

DRAFT IRELAND'S STABILITY PROGRAMME

April 2014 Update

Incorporating the
Department of Finance's Spring Forecasts



An Roinn Airgeadais
Department of Finance

DRAFT

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Foreword

This draft Update of Ireland's Stability Programme takes account of Budget 2014 and other Government initiatives. It includes an update of the economic and fiscal outlook.

The finalised document will be submitted to the European Commission by end-April in accordance with the requirements under the European Semester – Ireland is now a full participant in this process following exit from the EU-IMF financial assistance programme in late-2013.

The document incorporates horizontal guidance provided by the European Council to Member States in December 2013 and March 2014 as part of the discussions on the Annual Growth Survey. It also reflects the December 2010 ECOFIN Council recommendations to Ireland under the Excessive Deficit Procedure. It has been prepared in line with the September 2012 guidelines on the format and content of Stability and Convergence Programmes.

This Update of the Stability Programme should be read in conjunction with the 2014 Update of Ireland's National Reform Programme (NRP), which outlines progress to date in achieving Ireland's national targets within the context of the Europe 2020 Strategy.

The analysis and forecasts contained in this document are based on data available to late-March 2014. The macroeconomic forecasts contained herein were endorsed by the Irish Fiscal Advisory Council on 7 April 2014.

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Chapter 1

Summary Overview and General Policy Strategy

1.1 Policy strategy

Recent data confirm that the Government's economic strategy is yielding positive results.

While the headline measures of economic activity (namely GDP and GNP) can be distorted, both positively and negatively, from time-to-time by sector-specific developments in Ireland, the underlying picture at present is one of economic recovery that is gaining momentum. Labour market data provide the most concrete evidence for this, with annual employment growth of over 3 per cent in the second half of last year. This strong performance in the jobs market is consistent with the stabilisation of domestic demand that emerged over the course of last year; domestic sources of demand are typically more employment-rich than external sources.

Notwithstanding the improvement over the past two years, unemployment remains unacceptably high. In this regard, the Government's over-arching economic policy objective is to continue to create the necessary conditions for sustainable economic growth in order to further reduce unemployment.

In terms of key policies, the Medium-Term Economic Strategy sets out the Government's approach for jobs-rich economic growth over the period to the end of this decade. This involves a three pillar approach. Firstly, the Government is conscious that there remains scope for further improvements in competitiveness, including through structural reforms. These include targeted tax policy changes to stimulate activity in key sectors of the economy. The Action Plan for Jobs and Pathways to Work initiatives set out the Government's strategy for generating employment and engaging with the unemployed. In addition, the Government is working to ensure that sufficient credit is forthcoming in order to finance economic recovery. Finally, the Government recognises that sustainable public finances are a necessary condition for economic recovery. The immediate fiscal policy objective, therefore, remains the correction of the excessive deficit by next year. Thereafter, fiscal policy will be set in line with the requirement to move towards Ireland's medium-term budgetary objective, which is for a balanced budget in structural terms.

It is worth highlighting the institutional reforms that have taken place in the fiscal area in recent years. The establishment of the Irish Fiscal Advisory Council (IFAC) on a statutory basis, the placing of fiscal rules on a higher legal basis, and improvements to the budgetary process, all represent important enhancements to fiscal policy formulation and help further underpin confidence in the evolution of the public finances in Ireland. On foot of these developments, Ireland is now fully compliant with all of the fiscal governance reforms that have been initiated in recent years.

1.2 Economic and budgetary outlook

Headline measures of economic activity provide conflicting signals for last year: on the one hand GDP fell by 0.3 per cent while on the other hand GNP rose by 3.4 per cent. A more detailed inspection shows that sector-specific developments had a large negative impact on the GDP figure. For instance, the impact of patent-expiry depressed gross value added in the pharma-chem sector last year. Because most firms in this sector are foreign-owned, the reduction in value added gave rise to reduced profit payments to headquarters abroad, so that GNP was largely unaffected by this sector-specific issue.

Turning to this year, GDP is projected to increase by 2.1 per cent, broadly unchanged from the projection that underpinned the Budget last October. Domestic demand is expected to make a positive contribution to growth, while a small negative contribution from net exports is anticipated. Economic activity is expected to accelerate gradually next year and return to its estimated trend growth rate further out the forecast horizon.

The macroeconomic forecasts underpinning this Update have been endorsed by the IFAC (see annex 3).

Table 1: Economic growth, general government balance and debt ratio

	2013	2014	2015	2016	2017	2018
Real GDP (% change)	-0.3	2.1	2.7	3.0	3.5	3.5
Employment (% change)	2.4	2.2	2.0	2.0	1.9	1.9
Underlying general government deficit (% of GDP)	7.2	4.8	2.9	2.2	1.2	0.0
EDP target (% of GDP)	-7.5	-5.1	-2.9	n/a*	n/a*	n/a*
Debt ratio (year-end)	123.7	121.4	120.0	115.9	112.0	107.2
Net debt position (% of GDP)	98.3	100.8	100.9	97.6	94.6	90.6

* Final EDP target is for 2015

Source: 2013 - CSO; 2014 to 2018 - Department of Finance

Turning to the public finances, a general government deficit of 7.2 per cent of GDP was recorded last year, below the ceiling imposed by the recommendations under the excessive deficit procedure (EDP). In relation to 2014, there have been a number of important developments since the Budget last October. These include a lower than previously estimated cost of debt servicing and better than expected Central Bank surplus income. There are, however, a number of smaller offsetting factors such as a higher EU Budget contribution which, combined with a lower projection for the level of nominal GDP, mean that the projected deficit for 2014 is 4.8 per cent of GDP. This is unchanged from the Budget 2014 forecast, and remains below the EDP ceiling.

Looking to next year, the Government's firm commitment to correct the excessive deficit by 2015 remains the cornerstone of near-term fiscal policy. On present estimates, this should be achieved with the previously announced policy of a package of tax and expenditure measures of €2.0 billion. However, the actual consolidation effort required to meet the deficit objective will be based on the most up-to-date economic and fiscal data on Budget day. The specific measures will be announced in the Budget in October 2014, and will take on board the conclusions of the Comprehensive Review of Expenditure (CRE) and other ongoing reviews.

The general government debt-to-GDP ratio peaked at close to 124 per cent at the end of last year, and is now on a firm downward trajectory. It is important to highlight that the gross debt figure includes significant cash reserves and other assets accumulated in order to ensure a smooth re-entry to capital markets. Net public indebtedness – which excludes these cash reserves and other assets – amounted to just under 100 per cent of GDP last year, well below the gross figure. Finally, from a financing perspective, it is also worth pointing out that funding requirements over the short and medium term have been reduced significantly on foot of the maturity extension to official EU loans agreed last year.

Chapter 2

Economic Outlook

2.1 Summary

Provisional figures show that GDP fell slightly last year as *inter alia* headwinds associated with patent-expiry in the pharma-chem sector depressed output and exports. By contrast, domestic demand stabilised and returned to growth in the second half of the year. The recovery in domestic demand also helps explain the very strong labour market performance last year where employment growth outperformed expectations.

Turning to the short-term outlook, there is now mounting evidence that recovery is gaining momentum. Activity is improving in most of Ireland's key export markets, which should support the exporting sectors. While patent-expiry will continue to weigh on exports this year, available evidence suggests that the impact will not be as large as was the case last year. On the domestic front, the investment cycle has clearly turned, while strong employment growth allied with improving confidence should support an increase in personal spending. Against this general background, GDP is projected to increase by 2.1 per cent this year (GNP by 2.7 per cent)¹.

The pace of GDP growth is expected to accelerate in 2015 and beyond, as the output gap closes and the pace of growth reverts to its estimated trend rate of 3½ per cent. Employment is set to expand by around 2 per cent per annum with unemployment falling to 8 per cent by the end of the forecast horizon.

2.2 Macroeconomic outturn 2013

First estimates² of economic activity in 2013 were published by the Central Statistics Office (CSO) in March. The figures show a contraction in real GDP of 0.3 per cent for the full year. Exports grew only slightly as patent-expiry weighed on the volume of goods exports. Beyond this sector-specific issue, exports recorded a reasonably positive performance, with exports of services once again growing solidly.

Somewhat surprisingly, personal consumer spending fell by just over 1 per cent last year. After a number of years of under-investment, capital formation increased by over 4 per cent last year, with positive contributions from most of the sub-components. Imports rose by 1

¹ The Department of Finance's macroeconomic forecasts for 2014-2018 were endorsed by IFAC on 7 April 2014. For more detail please see chapter 5 and the endorsement letter at annex 3.

² All of the national accounts variables referred to in this document have been compiled on an ESA 1995 basis. The definitive national accounts for 2013 will be published in the summer and will incorporate methodological changes to make the data consistent with the new ESA 2010 statistical basis. The most important change from a national accounting perspective in Ireland is the capitalisation of R&D spending which *ceteris paribus* will boost the level of nominal GDP; previously R&D spending was treated as intermediate consumption.

per cent, driven by strong investment in machinery and equipment as well as higher royalty and licence payments by the multinational sector.

2.3 Macroeconomic projections 2014

Economic activity in Ireland’s main export markets strengthened during the second half of last year, and the pace of growth is expected to accelerate this year. Projections for GDP growth in Ireland’s key export markets for this year and next are set out in table 2, and are based on the European Commission’s winter forecasts published in February. High- frequency data – both hard and soft – in the intervening period broadly confirm the outlook. In summary, the data suggest increasing momentum in both the US and UK economies; on the other hand, while moving in the right direction, the recovery in the euro area will continue to lag, due *inter alia* to legacy effects of the crisis which will take time to work through.

