-flow in key export markets has, for the most part, surprised on the upside since the autumn. Several factors are behind this. First, a relatively mild European winter,[13] alongside conservation measures, has prompted lower demand for energy. Prices have, accordingly, fallen sharply from their highs recorded in the autumn, especially those for natural gas. Second, supply chain bottlenecks that weighed on production over the course of last year have unwound, *inter alia* due to the discontinuation of 'zero-Covid' in China. A third factor relates to the resilience of labour markets in most countries, with unemployment effectively at historical lows in many regions. Finally, budgetary policy has played an important stabilising role, with Governments in many countries deploying their balance sheets in a pro-active manner to shore-up private sector incomes.

These developments have prompted the main international forecasting agencies to incorporate modest upward revisions to near-term growth projections (**table 3**) relative to those that underpinned the autumn forecasts, with the exception of the UK. GDP is set to increase by 0.8 per cent this year in the euro area, followed by 1.4 per cent next year. For the US, the equivalent figures are 1.6 and 1.1 per cent, respectively, for this year and next. The UK is set to underperform (**box 2**) in the near-term, with a shallow contraction in economic activity assumed for this year. In all cases, price inflation is set to moderate, albeit slowly, although this is conditional upon no further energy price shocks.

[13] Data from the EU's Copernicus Climate Change service show that, this year, Europe had its third-warmest January on record.

Table 3: External assumptions, per cent change (unless stated)	2022	2023	2024	2025	2026
External GDP growth					
United States	2.1	1.6	1.1	-	-
Euro area	3.5	0.8	1.4	-	-
United Kingdom	4.0	-0.3	1.0	-	-
Technical assumptions					
Euro-sterling exchange rate (€1=)	0.85	0.88	0.88	0.88	0.88
Euro-dollar exchange rate (€1=)	1.05	1.07	1.07	1.07	1.07
Brent crude (dollars per barrel)	98.6	80.2	75.7	72.3	69.6

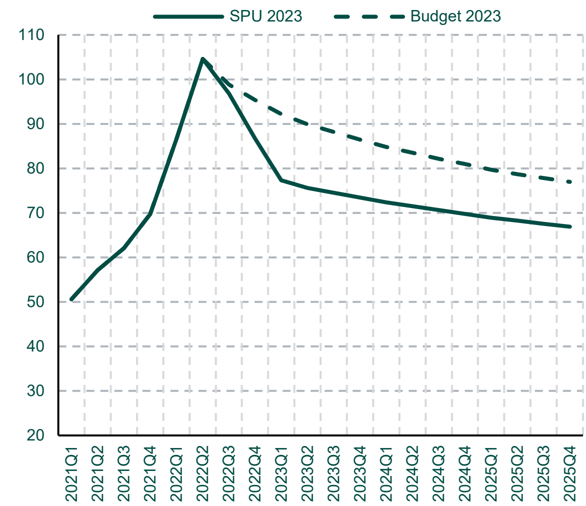
Source: Macrobond, IMF World Economic Outlook, Department of Finance calculations.

Notwithstanding this somewhat more optimistic assessment, it is clear that the external economic backdrop remains fragile, with heightened uncertainty a key feature of the global landscape. Geopolitical tensions remain high and are, by no means, confined to Europe. Any further escalation of tensions could trigger a 'risk-off' phase, in other words a tightening of global financial conditions, with spill-overs to household and business spending. The bank failures in the US and Switzerland during the spring highlight just how blurred the global economic situation is at present; in this type of environment, sentiment can be highly sensitive to the incremental data-flow, as market participants try to extract information regarding the scale of any vulnerabilities across the global system.

On the energy front, the risk of energy rationing in continental Europe has shifted to next winter (though post-winter storage levels remain relatively high), while the post-Covid rebound in the Chinese economy is an additional source of energy demand. At the same time, most advanced economies are transitioning from a prolonged period of rock-bottom interest rates, with borrowing costs having risen sharply in a short space of time. The adjustment to this higher interest rate environment could prove more challenging than currently suggested by the data. Finally, core inflation could prove more persistent than currently assumed, which might require additional policy action by central banks.

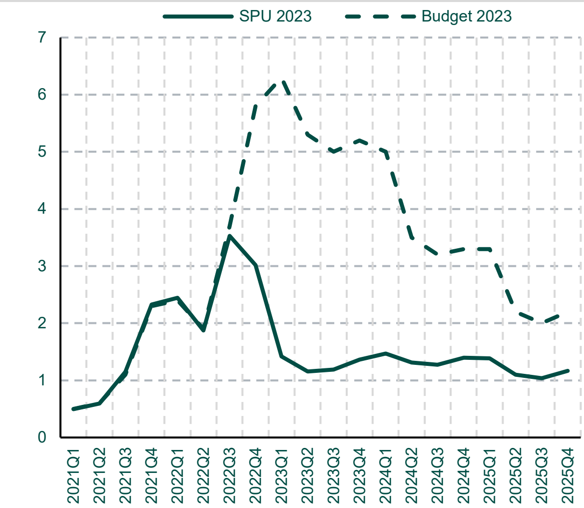
Figure 3: Global energy prices (at end-March)

A: **crude oil (Brent), €** per barrel



Source: Macrobond

B: **wholesale gas prices, £stg** per therm



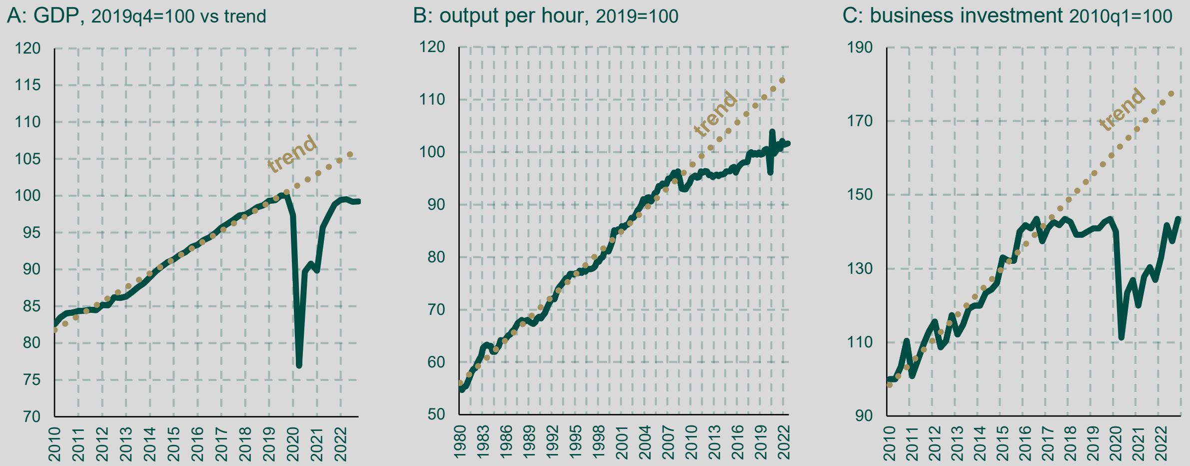
Source: Macrobond

Box 2: Key macro-trends in the UK economy – an overview

Notwithstanding much greater diversification over the past half century or so, the UK remains an important market for Irish exporters. This is especially the case for indigenous firms in more traditional sectors, mainly comprised of micro- as well as small- and medium-sized enterprises. Given its prominence as an export market for many labour-intensive, Irish-owned firms, monitoring economic developments in the UK economy is an important part of the Department's economic assessment toolkit.

The evolution of UK output, productivity and investment since the beginning of the last decade is set out below (**figure 4A**). The dashed line represents the trend growth between 2010-2019, extrapolated forward to 2022. In a sense, it represents a hypothetical scenario in which there had been no pandemic or energy price shock; in other words, it is a reasonable approximation as to what the level of activity might have been in the absence of the pandemic and war in Ukraine.

Figure 4: Key macro trends in the UK since 2010



Note: trend = 2010q1-2019q4. Source: Office for National Statistics
Note: trend = 1980q1-2019q4. Source: Office for National Statistics
Note: trend = 2010q1-2019q4. Source: Office for National Statistics

The most striking aspect is that, at the end of last year, the level of activity in the UK is not only 7/8 per cent below the level implied by the hypothetical no pandemic / no war scenario, it was also below its pre-pandemic level. This is in sharp contrast to other regions such as the euro area and US, where activity has surpassed pre-pandemic levels and almost back at levels implied by the pre-pandemic trend growth rate.

These trends beg the question as to source of the headwinds holding back economic activity in the UK. This is far-from an academic question, given the importance of demand in the UK for Irish producers. While a full diagnosis of the UK economy is beyond the scope of this box, it is insightful to group the various headwinds into short-term (demand) developments and medium-term (supply-side) factors.

A key short-term headwind relates to inflation where, given a relatively high dependence on natural gas as an energy source, the dynamics of UK consumer prices have been more adverse than elsewhere.^ Related to this, the monetary policy response in the UK has been more aggressive than in the euro area, which is also weighing on demand (it is also possible that the pass-through to the real economy is faster in the UK due to a greater home-ownership rates than in many euro area Member States).

Leaving aside these short-term factors, it is clear that the UK economy has underperformed in recent years, suggesting persistent supply-side factors at work. For instance, the post-pandemic participation rate is around 1 percentage point below its pre-pandemic level (the 'big quit'),^^ with most of this due to lower participation amount those aged >50 (early retirement, health issues associated with 'long-Covid'). Migration may also be a factor holding back labour supply, with the UK having formally exited the European Union at end-January 2020 and, in doing so, reduced net inflows (relative to the counter-factual scenario).

From a supply-side perspective, the other key input is labour productivity which, in the UK, has been almost stagnant since 2010 (**figure 4B**). While several explanatory factors have been put forward, perhaps the most compelling relates to the relatively low level of business investment (**figure 4C**), which has essentially moved sideways since 2016. One possible explanation for the stagnation in investment spending relates to heightened level of uncertainty regarding prospects for the UK economy upon exiting the European Union, with firms less likely to undertake large capital outlays against the backdrop of a more uncertain macro-economic environment.

^ UK inflation vis-à-vis other jurisdictions is evident from the main text (**figure 2B**).
^^ The change in UK labour force participation rates is evident from the main text (**figure 10A**).

The forecasts in this document are conditioned on the pathway for energy prices currently signalled by the futures curve.[14] This would imply oil prices averaging around €75 per barrel this year and €70 at the tail-end of next year (**figure 3A**); natural gas prices would be £1.3 per therm this year and £1.4 per therm at the end of next year (**figure 3B**). In calibrating the Department's forecasts, the pass-through from wholesale to retail prices is guided by historical norms which, in the case of natural gas, can be with a significant lag.[15]

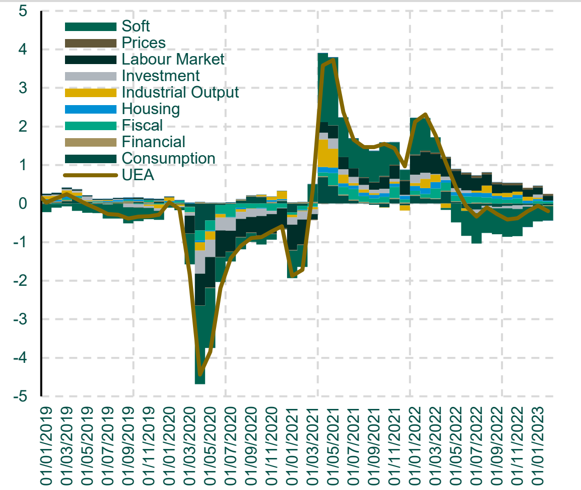
Diverging economic trends, and the associated differences in the pathway for monetary policy, were behind the rise in capital inflows to the US over the course of last year; 'safe-haven' flows may also have been at work. The upshot was an appreciation of the US dollar, including vis-à-vis the euro. This was partly reversed in the final quarter of last year and first quarter of this year. The euro-dollar bilateral rate averaged around €1 = $1.06 in the first half of March; on the basis of the purely technical assumption of no further change over the remainder of the forecast horizon, this would imply a 1.2 per cent euro-dollar appreciation this year relative to last. A similar, purely technical approach results in an implied euro-sterling appreciation of around 3 per cent this year relative to last year.

2.3.2 Domestic prospects

In light of the easing of energy prices and a general, albeit modest, improvement in the external outlook, prospects for the domestic economy are somewhat better than envisaged in the Department's autumn forecasts. Also underpinning this assessment is the relative strength of consumer spending in the second half of last year which, in part, reflected continued resilience in the labour market. Working in the opposite direction is the interest rate tightening cycle: the spending and investment decisions of households and firms will be tempered by the higher cost of borrowing resulting from increases in the policy rate. Meanwhile incoming dataflow suggests the economy has made a slow start to the year, as confirmed by the Department's underlying economic indicator which indicate below average growth in the first quarter (**figure 5**).

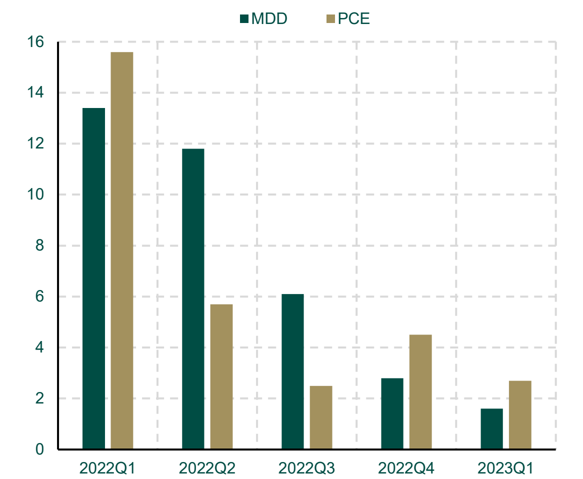
Figure 5: Department of Finance nowcasts[16]

A: underlying economic indicator



Note: average growth = 0
Source: CSO, Department of Finance

B: nowcast, year-on-year per cent change



Source: CSO, Department of Finance

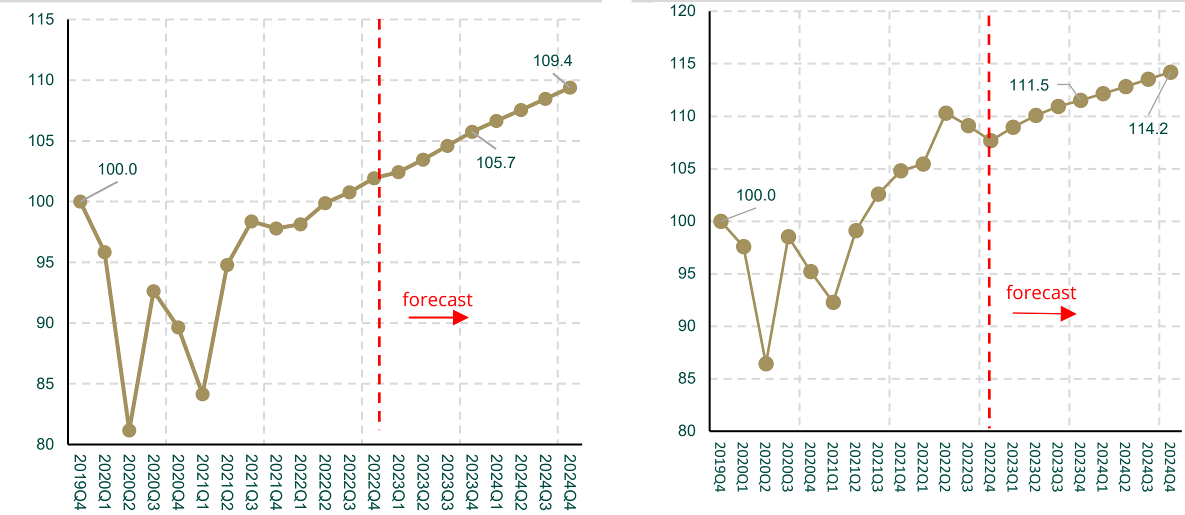
[14] The price market participants are willing to pay for energy to be delivered at some point in the future
[15] See Box 5: Energy prices – wholesale and retail price dynamics, *Stability Programme, April 2022 Update*, Department of Finance (2022), available at:
https://www.gov.ie/en/publication/1ca1d-draft-stability-programme-update-2022/.
[16] For details on the methodology see *Where are we now?* Department of Finance (2020), available at: https://www.gov.ie/en/publication/e6b3a7-where-are-we-now-examining-irish-economic-developments-in-real-time/

The key driver of near-term economic prospects will be the evolution of household income. The main source of this is labour income which should benefit from continued employment growth alongside increases in per-capita earnings, the latter reflecting the strength of labour demand relative to supply. In aggregate terms, nominal household disposable income is set to rise by around 5¾ per cent; while real (inflation-adjusted) earnings are set to strengthen as the year progresses as price inflation moderates.

In terms of consumer spending, the forecasts are calibrated on the assumption of a modest rise in nominal spending relative to the autumn forecast, reflecting higher incomes partly offset by increased outlays on mortgage debt service. However, most of the revisions from autumn take place on the real side, with the lower inflation rate allowing a shift in expenditure from prices to volumes – in other words, a greater quantity of goods and services can now be purchased for a given level of expenditure. In terms of the quarterly profile for consumer spending (**figure 6A**), following relatively modest growth in the first quarter, the pace of growth is assumed to accelerate from the second quarter as the easing in inflation gains pace.

Figure 6: Quarterly projections for key domestic indicators

A: quarterly profile for consumer spending, 2019q4 = 100 | B: quarterly profile for MDD, 2019q4 = 100



Note: data labels show level of activity at end-23, end-24
Source: CSO, Department of Finance

Note: data labels show level of activity at end-23, end-24
Source: CSO, Department of Finance

With the savings rate assumed to moderate this year, from a very high level of almost twice the long run 'norms',[17] overall consumer spending is expected to expand by 3.9 per cent this year. For next year, growth in consumer spending is projected at 3.8 per cent.