Table 2: External assumptions

	2013	2014	2015	2016	2017	2018
External GDP growth						
			% change			
United States	1.9	2.9	3.2	3.5	3.4	3.1
Euro area	-0.4	1.2	1.8	1.5	1.6	1.6
United Kingdom	1.9	2.5	2.4	2.0	2.1	2.3
Technical Assumptions						
Euro-sterling exchange rate	0.85	0.83	0.84	0.84	0.84	0.84
Euro-dollar exchange rate	1.33	1.38	1.39	1.39	1.39	1.39
Brent crude (dollars per barrel)	109	106	102	98	96	96

Source: European Commission Winter Forecasts; projections for beyond 2015 are taken from the IMF World Economic Outlook October 2013

Note: Exchange rates and oil prices (spot and futures) calculated on the basis of a ten-day moving average to 24 March 2014 and unchanged thereafter.

Against the backdrop of gradual recovery in Ireland’s main markets, exports of goods and services are projected to expand modestly in 2014 (by just over 2 per cent). Services exports will once again be the driving force, as patent-expiry will likely continue to weigh on goods exports, albeit not to the same extent as last year. Available data are consistent with this analysis; value-based export data were in positive territory in January, while soft data in the first quarter indicate that export order books remain healthy in both the manufacturing and service sectors.

Turning to domestic developments, consumer spending is set to rebound this year following the sharper-than-expected decline last year. Continued employment growth will support household income growth, while improving confidence should result in a decline in the savings rate. In overall terms, consumer spending – which is by far the largest component of domestic demand – looks set to increase by about 2 per cent this year. The strong retail sales figures in the opening months of this year support this assessment.

Available data confirm that investment growth has clearly resumed and an increase of around 15 cent is projected for this year. This is driven by broad-based growth across the three main sub-sectors: aircraft, other machinery and equipment and building and construction. Growth in construction activity is signalled by the pick-up in housing starts, reflecting supply shortages in certain areas, and double-digit growth in home renovation spending in recent quarters. Government consumption is set to decline again in line with Government fiscal policy. Finally, import growth is set to accelerate given the improvement in final demand which has a large import-content in Ireland.

Taking all of these elements into account, GDP is projected to increase by 2.1 per cent this year. Reduced profitability in the multinational sector as a result of the expiry of some patents in the pharma-chem sector is one of the factors behind the narrowing of the net factor flow deficit over the past year or so; a continuation of this is expected this year with the result that GNP growth is again projected to be stronger than GDP, with an expansion of 2.7 per cent projected. The balance of payments surplus will likely narrow slightly this year reflecting the rebalancing of growth towards more domestic sources.

Table 3: Macroeconomic prospects

	2013	2013	2014	2015	2016	2017	2018
	€m	year-on-year per cent change					
Real GDP	162,303	-0.3	2.1	2.7	3.0	3.5	3.5
Nominal GDP	164,050	0.1	2.6	3.6	4.3	4.7	4.7
Real GNP	137,476	3.4	2.7	2.3	2.5	2.7	2.7
<i>Components of GDP</i>	€m	year-on-year per cent change (real)					
Private consumption	83,061	-1.1	2.0	1.6	1.2	1.2	1.2
Government consumption	25,052	-0.5	-0.9	-1.6	0.0	0.0	0.0
Investment	18,385	4.2	15.4	12.4	7.5	7.5	6.0
Stock changes (% of GDP)	492	0.3	0.3	0.3	0.3	0.3	0.2
Exports	177,142	0.2	2.1	3.2	4.2	4.4	4.4
Imports	138,734	1.0	3.2	3.4	3.6	3.5	3.4
<i>Contributions to real GDP growth</i>		annual percentage point contribution					
Domestic demand		-0.2	2.6	2.2	1.6	1.7	1.5
Stock changes		0.1	0.0	0.0	0.0	0.0	0.0
Net exports		-0.6	-0.5	0.5	1.4	1.8	2.0
<i>Nominal aggregates (nearest €25m)</i>		€ millions					
GDP		164,050	168,375	174,450	181,925	190,575	199,600
GNP		137,925	142,425	147,050	152,700	158,575	164,675

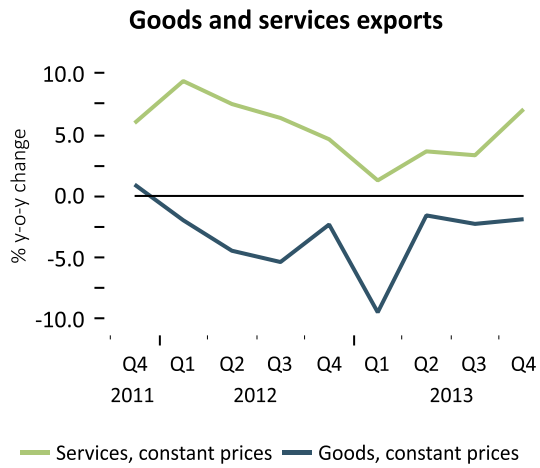
Source: 2013 - CSO; 2014 to 2018 - Department of Finance.

Notes: Rounding can affect totals.

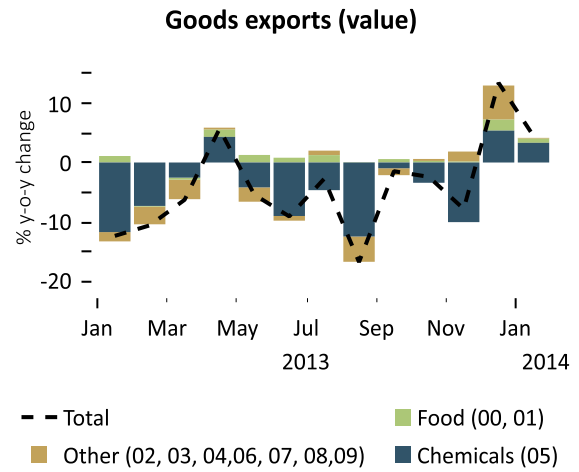
The level of expenditure components are in current prices except for real GDP and GNP which are in constant 2011 prices.

Stock changes are assumed unchanged 2014-2018 in nominal terms but fall as a share of GDP by the end of the forecast horizon.

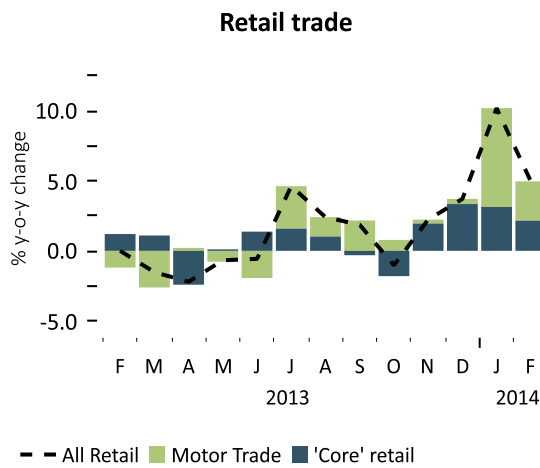
Figure 1: High frequency indicators



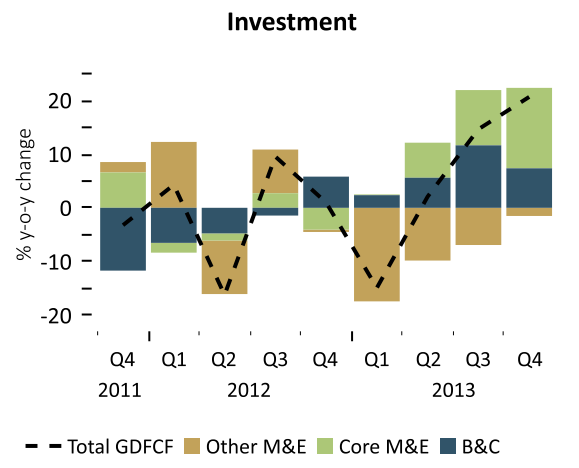
Source: CSO



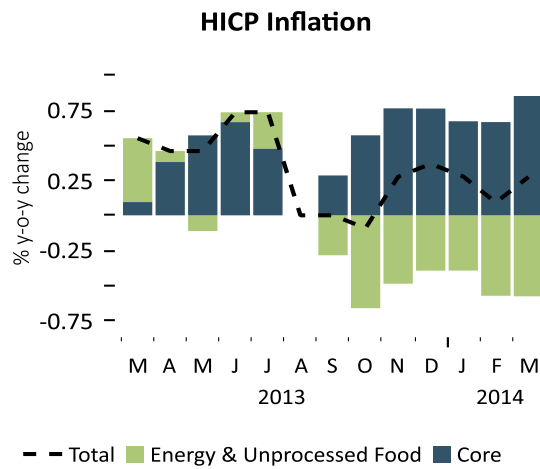
Source: CSO; Dept Finance calculations



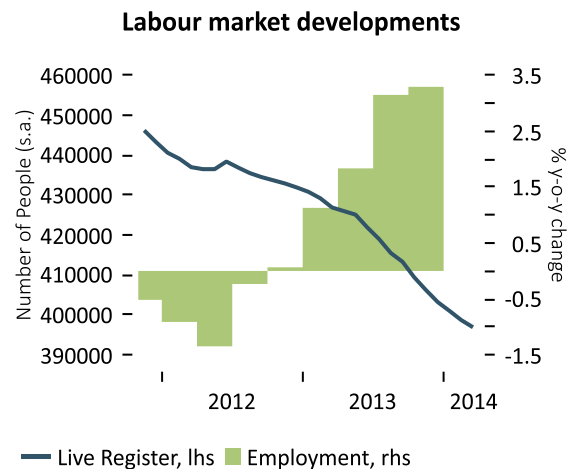
Source: CSO, Dept Finance calculations



Source: CSO; Dept Finance calculations



Source: CSO; Dept Finance calculations



Source: CSO

Table 4: External balance

	2013	2014	2015	2016	2017	2018
Current account (% of GDP)	6.6	5.8	5.2	5.3	5.3	5.3
Current account (% of GNP)	7.9	6.9	6.1	6.3	6.4	6.4
<i>Of which: (% of GDP)</i>						
- Balance on goods and services	23.3	22.0	21.9	22.7	23.6	24.7
- Balance of primary incomes and transfers	16.7	16.2	16.8	17.4	18.3	19.5
Capital account	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy (% of GDP)	0.8	0.8	0.8	0.8	0.7	0.7

Source: 2013 - CSO; 2014 to 2018 - Department of Finance.

Note: The statistical discrepancy is held constant in nominal terms but declines slightly as a share of GDP.

2.4 Medium-term growth prospects 2015-2018

Medium-term forecasts typically involve an assessment of the current imbalance between aggregate demand and supply (the output gap) as well as an assessment of the economy's productive capacity. Assumptions are then made regarding the pace at which the output gap closes over the medium term; once gap-closure is achieved, growth is assumed to evolve in line with trend. The projections in this document assume that the output gap closes around 2017 and that the potential growth rate thereafter is of the order 3½ per cent.³

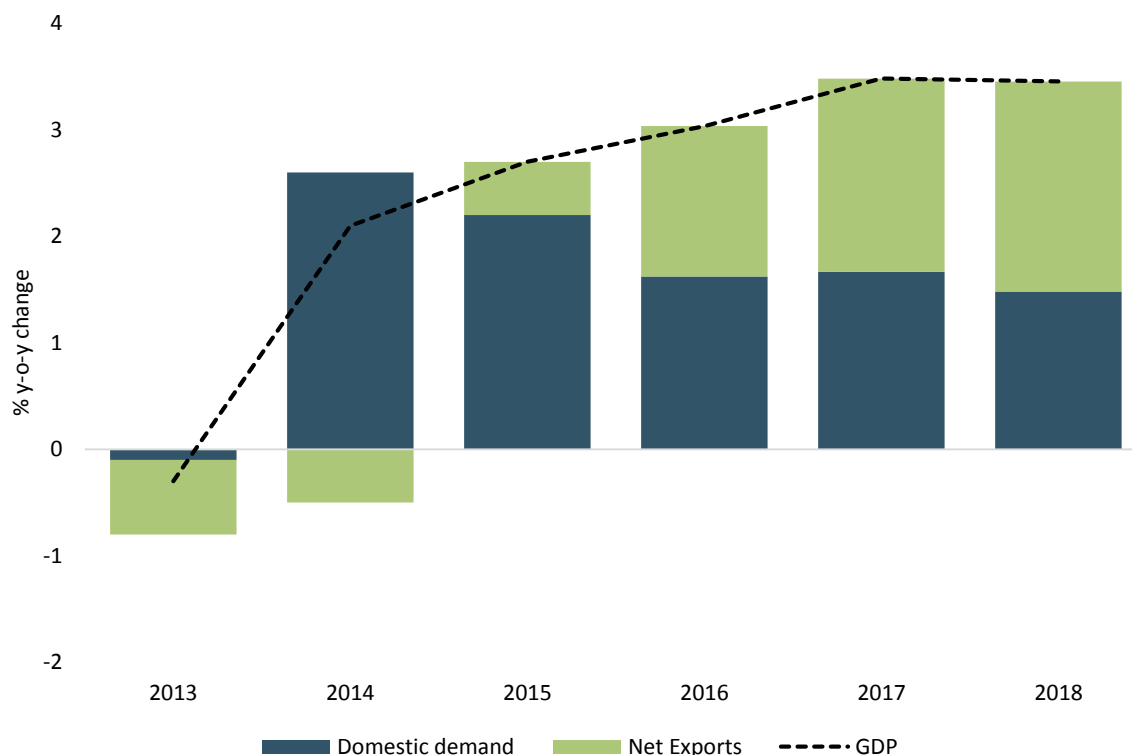
From a demand-side perspective, growth over the 2015-2018 period is assumed to be led by the exporting sectors, especially once the drag from patent-expiry tapers off. This export-driven growth projection is based on the critical assumption that further gains in competitiveness are realised.

Domestic demand will contribute positively, although legacy effects of the crisis – such as the need to continue repairing public and private balance sheets – will restrain the pace of growth at least to some extent. An important variable on the demand-side is the investment-output ratio; following a number of years of under-investment this ratio has fallen to very low levels, both in historical and comparative terms. Investment is assumed to grow reasonably strongly over the forecast horizon reflecting a normalisation of this ratio.

In overall terms, annual average GDP growth of 3.2 per cent is assumed over the 2015-2018 period. Given the assumption that exports will lead the way, and in particular the important role that the foreign-owned sector is likely to play, the pace of GNP growth is assumed to be somewhat lower, averaging 2.6 per cent.

³ It is stressed once again that estimates of the potential growth rate of the Irish economy are subject to wide margins of uncertainty, given *inter alia* the openness of the economy.

Figure 2: Contribution to GDP growth



Source: 2013 – CSO; 2014 to 2018 – Department of Finance.

2.5 The labour market

The labour market recorded a very strong performance in 2013, with almost all metrics surpassing expectations. Importantly, last year marked the end of five years of employment losses. Since the trough in employment recorded in the first quarter of 2012, more than a quarter of all employment lost over the crisis has been regained.

Looking at developments in more detail, Quarterly National Household Survey (QNHS) data show that employment growth gained steady momentum as 2013 progressed, with annual growth of 3.3 per cent recorded in the fourth quarter. After adjusting for seasonal factors, the number of people unemployed fell consistently over the year with the unemployment rate declining to just over 12 per cent by the fourth quarter. This fall from a peak of over 15 per cent is all the more noteworthy given that it was accompanied by an expanding labour force in 2013, the first annual increase in labour supply since the crisis began. Claimant-count data (the Live Register) point to a continued fall in the unemployment rate in the first quarter of this year.

Employment growth of 2.2 per cent is projected for 2014. This is driven by a combination of strong carryover from 2013, together with the improved outlook for domestic demand. Employment growth is supported by strengthening labour demand in the services sector in particular, and is consistent with both the outlook for services exports and trends emerging across more conjunctural PMI indicators. On the assumption of a further expansion of the labour force, unemployment is projected to average 11.5 per cent this year.

Employment growth averaging 2 per cent per annum over the forecast horizon is projected, consistent with a gradual reduction in the unemployment rate. At the same time, labour force growth is anticipated to accompany the improvement in employment over the forecast horizon, tallying with evidence of pro-cyclical labour supply dynamics in Ireland. With positive labour supply dynamics in prospect, this is likely to dampen an otherwise faster decline in the unemployment rate.

Table 5: Labour market developments⁴

	2013	2013	2014	2015	2016	2017	2018
	(‘000s)	% change (unless otherwise stated)					
Employment	1880	2.4	2.2	2.0	2.0	1.9	1.9
Unemployment rate (QNHS basis)		13.0	11.5	10.5	9.7	8.9	8.0
Labour productivity (GDP per person employed)		-2.6	-0.1	0.7	1.0	1.5	1.5
Compensation of employees*		2.9	3.4	3.6	4.1	4.1	4.2
Compensation per employee*		1.5	1.1	1.5	2.0	2.2	2.2

*Non-agriculture sector.

Source: 2013 - CSO; 2014 to 2018 - Department of Finance.

2.6 Price developments

As measured by the Harmonised Index of Consumer Prices (HICP), inflation averaged 0.5 per cent last year. This moderate rate was in no small part due to the absence of the energy effect that had been so pronounced throughout 2012.

Inflationary pressures are expected to remain relatively muted once again this year. Futures prices for oil suggest that energy prices will exert slight downward pressure on overall prices, while exchange rate movements over the first few months of the year should also limit external inflation pressures. The recovery in domestic demand is unlikely to result in the emergence of any significant price pressures on the domestic front, given the amount of spare capacity at present. Taking all of these factors into account, HICP inflation is expected to average 0.5 per cent this year. A gradual acceleration in HICP inflation is assumed over the forecast horizon on the back of a gradual pick-up in domestic demand and the waning of external factors that are currently dampening prices in Ireland.

⁴ It should be stressed that the Government’s goal is to achieve full employment by 2020 (defined as an unemployment rate of approximately 5 to 6 per cent) as per the 2013 Medium-term Economic Strategy (MTES), this goal can be achieved with the determined implementation of appropriate Government policies. For more detail see MTES page 13 (<http://mtes2020.finance.gov.ie/wp-content/uploads/2013/12/MTES.pdf>)

Table 6: Price developments

	2013	2014	2015	2016	2017	2018
			% change			
GDP deflator	0.4	0.5	0.9	1.2	1.2	1.2
Private consumption deflator	1.6	0.9	1.1	1.4	1.6	1.6
Harmonised index of consumer prices (HICP)	0.5	0.5	0.9	1.4	1.6	1.6
Export price deflator (goods and services)	0.1	0.5	0.9	1.2	1.2	1.2
Import price deflator (goods and services)	0.3	0.9	0.8	1.2	1.2	1.2

Source: 2013 - CSO; 2014 to 2018 - Department of Finance.

In terms of the GDP deflator – which accounts for price changes in all components of demand and, as such, is the broadest measure of price developments in the economy – an increase of 0.5 per cent is forecast for this year. This reflects the fact that the terms of trade effect is projected to be negative this year, due in part to recent exchange rate developments. The private consumption deflator is likely to record higher growth than the HICP in 2014 as well as 2015 reflecting, in part, the impact of rising private and imputed rents on the private consumption deflator.

Chapter 3

Outlook for the Public Finances

3.1 Summary

The general government deficit for 2013 is estimated at 7.2 per cent of GDP which is within the EDP ceiling of 7.5 per cent of GDP. Growth in tax revenues and expenditure restraint were key contributors in achieving the target. The 2014 Budget projected a deficit of 4.8 per cent of GDP for this year; this projection remains unchanged although minor offsetting compositional changes have been incorporated.