The outlook is more nuanced for capital spending. Research shows that the pre-pandemic trend of under-investment by Small- and Medium-sized firms has not radically changed.[18] Instead, investment spending in recent quarters has been largely driven by expansions of manufacturing facilities and data centres by the multinational sector. The large jump in this category of spending to record levels last year is unlikely to be repeated, thus lowering the overall growth profile for investment in machinery and

[17] As noted by Timoney, (2022), alternative estimates of consumption since the onset of the pandemic imply a lower overall savings rate. Available at: https://www.fiscalcouncil.ie/wp-content/uploads/2022/11/Household-Consumption-and-Savings-in-Ireland-Since-the-Covid-19-Pandemic-Fiscal-Council-Analytical-Note-18-by-Kevin-Timoney.pdf
[18] See recent analysis by Department of Finance and ESRI as part of the Joint Research Programme on the macroeconomy, taxation and baking : https://www.esri.ie/system/files/publications/SUSTAT113_0.pdf and Department of Finance SME Credit Demand Survey: https://www.gov.ie/en/publication/f5830-sme-credit-demand-survey-april-2022-to-september-2022/

equipment. That said, investment in this component of demand is expected to remain at high levels in line with the improved global economic environment and continued tightness in the labour market.[19]

On the construction side, last year saw the highest level of new housing supply since 2008, with nearly 30,000 units coming on-stream. Pipeline data point to a slight moderation in the level of completions this year, while the higher interest rate environment represents a further headwind for new housing starts.[20] Higher borrowing costs could also weigh on other forms of construction, while a moderation in demand for office space (due to hybrid working) is assumed to also weigh on commercial real estate spending.

Table 4: Macroeconomic prospects, per cent change (unless stated)

	2022	2023	2024	2025	2026
Economic activity			***per cent change***		
Real GDP	12.0	5.6	4.1	4.9	4.4
Nominal GDP	17.9	9.8	6.5	7.2	6.6
Real GNI*	9.3	1.6	2.1	2.5	2.3
Nominal GNI*	15.3	5.2	4.9	5.1	5.1
Real modified domestic demand	8.2	2.1	2.5	3.2	3.4
Components of GDP			***per cent change***		
Personal consumption	6.6	3.9	3.8	3.4	3.4
Government consumption	0.7	0.5	0.8	2.0	1.5
Investment	25.9	2.4	3.3	3.8	4.4
Modified investment^	19.8	-0.6	1.2	3.7	4.9
Stock changes^^	1.0	0.0	0.0	0.0	0.0
Exports	15.0	7.8	4.9	5.4	4.7
Imports	19.0	6.4	4.3	4.4	4.1
Modified imports	17.1	6.8	4.2	4.5	4.1
Contributions to GDP growth			***percentage points***		
Modified domestic demand	3.9	0.6	0.8	1.1	1.2
Modified net exports	7.1	5.0	3.3	3.7	3.2
Stock changes	1.0	0.0	0.0	0.0	0.0
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0
Nominal amounts			***€ millions***		
GDP (nearest €25m)	502,575	551,850	587,800	629,875	671,750
GNI* (nearest €25m)^^^	269,750	283,675	297,625	312,925	328,900

^ modified investment excludes investment in aircraft for leasing and investment in R&D from abroad; ditto for modified imports.
^^ contribution to GDP growth.
^^^ based on GNI less depreciation of R&D-related service imports and trade in IP, depreciation of aircraft for leasing, and net factor income of re-domiciled PLCs.
GNI* for 2022 is Department of Finance estimate.
Source: 2022 = CSO; 2023-26 = Department of Finance.

Taking all of these factors into account, modified investment is expected to fall by -0.6 per cent this year, with an increase of 1.2 per cent assumed for next year. The annual decline reflects the exceptionally high level of machinery and equipment last year and its 'normalisation' this year.

[19] The relative price of capital tends to fall as labour supply constraints become more binding, prompting substitution of labour with capital.
[20] See Economic Insights - Spring 2023, Department of Finance (February 2023), available at: https://www.gov.ie/en/publication/2c8b4-economic-insights-spring-2023/

Table 5: Key macroeconomic variables – quarter-on-quarter, per cent change (unless stated)

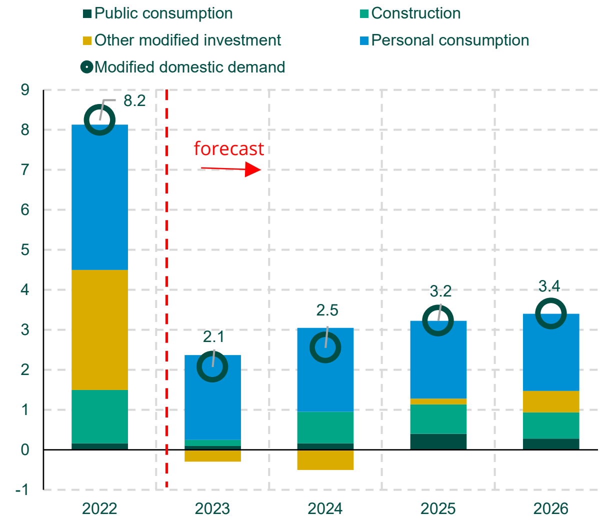
	2023				2024			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Consumer spending	0.5	1.0	1.1	1.1	0.9	0.9	0.9	0.9
Modified domestic demand	1.2	1.1	0.8	0.5	0.6	0.6	0.6	0.6
Inflation rate (annual per cent)	7.4	4.7	3.7	3.6	3.7	2.8	2.1	1.4
Unemployment rate (per cent)	4.4	4.4	4.4	4.4	4.4	4.5	4.5	4.5

Note: seasonally adjusted data (except for inflation rate).
Source: Department of Finance.

Against this backdrop, MDD growth of 2.1 per cent is projected for this year (**table 4**), an upward revision of 0.9 percentage points relative to the autumn forecast. The quarterly profile is set out above (**figure 6B**). For next year, MDD growth is projected at 2.5 per cent (**figure 7A**), lower than envisaged in the previous set of forecasts.

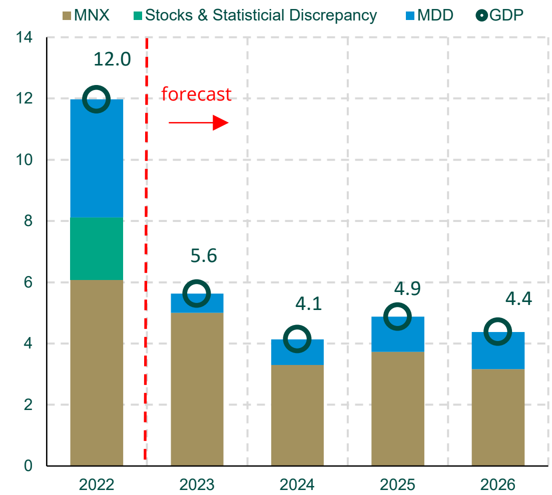
Figure 7: Contributions to modified domestic demand and to GDP, percentage points

A: contributions to change in MDD



Notes: Other modified investment is machinery and equipment excluding investments in aircraft by the leasing sector, plus domestic R&D.
Source: CSO, Department of Finance

B: contributions to change in GDP



Notes: MNX = Modified net exports is net exports (exports less imports) excluding investments in aircraft by the leasing sector and net R&D imports.
Source: CSO, Department of Finance

Sectoral evidence suggests a moderation in the rate of export growth this year. For instance, the demand for vaccines and Covid-related therapeutics is unlikely to be as strong as last year. Accordingly, the exceptional performance of the pharmaceutical sector last year, where the value of exports expanded by 30 per cent, is unlikely to be repeated. The ICT sector – another key driver of exports since the pandemic – appears to be in a correction phase, adjusting to the post-pandemic steady-state. The other main sectoral contributor in recent years has been exports related to out-sourced 'contract manufacturers'. These are extremely difficult to project with any degree of accuracy: the Department's approach involves the technical assumption that these exports grow in line with overall goods exports.[21]

[21] A technical assumption rather than a variable that can be explicitly modelled.

Indigenous exports such as food and beverages, tourism, etc. should benefit from the improved global outlook. An important caveat is that in the UK – a key market for these sectors – an outright fall in output is expected, which may impact on demand. The delay in the introduction of full customs procedures by the UK authorities under the *Trade and Cooperation Agreement* until at least 2024 will support indigenous exports this year, but will ultimately be a headwind once fully implemented.[22]

In aggregate terms, an annual increase of 7.8 per cent for exports of goods and services is projected for the year, with a further expansion of 4.9 per cent assumed for next year.

With modified import growth of 6.8 per cent – broadly in line with modified final demand – GDP is projected to increase by 5.6 per cent this year (**figure 7B**). For next year, GDP growth is forecast at 4.1 per cent. GNI*, a de-globalised measure of national income, is expected to increase by 1.6 per cent this year, followed by 2.1 per cent next year.

2.4 Price developments

Consumer price inflation accelerated sharply over the course of last year, with an annual average rate of just over 8 per cent recorded for the year as a whole (**table 6**). To put this into perspective, it compares with average inflation of just ½ per cent per annum in the previous decade (or to put it another way, the price level increased by 8 per cent in one year, compared to a cumulative price level increase of 8 per cent over the period 2006 to 2020). Almost all advanced economies were in the same position with, for instance, euro area inflation averaging almost 8½ per cent last year.

Table 6: Price developments, per cent change

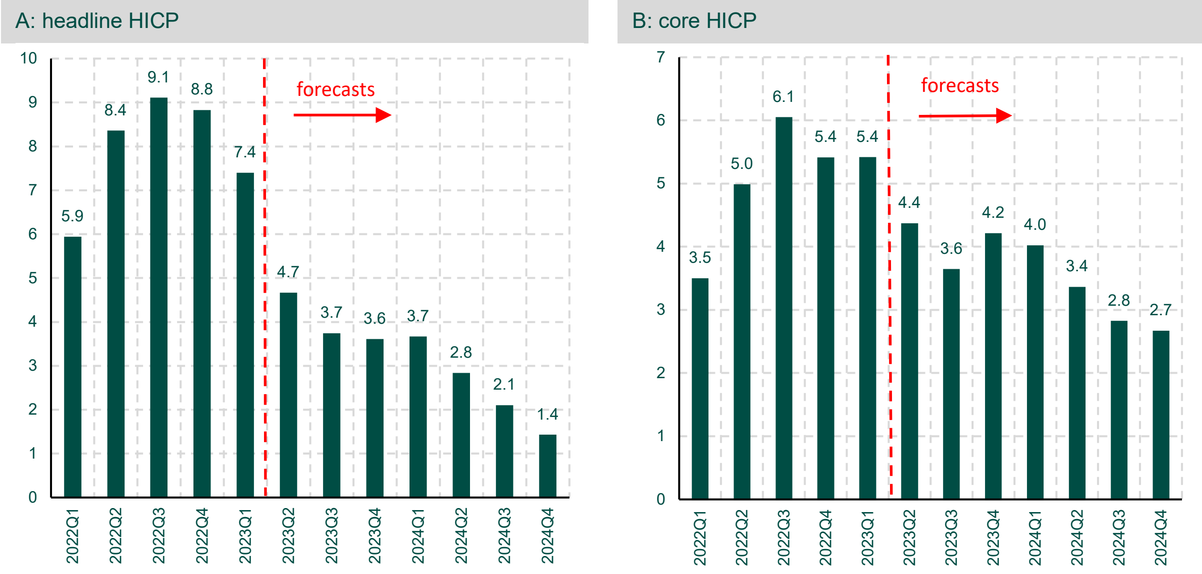
	2022	2023	2024	2025	2026
GDP deflator	5.3	4.0	2.3	2.2	2.2
Personal consumption deflator^	6.6	4.9	3.7	3.1	3.0
Harmonised index of consumer prices	8.1	4.9	2.5	2.0	2.0
Core HICP inflation^^	5.0	4.4	3.2	2.6	2.5
Export price deflator	4.5	2.6	1.4	1.4	1.4
Import price deflator	3.9	1.9	1.5	1.5	1.3
Terms-of-trade	0.5	0.7	0.0	0.0	0.0

Notes:
^ personal consumption deflator has been above headline HICP in recent years. The gap is largely explained by differences in the weights assigned to the goods and services in the HICP and consumption baskets.
^^ core inflation is HICP inflation excluding the most volatile components, namely energy and unprocessed food.
Source: 2022 = CSO; 2023-26 = Department of Finance.

Pandemic-related mismatches between demand and supply were behind the initial pick-up in consumer price inflation from mid-2021. The subsequent increase in wholesale energy prices triggered by Russia's invasion of Ukraine resulted in a rapid acceleration in headline inflation from the spring of last year. There was also evidence of indirect (spill-over) effects, with higher energy input prices passing-through to non-energy output prices, as firms sought to maintain margins: 'core' inflation, for example, accelerated sharply in the second half of last year.

[22] For the purposes of these projections, full implementation of the agreement is not assumed to take place until the start of 2024.

Figure 8: Quarterly inflation projections, annual per cent change



Source: Department of Finance

Source: Department of Finance

Energy prices have now retreated from their highs of last year. In particular, wholesale gas prices have moderated significantly: after peaking at around £4 per therm in August, spot prices are now around £1.1 per therm. In late-March, the month-ahead wholesale price fell below £1 per therm for the first time since mid-2021. The hedging strategies used by energy suppliers mean there will be a lag before recent declines in wholesale gas prices are passed on to the retail level (in the same way that there was a lag between wholesale and retail price increases last year).

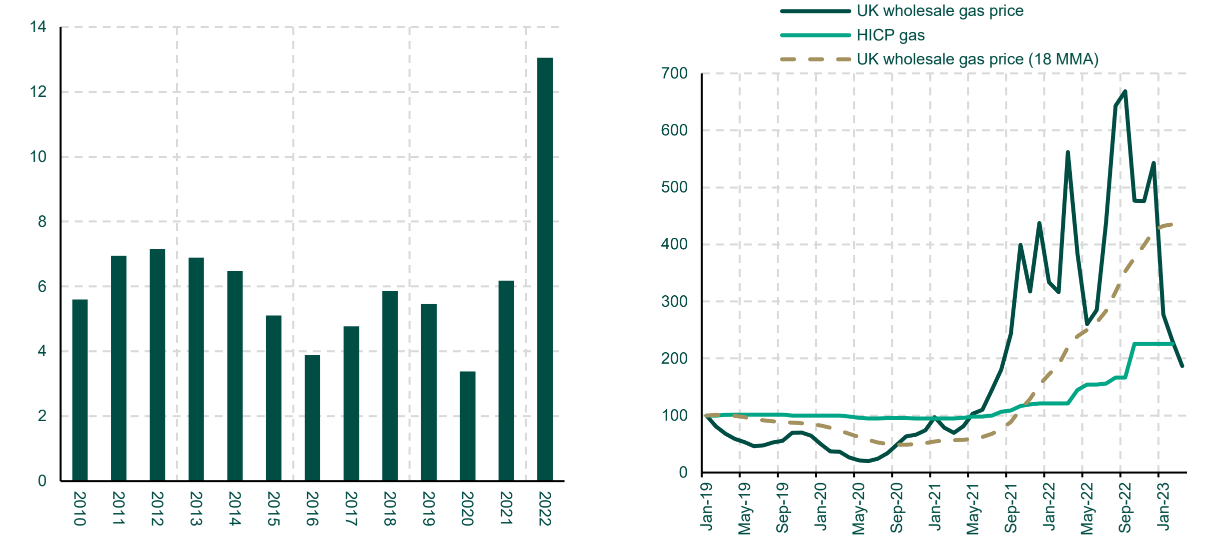
This easing in wholesale energy markets suggests that headline inflation is past its peak and now on a downward trajectory. By the final quarter of this year, headline inflation is projected at 3.6 per cent (**figure 8A**). The strength of demand, alongside continued supply bottlenecks in some areas (including in the labour market), means that core inflation will decelerate more slowly (**figure 8B**). For this year as a whole, headline inflation is currently projected at 4.9 per cent, with 'core' inflation at 4.4 per cent. For next year, the headline and core rates are projected at 2.5 and 3.2 per cent, respectively. The balance of risks are titled to the upside, particularly with respect to core inflation, which could prove 'stickier' and more durable than in the baseline assessment.

Given the scale of the traded sector in Ireland, the terms-of-trade (i.e. the price of exports relative to imports) is a key variable in driving the GDP deflator. Despite the large increase in the price of imported goods last year – the direct result of a higher imported energy bill, which was nearly €7 billion (2.6 per cent of GNI*) higher than in the previous year (**figure 9A**) – the overall terms-of-trade remained positive. This was because of an even stronger increase in export prices, largely reflecting the composition of Ireland's export portfolio. A small increase in the terms-of-trade is expected again for this year, with exports prices increasing at a faster rate than import prices, reflecting *inter alia* the decline in imported energy prices.

Overall, the GDP deflator – a whole-economy measure of price developments – is expected to increase by 4 per cent in 2023. With real GDP projected at 5.6 per cent this would result in nominal GDP growth of 9.8 per cent this year. For next year, the GDP deflator is currently projected at 2.3 per cent; this would result in nominal GDP expansion of 6.5 per cent based on a real growth rate of 4.1 per cent.

Figure 9: Energy prices

A: energy import bill, € billions | B: retail and wholesale prices, Jan 2019=100



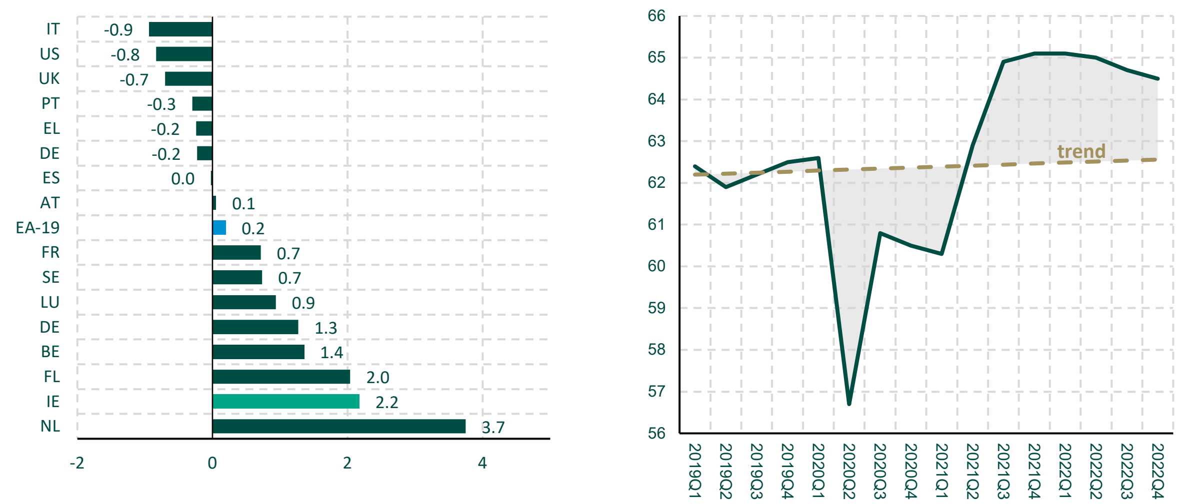
Source: CSO | Source: Department of Finance

2.5 Labour market developments

The significant budgetary support provided by Government to help firms and workers navigate the pandemic helped pave the way for a rapid recovery in the labour market.