Turning to 2015, a deficit of under 3 per cent is forecast, in line with commitments under the EDP. Thereafter, the fiscal rules require sufficient progress towards achieving a balanced budget in structural terms by 2018. The debt ratio peaked in 2013 and will be on a downward trajectory over the forecast horizon. With regard to funding, recent issuance by the NTMA has been at favourable rates with the majority of the 2014 funding target achieved.

3.2 Budgetary outturn 2013

The end-year outturn for 2013 was broadly in line with expectations at Budget time. Tax revenue grew by 3.2 per cent and finished the year within €19 million (0.1 per cent) of the Budget 2014 forecast of €37,825 million. Over the course of the year, the strongest performing tax heads against profile were stamp duties and corporation tax. Net voted expenditure for 2013 was €43.1 billion, which was 4.2 per cent lower than the previous year and 0.7 per cent below the voted expenditure allocation of €43.4 billion.

Budget 2014 forecast that the 2013 general government deficit would be €12.1 billion or 7.3 per cent of GDP. The actual outturn was somewhat better at €11.8 billion. However, first estimates of 2013 nominal GDP are lower than forecast at Budget time. So the headline saving is offset to some extent by the denominator effect from lower GDP. This still results in a 2013 deficit estimated at 7.2 per cent of GDP, comfortably inside the EDP ceiling of 7.5 per cent of GDP.

3.3 Budgetary outlook 2014

Budget 2014 forecast a general government deficit of 4.8 per cent of GDP for 2014. In broad terms, the updated projections in this document reaffirm this forecast despite some changes in the underlying composition.

In terms of deviation from Budget day forecasts, in Exchequer terms, there has been an improvement of some €900 million. While very positive in cash terms, most of this does not impact on the general government balance and relates to timing issues rather than new windfall gains. For example, receipts from the sale of the National Lottery were provisionally expected to be received in two tranches, one in late 2013 and one in 2014. Because the agreement was not signed until early 2014, the full €405 million will now be received in 2014

resulting in an Exchequer improvement of €202.5 million relative to the initial 2014 profile. In general government terms for 2014, the full €405 million had been included as a receipt in Budget 2014.

National debt cash interest costs this year are now projected to be some €400 million lower than estimated at the time of Budget 2014. This reduction largely reflects timing factors – including the buy-back in December 2013 of €4.1 billion of a Government bond, which led to lower interest payments in the early part of 2014 – as well as a more favourable interest rate environment generally. In general government terms, interest expenditure is now projected to be around €200 million below the Budget 2014 estimate. The other significant deviation from expectation is the estimated Central Bank surplus which is much higher than anticipated. Offsetting these improvements were a series of more modest changes across a range of issues. In overall terms, the outcome of these revised figures is that the nominal deficit is slightly improved on that at Budget time.

Budget 2014 forecast tax revenue to increase by close to 6 per cent year-on-year in 2014. Performance through the first quarter 2014 has been positive with taxes ahead of profile by €257 million (2.9 per cent) which represents a year-on-year increase of €415 million (4.7 per cent). Looking at the individual tax heads, of particular note is the strong performance of income tax, the largest tax head, on the back of a recovering labour market. Performance in the first three months of the year is encouraging and gives confidence that the forecast for tax revenue growth for 2014 will be achieved.

Turning to the spending side, the Revised Estimates for Public Services 2014 (REV), which was published in December 2013, set out the detailed allocations for all Government Departments. The 2014 estimate for total gross voted expenditure is €53 billion. This is 2.7 per cent below the 2013 provisional outturn figure. Net voted expenditure for 2014 at €41.4 billion is 4 per cent lower than in 2013. Expenditure by all Departments will continue to be monitored closely against their detailed monthly gross and net profiles.

Gross voted expenditure up to the end of March 2014 was €163 million (1.2 per cent) lower than profile, representing a year-on-year decrease of €452 million (3.4 per cent). Due to increased revenue from PRSI, receipts to the Social Insurance Fund and the National Training Fund were 7.2 per cent ahead of profile for the first quarter. Net voted expenditure up to the end of March 2014, was €631 million (5.8 per cent) down year-on-year and €261 million (2.5 per cent) below the estimate profile.

3.4 Transition from the deficit for 2013 to the deficit for 2014

The first official estimate of the general government deficit and debt for 2013 is made by the Central Statistics Office (CSO). This report shows the deficit at 7.2 per cent of GDP in 2013. The Department of Finance's forecast of the deficit for 2014 is 4.8 per cent of GDP.

Figure 3 details the transition from the deficit for 2013 to the deficit for 2014. The diagram shows measures amounting to €3.1 billion as well as other factors impacting on the fiscal accounts to achieve a deficit in 2014 within the EDP ceiling of 5.1 per cent of GDP.

Figure 3: Transition from 2013 to 2014 general government deficit



Notes:

Diagram not drawn to scale.

The diagram starts with the 2013 general government deficit of 7.2 per cent of GDP. All further adjustments show the difference between 2014 and 2013 items to arrive at the 2014 deficit. A negative adjustment lowers and improves the deficit while a positive adjustment has the opposite effect.

The diagram shows changes on a general government basis.

- With 2.6 per cent year-on-year nominal GDP growth there is an improvement to the deficit ratio of about 0.2 per cent.
- General government taxes for 2014 are scheduled to be €2.1 billion better than were collected in 2013. Less than €1 billion of this increase is due to new measures introduced in the Budget as well as carryover from previous Budgets with the remainder of increased taxes due to the impact of economic growth.
- Expenditure savings measures of €1.6 billion were announced in Budget 2014.
- *Bank guarantee pay-out and income:* Payments of €1.1 billion were required to be made by the Minister for Finance last year under bank guarantee schemes resulting from the liquidation of IBRC in February 2013. Some further minor payments will be required in 2014. This results in a decrease in expense from 2013 to 2014 of €1.0 billion.
Also in February 2013, the Minister for Finance announced that the end of the eligible liabilities guarantee (ELG) scheme. This results in a decrease of €0.3 billion in income to the State between the two years.
- There is €0.3 billion further interest payable in 2014 than in 2013.
- Among the other effects is the sale of state assets. In 2013 €0.7 billion accrued to the State as a result of revenue from the sales of mobile phone licences; in 2014, the State receives €0.4 billion from the sale of the licence to run the national lottery.

Source: Department of Finance

Table 7: Budgetary projections 2013-2018

	2013	2014	2015	2016	2017	2018
CURRENT BUDGET						
Expenditure	€m	€m	€m	€m	€m	€m
Gross Voted Current Expenditure	51,080	49,605	48,250	48,300	48,350	48,400
Non-Voted (Central Fund) Expenditure	11,105	10,535	11,060	11,610	11,630	12,085
Gross Current Expenditure	62,185	60,140	59,310	59,910	59,980	60,485
less Expenditure Receipts and Balances	11,080	11,220	11,580	11,925	12,275	12,645
Net Current Expenditure	51,105	48,920	47,730	47,985	47,705	47,840
Receipts						
Tax Revenue	37,805	40,040	42,135	43,860	45,850	48,115
Non-Tax Revenue	2,675	2,285	1,890	1,615	1,225	1,195
Net Current Revenue	40,480	42,325	44,025	45,475	47,075	49,310
CURRENT BUDGET BALANCE	-10,625	-6,595	-3,705	-2,510	-630	1,470
CAPITAL BUDGET						
Expenditure						
Gross Voted Capital	3,420	3,335	3,250	3,255	3,255	3,255
Non-Voted Expenditure	2,010	1,190	930	1,020	890	890
Gross Capital Expenditure	5,430	4,525	4,180	4,275	4,145	4,145
less Capital Receipts	350	335	335	340	340	340
Net Capital Expenditure	5,080	4,190	3,845	3,935	3,805	3,805
Capital Resources	4,205	2,090	1,615	3,585	1,625	1,625
CAPITAL BUDGET BALANCE	-875	-2,100	-2,230	-350	-2,180	-2,180
EXCHEQUER BALANCE	-11,505	-8,700	-5,935	-2,865	-2,815	-705
GENERAL GOVERNMENT BALANCE	-11,780	-8,090	-5,235	-4,050	-2,265	-85
% of GDP	-7.2	-4.8	-3.0	-2.2	-1.2	0.0
UNDERLYING GENERAL GOVERNMENT BALANCE	-11,755	-8,040	-5,135	-3,950	-2,265	-85
% of GDP	-7.2	-4.8	-2.9	-2.2	-1.2	0.0
UNDERLYING GENERAL GOVERNMENT PRIMARY BALANCE	-4,075	-75	3,315	4,885	6,985	9,485
% of GDP	-2.5	0.0	1.9	2.7	3.7	4.8

Source: Department of Finance

Note: The levels of expenditure and taxation in 2016-2018 will be subject to Government policy decisions and the overarching policy objective of reaching the MTO of a balanced budget in structural terms. The underlying balance: the net lending of general government adjusted for the effect of financial measures.

Figure 4: Developments in the public finances



3.5 Budgetary outlook 2015-2018

The fiscal outlook for 2015 remains broadly unchanged from that set out in Budget 2014, with the Government committed to introducing the necessary tax and expenditure measures to bring the deficit below the 3 per cent of GDP deficit target by the end of 2015, as set out in the Excessive Deficit Procedure. On present estimates, this should be achieved with the previously announced package of tax and expenditure measures of €2.0 billion. However, the actual consolidation effort required to meet the deficit objective will be based on the most up-to-date economic and fiscal data on Budget day. The specific measures will be announced in the Budget in October 2014, and will take on board the conclusions of the Comprehensive Review of Expenditure (CRE) and other ongoing reviews.

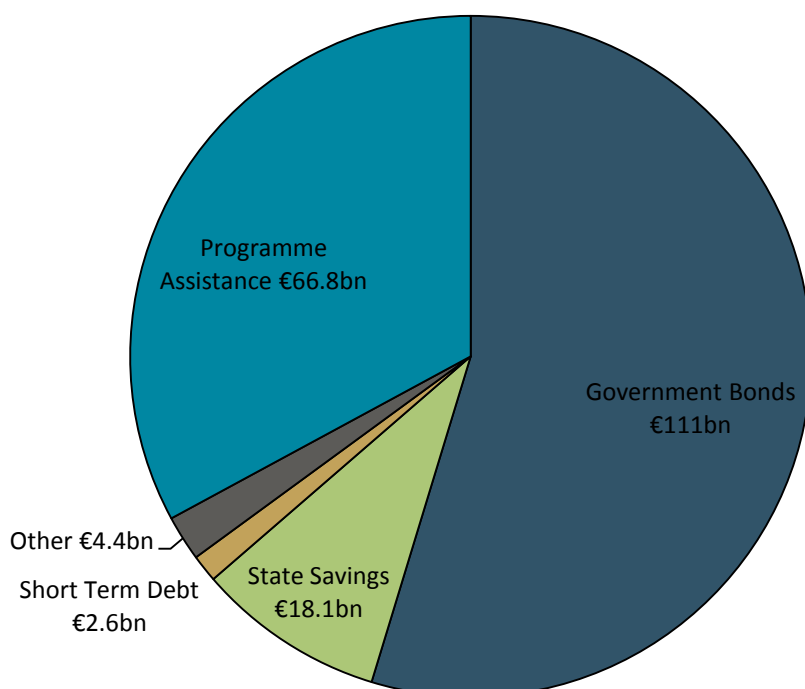
Once the excessive deficit is corrected in 2015, it will be necessary to make progress over the period 2016 to 2018 towards achieving Ireland’s medium-term budgetary objective (MTO) which is to achieve a balanced budget once allowance is made for the impact of the economic cycle on the public finances.

3.6 Debt level and developments

At the end of 2013, Ireland’s general government debt stood at an estimated €202.9 billion or 124 per cent of GDP. Figure 5 shows the compositional breakdown of the end-2013 stock of debt. The diagram shows that 55 per cent of government debt is held in government bonds. Funding sourced from the EU-IMF programme agreed in 2010 comprises a further 33 per cent of government debt. Programme related debt consists of loans from the IMF; the European Financial Stabilisation Mechanism; the European Financial Stability Facility; as well as bilateral loans from the UK, Sweden and Denmark. The last drawdown of funds from these sources occurred in the first quarter of 2014. State savings, short term debt and other debt make up the remaining 12 per cent of general government debt.

While the February 2013 promissory note transaction had no immediate impact on the total general government debt, it did impact the composition of debt. At the end of 2012, 13 per cent of general government debt was in the form of promissory notes and the effect of the promissory note transaction in February 2013 was to switch €25 billion from promissory note debt to government bonds (figure 5).

Figure 5: Composition of general government debt at end-2013



Source: Department of Finance, NTMA and CSO

Note: The “other” category includes consolidation adjustments in respect of debt, including bonds, held by general government entities.

The general government debt-to-GDP ratio has increased significantly in recent years, as a result of a substantial mismatch between government expenditure and revenue, the large support the State has had to provide to the banking sector, and the accumulation of liquid assets. However, the debt ratio peaked at close to 124 per cent of GDP in 2013. For this year, the reduction in previously-accumulated cash balances will help reduce the debt ratio.

Beyond 2014, Ireland will be required to run primary surpluses for many years in order to keep debt on a firm downward path. Given that forecasts for nominal growth and the average interest rate are broadly convergent over the forecast horizon, targeted primary surpluses should see a reduction in the debt ratio to around 107 per cent by 2018. The projected evolution of general government debt for Ireland over the period 2013-2018 is shown in table 8.

Table 8: General government debt 2013-2018

€ billion and per cent of GDP	2013	2014	2015	2016	2017	2018
General government debt	202.9	204.4	209.3	210.8	213.5	214.1
Debt-to-GDP Ratio	123.7	121.4	120.0	115.9	112.0	107.2

Source: Department of Finance, NTMA (National Debt data provider) and CSO

Given the significant increase in the volume of debt in recent years, debt service costs have also risen considerably. In 2007, general government interest expenditure as a percentage of general government revenues was just 2.8 per cent. In 2013, the equivalent figure amounted to 13.0 per cent.

Gross debt and net debt

General government debt, as defined under the Excessive Deficit Procedure (EDP) regulation, is a gross measure and consists of certain liabilities that require payment by the debtor to the creditor at a date or dates in the future. The net general government debt figure (obtained by deducting the corresponding financial assets to those liabilities used in the calculation of general government debt) is reported in table 9.

Table 9: General government debt and net general government debt 2013 and 2014

End-year	2013	2014
<i>% of GDP</i>		
General government debt	123.7	121.4
EDP debt instrument assets	25.4	20.5
Net debt position	98.3	100.8

Source: Department of Finance, NTMA (National Debt data provider) and CSO

Market Return

In 2013, the National Treasury Management Agency (NTMA) raised €7.5 billion from two medium and long-term syndications and in the process eliminated the January 2014 “funding cliff”, which was seen by investors as a major obstacle to Ireland’s smooth exit from the EU-

IMF programme. Notably, the 10-year bond issued in March 2013 was the first new 10-year issuance since January 2010, prior to Ireland's entry into the EU-IMF programme.

Cementing its return capital markets in January 2014, the NTMA issued €3.75 billion of a new 10-year bond, at a yield of 3.54 per cent.

Following this syndicated issue in January, the NTMA issued a *Funding Statement*⁵ to the market in February, setting an indicative target for total Irish Government bond issuance in 2014, so as to pre-fund 2015 needs of approximately €8 billion. A working plan to raise approximately €4 billion through a series of bond auctions over the course of 2014 with indicative sizes ranging from €0.5 to €1 billion was outlined in the *Funding Statement*.

The bond auctions in March and April 2014, each raised €1 billion at respective yields of 2.967 per cent and 2.917 per cent, the lowest yields ever achieved on the issue of Irish 10-year bonds. With these transactions over 70 per cent of the funding target of €8 billion for 2014 has been completed. As also announced in the February 2014 *Funding Statement*, a limited programme of Treasury Bill auctions resumed in March with the first auction raising €500 million of three month Bills at an annualised yield of 0.20 per cent.

Cash Balances

At end-2013, the Exchequer maintained cash and deposits of €18.5 billion, leaving the Exchequer fully funded into the first quarter of 2015, consistent with the stated aim of having 12-15 months of advance funding in place when the EU-IMF programme reached its conclusion. This helped provide investors with the necessary funding visibility to enable the State to exit the EU-IMF programme successfully.

By end-2014, it is projected that the balance in Exchequer cash and deposits will be sufficient to meet Exchequer requirements into the early part of 2016. The reduction in cash balances, which have been built up by the NTMA, will help in reducing the end-2014 general government debt-to-GDP ratio, to an estimated 121.4 per cent.

Funding Requirements

The State's funding requirements over the coming decade were reduced significantly following the February 2013 IBRC Promissory Note transaction and the agreed extension, in June 2013, of EFSF and EFSM loan maturities. The Promissory Note transaction means that the Exchequer no longer has to fund an annual payment of €3.06 billion to IBRC. The maturity extensions mean that Ireland is not expected to have to repay any of its EFSF or EFSM loans until 2027 at the earliest.

The bond redemption in February 2015 is relatively modest, at €2.9 billion. However, the process of repaying the loans borrowed under the EU-IMF programme will begin in mid-2015, starting with the amortisation of the loans from the IMF. Together, the Exchequer Borrowing Requirement (EBR) and maturing medium- and long-term debt result in a 2015 funding requirement of approximately €9.6 billion.

⁵ <http://www.ntma.ie/news/ireland-funding-statement-for-2014/>

While the EBR is projected to decline over the forecast horizon, to €0.7 billion by 2018, there are significant bond maturities over the period 2016-2018 and beyond which must be adequately and prudently funded. In its *Funding Statement* of February 2014, the NTMA indicated that it would, subject to market conditions, look at the possibility of offering investors the opportunity of switching some of their holdings of the *4.6 per cent Treasury Bond 2016* into longer dated bonds.

Credit Rating

Ireland is now rated as investment grade by all of the main credit rating agencies. Standard and Poor's (S&P), Fitch and R&I have assigned a sovereign credit rating of BBB+ while DBRS is one notch higher, at A (low).

Moody's upgraded Ireland's rating to Baa3 with positive outlook in January 2014, the return to investment grade rating marking the first rating upgrade by Moody's since July 2011. The main motivation for this upgrade include the growth potential of the Irish economy, along with continued fiscal consolidation, which is expected to reduce the Government debt ratio in the medium term. Ireland's exit from the EU-IMF programme and restored market access were also highlighted as positives.

In February 2014, Fitch reaffirmed Ireland's rating at BBB+, stable outlook. Strengths outlined were continued fiscal consolidation and solid market access; along with the EU-IMF programme exit and large cash buffers. DBRS also revised its outlook from negative to stable in March.

Debt dynamics and the stock-flow adjustment

In analysing debt developments, it is helpful to consider the components of the stock-flow adjustment. These are effects that change the debt ratio which are not due to the deficit of the given year. The main component of the stock-flow adjustment is the change in liquid assets. An increase in liquid assets, for instance, indicates borrowing beyond the need to fund the deficit. Operations in financial instruments such as loans, investments and other equity transactions do not affect the deficit but impact on funding requirements. These operations are also part of the stock-flow adjustment. Table 10 sets out the stock-flow adjustment over the forecast horizon.