Figure 10: Labour market developments

A: change in labour force participation, Q422 v Q419 | B: Ireland – participation rate, age 15+, s.a.



Note: Participation rate, age 15+
Source: OECD.

Note: trend = 2015-2019
Source: CSO.

This is borne out in the data: an additional 160,000 jobs were added over the course of last year, with employment levels reaching a record high of almost 2.6 million in the final quarter of the year. This was an expansion of around 220,000 jobs relative to the pre-pandemic level, driven by additions to the labour force (higher participation rates and (net) inward migration). The participation rate at end-2022 was c. 2 percentage points ahead of its pre-pandemic level; while part of this reflects the cyclical position of the economy,[23] the scale of the change suggests that structural shifts, such as the higher incidence of hybrid-working, have allowed more persons to enter, or remain in, the labour market.

For this year and next, employment growth of 1.6 and 1.4 per cent, respectively, is projected, consistent with the outlook for MDD growth. Strong employment growth has prompted a rapid decline in the unemployment rate which, at just over 4¼ per cent in the first quarter, is consistent with any reasonable estimate of 'full employment'. In the absence of any disturbance to the labour market, unemployment is projected to remain at low rates through this year and next year. The labour market projections are calibrated on the assumption that labour supply – as opposed to labour demand – remains the binding constraint on employment growth over the next year or so. These imbalances in the labour market could potentially trigger a shift in relative bargaining power.

Table 7: Labour market developments, per cent change (unless stated)

	2022	2023	2024	2025	2026
Employment	6.6	1.6	1.4	1.5	1.6
Unemployment (per cent)	4.5	4.4	4.5	4.5	4.5
Labour productivity^	5.0	4.0	2.7	3.4	2.8
Wages per head	4.2	5.6	5.0	4.8	4.3
Compensation of employees^^	11.3	8.3	6.9	6.7	6.4

Notes:
^ GDP per worker
^^ non-agricultural sector.
Source: 2022 = CSO; 2022-26 = Department of Finance.

Nominal wage inflation – at just over 4 per cent – lagged the increase in consumer prices last year, a feature that was common across advanced economies. This erosion of purchasing power is set to be reversed over the course of this year and next: nominal wage growth should benefit from the mis-match between demand and supply, while inflation is set to moderate.

2.6 Balance of payments and flow-of-funds

Interpreting balance of payments trends in Ireland is complicated by cross-border purchases of *inter alia* intangible assets and aircraft for leasing purposes. Since the mid-part of the last decade, these cross-border flows have been exceptionally large relative to the size of the economy, meaning the headline balance of payments current account is exceptionally volatile on a year-to-year basis. The modified current account (CA*) removes most of these distortions and, as such, is a more meaningful representation of economic transactions between domestic residents and the rest of the world.[24] The evolution of CA* is set out below.

While outturn data are not yet available, the Department estimates a modified current account surplus of 9.7 per cent of GNI* last year, the result of an excess of savings over investment in the domestic sectors. In the main, this reflects the improved headline position of the government sector alongside elevated levels of savings, relative to investment, in the household sector (due to under-investment in new housing assets).

[23] Participation rates tend to be 'pro-cyclical', i.e. they tend to move in-sync with demand.
[24] For more on recent developments in the CA* and the Savings-Investment balance, see Economic Insights - Winter 2022, Department of Finance (December 2022), available at:
https://www.gov.ie/en/publication/2e14a-economic-insights-winter-2022/

Table 8: Savings, investment and the balance of payments, per cent of GDP (unless stated)	2022	2023	2024	2025	2026
Gross savings	37.4	38.3	38.3	38.5	38.6
Modified gross savings (per cent GNI*)	34.6	33.4	32.7	32.2	31.9
of which:					
- households	10.9	9.7	8.4	7.5	6.9
Investment^	28.6	27.2	26.7	26.3	26.0
Modified investment (per cent GNI*)	25.0	24.3	24.0	24.2	24.6
of which:					
- households	3.7	3.6	3.9	4.1	4.3
Current account	8.8	11.2	11.6	12.3	12.5
of which:					
- trade balance	37.3	39.6	40.1	40.9	41.4
- income balance	28.5	28.4	28.5	28.7	28.9
Modified current account (per cent GNI*)	9.7	9.1	8.7	8.0	7.2

Notes: ^ More specifically, gross capital formation which is the sum of gross domestic fixed capital formation, changes in stocks and the statistical discrepancy.
Source: CSO; Department of Finance.

The CA* is projected to remain in surplus in 2023, though the excess of savings over investment is expected to be lower than in recent years, mainly due to reduced levels of savings in the household sector. In later years, the CA* surplus is set to narrow further, in line with higher levels of investment in new housing assets and the re-normalisation of savings behaviour by the household sector.

2.7 Medium-term economic prospects

Medium-term prospects are determined by the availability of capital and labour, together with the efficiency (total factor productivity) with which these are combined to produce output. Beyond the short-term, economic activity is assumed to evolve in line with the economy's supply capacity, which is assumed to moderate slightly over the medium–term in line with *inter alia* an ageing population. The Department's medium term estimate of the supply potential is based on long-term assessment of labour supply, the capital stock and total factor productivity, a summary of which is set out below (**box 3**),[25] with a more detailed description set out in *Hogan, Rehill and Sanjani (2023)*.[26]

Forecasts for aggregate demand, consistent with these supply-side estimates are presented below (**table 9**). The motivation for the production of demand-side projections is two-fold: firstly, to provide a benchmark against which key components such as consumer spending and investment are likely to evolve and, secondly, to facilitate the production of granular taxation forecasts over the medium-term (which will be set out at a later stage).

[25] See also the Department's presentation to the Irish Fiscal Advisory Council (op cit.)
[26] Hogan S., Rehill L., Sanjani MT., *Downbound Train: how demographics may derail long-run economic growth in Ireland*, Department of Finance working paper (forthcoming).

Table 9: Medium term forecasts – key macro variables

	2024	2025	2026	2027	2028	2029	2030
Personal consumption	3.8	3.4	3.4	3.1	2.9	2.7	2.5
Modified investment	1.2	3.7	4.9	5.0	4.7	4.2	4.2
Modified Domestic Demand	2.5	3.2	3.4	3.1	3.1	2.8	2.7
Exports	4.9	5.4	4.7	4.0	4.0	4.0	4.0
GNI*	2.1	2.5	2.3	2.2	2.1	2.1	2.1
Labour force	1.4	1.5	1.6	1.0	0.7	0.6	0.6
Employment	1.4	1.5	1.6	1.0	0.6	0.6	0.6
Unemployment rate	4.5	4.5	4.5	4.6	4.7	4.7	4.7
Inflation (HICP)	2.5	2.0	2.0	2.0	2.0	2.0	2.0
GNI*, nearest € bn	297.6	312.9	328.9	344.3	360.5	376.7	393.5
GDP, nearest € bn	587.8	629.9	671.8	711.8	754.0	798.0	843.9

Source: Department of Finance calculations

Box 3: Horizon scanning – calibrating medium-term economic projections

The approach to constructing medium- and long-term economic projections is grounded on a 'growth accounting' framework, based on Robert Solow's (1956) methodology. This involves decomposing growth in GNI* into the contribution of factor inputs (capital and labour) and total factor productivity (TFP). Long-term growth can then be captured through this production-function approach by forecasting the labour, capital and TFP components individually (**figure 11A**).^

The labour contribution to production is determined by the total hours worked in the economy. This depends, first of all, on the size of the population, which in turn is determined by the "natural increase" arising from births less deaths in a given year, as well as the level of net migration. With a rapidly ageing population, the natural increase in Ireland's working age population is slowing over the forecast horizon.

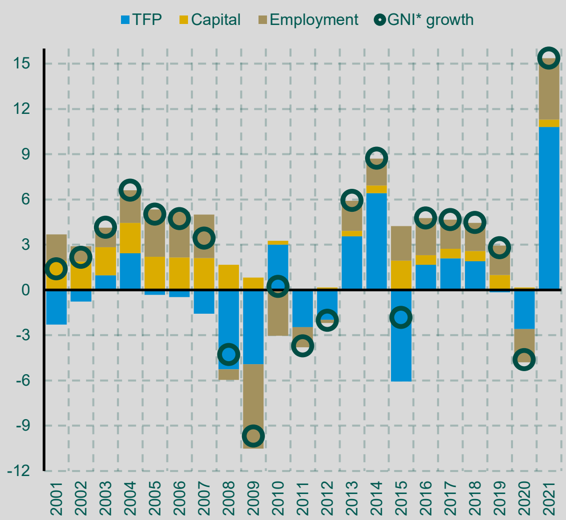
Given the demographic factors at work, with a higher share of older workers in the labour force, the participation rate is also expected to decline over the coming years. Unemployment is assumed to remain at its "natural rate" of slightly below 5 per cent over the forecast horizon, while average hours worked is assumed to be marginally below pre-pandemic levels. Combining all these factors gives a declining labour contribution to GNI* over the forecast period (**figure 11B**).

The capital contribution is determined by the rate of investment over the forecast period. The *National Development Plan* and private investment requirements for 'greening' should see levels of overall investment (as a share of GNI*) be at least as high as their long-term average over the horizon.^^

TFP is expected to converge towards a yearly growth rate of 0.8 percentage points by 2030. This is consistent with the Fiscal Council (2020), the EU Ageing Working Group (2023), and the historical average of TFP in the most recent decade (2010-2019).

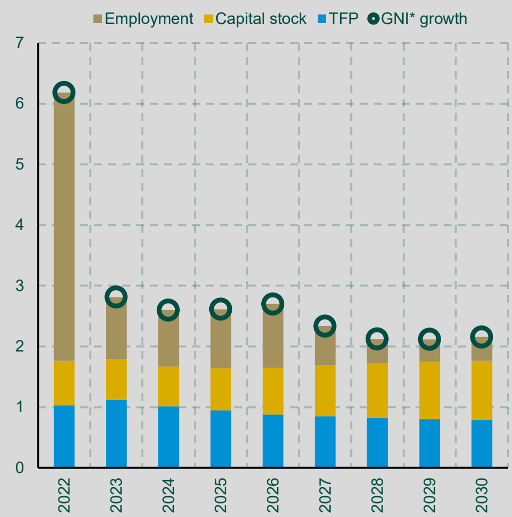
Figure 11: Accounting for growth in the medium-term

A: historical growth decomposition, 2001-2021



Source: Department of Finance.

B: medium-term projections, 2022-2030



Source: Department of Finance.

By putting these three components together, a forecast of the 'supply side' of the economy can be constructed. As expected it shows a declining contribution from labour due to demographic factors, while capital and TFP continue to contribute to most of GNI* growth.

These contributions result in GNI* growth of 2¼ percentage points by the end of the forecast horizon, compared to 2½ per cent on average over the previous decade. This figure is used to anchor the 'demand side' economic projections in this document, as well as labour market developments.

Given uncertainty regarding some of the key inputs, upside (high-growth) and downside (low-growth) scenarios based on this approach are described in later in this document (**chapter 6**).

^ A similar analysis of GNI* per capita growth and changes in living standards over recent decades was conducted for the Department of Finance Economic Insights – Spring 2022 series.
^^ Department of Finance Economic Insights – Spring 2023; "*Climes are Changing: the possible macroeconomic implications.*"

Chapter 3
Exchequer Developments and Outlook

3.1 Summary

Last year the Exchequer recorded a surplus of €5 billion, though the headline position was flattered by yet another large increase in corporation tax receipts. If these 'windfall' corporation tax receipts are excluded, the Exchequer accounts would have recorded a deficit once again last year. Temporary policy measures to help households and firms navigate the tail-end of the pandemic and the energy price shock triggered by the war in Ukraine were key factors behind this underlying deficit.

An Exchequer surplus of €4.5 billion is in prospect this year. The modest deterioration in the Exchequer position reflects the transfer of €4 billion to the *National Reserve Fund* earlier this year (compared with a transfer of €2 billion last year). On an existing policy basis, involving (net) core public expenditure rising by 5 per cent, a headline surplus is in prospect again for next year.

As highlighted earlier, uncertainty regarding near-term economic prospects remain elevated; a less favourable economic outcome would have a direct read-across to the public finances, mainly via lower tax receipts.

3.2 Exchequer Outturn 2022

Tax receipts amounted to €83.1 billion in 2022, up almost €15 billion (over 21 per cent) on the previous year. The post-pandemic rebound in economic activity was responsible for the lion's share of this, with nominal GDP increasing by an estimated 18 per cent last year. A key factor behind the jump in GDP was the strong growth in corporate profitability; this, in turn, prompted an almost 50 per cent increase in corporation tax receipts. Elsewhere, tax revenue increased by 14 per cent last year, underpinned by the recovery in the labour market and consumer spending.

Non-tax revenue amounted to €2.4 billion, down slightly from a year earlier, with the increase in Central Bank of Ireland (CBI) surplus income almost offsetting a decline in National Asset Management Agency (NAMA) surplus income. Capital receipts, which include EU funding under the *Brexit Adjustment Reserve* (€0.3 billion), the proceeds arising from the sale of bank shares (€1.4 billion) and repayment of intra-month loans to the *Social Insurance Fund* (€2.4 billion), amounted to €5.2 billion last year, compared with €11.3 billion a year earlier.[27]

Gross voted expenditure last year was just under €89 billion, composed of nearly €78 billion in current and €11 billion in capital expenditure. Voted spending was €1.2 billion (1.4 per cent) higher than a year earlier, though the annual comparison is affected by the significant decrease in pandemic-related public expenditure last year (non-core expenditure fell by €4.7 billion), as restrictions were lifted at the end of the first quarter. Core expenditure amounted to €80 billion, an annual increase of €6 billion reflecting increased investment in core public services. Core current expenditure was broadly in line with the parameters set out in the *Summer Economic Statement*. While areas of capital expenditure were lower than planned, overall capital spending levels were €1 billion higher than in 2021.

[27] The large decrease in capital resources and non-voted capital expenditure in 2022 was due to a decline in monthly Exchequer cash flow loans, which ceased from end-June last year, to the Social Insurance Fund reflecting the recovery in the labour market and, hence, PRSI income. These transactions have no impact on the Exchequer balance.

Temporary, non-core supports continued to be provided last year, including in relation to the pandemic. In-year developments resulted in a re-purposing of non-core expenditure towards new challenges: namely cost of living pressures and the provision of humanitarian assistance to Ukrainians migrants. Around €8.8 billion of spending in 2022 was 'non-core'.

Non-voted current expenditure of €7.8 billion was recorded last year, a modest annual increase. Both debt servicing costs and Ireland's contribution to the EU Budget were slightly higher. Non-voted capital expenditure amounted to €5.2 billion; this was primarily composed of the transfer to the *National Reserve Fund* (€2 billion) and intra-month loans to the *Social Insurance Fund* (€2.4 billion), although the latter has no impact on the Exchequer position (as the loans were repaid from the *Social Insurance Fund*).

In aggregate terms, therefore, an Exchequer surplus of €5 billion was recorded last year. 'Windfall' corporation tax receipts are estimated at almost €11 billion; if these were excluded, a significant deficit would have been recorded.

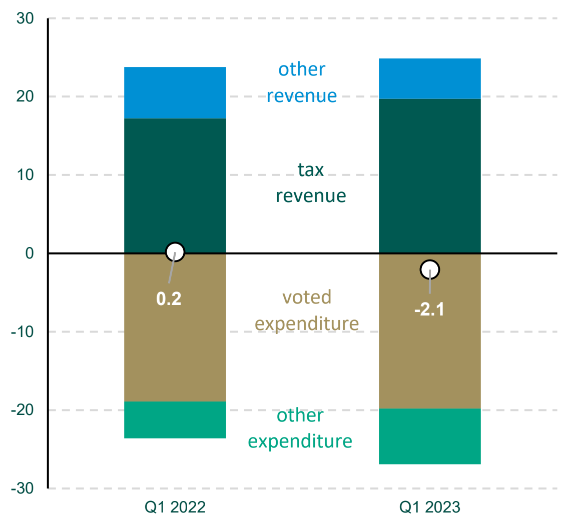
3.3 Exchequer outlook for 2023 and 2024

3.3.1 Tax forecast

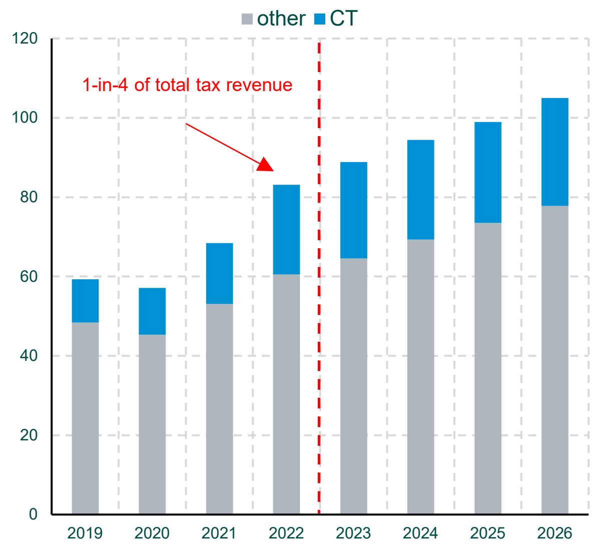
At the end of the first quarter, taxation receipts were up €2.5 billion (almost 15 per cent) on the same period last year (**figure 12A**). Direct taxes – income and, in particular, corporation tax – recorded very strong growth while, in terms of indirect taxes, VAT receipts were very robust.