Table 10: General government debt developments

<i>% of GDP</i>	2013	2014	2015	2016	2017	2018
Gross debt	123.7	121.4	120.0	115.9	112.0	107.2
Change in gross debt (=1+2+3)	6.3	-2.3	-1.4	-4.1	-3.9	-4.8
<i>Contributions to change in gross debt ratio:</i>						
1. General Government Deficit	7.2	4.8	3.0	2.2	1.2	0.0
2. Stock-flow adjustment	-0.8	-3.9	-0.2	-1.4	0.2	0.3
3. Nominal GDP contribution to Δ in debt ratio	-0.1	-3.2	-4.2	-4.9	-5.3	-5.1
<i>Composition of GGB</i>						
4. General Government Balance	-7.2	-4.8	-3.0	-2.2	-1.2	0.0
5. Interest expenditure	-4.7	-4.7	-4.8	-4.9	-4.9	-4.8
6. Primary balance* (= 4 - 5)	-2.5	-0.1	1.8	2.6	3.7	4.8
<i>Composition of stock-flow adjustment</i>						
7. Change in cash and other assets	-0.2	-4.2	-0.5	-0.3	0.0	0.0
8. Interest adjustments	-0.1	-0.1	0.0	0.1	-0.1	-0.1
9. Equity transactions	-0.9	0.0	0.0	-1.0	0.0	0.0
10. Accrual adjustments	0.3	0.2	0.1	0.0	0.1	0.1
11. Impact of NPRF	0.4	0.2	0.2	0.2	0.2	0.2
12. Collateral held	-0.3	0.0	-0.1	-0.1	-0.1	0.0
13. Net discounts	0.0	0.1	0.1	0.1	0.1	0.1
14. EFSF prepaid margin	0.0	0.0	0.0	-0.3	0.0	0.0
14. Other	0.0	-0.2	0.0	-0.1	0.0	0.0
<i>Memorandum item:</i>						
Average interest rate (%)	4.0	3.9	4.1	4.2	4.4	4.5

Source: Department of Finance, NTMA (National Debt data provider) and CSO

*The underlying primary balance is presented in table 7.

3.7 Structural budget balance and medium-term objective

Once the excessive deficit is corrected next year, the fiscal rules require rapid progress towards Ireland's medium-term budgetary objective (MTO) which is for a balanced budget in structural terms.

Table 11: Cyclical developments

	2013	2014	2015	2016	2017	2018
1. Real GDP growth (%)	-0.3	2.1	2.7	3.0	3.5	3.5
2. Headline general government balance	-7.2	-4.8	-3.0	-2.2	-1.2	0.0
3. Interest expenditure	4.7	4.7	4.8	4.9	4.9	4.8
4. One-off and other temporary measures	-0.4	0.2	-0.1	-0.1	0.0	0.0
5. Potential GDP growth (%)	0.4	1.5	2.2	2.9	3.3	3.5
<i>Contributions to potential growth</i>						
- labour	0.1	0.8	1.2	1.6	1.7	1.7
- capital	0.1	0.4	0.6	0.7	0.8	0.9
- total factor productivity	0.1	0.3	0.5	0.6	0.8	0.9
6. Output Gap	-1.3	-0.7	-0.3	-0.1	0.0	0.0
7. Cyclical budgetary component	-0.6	-0.3	-0.1	-0.1	0.0	0.0
8. Structural budget balance [2-4-7]	-6.2	-4.7	-2.8	-2.1	-1.2	0.0
9. Structural primary balance [2+3-4-7]	-1.5	0.1	2.0	2.7	3.6	4.7

Source: Department of Finance

The structural balance provides an estimate of the budgetary position that would prevail in the absence of the economic cycle (net of one-offs and other temporary factors)⁶.

Estimates are shown in table 11, and incorporate changes recently agreed (see box 1) at EU level. The estimates show a structural deficit of 6.2 per cent of GDP this year. They also show an average annual improvement of 1¼ percentage points of GDP over the next few years with the structural deficit being eliminated by 2018; in other words, the MTO of a balanced budget in structural terms is achieved in 2018.

⁶ Estimates of the structural balance in Ireland are subject to a wider margin of uncertainty than elsewhere given *inter alia* the openness of the economy.

Box 1: impact of methodological changes for calculating potential output in Ireland

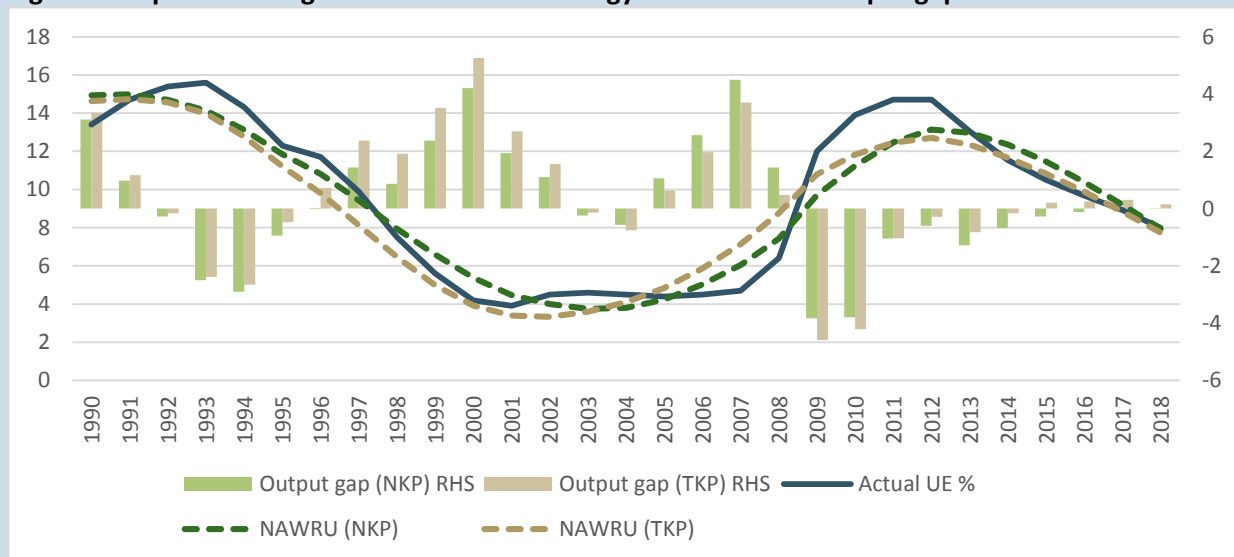
A harmonised approach to calculating potential output (and hence the structural balance) is used to assess compliance with the Stability and Growth Pact.⁷ Changes to the methodology – in particular in estimating the degree of labour market slack – have recently been agreed at EU level,⁸ which have had a significant impact on estimates of the output gap in Ireland.

Estimating the underlying level of labour supply relies on an estimate of the natural or structural unemployment rate. To estimate the latter, the previous approach used a traditional wage Philips curve (TKP) model to derive the unemployment gap based on the change in nominal wage inflation. This approach was highly unsuitable for countries such as Ireland with high levels of observed unemployment and nominal wage rigidities. It resulted in implausibly high estimates of the natural rate of unemployment (or the ‘NAWRU’) which closely traced actual unemployment displaying a high degree of pro-cyclicality. On the basis of SPU 2014 numbers, the previous methodology suggests a small (or even positive) output gap despite the presence of high rates of actual unemployment.

To rectify the shortcoming of this approach, technical changes were recently made to how the NAWRU is estimated. The newly-endorsed approach relies on a forward-looking New Keynesian Philips (NKP) curve model to identify the unemployment gap using real unit labour costs. These are approximated by the real wage share (wage inflation less labour productivity growth less the change in consumer price deflator).

For comparative purposes, the different NAWRU paths implied together with the resultant impact on the output gap are illustrated in figure 6. The new approach lowers the estimate of structural unemployment over 2013 to 2018 by an average of 0.5 percentage points per annum. Whilst this new approach produces a more sensible short-term outlook for the output gap lowering it an average of 0.4 percentage points per annum over the period, it remains a far from perfect estimate in the longer-run Irish context⁹.

Figure 6: Impact of change in NAWRU methodology on estimate of output gap



Note: NKP refers to revised new Keynesian methodology. TKP refers to old Philips curve approach. NAWRU expressed as % of labour force. Output gap expressed as % of potential GDP.

⁷ This full Cobb-Douglas production function approach is explained in detail in [European Economy Economic Papers](#) 420, July 2010. Although the approach to estimating the level of structural unemployment (the ‘NAWRU’) has since been revised, all other components of the approach remain unchanged.

⁸ These were endorsed by the Economic Policy Committee (EPC) on March 19th 2014.

⁹ Although representing an improvement, the long term path for the NAWRU remains highly pro-cyclical suggesting significant peak-to-trough movements in the structural unemployment rate over the economic cycle.

Chapter 4

Sensitivity Analysis

4.1 Summary

This chapter sets out quantitative estimates of the impact of particular shocks on the Irish economy. Given the openness of the Irish economy and the high indebtedness of the household sector, deviations from baseline in this regard can have a high impact on output and fiscal ratios.

On the external side, downside risks remain, stemming from the fragile nature of recovery in trading partners as well as geopolitical risks. Domestically, developments in the multinational sector (in particular the pharma-chem sector) have depressed GDP and there is potential for this effect to persist over the short term. Upside risks relate to the low level of economy-wide investment and the potential for this to rise towards more normal levels over the medium term.

4.2 Risks to the forecasts¹⁰

The macroeconomic and fiscal projections set out in this document represent the Department of Finance's baseline scenario for the 2014-2018 period. There is, of course, considerable uncertainty regarding short-term developments – in other words how the components of aggregate demand will evolve in the near term. It is also acknowledged that there is uncertainty regarding estimates of the supply side – in other words the medium-term capacity of the economy to expand – given *inter alia* the openness of the Irish economy.

The sensitivity analysis contained in this chapter assesses how the key budget variables (revenue, expenditure, deficit and debt) might evolve in the event of deviation from the baseline macroeconomic scenario. Deviations from the baseline economic scenario could arise from external or domestic sources, with differing implications for the evolution of the public finances.

The main source of external risk relates to demand in Ireland's main export markets given the importance of exports to the Irish economy. While the recent flow of data in Ireland's main trading partners has been somewhat better than expected, recovery remains fragile in many regions and downside risks remain. In particular, risks associated with excessively low inflation have come to the fore in some parts. Geopolitical risks have also emerged in recent months.

One of the main domestic risks relates to household savings behaviour, which in recent years has been affected by the need to reduce high levels of indebtedness. Consumer spending is

¹⁰ The Government will shortly publish a draft National Risk Assessment that will set out the key sources of economic and non-economic risks, address the issue of governance of risk management and establish a steering group to develop the assessment further.

by far the largest component of domestic demand and the baseline assumption is for a reduction in the savings rate this year with stabilisation thereafter. Although the household debt-to-income ratio is falling, the post-crisis path for household savings is unclear. Potential exists for the savings rate to remain elevated over the medium term as household balance sheet repair continues. In addition, the downside risks relating to reductions in pharm-chem activity have been articulated previously and, to a large extent, have been borne out in the data for the last number of quarters. Notwithstanding this, the potential exists for stronger-than-assumed output losses over the medium term. Finally, the strong performance of the IT services sector in recent quarters is concentrated in nature, and firm- and sector-specific developments have the potential to impact considerably on both exports and value added over the forecast horizon.

It is important to stress that upside risks also exist on the domestic front. Firstly, economy-wide investment remains at close to record low levels. While the baseline scenario assumes a recovery in the investment-to-output ratio over the medium term, a more rapid 'normalisation' is possible. Secondly, employment growth has surpassed even the most optimistic expectations over the past year or so. Stronger-than-assumed employment growth would have a favourable impact on household income and *ceteris paribus* consumer spending.

4.3 Sensitivity analysis

Table 12 provides a quantitative assessment of the impact on the public finances of alternative growth trajectories, based on the results of three simulations undertaken using the Economic and Social Research Institute's macroeconomic (HERMES-13) model.¹¹

In terms of the external situation, simulations show that a 1 per cent permanent increase in world output would have a favourable impact on Irish exports and lead to an increase in Ireland's GDP of about 1 per cent by 2018. This, in turn, would reduce the deficit of around a ¼ percentage point relative to baseline. The results are broadly symmetric in that a permanent reduction in world output would have a negative impact on Ireland's output and the fiscal variables of a similar magnitude.

As outlined earlier, household savings behaviour will be an important driver of domestic demand trends over the next few years. Simulations show that if the savings rate was permanently 1 percentage point higher than assumed, the level of GDP would be around ¼ percentage point lower, with an adverse impact on the deficit.

While unlikely in the short term, higher policy-induced interest rates would have a dampening impact on Ireland's economic activity. Simulations suggest that a 1 percentage point increase in policy interest rates could reduce the level of GDP by around 2½ percentage points by 2018. This effect is especially pronounced given the large debt overhang. Such a

¹¹ https://www.esri.ie/irish_economy/mediumterm_review/

deterioration in the economy would add nearly 1 percentage point to the budget deficit by 2018.

Table 12: Impact on main aggregates

		2014	2015	2016	2017	2018
		1 per cent Increase in World Output				
GDP	% change compared to base	0.8	0.9	1.0	1.1	1.1
Total Revenue	% change compared to base	0.2	0.4	0.7	0.9	1.0
Total Expenditure	% change compared to base	-0.1	-0.1	0.0	0.0	0.0
Deficit-GDP Ratio	pp change compared to base	-0.1	-0.2	-0.2	-0.3	-0.3
Debt-GDP Ratio	pp change compared to base	-0.9	-1.3	-1.6	-1.9	-2.2
Primary Balance–GDP Ratio	pp change compared to base	-0.1	-0.1	-0.2	-0.2	-0.2
		1 Percentage Point Increase in Savings Rate				
GDP	% change compared to base	-0.3	-0.3	-0.3	-0.3	-0.3
Total Revenue	% change compared to base	-0.3	-0.4	-0.4	-0.4	-0.4
Total Expenditure	% change compared to base	0.0	0.0	0.0	0.0	0.1
Deficit-GDP Ratio	pp change compared to base	0.1	0.1	0.1	0.1	0.1
Debt-GDP Ratio	pp change compared to base	0.4	0.5	0.6	0.7	0.8
Primary Balance–GDP Ratio	pp change compared to base	0.1	0.1	0.1	0.1	0.1
		1 Percentage Point Increase in Interest Rate				
GDP	% change compared to base	-0.3	-1.4	-2.1	-2.4	-2.4
Total Revenue	% change compared to base	-0.7	-1.7	-2.1	-2.3	-2.1
Total Expenditure	% change compared to base	0.2	0.5	0.6	0.7	0.7
Deficit-GDP Ratio	pp change compared to base	0.4	0.8	0.9	1.0	0.9
Debt-GDP Ratio	pp change compared to base	1.7	3.5	5.3	6.7	7.4
Primary Balance–GDP Ratio	pp change compared to base	0.3	0.6	0.6	0.6	0.4

Source: Economic and Social Research Institute

4.4 Range of forecasts

Table 13 provides a comparison of the Department's forecasts for this year and next year against those of other institutions, both national and international. Looking to the contemporaneous forecasts, the Department's projections are broadly in line with those of the other institutions for 2014. There is broad consensus that Ireland looks set for a return to more robust growth this year, with the growth rate to accelerate in 2015. All of the forecasts point to robust employment growth in both years.

Table 13: Range of forecasts

			Annual % change			
			GDP	GNP	HICP	Employment
2014						
Department of Finance	April 2014	2.1	2.7	0.5	2.2	
Central Bank of Ireland	April 2014	2.0	2.7	0.5	2.6	
IMF	April 2014	1.7	n/a	0.6	2.2	
ESRI	April 2014	2.6	3.5	0.4	2.7	
European Commission	February 2014	1.8	n/a	0.8	1.5	
OECD	November 2013	1.9	n/a	0.8	n/a	
2015						
Department of Finance	April 2014	2.7	2.3	0.9	2.0	
Central Bank of Ireland	April 2014	3.2	2.6	1.0	2.2	
IMF	April 2014	2.5	n/a	1.1	1.8	
ESRI	April 2014	3.5	3.7	1.2	2.7	
European Commission	February 2014	2.9	n/a	1.1	1.4	
OECD	November 2013	2.2	n/a	1.0	n/a	

Source: Institutions cited

4.5 Comparison with last year's Update

Table 14 compares the headline macroeconomic and fiscal figures with the projections set out in the April 2013 Update of the Stability Programme. The under-performance of GDP last year was mainly due to sector-specific developments related to the pharma-chem sector (i.e. the 'patent cliff'), which acted to dampen export growth; as highlighted earlier, GNP (not shown in the table) was largely unaffected by this issue and outperformed expectations last year.

The GDP forecast for this year has been revised down modestly ($\frac{1}{4}$ per cent) relative to the projections this time last year. For next year, the forecast for real GDP is largely unchanged.

Table 14: Comparison with previous Update

	2013	2014	2015	2016	2017	2018
Real GDP growth (%)						
- Previous forecast	1.3	2.4	2.8	2.7	n/a	n/a
- Current update	-0.3	2.1	2.7	3.0	3.5	3.5
- Difference	-1.6	-0.3	-0.1	0.3	n/a	n/a
Net lending of general government (% of GDP)*						
- Previous forecast	-7.5	-4.4	-2.2	-1.7	n/a	n/a
- Current update	-7.2	-4.8	-2.9	-2.2	-1.2	-0.0
- Difference	0.3	-0.4	-0.7	-0.5	n/a	n/a
General government gross debt (% of GDP)						
- Previous forecast	123.3	119.4	115.5	110.8	n/a	n/a
- Current update	123.7	121.4	120.0	115.9	112.0	107.2
- Difference	0.4	2.0	4.5	5.1	n/a	n/a

*SPU 2013 figures were a technical presentation based on the already announced consolidation plans and in advance of Government consideration of the fiscal implications of the cancellation of the IBRC promissory note. This was made clear in the April 2013 Update of the Stability Programme.

Source: CSO, Department of Finance

Note: Totals may not sum due to rounding. 2017 and 2018 variables were not forecast in Budget 2014.

Chapter 5

Quality and Institutional Features of the Public Finances

5.1 Summary

A number of innovations in the institutional framework on both the revenue and expenditure sides have been taken since the last SPU was published in April of last year. Legislation was introduced to underpin the ceilings for medium-term expenditure in July 2013. A Comprehensive Review of Expenditure is under way, the results of which will be published alongside Budget 2015 in October. Performance-based budgeting has been rolled out further and the Public Spending Code has been updated to focus more on achieving value for money.

The introduction of the two-pack of economic governance reforms necessitated a number of institutional changes at national level, as set out in the Medium-Term Budgetary Framework. Legislative changes were also introduced to allow for the endorsement of the macroeconomic forecasts, with the endorsement function assigned to the Irish Fiscal Advisory Council (IFAC). A revised Memorandum of Understanding (MoU) relating to the provision of macroeconomic forecasts to IFAC by the Department of Finance was agreed in February 2014. The forecasts contained in this document were endorsed by IFAC on 7 April (see annex 3). A response to IFAC's November Fiscal Assessment Report (FAR) was provided by way of a letter from the Minister for Finance in December of 2013.

5.2 Developments on the expenditure side

The main development on the expenditure side since the last Update arises in relation to the introduction of a legislative underpinning for medium-term expenditure. The Ministers and Secretaries (Amendment) Act 2013 was enacted in July 2013¹². The Act puts in place binding multi-annual ceilings on both the aggregate level of gross voted expenditure and also on expenditure at a Departmental level. This effectively operationalizes the Expenditure Benchmark, an upper limit on general government expenditure introduced as part of the six-pack of measures introduced at a European level to improve economic governance across the EU.