Figure 12: Exchequer developments

A: composition of Exchequer balance, € billions



B: tax receipts, € billions



Notes: IT = income tax; CT = corporation tax.
Source: Department of Finance

Source: Department of Finance

Annual tax revenue is projected at €88.9 billion for this year, an annual increase of almost 7 per cent. This is an increase of €1.9 billion relative to the autumn fiscal forecasts, and reflects the stronger-than-expected outturn last year as well as the upward revision to the forecasts for economic activity (**table 10**). Working in the other direction, policy measures introduced in mid-February will reduce total receipts. For next year, tax revenue is projected at €94.4 billion, an increase of over 6 per cent. This is €3.2 billion higher than in the previous forecast vintage; the upward revision stems from a combination of factors including the ‘base effect’ from the upward revision to 2023, stronger macroeconomic drivers and changes to the Department’s assumptions around the timing of the OECD Base Erosion and Profit Shifting (BEPS) process and its impact on corporation tax receipts.

At a disaggregated level, income tax is projected at €32.8 billion this year, an annual increase of almost 7 per cent.[28] This is €0.8 billion higher than assumed in the autumn, with the upward revision largely arising due to the stronger-than-expected outturn last year. For next year, income tax revenue is projected at €34.9 billion; this is higher than projected in the autumn and arises from the stronger performance this year.

Corporation tax is projected at €24.3 billion this year, over 7 per cent higher than last year. Revisions from the autumn are significant: the projected revenue stream is €1.6 billion higher than previously foreseen, driven by the higher-than-expected receipts in the final quarter of last year. Gross operating surplus – the macro-economic base for corporation tax – has been revised up marginally. For next year, corporation tax revenue is projected at €25.1 billion; this is almost €3 billion higher than projected in the autumn and arises from the stronger performance this year as well as the assumption of a later implementation of BEPS-related changes. Windfall corporation tax receipts both this year and next are currently estimated at almost €12 billion.

Table 10: Evolution of near-term tax forecast vs previous forecast, €bn

			Δ_2023 since autumn forecast						Δ_2024 since autumn forecast				
	2022	2023	total	: base	: macro	: policy	: other	2024	total	: base	: macro	: policy	: other
Income tax	30.7	32.8	0.8	0.5	0.0	0.0	0.2	34.9	0.7	0.8	0.3	0.0	-0.4
Corporation tax	22.6	24.3	1.6	1.6	0.2	0.2	-0.4	25.1	2.8	1.6	0.4	-0.2	1.0
VAT	18.6	20.4	1.1	0.3	0.2	-0.5	1.0	22.4	1.3	1.1	0.1	0.5	-0.3
Excise	5.4	5.8	-0.5	-0.3	0.1	-0.3	0.0	6.3	-0.6	-0.5	-0.2	0.3	-0.3
Other taxes	5.7	5.5	-1.1	-0.5	0.0	0.0	-0.5	5.8	-1.1	-1.1	0.0	0.0	0.0
Total	**83.1**	**88.9**	**1.9**	1.6	0.4	-0.6	0.5	**94.4**	**3.2**	1.9	0.6	0.6	0.1

Note:
‘Base’ refers to the change in the previous year’s outturn which changes the level (the ‘starting point’ effect).
‘Macro’ refers to the impact of changes in the projected macroeconomic base for each tax heading.
‘Policy’ refers to changes in Government policy since the Department’s previous set of forecasts.
‘Other’ includes one-off and other adjustments.
Note that the breakdown in this manner is based on estimates.
Source: Department of Finance calculations.

In terms of indirect taxes, VAT receipts are now projected at €20.4 billion for this year, an annual increase of just under 10 per cent. This represents a €1.1 billion upward revision relative to the previous forecast vintage, reflecting higher-than-expected receipts in the final quarter of last year and other adjustments which more than offset the impact of policy changes e.g. the extension of the lower rate of VAT on hospitality. It is also attributable to an upward revision in real consumer spending partly offset by the downward revision to consumer price inflation. For next year, VAT receipts are projected at €22.4 billion, an annual increase of over 9 per cent. This is €1.3 billion higher than in the autumn forecasts and primarily reflects the stronger-than-expected performance this year.

[28] Income tax (and VAT) receipts also benefit from the impact of tax ‘warehousing’, whereby firms could defer the payment of tax liabilities during the pandemic. These receipts are being gradually repaid to the Exchequer, with repayments expected to be broadly similar in 2023 compared to last year.

Excise duties are projected at €5.8 billion this year, an increase of over 6 per cent. This is less than projected in the autumn forecasts, and reflects the lower-than-anticipated outturn last year as well as the impact of policy changes, i.e. the extension of reduced excise duties on fuel. For next year, excise duty receipts are projected at €6.3 billion; this is an annual increase of over 9 per cent and reflects the phasing out of the temporary reduction in excise duties on fuel over the course of this year. The revision relative to the previous iteration primarily reflects the lower-than-expected performance this year.

The revenue from other tax headings (customs, stamp duty, capital gains tax, capital acquisitions tax and motor tax) is relatively small; in aggregate these tax headings are expected to fall by around 3 per cent on last year and increase by over 4 per cent next year.

3.3.2 Other revenue

Non-tax revenue will continue to benefit from dividend payments to the Exchequer. Payments to the Exchequer from the CBI and NAMA surpluses are projected at €0.5 and €0.4 billion, respectively, this year.[29]

On the capital side, the continued unwinding of the State's equity in *Allied Irish Banks* is set to contribute positively to the Exchequer this year. In addition, the first instalment (€0.3 billion) from the European Union's *Recovery and Resilience Facility* is pencilled in for the fourth quarter of 2023, while the third tranche of funding from the *Brexit Adjustment Reserve* is expected in the second quarter (bringing the total received so far to €0.8 billion).

Non-tax revenue is projected at €1.5 billion next year. The decline reflects, in part, the expectation that the Central Bank – similar to a number of other central banks globally - is unlikely to record surplus income this year due to *inter alia* the change in the interest rate environment (surplus income payable to the Exchequer is based on the previous year's surplus).

3.3.3 Expenditure

Government has provided for just over €91 billion in gross voted expenditure this year. Nearly €86 billion in core spending will provide for increased investment in core public services and supports as well as in infrastructure as part of the *National Development Plan*.

In addition, the overall expenditure ceiling provides for €5.2 billion in non-core expenditure. This funding will provide continued support for temporary challenges, including the provision of humanitarian assistance for Ukrainian migrants, cost of living supports and Brexit. In relation to humanitarian assistance associated with the war in Ukraine, funding of c. €1½ billion has been allocated in 2023 to date. This funding and future requirements will continue to be considered over the coming months based on the latest trends of arrivals and expenditure requirements.

€89.9 billion of this available funding has been allocated to Departments. The majority of the remaining unallocated provision relates to reserve funding for non-core measures, which will be allocated over the course of the year, if required. To assist those most impacted by the continued inflation, and in particular energy inflation, Government announced a further package of cost of living measures in February. These measures build on the supports previously introduced. The package included €0.5 billion of temporary and targeted expenditure measures, primarily related to social protection and education. Allocations, from within the Government Expenditure Ceiling, will be made later in the year, if required, to meet the costs of this package.

[29] As purely financial transactions, these transfers do not benefit the general government balance.

Box 4: Exposure of the public finances to the ICT sector

The fog is gradually lifting on the post-pandemic economic landscape, though it will be some time before there is full clarity on what the 'new-norm' might be.

At a minimum, some reallocation of workers and firms across sectors is likely, as households, governments and firms adapt to *inter alia* hybrid working.

One sector that appears to be adjusting more quickly than others is the ICT sector, which expanded rapidly during the pandemic but where prospects are now being re-evaluated.

From an Irish economic perspective, this sector is of strategic economic importance: industrial policy has long-been geared towards expanding the sector in Ireland *inter alia* because ICT services can be exported at very little cost (and, hence, reduce Ireland's geographical disadvantage^). In addition, employment in the sector is relatively knowledge-intensive and, accordingly, remuneration levels higher than average.

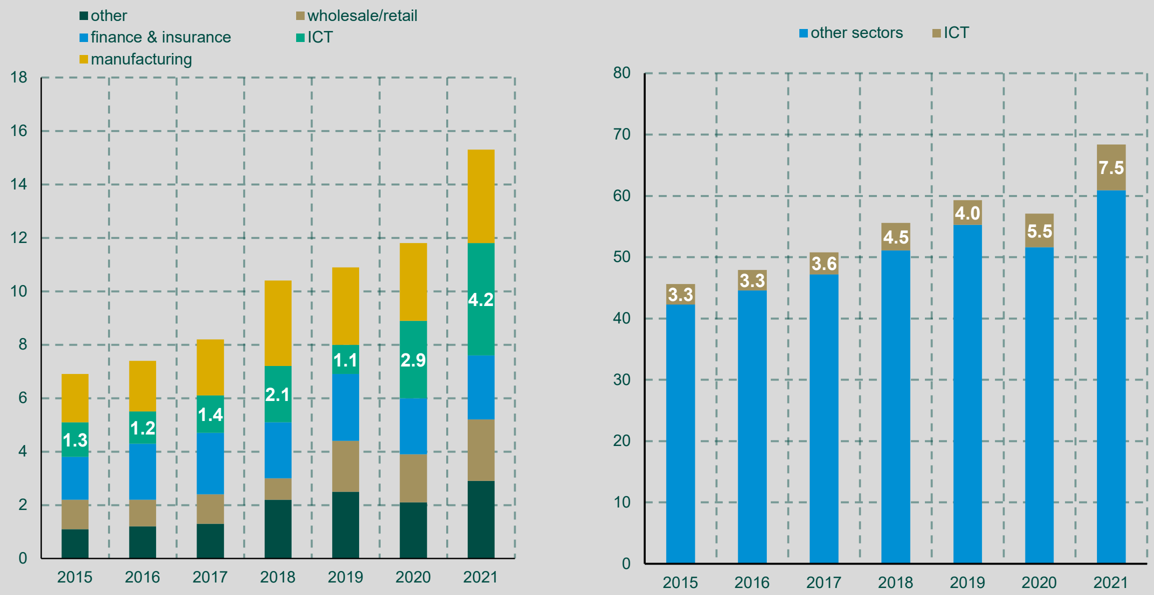
Available data show that around 165,000 people are employed in the ICT sector in Ireland, c. 6.4 per cent of total employment. This figure that would be somewhat higher if indirect effects were taken into account. Because the sector is largely composed of higher-wage earners, income tax payments in the sector amounted to €2.7 billion in 2021 (latest year for which data are available), 10 per cent of the total income tax-take.

As well as generating 28 per cent of Irish exports last year, the sector also accounted for €4.2 billion in corporation tax receipts in 2021 (**figure 13A**). This equated to over one-quarter of the total corporation tax-take that year. Preliminary data suggest that the share increased further last year and now accounts for around one-third of overall corporation tax receipts. Overall, the ICT sector contributed some €7.5 billion in tax receipts in 2021 (12 per cent of total tax receipts) (**figure 13B**).

Figure 13: ICT and corporation tax

A: corporation tax receipts by sector, € billions

B: sectoral distribution of tax receipts, € billions



Note: ICT includes ICT manufacturing in 2021.^^
Source: CSO, Department of Finance calculations.

Note: ICT includes IT, VAT, CGT and CT receipts.
Source: Revenue Commissioners.

The tax data, therefore, confirm a significant exposure of the public finances to the ICT sector. The ultimate extent of the correction in the sector is clearly unknowable, though the baseline labour market scenario assumes that the ICT sector remains relatively resilient. That said, a more painful adjustment cannot be ruled out.

The re-normalisation of the sector is a reminder that economic activity in Ireland is relatively concentrated and that micro-economic (or sectoral) shocks can have macroeconomic implications.

^ Ireland does not have a comparative advantage in heavy manufacturing because of its peripheral location and small domestic market. On the other hand, economic research confirms a comparative advantage in the production of human capital-intensive, physically light goods and services.
^^ ICT manufacturing includes technology firms that are, for statistical purposes, classified in the manufacturing sector.

Table 11: Technical assumptions on expenditure, € billion					
	2022	2023	2024	2025	2026
Voted Expenditure	**88.8**	**91.1**	**90.9**	**95.1**	**99.7**
:'Core' expenditure	80.0	85.9	90.2	94.7	99.5
: Non-Core' expenditure	8.8	5.2	0.7	0.4	0.2
core – year-on-year increase		5.9	4.3	4.5	4.8
core – year-on-year increase, per cent		7.4	5.0	5.0	5.0

Notes:
The percentage increase in core expenditure in 2023 refers to the outturn in 2022, this differs from the growth rate shown as per the adjusted Medium Term Expenditure Strategy outlined in the Mid-Year Expenditure Report 2022 due to the lower than allocated outturn in 2022.
Source: Department of Finance, Department of Public Expenditure and Reform.

For the first quarter of 2023, gross voted expenditure of €19.8 billion was up almost €1 billion (4.9 per cent) over the same period in 2022. This increase reflects enhanced supports for core day-to-day expenditure and continued investment in infrastructure as part of the *National Development Plan*. Gross Voted Current Expenditure of €18.6 billion was €0.6 billion (3.5 per cent) ahead of 2022, reflecting *Budget 2023* investment in key sectors including health and childcare, investment in the public sector workforce and support to minimise the shock to living standards from higher energy prices. It also reflects the provision of support, including accommodation, for those arriving in Ireland fleeing the war in Ukraine. Gross Voted Capital Expenditure of €1.2 billion is €0.3 billion (33.9 per cent) higher than in 2022, reflecting continued investment in the education and housing sectors, alongside strong demand for energy retrofit.

For next year, the Government expenditure ceiling is set at €90.9 billion. The Government's spending rule is calibrated on the basis of net spending, i.e. spending net of discretionary taxation measures. Accordingly, the expenditure ceiling figure would be different – higher or lower – if the Government introduced discretionary tax changes.

3.3.4 Summary

Putting all of these together, an Exchequer surplus of €4.5 billion is in prospect for this year. The projected surplus takes into account the transfer of €4 billion to the *National Reserve Fund* earlier this year. Windfall receipts from the corporate sector are estimated at almost €12 billion, with an underlying Exchequer deficit in prospect again this year. For next year, the updated macroeconomic forecasts alongside existing budgetary policy results in an Exchequer surplus of €12.9 billion.

Table 12: Changes in Exchequer balance since autumn forecast					
	2022	2023	2024	2025	2026
EBR: previous (autumn) forecast	345	1,720	10,210	10,780	-
EBR: current (spring) forecast	4,985	4,535	12,925	13,160	14,985
Difference (1= 2 - 3)	4,640	2,815	2,715	2,380	-
Change in revenue (2= 2a + 2b)	2,235	2,335	2,660	2,345	-
: ∆_tax revenue (2a)	1,565	1,900	3,180	1,985	-
: ∆_other revenue (2b)	670	435	-520	360	-
Change in expenditure (3 = 3a + 3b)	-2,405	-485	-55	-35	-
: ∆_current (3a)	-1,495	-605	-55	-35	-
: ∆_capital (3b)	-910	120	-	-	-

Source: Department of Finance

3.4 Medium-term outlook for the Exchequer

Fiscal projections for 2023-2026 are set out below (**table 13**). Tax revenue forecasts are grounded in the economic projections. The projections for corporation tax receipts over the medium-term are impacted by reforms to be introduced under the OECD's *Base Erosion and Profit Shifting* (BEPS) process. The projections for future years assume a loss in corporation tax revenues as a result of the BEPS changes from 2025 onwards: the Department's current baseline estimate of the impact of BEPS is that €2 billion could be lost relative to baseline.

Voted expenditure projections are grounded in the Government's expenditure rule, adopted in mid-2021. The rationale is to anchor the growth rate of (net) expenditure to the trend growth rate of the economy. This 'expenditure rule' allows for steady improvements in public services while, at the same time, keeping the debt-income ratio on a downward trajectory.

Beyond the mid-part of this decade, demographic change means the trend growth rate of the economy is set to slow to an estimated 4.7 per cent per annum over 2026-2030.

As noted in the 2022 *Mid-Year Expenditure Report*, the key to a sustainable expenditure strategy is the ability to respond appropriately to temporary developments. The medium term expenditure strategy, as presented in the 2021 *Summer Economic Statement*, outlined the Government's commitment to ensuring public finances maintain a sustainable position while continuing to address priority policy areas. In respect of core expenditure, the strategy aims to increase overall expenditure (net of any discretionary tax changes) by c.5 per cent per annum, on average, over the period 2021-2025. This document assumes this approach is continued in 2026 but, clearly, this will be a decision for the next government. This strategy is the basis for the core expenditure amounts set out within this document.

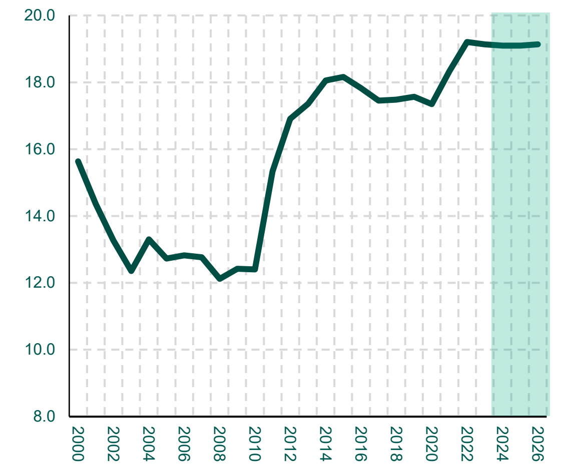
For core current expenditure, the average annual growth rate stands at 4.8 per cent across the 2024-2026 period. Total capital spending is growing by an annual average of 6.6 per cent, and reaching record levels of over €14 billion in 2026. In overall terms, this involves overall voted expenditure increasing from €88.8 billion in 2022 to almost €100 billion out to 2026 (these figures would be different – either higher or lower – if Government opted instead for changes in discretionary taxation).

Non-core expenditure has provided funding for temporary provisions and measures which do not become part of the core expenditure base. Acting as a flexible tool for policy responses to a range of externally driven challenges to the economy and society, non-core expenditure has seen the introduction of extensive public supports since the onset of the Covid-19 pandemic.

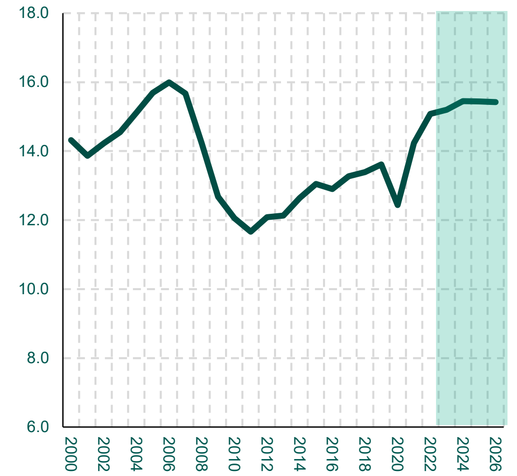
Substantial resources have been allocated to support the humanitarian response to the war in Ukraine, Brexit and cost of living pressures facing households and businesses alike. Once no longer required, a careful phased approach to the withdrawal of these supports will be essential to ensuring our public finances remain sustainable into the future.

Figure 14: Tax revenue relative to their bases, 2000-2026

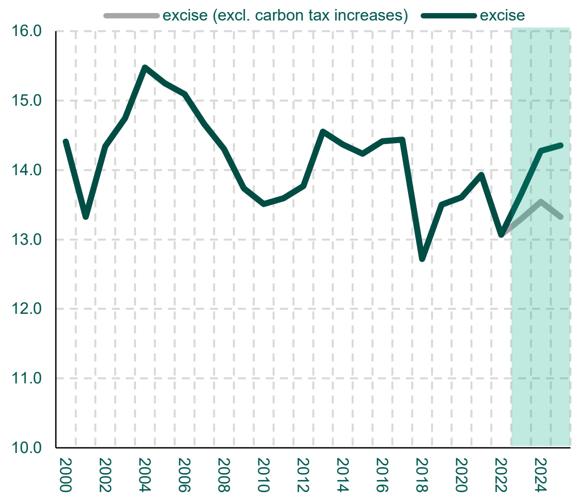
A: income tax as share of national wage bill, per cent



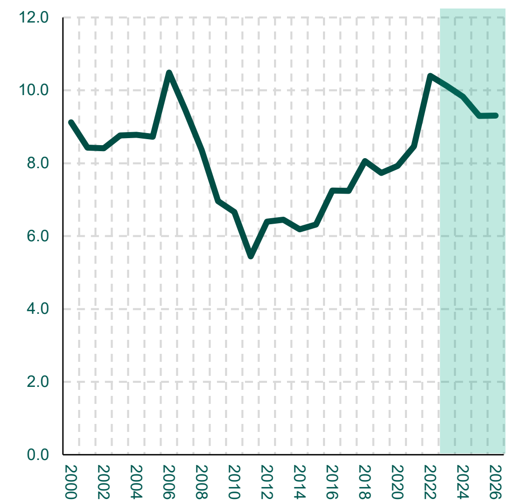
B: VAT as share of consumer spending, per cent



C: excise duties as share of (real) goods spending, per cent



D: corporation tax as share of GOS^, per cent



Source: Department of Finance calculations.

^GOS = gross operating surplus.
Source: Department of Finance calculations.

Table 13: Budgetary projections 2022-2026, € million					
	2022	**2023**	**2024**	**2025**	**2026**
CURRENT BUDGET					
Expenditure					
Gross voted current expenditure	77,840	78,615	78,090	81,530	85,280
Non-voted current expenditure*	7,765	7,730	8,375	8,640	8,420
Gross current expenditure	**85,605**	**86,345**	**86,465**	**90,170**	**93,700**
less expenditure receipts and balances	15,865	15,530	15,815	16,075	16,370
Net current expenditure	**69,740**	**70,815**	**70,650**	**74,095**	**77,330**
Receipts					
Tax revenue	83,130	88,885	94,415	98,995	105,020
: income tax	30,730	32,830	34,905	37,035	39,220
: VAT	18,600	20,435	22,350	23,825	25,350
: corporation tax	22,645	24,305	25,060	25,450	27,190
: excise duties	5,440	5,790	6,330	6,630	6,910
: stamp duties	1,825	1,640	1,700	1,790	1,885
: motor tax	905	905	910	915	915
: customs	635	560	585	620	650
: capital gains tax	1,745	1,805	1,920	2,035	2,160
: capital acquisitions tax	605	615	655	695	740
Non-tax revenue	2,440	1,935	1,470	1,205	1,205
Net current revenue	85,570	90,820	95,885	100,200	106,225
CURRENT BUDGET BALANCE	**15,830**	**20,005**	**25,235**	**26,105**	**28,895**
CAPITAL BUDGET					
Expenditure					
Gross voted capital expenditure	10,930	12,485	12,825	13,600	14,380
Non-voted capital expenditure*	5,185	5,295	1,195	990	990
Gross capital expenditure	**16,115**	**17,780**	**14,020**	**14,590**	**15,370**
Less capital receipts	65	45	45	45	45
Net capital expenditure	**16,050**	**17,735**	**13,975**	**14,545**	**15,325**
Capital resources	**5,205**	**2,265**	**1,665**	**1,600**	**1,415**
CAPITAL BUDGET BALANCE	**-10,845**	**-15,470**	**-12,310**	**-12,945**	**-13,910**
Exchequer Balance	**4,985**	**4,535**	**12,925**	**13,160**	**14,985**
Government Expenditure Ceiling		**91,100**	**90,915**	**95,130**	**99,660**

Notes:
Figures are rounded to the nearest €5 million and this rounding may affect totals.
Fiscal numbers are presented on an *ex-post* basis.
* Central Fund.
2022 voted expenditure figures are based on the provisional outturn as reported in the December 2022 Analytical Exchequer Statement.
Source: Department of Finance.

Chapter 4
General Government Developments and Outlook

4.1 Summary

A general government surplus of €8 billion (3 per cent of GNI*) was recorded last year. The headline position benefited, once again, from the strength of corporation tax receipts. Excluding the estimated windfall component of corporation tax receipts, an underlying general government deficit – GGB*[30] – €2.8 billion (1 per cent of GNI*) was recorded.

Taking account of the updated economic projections, as well as the policy measures set out in mid-February*,* a general government surplus of €10 billion (3.5 per cent of GNI*) is now forecast for this year. Excluding the impact of excess corporation tax receipts, an underlying general government deficit of €1.8 billion (0.6 per cent of GNI*) is projected.

For next year, the general government surplus is projected at €16.2 billion (5.4 per cent of GNI*); this takes account of a (net) spending increase (i.e. spending less allowance for discretionary tax measures) of 5 per cent, in line with the Government's medium-term fiscal framework.

4.2 General government balance: 2022

General government revenue amounted to €115.5 billion (42.8 per cent of GNI*) last year. This was an annual increase of €16.6 billion (17 per cent), largely driven by the post-pandemic economic rebound.

On the other side of the accounts, general government expenditure was €107.5 billion (39.8 per cent of GNI*); this was €1.8 billion higher than 2021. While expenditure did benefit from the winding down of pandemic-related fiscal supports, an increase in expenditure persisted as a result of the one-off measures to help alleviate the increase in energy prices and costs associated with re-settling refugees from Ukraine.

Taking these together, a general government surplus of €8 billion, 3 per cent of GNI* was recorded last year.

4.3 General government balance: outlook for 2023 and 2024

Taxes on income and wealth – mainly income and corporation taxes – are projected at €60.7 billion, an increase of 7 per cent relative to last year, reflecting further wage bill increases as well as further profitability gains. Taxes on production and imports (mainly indirect taxes such as VAT, excise and customs duties) are projected at around €33.3 billion, an annual increase of just over 5½ per cent. Social security receipts are projected at €21.1 billion, an annual increase of 6½ per cent and broadly in line with employment trends. Other general government receipts are projected at €8.3 billion.

All told, therefore, general government revenue is projected at €123.4 billion (43.5 per cent of GNI*) this year, an annual increase of 7 per cent.

[30] The Department has introduced a new metric – the underlying general government balance (GGB*) – that removes the impact of windfall corporation tax receipts from the headline balance. The objective is to help avoid a situation in which windfall revenues are used to finance permanent fiscal obligations.

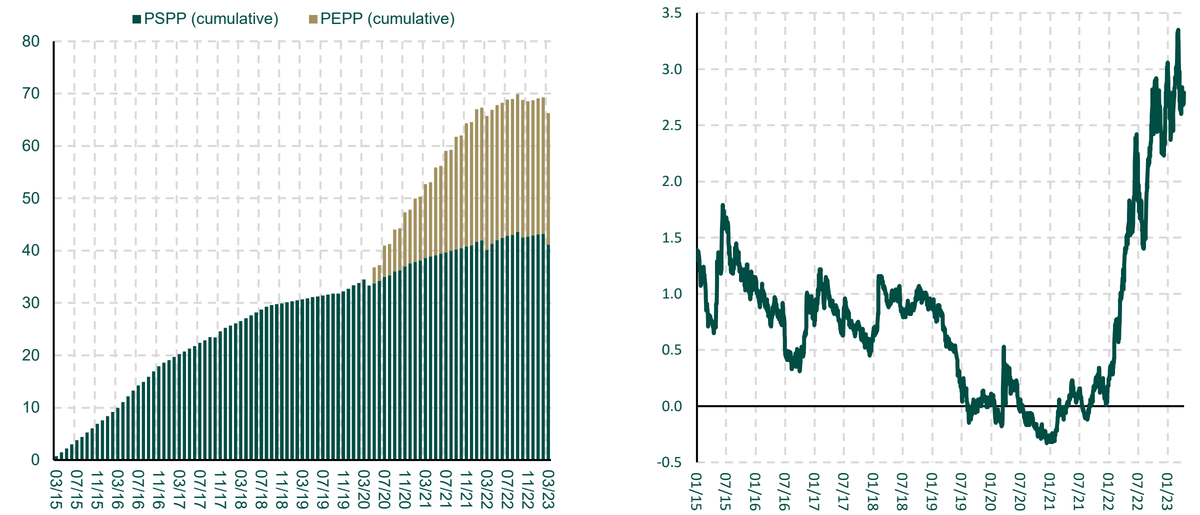
General government expenditure is estimated at €113.4 billion (40 per cent of GNI*) this year. This includes €5.2 billion of temporary (non-core) public expenditure, €2 billion of which will be used to provide humanitarian assistance to refugees from Ukraine.

Primary expenditure – total expenditure excluding debt interest payments – is estimated at €110 billion. Interest expenditure is estimated at €3.4 billion this year. The interest bill has benefited in recent times from the decline in borrowing costs, including via central banks across the euro area increasing their footprint in sovereign debt markets (**figure 15A**); this has now been reversed (**figure 15B**) and will pass-through over time into higher debt service costs.

Figure 15: Borrowing costs, 2015-2023

A: ECB cumulative holdings of IE public sector debt, €bn

B: Irish sovereign 10-year borrowing costs, per cent



PSPP = Public Sector Purchase Programme;
PEPP = Pandemic Emergency Purchase Programme
Source: European Central Bank.

Source: Macrobond.

As a result of these developments, the general government surplus for this year is estimated at €10 billion, or 3.5 per cent of GNI*. Excluding windfall corporation taxes, an underlying deficit of €1.8 billion (0.6 per cent of GNI*) is in prospect.

For next year, taxes on income and wealth are projected at €63.6 billion, in line with the projections for the wage bill and for profitability. This would be an increase of 5 per cent. Taxes on production and imports are projected at €35.8 billion, an increase of 7.4 per cent and consistent with expectations for consumer spending. Other general government revenue, including social security receipts, is projected at €29.7 billion. As a result, general government revenue is projected at €129.2 billion (43.4 per cent of GNI*) next year.

On the expenditure side, the largest components relate to the public sector pay-bill (compensation of employees) and current transfers from the general government sector (social payments). The former is projected at just under €31 billion for next year, while the latter is projected at €38.4 billion. Government investment is projected at €12 billion, the equivalent of 4 per cent of GNI*, and consistent with Government policy as set out in the *National Development Plan*. Other expenditure is projected at €31.6 billion so that, in aggregate terms, general government spending is projected at just under €113 billion (38 per cent of GNI*).

On this basis, a general government surplus of €16.2 billion (5.4 per cent of GNI*) is currently in prospect for 2024. Total corporation tax receipts are projected at €25 billion, of which €11.8 billion is estimated as windfall. On this basis, GGB* is projected at €4.4 billion (1.5 per cent of GNI*) next year.

Table 14: Exchequer balance to GGB 2022-2026, € million (unless stated)

	2022	2023	2024	2025	2026
Exchequer balance	4,985	4,535	12,925	13,160	14,985
Walk	3,050	5,475	3,290	4,955	5,855
General government balance	**8,035**	**10,010**	**16,215**	**18,115**	**20,840**
of which:					
General government revenue	**115,505**	**123,440**	**129,170**	**134,955**	**142,120**
Taxes on production and imports	31,565	33,335	35,790	37,660	39,550
Current taxes on income, wealth	56,730	60,675	63,640	66,295	70,360
Capital taxes	615	615	655	695	740
Social contributions	19,835	21,115	22,740	24,000	25,130
Property Income	620	1,410	735	790	795
Other	6,135	6,290	5,610	5,520	5,550
General government expenditure	**107,475**	**113,440**	**112,955**	**116,845**	**121,285**
Compensation of employees	28,860	29,805	30,860	32,010	33,290
Intermediate consumption	17,845	18,275	18,185	18,565	19,170
Social payments	37,135	38,625	38,435	39,520	40,765
Interest expenditure	3,275	3,430	3,470	3,320	3,380
Subsidies	3,305	2,815	2,175	2,190	2,170
Gross fixed capital formation	9,980	10,965	12,050	13,200	14,290
Capital transfers	1,855	2,340	2,355	2,355	2,295
Other	5,225	5,985	5,425	5,680	5,925
Resources not allocated	-	1,195	-	-	-
memo items					
GGB per cent GNI*	3.0	3.5	5.4	5.8	6.3
Total revenue, per cent GNI*	42.8	43.5	43.4	43.1	43.2
Total expenditure, per cent GNI*	39.8	40.0	38.0	37.3	36.9
Estimated windfall corporation tax	10,800	11,800	11,800	11,400	12,400
Underlying GGB	- 2,765	-1,790	4,415	6,715	8,440

Notes: the 'walk' from the Exchequer balance to the general government balance is set out in the appendix.
Source: Department of Finance, Department of Public Expenditure and Reform, CSO.

4.4 Medium-term outlook for the general government sector

On the basis of the economic scenario set out earlier, general government revenue is projected to increase further in the coming years (**table 14**). On the expenditure side, beyond this year no provision is made for humanitarian assistance to those fleeing war in Ukraine; this will require a formal government decision. Policy-induced (BEPS) changes to corporation taxation is assumed to weigh on corporation tax revenue from 2025 onwards.

Box 5: Proposed reforms to the European fiscal rules

Following a pandemic-related pause, the European Commission relaunched its review of the EU's Economic Governance Framework (EGF) in October 2021. The review revolves around *inter alia* potential reform of the Union's fiscal rules, which constitute the framework within which Member States make budgetary decisions.

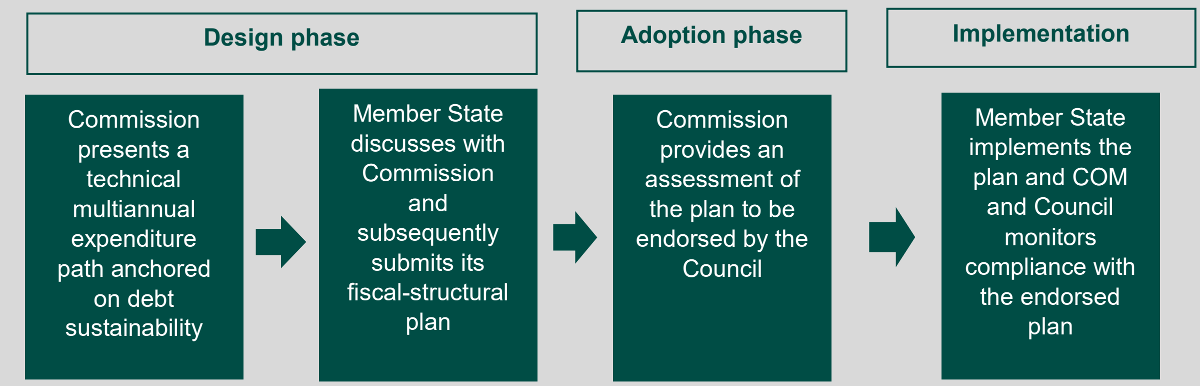
The current set of fiscal rules, known as the *Stability and Growth Pact* (SGP), first came into effect in 1999. They have subsequently been revised twice, most recently following the Global Financial Crisis. Notwithstanding these revisions, changes in the macroeconomic environment (not least due to increasingly frequent economic shocks), elevated levels of public debt in some Member States, and excessive complexity have raised fundamental questions as to whether the rules remain fit-for-purpose.

In November 2022, the European Commission set out an overview of its proposals for a reformed set of rules.^ The Commission's proposals incorporate a greater focus on the medium-term, with new 'fiscal-structural plans', set over a four-year horizon, forming the cornerstone of the proposals. These national plans, combining the current Stability Programme Update and National Reform Programme, are intended to allow for greater country-specific differentiation, while still being assessed and agreed within a common rules-based framework. The basis of this common framework would be the Commission's existing debt sustainability analysis (DSA) methodology, which would allow for an assessment of debt trajectories over the medium term..^^

Under the proposals, the Treaty reference values of a 3 per cent budget deficit and 60 per cent debt-to-GDP ratio would remain unchanged. Member States would be categorised according to the extent of their public debt challenges, based on the Commission's DSA. This categorisation would determine the length of the adjustment period for putting debt on a sustainably declining path. The adjustment period could be extended if a Member State commits to reforms and investments which could help put debt on a more sustainable path.

Assessment of the national fiscal plans would be based on a single operational indicator – net primary expenditure^^^ – anchored on a debt target. As a first step, the Commission would put forward multi-annual fiscal trajectories for Member States, based on results from the DSA – with the trajectory corresponding to the minimum fiscal effort required to put debt on a sustainably declining path over the medium-term. Following a bilateral dialogue with the Commission, Member States would then submit a medium-term fiscal-structural plan for assessment by the Commission and endorsement by the Council (**figure 16**).

Figure 16: Summary of the reform proposals



Source: European Commission

The Commission's proposals have formed the basis for discussion of a new framework among Member States over recent months. Member States agreed Council Conclusions^^^^ on the Economic Governance Review at the European Union's monthly Finance Minister's meeting (ECOFIN) on 14th March. The Council Conclusions highlight a number of areas of convergence that have emerged in the discussions so far, as well as identifying areas where additional work is needed.

The next step in the process is for the Commission to bring forth legislative proposals.

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^ *Communication on Orientations*, European Commission (2022), available at: https://economy-finance.ec.europa.eu/system/files/2022-11/com_2022_583_1_en.pdf
^^ See *Fiscal Sustainability Report 2021,* European Commission (2022), available at: https://economy-finance.ec.europa.eu/publications/fiscal-sustainability-report-2021_en
^^^ The expenditure indicator is net of discretionary revenue measures, as well as interest expenditure, EU-funded expenditure and the cyclical element of unemployment spending.
^^^^ *Orientations for a reform of the EU economic governance framework - Council Conclusions,* European Commission (2023), available at: https://data.consilium.europa.eu/doc/document/ST-6995-2023-REV-1/en/pdf

4.5 Changes from previous forecast and structural budget balance

The evolution of the headline balance is set out below (**table 15**) and compared with projections in the autumn forecasting round.

Table 15: Changes in Exchequer balance since autumn forecast

	2022	2023	2024	2025	2026
GGB: previous (autumn) forecast	965	6,170	10,710	13,655	-
GGB: current (spring) forecast	8,035	10,010	16,215	18,115	20,840
Difference (1= 2 - 3)	**7,070**	**3,840**	**5,505**	**4,460**	-
Change in GG revenue (2= 2a + 2b)	**3,030**	**3,950**	**5,130**	**4,085**	-
: ∆_tax revenue (2a)	1,510	1,630	2,830	1,585	-
: ∆_other revenue (2b)	1,520	2,320	2,300	2,500	-
Change in GG expenditure (3 = 3a + 3b)	**-4,025**	**120**	**-375**	**-380**	-
: ∆_capital^ (3a)	2,800	35	-1,135	-1,390	-
: ∆_other (3b)	- 1,225	85	760	1,010	-

^includes gross fixed capital formation and capital transfers
Source: Department of Finance.

The fiscal balance, adjusted for the impact of the economic cycle and for temporary factors, is known as the structural (or cyclically-adjusted) budget balance, with estimates presented below (**table 16**).

Table 16: Structural budget balance, per cent of GNI* (unless stated)

	2022	2023	2024	2025	2026
Headline fiscal developments					
General government balance	3.0	3.5	5.4	5.8	6.3
One-off / temporary measures	0.7	2.0	3.8	3.6	3.8
: windfall taxes	4.0	4.2	4.0	3.6	3.8
: other	-3.3	-2.2	-0.2	-0.1	0.0
Interest expenditure	1.2	1.2	1.2	1.1	1.0
General government primary balance	4.2	4.7	6.6	6.8	7.4
Economic cycle					
GNI* growth rate	9.3	1.6	2.1	2.5	2.3
Potential growth rate	3.8	1.8	2.3	2.4	2.3
Output gap	1.6	1.4	1.1	1.2	1.3
Structural fiscal developments					
Cyclical budgetary component	0.8	0.8	0.6	0.6	0.7
Cyclically adjusted balance	2.1	2.8	4.9	5.2	5.7
Structural budget balance^	1.4	0.8	1.1	1.6	1.9
Structural primary balance	2.6	2.0	2.2	2.7	2.9

Notes:
^ excludes estimated windfall taxes.
Estimates of output gap based on the Department's preferred methodology for calculating the potential output.
Source: Department of Finance.

Chapter 5
General Government Debt

5.1 Summary

At the end of last year public indebtedness stood at €224.8 billion (83.3 per cent of GNI*). A figure of €223.5 billion (78.8 per cent of GNI*) is projected for the end of this year. The baseline projection involves only a modest reduction in the amount of outstanding debt by the end of the forecast horizon; however, reasonably solid economic prospects over the medium-term mean that the debt-national income ratio should continue to fall.

The normalisation of monetary policy means that sovereign borrowing costs have been on a rising trajectory over the past year. This shift will have important implications: the re-financing of maturing debt in the second half of this decade will likely trigger higher debt servicing costs (as some debt issued in recent years carried a near-zero coupon).

Demands on the public finances are set to increase in the years ahead, with the need to fund longer-term structural economic and societal changes, such as the fiscal impact of shifting demographics and climate change mitigation.

5.2 Debt developments and outlook

The mobilisation of large fiscal support to support the private sector during the pandemic resulted in a step-change in public indebtedness – from €203.4 billion (96.5 per cent of GNI*) at end-2019 to €236 billion (101 per cent of GNI*) at end-2021. The strong revenue performance over recent years has dampened the increase and, furthermore, contributed to a reduction of outstanding liabilities last year to €224.8 billion (83.3 per cent of GNI*).

With a headline general government surplus of €10 billion (3.5 per cent of GNI*) in prospect, public debt is set to fall further this year, to €223.5 billion. This would leave the debt-GNI* ratio at 78.8 per cent this year, a decline of 4.5 percentage points relative to last year. This downward trajectory in the debt-income is set to continue next year and over the medium-term but, crucially, is contingent upon continued robust economic growth, sound budgetary management and the absence of any significant shock to corporation tax revenue (or, indeed, other revenue streams). As previously highlighted, the corporation tax revenue stream is highly concentrated, and any sharp reversal would have negative implications for the debt-income trajectory.

Debt interest payments as a percentage of total revenue – an important indicator of repayment capacity as it sets out the share of revenue absorbed by debt interest payments. The data show that, because of lower borrowing costs during the pandemic, the burden of servicing public debt has not deteriorated on foot of increased liabilities.

However, the exceptional monetary policy support is now gradually being withdrawn. This means that the marginal cost of debt has been rising.

Table 17: General government debt developments, per cent of GNI* (unless stated)					
	2022	2023	2024	2025	2026
Gross debt (€ billions)	224.8	223.5	224.4	220.2	215.0
Gross debt ratio	83.3	78.8	75.4	70.4	65.4
Change in gross debt ratio(=1+2+3)	-17.6	-4.5	-3.4	-5.0	-5.0
Contributions to change in debt ratio^:					
General Government balance (1=1a+1b)	-3.0	-3.5	-5.4	-5.8	-6.3
: interest expenditure (1a)	1.2	1.2	1.2	1.1	1.0
: primary deficit (1b)	-4.2	-4.7	-6.6	-6.8	-7.4
SFA (2=2a+2b+2c+2d+2e+2f+2g)	-1.2	3.1	5.8	4.4	4.8
: change in liquid assets (2a)	-1.0	0.7	4.0	2.3	2.4
: interest adjustments (2b)	0.1	0.1	0.1	0.2	0.0
: equity transactions (2c)	-1.0	-0.2	-0.1	0.0	0.0
: accrual adjustments (2d)	0.4	0.1	0.1	0.0	0.1
: impact of ISIF (2e)	0.0	0.1	0.1	0.1	0.1
: collateral held (2f)	0.0	0.0	0.0	0.0	0.0
: other (2g)	0.3	2.5	1.6	1.9	2.1
Nominal GNI* contribution (3)	-13.4	-4.1	-3.7	-3.7	-3.4
Memorandum items:					
: average interest rate	1.4	1.5	1.6	1.5	1.5

Notes:
^ A positive sign indicates that a component is increasing the debt ratio and *vice versa.*
SFA = stock-flow adjustment.
Source: CSO, Department of Finance and NTMA.

5.3 Structural aspects of Irish public debt[31]

5.3.1 Composition of debt

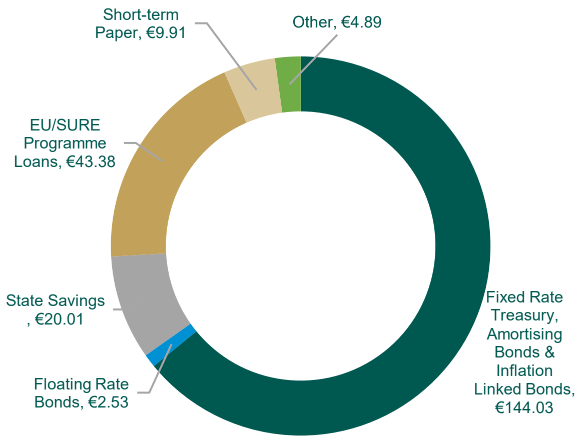
The composition of public debt is an important structural dimension that must be considered in any assessment. At end-2022, total outstanding liabilities amounted to €224.8 billion (**figure 17A**). Almost two-thirds of these were fixed-rate treasury, amortising and inflation-linked bonds. Obligations to the official sector – the *European Financial Stability Mechanism* (EFSM) and *European Financial Stability Facility* (EFSF) – were the next most important, accounting for just under a fifth of liabilities.

Of note has been the steady decline in recent years of the Floating Rate Notes (FRNs) issued in 2013 (to replace the IBRC promissory notes held by the Central Bank of Ireland (CBI)). In 2022, the National Treasury Management Agency (NTMA) purchased from the CBI, and subsequently cancelled, a further €3 billion of FRNs, replacing them with medium- to long–term fixed rate market funding. This brought the outstanding FRN balance to €2.5 billion at end-2022.

[31] More detail on the structural aspects of Irish public debt is set out in the *Annual Report on Public Debt 2022,* op cit.

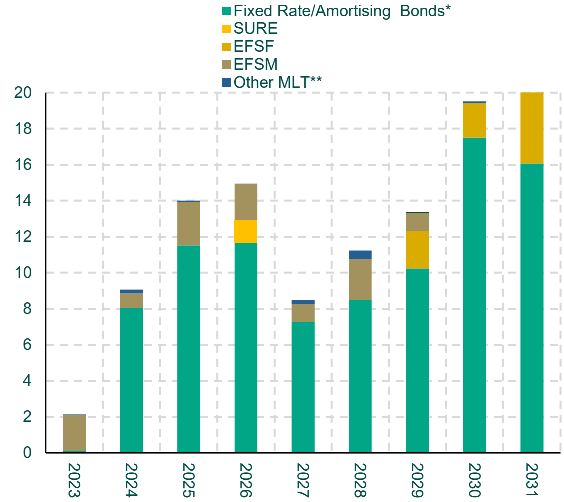
Figure 17: Structural aspects of Irish general government debt

A: composition of debt at end-2022, € billion



Note:
The "other" category includes POSB deposits, other MLT debt, and consolidation adjustments in respect of debt, including Government bonds, held by General Government entities.
Source: NTMA.

B: debt maturity profile 2022-2031, € billions^



Note:
^ as at end-March 2023.
*Includes NTMA repo activity.
Source: NTMA.

5.3.2 Funding and maturity profile

In December of last year, the NTMA set a funding range of €7-11 billion for 2023. By end-March, just over €4.9 billion[32] of Government bonds had been issued, with a weighted average yield of just below 3.2 per cent, and a weighted average maturity of more than 18 years. The yield on sovereign bonds has risen significantly since the lows of 2020/2021, as the European Central Bank unwinds its exceptionally monetary policy support.

Issuance in the first quarter of this year included a new 20-year green bond; €3.5 billion was issued by way of a syndicated transaction in January at a yield of 3.11 per cent. In addition, there was a dual bond auction in March, with €517.5 million of the 10-year bond (2032 maturity) sold at a yield of 3.13 per cent, alongside €920 million of the 1.7 per cent 2037 bond sold at a yield of 3.37 per cent.

The NTMA also purchased from the Central Bank of Ireland, and subsequently cancelled, a further €1 billion of FRNs in the first quarter of the year. The outstanding balance of the 2053 maturity – the last remaining FRN – is €1.5 billion.

On the redemptions front, there was a €7 billion bond maturity in March. There is also a €2 billion EFSM (European Financial Stability Mechanism) maturity later this year. For next year, there is one bond maturing in March – the 3.4 per cent 2024 bond – which has an outstanding balance of €8 billion (**figure 17B**). There is also a further EFSM maturity of €0.8 billion.

Cash/liquid asset balances were over €23 billion at the start of the year. These are expected to be at a broadly similar level at year-end 2023.

[32] Bond issuance figures are nominal amounts and include the issuance from the non-competitive bond auction in March.

5.3.3 Net debt

General government debt, as defined under the Excessive Deficit Procedure (EDP) regulation, is a gross measure of government liabilities. In Ireland, financial assets corresponding to the categories of financial liabilities which comprise gross debt, include liquid assets held by the Exchequer, *Ireland Strategic Investment Fund* cash and non-equity investments and other cash and liquid assets held by the general government sector.

Table 18: Gross and net general government debt, per cent of GNI* at end-year

	2022	2023	2024	2025	2026
General government debt (gross)	83.3	78.8	75.4	70.4	65.4
EDP debt instrument assets	14.6	14.1	17.0	18.1	19.3
Net debt position	68.7	64.7	58.4	52.3	46.0

Source: CSO, Department of Finance and NTMA.

Net debt is gross government liabilities excluding these liquid financial assets of government (**table 18**). At end-2022, net public indebtedness was 68.7 per cent of GNI* and is projected at 64.7 per cent of GNI* for the end of this year.

5.3.4 Credit rating

Ireland's long-term credit rating is now firmly in the "A" category with all the main rating agencies (**table 19**).

Table 19: Irish sovereign credit rating

	Long-term rating	Short-term rating	Outlook
Standard & Poor's	AA-	A-1+	Positive Outlook
Moody's	A1	P-1	Positive Outlook
Fitch Ratings	AA-	F1+	Stable Outlook

Notes: as per end-March 2023.
Source: NTMA

Chapter 6
Risks and Sensitivity Analysis

6.1 Summary

Uncertainty surrounding the near-term central scenario set out in this document is very high. Much hinges on the projected pathway for inflation / energy prices; accordingly, the analysis set out in this chapter considers alternative pathways for inflation in the event of changes to the key assumptions that are the building blocks of the central scenario.

The medium-term forecasts presented earlier are also stress-tested, with high- and low-growth scenarios over the period to end-decade presented.

The Department's assessment of the main short- and medium-term macroeconomic and fiscal risks (the 'risk matrix') is set out. In relation to economic activity, risks to the central scenario are two-sided though tilted to the downside; for inflation, upside risks dominate.

6.2 Scenario analysis: inflation

Heightened uncertainty means that risks to the Department's baseline inflation projection are two-sided. On the one hand, the impact on economic activity from the aggressive (and synchronised across Ireland's main export markets) monetary tightening in recent months could result in weaker demand which, in turn, could lower the rate of core inflation. On the other hand, higher energy prices could add to headline inflation, triggering additional second-round effects.

To better reflect these risks, two alternative scenarios are set out below, highlighting both the potential upside and downside trajectories for inflation. The scenarios presented are a form of partial equilibrium, i.e. the focus is on one variable only. Of course, a different trajectory for inflation would also have knock-on effects for the economy, for instance by altering household real incomes and, hence, consumer spending, as well as firm investment decisions.

6.2.1 Downside Inflation Scenario

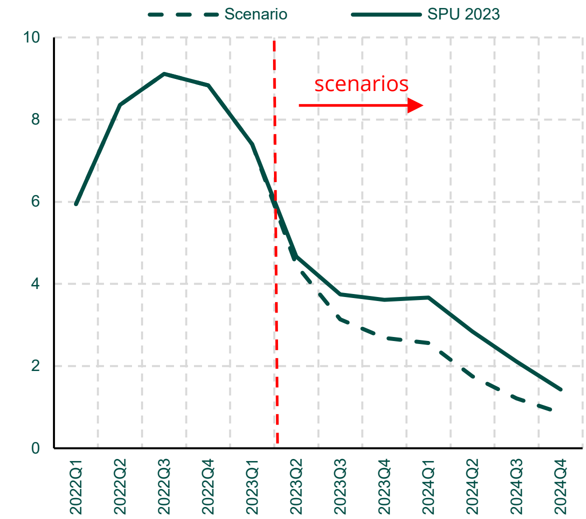
The Department's baseline inflation projections assume that movements in wholesale gas prices are passed-through to retail gas and electricity prices with a lag, reflecting the forward-purchasing strategies (i.e. hedging) by energy suppliers. On this basis, energy prices are expected to remain elevated this year, with a gradual easing anticipated thereafter.

It is possible, however, that the recent easing in wholesale energy prices could be passed-through to retail gas and electricity prices more quickly. An alternative scenario is presented (**figure 18A**) in which the pass-through from wholesale to retail prices takes place more rapidly, with retail gas and electricity prices declining from the second quarter of this year and returning to their pre-war (first quarter of 2022) level by end-2025. A more immediate decline in retail energy prices would also spill-over into other sectors (e.g. food, consumer goods), lowering input costs and easing pressures on non-energy prices.

Inflation in this scenario would average 4.4 per cent this year and 1.6 per cent next year, compared with 4.9 and 2.5 per cent respectively in the central scenario. Approximately three-quarters of the estimated decline in headline inflation in each year is accounted for by the direct impact on energy prices, with the remainder explained by spill-over effects to other sectors.

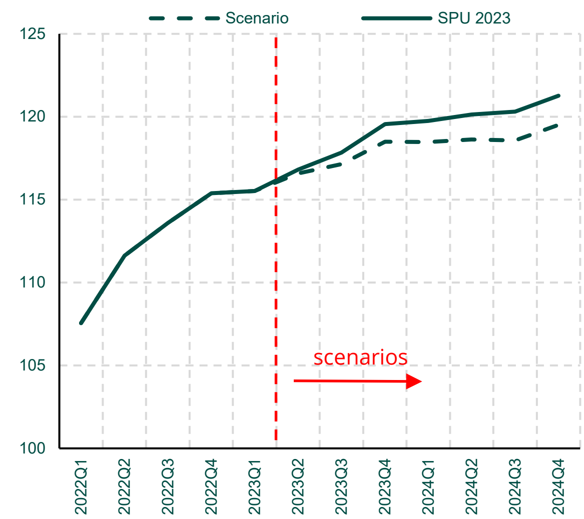
Figure 18: Downside inflation scenario

A: headline HICP – y/y per cent change



Source: Department of Finance

B: headline HICP – price level



Source: Department of Finance

6.2.2 Upside Inflation Scenario

A scenario in which inflation proves more persistent ('stickier') is also possible. The baseline inflation projections set out in this document are based on energy prices as per the futures curve (wholesale oil and gas prices futures) in the second half of March. However, energy markets remain volatile and it's possible that wholesale prices could move higher-than-assumed. Indeed, oil prices picked-up at the beginning of April following the decision of OPEC[33] to cut production. Any further reductions in supply could see oil prices spike once again. At the same time, stronger demand – for instance, from a harsh European winter or stronger global economic growth – would raise wholesale energy prices and add to inflation (it is worth highlighting that late last year, the Chinese economy was in 'lockdown', and this was a key factor holding back wholesale energy prices at the time).

Additionally, given the tight labour market, there is a risk that wage growth could prove higher than anticipated, triggering second-round effects and stalling the anticipated easing of headline and core inflation over this year and next.

In light of these risks, the impact of both an oil price shock and higher than anticipated wage growth on inflation is estimated. Specifically, it is assumed that oil prices are 40 per cent higher than in the central scenario this year and next. In parallel, higher-than-anticipated wage growth as a result of the tight labour market is assumed to result in stronger services inflation putting upward pressure on headline and core inflation.

As the pass-through from wholesale oil to retail prices tends to be fairly rapid, higher oil prices in this scenario add an estimated 0.7 percentage points to headline inflation this year and around ¼ percentage point to headline inflation next year. Pass-through from wages to services prices however likely occurs more slowly, with higher than anticipated wage growth assumed to add around 0.2 percentage points to headline inflation this year and ½ percentage point to headline inflation in 2024.

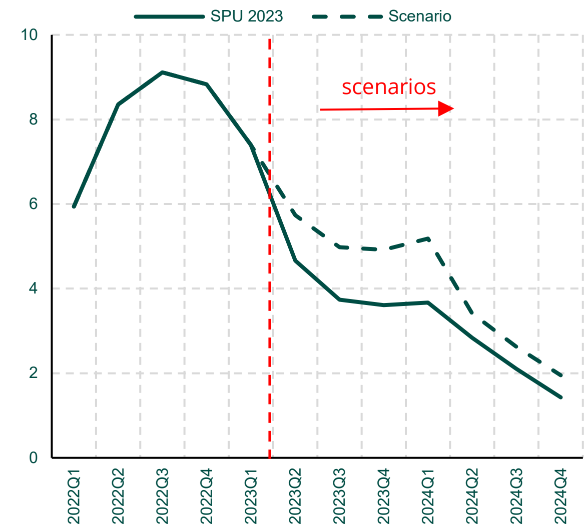
Overall, headline inflation in this scenario would average 5.8 per cent this year and 3.3 per cent next year compared with 4.9 and 2.5 per cent respectively in the central scenario, with core inflation

[33] Organisation of Petroleum Exporting Countries.

averaging 4.7 per cent 3.8 per cent in 2023 and 2024 respectively (compared with 4.4 and 3.2 per cent in the central scenario). Importantly, core inflation would remain elevated for longer, moderating to around 3¼ per cent by the fourth quarter of 2024, compared with 2.7 per cent in the central scenario. Though not accounted for in this analysis, higher oil prices would likely also spill-over to other sectors (food, transport etc.) and put further upward pressure on inflation.

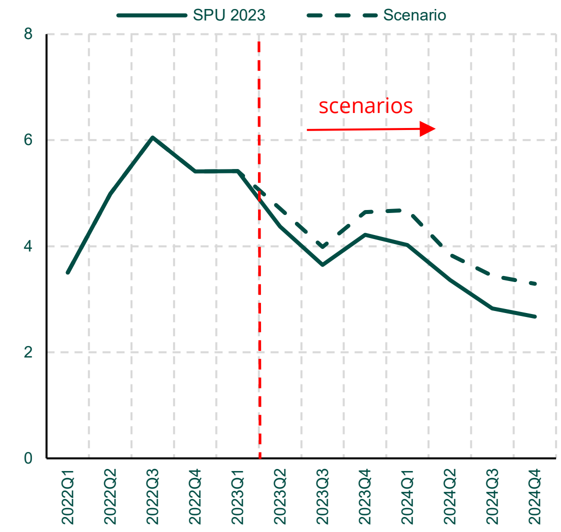
Figure 19: Upside inflation scenario

A: headline HICP – y/y per cent change



Source: Department of Finance

B: core HICP – y/y per cent change



Source: Department of Finance

It is important to stress that the higher and lower scenarios outlined above do not represent upper and lower bound estimates for inflation. Instead, the purpose of the analysis is to highlight the considerable uncertainty surrounding the inflation outlook and the sensitivity of inflation to changes to the assumptions underlying the forecasts.

6.3 Shocks to the medium-term projections

The supply-side methodology used to calibrate the medium-term projections relies on a set of assumptions for key economic variables, including participation rates, migration, the economy's capital stock and the likely evolution of total factor productivity.

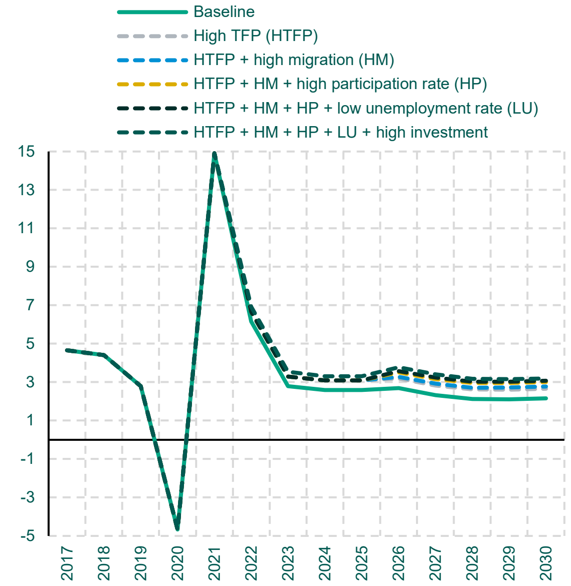
As always, it is important to stress-test these assumptions – in other words, to assess how sensitive the projections are to alternative assumptions for key inputs.

For labour market inputs, it is entirely plausible that population growth over the medium-term is stronger-than-assumed, *inter alia* due to stronger migration flows or changing work practices that result in higher participation rates. In addition, the equilibrium (or 'natural') rate of unemployment could also prove to be lower than estimated. Stronger assumptions for productivity (TFP) and a higher rate of investment would also boost medium-term economic growth prospects.

The converse holds true in the case of more pessimistic scenarios such as weaker TFP assumptions or higher equilibrium unemployment rates. Indeed many of the above scenarios could also be positively or negatively impacted by the pace of the transition to net zero or digitalisation.[34] The sensitivity of the model to any departure from the baseline assumptions is set out below (**figure 20**).

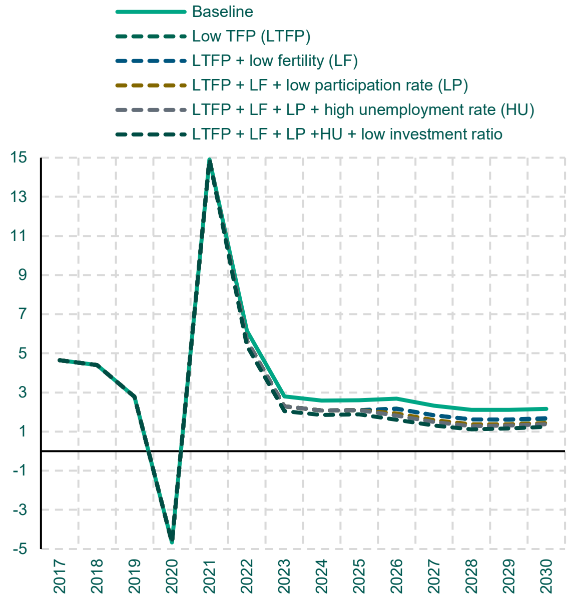
Figure 20: Scenario analysis for medium-term approach

A: high growth scenario (GNI* growth)



HTFP = high TFP
HM= high migration;
HP = high participation
Source: Department of Finance

B: low growth scenario (GNI* growth)



LTFP = low TFP
LM= low migration;
LP = low participation
Source: Department of Finance

There are, of course, numerous permutations and, to summarise, it is useful to set out high and low growth scenarios: high growth involves the scenario in which all inputs are stronger-than-assumed while the low growth is the polar opposite (**table 20**).

Growth in GNI* is a percentage point below the baseline estimate of 2.3 per cent on average over the latter half of this decade in the ‘low growth scenario’ and a percentage point above baseline in the ‘high growth scenario’. In all scenarios, contributions from capital and productivity are the main drivers of growth in the medium-run due to the impact of weakening demographics on employment growth. Further details of this supply-side methodology for the baseline and alternative scenarios will be set out in *Hogan, Rehill and Sanjani* (forthcoming).

Table 20: Contribution to growth 2026-2030, baseline and scenarios, pp

	Baseline	Low growth	High growth
GNI*	2.3	1.3	3.3
TFP	0.8	0.3	1.3
Capital stock	0.9	0.7	1.0
Employment	0.6	0.3	1.0

Source: Department of Finance calculations

[34] See Economic Insights - Spring 2023, Department of Finance (February 2023), available at: https://www.gov.ie/en/publication/2c8b4-economic-insights-spring-2023/

Table 21: Risk assessment matrix – economic

Risk	Likelihood	Origin	Impact and main transmission channel
Downside			
Escalation of geopolitical tensions	**Medium**	**External**	**High** – any escalation, or broadening, of geopolitical tensions could result in a sharp shock to global activity, further global economic de-integration, triggering lower levels of economic activity in Ireland.
Weaker trading partner growth	**Medium**	**External**	**Medium** – the outlook for the global economy is highly uncertain and weaker-than-assumed economic activity in key export markets (including the possibility of 'stagflation') would be an additional headwind for the economy.
Sector specific shocks	**Medium**	**External**	**High** – a sector (or firm-specific) shock in the highly concentrated MNC sector would be damaging to the domestic economy while any deterioration in the global financial system could prompt further tightening of global credit conditions.
Additional monetary tightening	**Medium**	**External**	**Medium** – core inflation in the euro area may prove 'stickier' than expected requiring more aggressive than anticipated monetary policy, which would be a strong headwind for real economic activity in Ireland (and elsewhere in the euro area).
Customs checks by UK	**Low**	**Domestic/ External**	**Low** – the full introduction of customs and regulatory checks by the UK (assumed for 2024) under the *Trade and Cooperation Agreement* could have a more significant than anticipated adverse impact on Irish exports, in particular in the SME sector.
Economic adjustment in China	**Low**	**External**	**Medium** – imbalances in the Chinese economy have built up in recent years,[35] particularly in the construction sector, and a potential disorderly adjustment would have significant negative spillover effects on the global economy.
Loss of competitiveness	**Medium**	**Domestic**	**Medium** – a wage-price spiral would damage cost competitiveness and hamper the economy's ability to compete in the global marketplace.
Further energy price shock	**Medium**	**External**	**High** – Further instability in global oil and gas supplies could lead to a larger than expected energy price shock which, in turn, would lead to higher levels of inflation and lower domestic demand.
Undersupply of housing	**Medium**	**Domestic**	**High** – The housing market faces a number of headwinds (higher interest rates, regulatory / planning delays, etc.); lower-than-assumed housing supply would have negative economic impacts via labour mobility, productivity, competitiveness, etc.
Upside			
Stronger activity from MNCs	**Medium**	**External**	**High** – stronger than expected investment and exports from MNCs (ICT, pharma, contract manufacturing, etc.) would boost corporate sector output and increase GDP.
Unwinding of 'excess' savings	**Low**	**Domestic**	**Medium** – greater than assumed use of 'excess' savings by consumers would boost spending and increase domestic demand (and potentially prices).
Net inward migration	**Medium**	**Domestic**	**Medium** – Higher than expected inward migration would boost the overall level of output in the economy and help address labour market mismatches.

Source: Department of Finance

[35] See Economic Insights - Winter 2022, Department of Finance (December 2022), available at: https://www.gov.ie/en/publication/2e14a-economic-insights-winter-2022/

Table 22: Risk assessment matrix – fiscal

Risk	Likelihood	Impact and main transmission channel
Domestic		
Humanitarian assistance	**High**	**High** – Expenditure on humanitarian assistance in 2024 and potentially over the medium-term is likely to have a material impact on the public finances.
Ageing population	**High**	**Medium** – unfunded reversals to the retirement age and/or higher than anticipated ageing-related expenditure would adversely affect the public finances over the medium-term.
Corporation tax: policy change (BEPS)	**High**	**High** – revenue from this source is expected to be negatively affected as international tax policy changes (BEPS) take effect; the actual cost could be higher than the €2 billion by 2025 currently assumed.
Corporation tax: concentration risk	**Medium**	**High** – over half of corporation tax revenue arises from the 10 largest payers; a company or sector-specific shock to this revenue stream would have significant negative implications for the public finances.
Contingent liabilities	**Low**	**Low** – government guarantees increased in 2020 as a result of counter guarantees for the European Commission to provide financial support during the pandemic.
External		
Borrowing costs	**Medium**	**Medium** – Tightening of monetary policy could be more aggressive than expected which would result in higher debt service costs.
Climate change and renewable energy targets	**High**	**High** – climate policy and the corresponding actions needed to reduce emissions by 50 per cent by 2030 and transition to net-zero by 2050 will have macroeconomic and fiscal implications.
Litigation or one-off measures	**Medium**	**Medium** – an adverse or unexpected outcome of litigation against the State or other one-off fiscal costs which resulted in additional expenditure could pose a risk to the achievement of budgetary targets.

Source: Department of Finance

Chapter 7
Long-Term Sustainability of the Public Finances

7.1 Summary

The demographic structure of the Irish population is set to shift significantly in the coming decades. This will have significant implications for the economy, with the underlying trend growth rate set to slow which, in turn, will weigh on tax revenue growth. On the other side of the equation, an ageing population will trigger a significant rise in public expenditure, as higher outlays on healthcare, pension payments and long-term care will be needed.

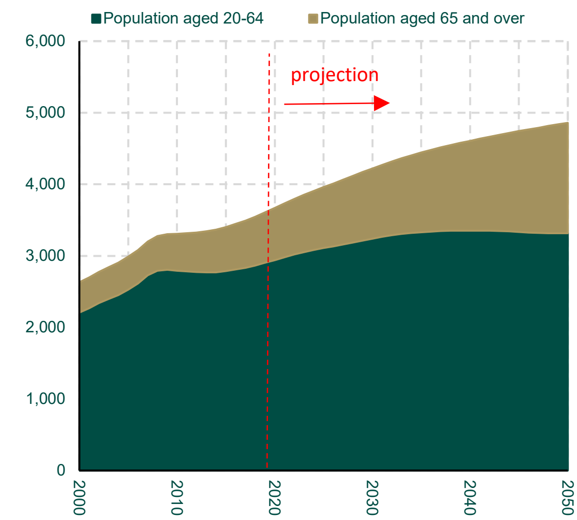
In the absence of structural reforms, the public finances do not have the capacity to fully absorb these increases without either compromising expenditures in other areas or raising revenues.

7.2 Long-term demographic and budgetary prospects

Ireland's relatively favourable demographic window is beginning to close. Longer-term trends – increases in life-expectancy and falling fertility rates – mean that the population aged 65 and over is projected to grow significantly faster than the population aged 20 to 64, i.e. the working age population, in the coming years. The evidence is clear-cut: the number of persons of working age for each person aged 65 and over is set to fall from around 4 today to just over 2 by 2050.

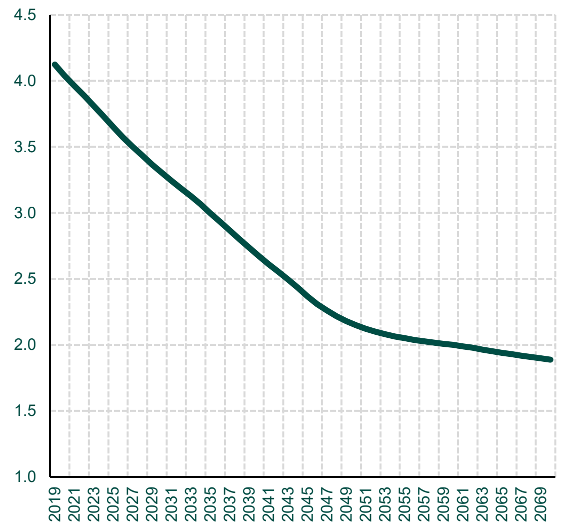
Figure 21: Impact of demographic developments

A: population aged 20 and over by age group, (000's)



Source: CSO, Eurostat.

B: inverse old-age dependency ratio



Source: Department of Finance.

This demographic transition will have important budgetary implications, affecting both the revenue and expenditure sides of the fiscal accounts. In relation to the former, an ageing population will weigh on labour force growth and constrain the pace at which the economy can expand; as tax revenue evolves in line with economic activity, this will lower the pace of revenue growth. On the expenditure side, an ageing population requires additional outlays in a number of functional areas, including health-care provision, pensions and long-term care. Longer-range fiscal projections produced by the Department suggest additional annual expenditure amounting to over 8 per cent of GNI* by 2050.[36]

Even by the end of this decade, the budgetary implications of an ageing population will be increasingly evident. For instance, relative to 2019 (just before the pandemic), age-related expenditure will be €7-8 billion higher per annum by the end of this decade.

7.3 Options to limit the fiscal cost of demographic change

From an economic perspective, the optimum response to reduce the fiscal costs of population ageing is to gradually increase the retirement age in line with improvements in life-expectancy. Following consideration of the *Commission on Pensions* report,[37] the Government decided to keep the State Pension Age at 66 and to introduce a new flexible system whereby people will be given the choice to work until age 70 in return for a higher State Pension. Government has decided that the additional costs will be met by raising social insurance contributions. Specifically, the Department of Social Protection has proposed that the long-term sustainability of the State Pension system will be addressed through gradual, incremental increases in PRSI rates over time. The level and rate of increase in social insurance rates will be determined on a structured basis every 5 years informed by the outcome of a statutory actuarial review of the Social Insurance Fund.

In terms of wider pension provision, in March 2022, the Government announced details of an automatic-enrolment (AE) retirement savings system, which will automatically enrol approximately 750,000 employees who are not already participating in an occupational pension scheme. Once fully operational, the overall contribution rate will be 14 per cent which consists of 6 per cent from the employer, 6 per cent from the employee and a further 2 per cent from the State. Preparations for implementation of the AE system are underway with an envisaged commencement date of 2024.

Alongside these initiatives, the Minister for Finance will bring shortly bring forward a proposal to establish a long-term fund that will contribute to future ageing-related and other costs. To contextualise this, the Department of Finance will shortly publish a scoping paper,[38] detailing some of the options and simulating a range of illustrative options. It is worth highlighting that under all of the options modelled by the Department, additional structural reforms will also be required to offset future age related expenditures.

7.4 Conclusion

The fiscal costs of demographic change are now very clearly on the horizon – by the end of this decade, additional outlays of €7-8 billion per annum, relative to the level of outlays at the beginning of the decade, will be required simply to deliver existing levels of public service. The first-best solution – raising the retirement age to reflect increased longevity – to fund these additional outlays is no longer an option. In recognition of this, a complementary policy will shortly be proposed by the Minister for Finance, namely pre-funding a portion of these costs via a longer-term public savings vehicle.

[36] See *Population Ageing and the Public Finances in Ireland* Department of Finance (September 2021). Available at: https://www.gov.ie/en/press-release/7908d-minister-donohoe-publishes-population-ageing-and-the-public-finances-in-ireland-report/
[37] https://www.gov.ie/en/publication/6cb6d-report-of-the-commission-on-pensions/
[38] *Future proofing the public finances – the next steps*, Department of Finance (forthcoming).

Annexes

Irish Fiscal
Advisory Council

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Whitaker Square, Sir John Rogerson's Quay, Dublin D02 K138, Ireland.

6 April 2023

Dear Secretary General Hogan,

The Council has a statutory obligation to endorse, as appropriate, the macroeconomic forecasts prepared by the Department of Finance on which the Stability Programme Update (SPU) *2023* will be based.[1]

The Council's endorsement approach has three elements:

1) comparing the Department's macroeconomic forecasts with the Council's Benchmark projections and with forecasts from other bodies;
2) considering the methodologies used to produce the forecasts; and
3) reviewing the Department's past forecast errors for evidence of systematic bias.

The Council discussed the Department's forecasts at its endorsement meeting on 31st March 2023.

The Irish Fiscal Advisory Council endorses as within the range of appropriate forecasts the set of macroeconomic projections prepared by the Department of Finance for *SPU 2023* covering the years 2023 to 2030.

The Council is satisfied that the forecasts are within an endorsable range taking into account the methodologies used and the plausibility of the judgements made. This endorsement comes as the outlook for the international economy faces many risks, including from adverse financial sector developments. The Irish economy, by contrast, faces ongoing risks related to capacity constraints, including from a tight labour market.

The Department's forecasts extend to 2030. This is a much longer horizon than has been the case in previous forecast rounds. Having called for a greater medium-term focus in both the Government's macroeconomic and fiscal orientation, the Council welcomes this development. Longer-term forecast horizons should promote a better understanding of the medium-term trajectory of the economy and of potential economic imbalances.

The Council will discuss the endorsement process and assess the macroeconomic projections in its forthcoming Fiscal Assessment Report, due in May 2023.

Yours sincerely,

Sebastian Barnes, Chairperson.

[1] 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".

Annex 2
Comparison of forecasts

Table A1: Comparison of 2023 forecasts with other public sector institutions

	GDP	employment	inflation	gg balance	gg debt
Department of Finance	5.6	1.6	4.9	1.8	40.5
Central Bank of Ireland	5.6	1.4	5.0	1.4	40.5
ESRI	5.5	2.2	4.5	0.9	42.2
IMF	5.6		5.0	1.3	39.8
European Commission	3.2		6.0	0.8	41.2

Notes:
Economic variables in per cent change; fiscal variables as a per cent of GDP.
The ESRI and the Department of Finance use Covid adjusted employment figures, the Central Bank does not.
Source: latest forecasts from the institutions cited.

Table A2: Comparison of 2024 forecasts with other public sector institutions

	GDP	employment	inflation	gg balance	gg debt
Department of Finance	4.1	1.4	2.5	2.8	38.2
Central Bank of Ireland	4.8	1.7	3.2	2.6	38.1
ESRI	6.0	0.4	3.5	1.7	38.0
IMF	4.0		3.2	1.2	36.0
European Commission	3.1		2.4	1.2	39.3

Notes:
Economic variables in per cent change; fiscal variables as a per cent of GDP.
The ESRI and the Department of Finance use Covid adjusted employment figures, the Central Bank does not.
Source: latest forecasts from the institutions cited.

Table A3: Comparison of spring vs autumn economic forecast, per cent

	2023 forecast		Δ pp	2024 forecast		Δ pp
	Spring 2023	Autumn 2022		Spring 2023	Autumn 2022	
Economic activity						
Real GDP	5.6	4.7	0.9	4.1	3.3	0.8
Real GNP	5.1	4.2	0.9	3.6	2.8	0.8
MDD	2.1	1.2	0.9	2.5	3.3	-0.8
Prices						
HICP	4.9	7.1	-2.2	2.5	2.4	0.1
Core HICP	4.4	4.6	-0.2	3.2	3.0	0.2
GDP deflator	4.0	4.4	-0.4	2.3	2.1	0.2
Labour market						
Employment (per cent)	1.6	1.2	0.4	1.4	1.6	-0.2
Unemployment rate (per cent)	4.4	5.1	-0.7	4.5	5.0	-0.5

Source: Department of Finance, Department of Public Expenditure and Reform, CSO and NTMA estimates.

Annex 3
Additional fiscal data

Table A4: Difference between exchequer balance and general government balance, € millions					
	2022	2023	2024	2025	2026
Exchequer balance	4,985	4,535	12,925	13,160	14,985
Exclude equity and loan transactions	-2,770	-695	-180	-85	-70
Adjust for interest accrual	315	265	260	560	145
Adjust for tax accruals	465	400	295	315	335
Adjust for other accruals	655	-310	-40	-315	-65
Net lending of NCSSBs^	100	-1,175	-1,105	-735	-1,085
Impact of ISIF	70	160	165	170	170
Net lending of Social Insurance Fund	2,330	3,305	4,625	5,575	6,525
Net lending of other EBFs^	640	425	375	325	370
Net lending of Local Government	-755	-900	-1,105	-855	-470
National Reserve Fund	2,000	4,000	0	0	0
General government balance (GGB)	8,035	10,010	16,215	18,115	20,840
GGB, per cent of GNI*	3.0	3.5	5.4	5.8	6.3
Nominal GNI*	269,750	283,675	297,625	312,925	328,900

Notes:
In the case of 'net lending', a positive sign indicates a sector is a net lender, a negative sign a net borrower.
GNI* rounded to nearest €25 million.
^ NCSSB = non-commercial semi-state bodies, EBF = extra budgetary fund.
Source: Department of Finance, CSO, NTMA

Table A5: General government balance, per cent of GNI*					
	2022	2023	2024	2025	2026
Net lending by sub-sector					
General government balance	3.0	3.5	5.4	5.8	6.3
: Central government	3.3	3.8	5.8	6.1	6.5
: Local government	-0.3	-0.3	-0.4	-0.3	-0.1
General government					
Total Revenue	42.8	43.5	43.4	43.1	43.2
Total Expenditure	39.8	40.0	38.0	37.3	36.9
Net lending/borrowing	3.0	3.5	5.4	5.8	6.3
Interest expenditure	1.2	1.2	1.2	1.1	1.0
Primary balance	4.2	4.7	6.6	6.8	7.4
One-off / other temporary measures	0.7	2.0	3.8	3.6	3.8
Revenue					
Total taxes	33.0	33.4	33.6	33.4	33.6
: Taxes on production and imports	*11.7*	*11.8*	*12.0*	*12.0*	*12.0*
: Current taxes on income, wealth etc.	21.0	21.4	21.4	21.2	21.4
: Capital taxes	*0.2*	*0.2*	*0.2*	*0.2*	*0.2*
Social contributions	7.4	7.4	7.6	7.7	7.6
Property Income	*0.2*	*0.5*	*0.2*	*0.3*	*0.2*
Other	2.3	2.2	1.9	1.8	1.7
Total revenue	42.8	43.5	43.4	43.1	43.2
p.m.: Tax burden	40.7	41.2	41.7	41.5	41.7
Expenditure					
Compensation of employees	10.7	10.5	10.4	10.2	10.1
Intermediate consumption	6.6	6.4	6.1	5.9	5.8
Social payments	13.8	13.6	12.9	12.6	12.4
: Social transfers in kind via mkt producers	*3.3*	*3.2*	*3.0*	*2.9*	*2.9*
: Social transfers other than in kind	*10.5*	*10.5*	*9.9*	*9.7*	*9.5*
Subsidies	1.2	1.0	0.7	0.7	0.7
Interest expenditure	1.2	1.2	1.2	1.1	1.0
Gross fixed capital formation	3.7	3.9	4.0	4.2	4.3
Capital Transfers	0.7	0.8	0.8	0.8	0.7
Other	1.9	2.1	1.8	1.8	1.8
Resources to be allocated	0.0	0.4	0.0	0.0	0.0
Total expenditure	39.8	40.0	38.0	37.3	36.9
p.m. : Government consumption	21.1	20.6	20.1	19.8	19.6
GNI* at current market prices	269,750	283,675	297,625	312,925	328,900

Source: Department of Finance, CSO and NTMA.

Table A6: General interest expenditure, € millions

	2022	2023	2024	2025	2026
National Debt cash interest	3,700	3,400	3,795	3,780	3,420
per cent tax revenue	4.5	3.8	4.0	3.8	3.3
per cent of GNI*	1.4	1.2	1.3	1.2	1.0
National Debt cash interest accruals	-225	-265	-260	-560	-145
Consolidation and grossing adjustments	-265	-265	-110	-50	15
Accrued promissory note interest	0.0	0.0	0.0	0.0	0.0
Other	60	35	45	145	90
Total Interest on ESA2010 basis	3,270	3,435	3,470	3,315	3,380
per cent of total gg revenue	2.8	2.8	2.7	2.5	2.4
per cent of GNI*	1.2	1.2	1.2	1.1	1.0

Source: Department of Finance, CSO and NTMA.

Table A7: Projected movement in general government debt, € billions

	2022	2023	2024	2025	2026
GG Debt: Opening Position	236.1	224.8	223.5	224.4	220.2
In-Year Flows:					
Exchequer borrowing requirement	-5.0	-4.5	-12.9	-13.2	-15.0
Change in Exchequer deposits	-2.8	1.8	11.9	7.1	8.0
Net lending of NCSSBs	-0.4	1.0	0.9	0.9	1.3
Net lending of local government	0.2	0.9	1.1	0.9	0.5
Other flows	-3.3	-0.5	0.0	0.0	0.0
GG Debt: Closing Position	224.8	223.5	224.4	220.2	215.0

Notes:
NCSSBs = Non-commercial semi-state bodies
Source: Department of Finance, CSO and NTMA.

Table A8: Fiscal response to cost of living, € million

	2022*	2023	Total
Energy related			
Energy Efficiency	169	291	460
Transport	54	152	206
Income Support	294	63	357
Energy Credit	1,578	-	1,578
Business / Other Sector Supports	1,018	840	1,858
Reduction in excise duty	581	500	1,081
Reduction in VAT rate on electricity and gas	46	160	206
Other measures with cost mitigating impacts			
Income supports	1,155	1,367	2,522
Other expenditure	732	414	1,146
Budget 2022 income tax package	520		520
Budget 2023 income tax package^	-	1332	1,332
Rent credit for rent paid in 2022	-	200	200
Extension of 9 per cent reduction in VAT rate on hospitality	83	467	550
TOTAL	**6,230**	**5,786**	**12,016**

Notes:
*2022 figures relate to allocated funding. Figures are reported on an exchequer basis. Measures include temporary and permanent supports for households and other sectors
^ This includes the rent credit for rent paid in 2023.
Source: Department of Finance and Department of Public Expenditure, NDP delivery and Reform

Table A9: Expenditure on Ukraine humanitarian response, € million

	ESA	2022	2023
General government expenditure		**1,030**	**2,000**
Compensation of employees	D1	15	35
Intermediate consumption	P2	23	173
Social payments	D6	746	1,134
Interest expenditure	D4	-	-
Subsidies	D3	1	20
Gross fixed capital formation	P51g	57	30
Capital transfers	D9	29	63
Other	D7	158	100
Resources not allocated		-	446
memo items			
Number of refugees hosted^		64,322	65,000 - 79,000

Notes:
^ These numbers do not account for those who may have left the state in the intervening time.
As of end-March 2023, 71,448 Ukrainian refugees arrived in Ireland. Using assumptions on outflows (based on data from the CSO) and assumptions regarding inflows (based on trends) it is projected that between 65k and 79k will be hosted at the end of 2023. This is broadly in line with expectations at the time of Budget 2023.
Source: Department of Finance, Department of Public Expenditure, NDP delivery and Reform and Department of Justice

Annex 4
Summary: macroeconomic and fiscal aggregates

Table A10: Summary – macroeconomic aggregates					
	2022	2023	2024	2025	2026
Economic activity	***year-on-year per cent change (unless stated)***				
Real GNP	6.6	5.1	3.6	4.4	3.8
Real GDP	12.0	5.6	4.1	4.9	4.4
Nominal GDP (nearest €25m)	502,575	551,850	587,800	629,875	671,750
Nominal GNP (nearest €25m)	363,450	399,250	424,325	453,725	482,525
Nominal GNI* (nearest €25m)	269,750	283,675	297,625	312,925	328,900
Components of GDP	***year-on-year per cent change***				
Personal consumption	6.6	3.9	3.8	3.4	3.4
Government consumption	0.7	0.5	0.8	2.0	1.5
Investment	25.9	2.4	3.3	3.8	4.4
Modified investment	19.8	-0.6	1.2	3.7	4.9
Modified domestic demand	8. 2	2.1	2.5	3.2	3.4
Exports	15.0	7.8	4.9	5.4	4.7
Contributions to real GDP growth	***percentage points***				
modified domestic demand	8.2	2.1	2.5	3.2	3.4
modified net exports	7.1	5.0	3.3	3.7	3.2
stock changes	1.0	0.0	0.0	0.0	0.0
statistical discrepancy	0.0	0.0	0.0	0.0	0.0
Price developments	***year-on-year per cent change***				
HICP	8.1	4.9	2.5	2.0	2.0
GDP deflator	5.3	4.0	2.3	2.2	2.2
Personal Consumption Deflator	6.6	4.9	3.7	3.1	3.0
Labour market	***year-on-year per cent change (unless stated)***				
Employment	6.6	1.6	1.4	1.5	1.6
Unemployment (per cent of labour force)	4.5	4.4	4.5	4.5	4.5
Labour productivity	5.0	4.0	2.7	3.4	2.8
Compensation of Employees^	11.3	8.3	6.9	6.7	6.4
Compensation per Employee^^	4.2	5.6	5.0	4.8	4.3
External	***per cent of GDP***				
Trade balance	37.3	39.6	40.1	40.9	41.4
Modified current account (per cent GNI*)	9.7	9.1	8.7	8.0	7.2
Cyclical Developments	***per cent of potential GDP***				
Domestic Output	1.6	1.4	1.1	1.2	1.3

Notes:
^ non-agricultural sector
^^ per worker, non-agricultural sector
Source: 2022 = CSO; 2023-26 = Department of Finance.

Table A11: Summary – fiscal aggregates					
	2022	2023	2024	2025	2026
Exchequer			*€ millions*		
Exchequer Balance	4,985	4,535	12,925	13,160	14,985
Tax Revenue	83,130	88,885	94,415	98,995	105,020
General government			*€ millions*		
Total Revenue	115,505	123,440	129,170	134,955	142,120
Total Expenditure	107,475	113,440	112,955	116,845	121,285
General government balance	8,035	10,010	16,215	18,115	20,840
General Government			*per cent GNI**		
Total Revenue	42.8	43.5	43.4	43.1	43.2
Total Expenditure	39.8	40.0	38.0	37.3	36.9
General government balance	3.0	3.5	5.4	5.8	6.3
Interest expenditure	1.2	1.2	1.2	1.1	1.0
Primary balance	4.2	4.7	6.6	6.8	7.4
Gross fixed capital formation	3.7	3.9	4.0	4.2	4.3
Gross debt	83.3	78.8	75.4	70.4	65.4
Net debt	68.7	64.7	58.4	52.3	46.0

Source: Department of Finance, Department of Public Expenditure and Reform, CSO and NTMA.

Annex 5
Ageing Report 2021 expenditure projections

Table A12: Main Demographic Developments

	2019	2030	2040	2050
Labour input (growth rate)	2.1	0.3	0.2	0.1
: Employment (growth rate)^	2.1	0.3	0.1	0.1
: Hours worked per employee (growth rate)	0.1	0.0	0.0	0.0
Labour productivity (growth rate)	3.4	1.2	1.5	1.5
: Total Factor Productivity (growth rate)	1.6	0.9	1.0	1.0
: Capital deepening (growth rate)	1.8	0.3	0.5	0.5
Potential GDP (growth rate)	5.6	1.4	1.7	1.6
Population aged >= 65 ('000s)	704	981	1,254	1,543
Population aged 20-64 ('000s)	2,904	3,241	3,353	3,315
Old-age dependency ratio (per cent)	24.2	30.3	37.4	46.5

^ 15-74 basis.
Source: Ageing Report 2021 and Department of Finance calculations.

Table A13: Long-term spending projections, per cent of GDP (unless otherwise stated)

	2019	2030	2040	2050
Total age-related expenditure	**13.2**	**15.2**	**16.7**	**18.1**
- Total pension expenditure	4.6	5.9	6.9	7.5
: State (Social Welfare) pension	3.5	4.4	5.2	6.1
: Public Sector pension	1.0	1.5	1.6	1.4
- Health care	4.1	4.4	4.8	5.1
- Long-term care	1.3	1.6	2.0	2.4
- Education	3.3	3.3	3.1	3.2

Source: Ageing Report 2021 and Department of Finance calculations.

Table A14: Long-term spending projections, per cent GNI* (unless otherwise stated)

	2019	2030	2040	2050
Total age-related expenditure	**21.4**	**24.7**	**27.2**	**29.5**
- Total pension expenditure	7.4	9.6	11.2	12.1
: State (Social Welfare) pension	5.8	7.2	8.5	9.9
: Public sector pension	1.6	2.4	2.7	2.3
- Health care	6.6	7.2	7.8	8.3
- Long-term care	2.0	2.7	3.2	3.9
- Education	5.3	5.3	5.0	5.2

Source: Ageing Report 2021 and Dept. of Finance calculations.

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