Government Circular 15/13¹³ was published on 30 September 2013. This Circular provides Departments with the detailed rules that apply with regard to the implementation of the new Medium-Term Expenditure Framework. It is centred around the principles of transparency and openness and the necessity for clear medium-term planning so that available resources are deployed, managed and re-allocated (as appropriate) to best effect. The features of the new model include:

¹² <http://www.irishstatutebook.ie/pdf/2013/en.act.2013.0029.pdf>

¹³ <http://circulargov.ie/pdf/circular/per/2013/15.pdf>

- A facility for limited carryover of unspent current funding from one year to the next (capital carryover is already permitted in certain circumstances);
- the retention of a proportion of the funding arising from certain categories of asset disposal;
- the application of an offsetting adjustment in the future ceiling for Departments that fail to manage within their expenditure ceiling; and
- special arrangements will apply to certain demand-driven blocks of expenditure, notably the Live Register, which are related to the economic cycle and are not perfectly amenable to multi-annual planning and control.

A further development, announced as part of the Medium-Term Expenditure Framework, was the Comprehensive Review of Expenditure. This encompasses a periodic review of expenditure approximately every 3 years to inform budgetary decisions and the re-setting of ceilings so as to reflect developing Government priorities. These reviews will examine every area of spending to enable the Government to meet its overall budgetary objectives, to maximise the scope for reform and restructuring across the public services, and to realign the allocations with the Government's new priorities. The first comprehensive review of expenditure took place in 2011 and the next one has now commenced. The results of the review will be published as part of the Expenditure Report in October 2014.

Other initiatives being progressed are outlined below:

Performance-based budgeting

In the Comprehensive Expenditure Report 2012-14, the Government announced that it was modernising the Estimates process by building performance information into the heart of the budgetary documentation. The performance budgeting initiative has adopted a single, coherent method of presenting public service performance information to show what public service outputs and outcomes are being delivered with public funds.

Performance information has now been included for almost every Vote in the 2014 Estimates. This element of the performance budgeting initiative facilitates the Oireachtas in holding Ministers and Departments to account for the effective and efficient use of resources.

The Government has decided to extend the Ireland Stat project to all Votes and a data collection process is underway. Ireland Stat is a public-facing portal that builds on the progress already made in the Estimates and is aimed at disseminating public service performance information to an even wider and more diverse audience¹⁴.

Public Spending Code

The Department of Public Expenditure and Reform has introduced a new, consolidated Public Spending Code. The Code is designed to ensure that the State gets the best possible value for the resources at its disposal. It brings together and updates a range of VFM, appraisal and evaluation processes that have had limited impact in the past in terms of influencing the policy debate on resource allocation issues. In particular, the procedures for conducting VFM

¹⁴ www.irelandstat.gov.ie

& Policy Reviews (VFMPRs, i.e., in-depth evaluations of existing expenditure programmes) have now been streamlined and have been complemented with Focused Policy Assessments (FPAs) – short, intensive evaluations of particular policy topics. The existing spot check regime is being replaced with a new streamlined quality assurance process to facilitate reporting on how Departments are meeting their obligations under the Public Spending Code. In addition, there is an ongoing series of awareness and technical training activities underway to promote the Public Spending Code.

5.3 Developments on the revenue side

Reform of the tax system in recent years has been aimed at moving to a more stable and less cyclical sources of tax than was the case during the last decade. In this respect, the introduction of the Local Property Tax (LPT) in 2013 was an important step in this reform. A compliance level in excess of 90 per cent was achieved for this tax in 2013. In addition, a number of tax expenditures have been reviewed and subsequently restructured including changes to income tax relief in respect of medical insurance premiums.

In its recently published Medium Term Economic Strategy (MTES), the Government committed to ensure that Ireland maintains a competitive and fair taxation policy. As part of this commitment, the Government intends conducting a regular programme of tax relief reviews using public consultation as appropriate and will publish the results. Accordingly, and in advance of Budget 2015, a comprehensive review of a broad range of tax reliefs and incentives is currently underway in the Department of Finance.

5.4 European developments

The two-pack of economic governance regulations came into force in May 2013 and has led to a number of changes to Ireland's budgetary system. The regulations necessitate strengthened budgetary surveillance procedures and a common budgetary timeline for all euro area Member States. Under the common timeline, all euro area Member States are required to publish their draft budget for central government and the main parameters of all other general government sub-sectors no later than 15 October each year. The common budgetary timeline also foresees that the final budget should be adopted or fixed upon annually by 31 December. The Budget and Stability Programme must be based on macroeconomic forecasts which are endorsed or produced by an independent body at national level.

The impact of these changes on Ireland's budgetary process has been threefold. Firstly, legislation¹⁵ was passed to give the endorsement function to the Irish Fiscal Advisory Council (IFAC). Secondly, Budget 2014¹⁶ was presented and published on Tuesday, 15 October.

¹⁵ Section 3 of the Ministers and Secretaries (Amendment) Act 2013

<http://www.irishstatutebook.ie/pdf/2013/en.act.2013.0029.pdf>

¹⁶ <http://budget.gov.ie/Budgets/2014/2014.aspx>

Thirdly, the subsequent Finance Act¹⁷ was signed into law on 18 December. On the expenditure side, the Revised Estimates for Public Services (REV) were published on 18 December¹⁸.

Other changes introduced since the last Update were the transposition of the Budgetary Frameworks Directive¹⁹ into Irish legislation through the adoption of SI 508 of 2013²⁰, and the corresponding publication of the Medium-Term Budgetary Framework²¹. The Medium-Term Budgetary Framework acts as a procedural manual, providing an overview of the set of arrangements, procedures, rules and institutions that underlie the conduct of budgetary policies of general government in Ireland.

5.5 Forecast endorsement

Following the passing of the two-pack Regulation (EU) 473/2013 which came into force on 30 May of 2013, both the Budget and Stability Programme Update must be based on macroeconomic forecasts which are either produced or endorsed by an independent body at national level. In Ireland, the endorsement route has been selected, and the Irish Fiscal Advisory Council (IFAC) was assigned the task of endorsement in the Ministers and Secretaries (Amendment) Act 2013. The procedures underlying the endorsement process have been set out in a Memorandum of Understanding (MoU), which was agreed between the Department of Finance and IFAC, and was made public in August 2013. A revised MoU, which provided for endorsement of the SPU forecasts, was agreed and published in February 2014.

Under the agreed methodology, provisional macroeconomic forecasts are prepared by the Department of Finance and shared with IFAC. IFAC then query and discuss the forecasts with the Department, and raise any significant reservations they might have.

Forecasts may be revised to address any concerns. If IFAC agrees that the forecasts fall within an endorsable range, a letter of endorsement is issued to the Department of Finance and published subsequently by both IFAC and the Department.

In the event that IFAC are unable to endorse the forecasts, the Budget or Stability Programme shall still be published, with supporting explanations for the non-endorsement of forecasts. IFAC's decision shall also be made public alongside this.

The first endorsement process was undertaken in October 2013 in advance of Budget 2014 and IFAC endorsed the Department's macroeconomic forecasts. IFAC have also endorsed the macroeconomic forecasts contained in this document on 7 April 2014 (see annex 3).

¹⁷ Finance Act (no. 2) 2013 <http://www.irishstatutebook.ie/2013/en/act/pub/0041/index.html>

¹⁸ <http://per.gov.ie/wp-content/uploads/REV-2014-final2.pdf>

¹⁹ Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0041:0047:EN:PDF>

²⁰ European Union (Requirements for Budgetary Frameworks of Member States) Regulations 2013 <http://www.irishstatutebook.ie/2013/en/si/0508.html>

²¹ <http://www.finance.gov.ie/sites/default/files/131219%20Medium%20Term%20Budgetary%20Framework%20-%20FINAL%20REV.pdf>

5.6 Response to Irish Fiscal Advisory Council's November Fiscal Assessment Report

The latest Fiscal Assessment Report (FAR) was published by IFAC in November 2013 subsequent to Budget 2014. The official response to the FAR was provided by way of a letter from the Minister for Finance to the Chair of IFAC, and published on the Department of Finance's website on 20 December 2013.²² This response welcomed the IFAC endorsement of the macroeconomic forecasts underlying Budget 2014 and its assessment that the fiscal stance was conducive to prudent economic and budgetary management. IFAC also concluded that Ireland's budgetary projections were both appropriate and consistent with compliance with all national and European fiscal rules, including those set out in the Fiscal Responsibility Acts 2012 and 2013. The letter from the Minister for Finance also responded to specific comments made by IFAC in their report, for example regarding fiscal reporting.

²² <http://www.finance.gov.ie/sites/default/files/letter%20from%20min%20to%20IFAC.pdf>

Chapter 6

Long-Term Sustainability of the Public Finances

6.1 Summary

While Ireland's population is currently one of the youngest in the EU, unfavourable demographic trends in the coming decades will put pressure on age-related public spending. Given the budgetary implications of likely demographic shifts, policies have been implemented in recent years in order to mitigate the impact.

6.2 Long-term budgetary prospects

Ireland's population is currently one of the youngest in the EU. However, longer-term population projections indicate a shift in composition of the Irish population over the coming decades with the share of population aged 65 years and over expected to almost double between 2010 and 2060. Alongside this, the projected contraction in the share of working age population will contribute to a marked upward shift in the old-age dependency ratio. Whereas at the beginning of this decade there were almost four people employed for every retired (inactive) person over 65, this figure is projected to fall to below 2 by 2060.

Given the importance of this issue (in Ireland and elsewhere in the EU), the EU Economic Policy Committee undertakes an assessment every three years reviewing the impact of long-term demographic trends on the public finances of the Member States.

The results reported below pertain to the latest publicly available *Ageing Report 2012*²³ and are based on long-term demographic projections produced by Eurostat (EUROPOP2010). The results assume no further policy change over the period to 2060 beyond those announced to date. This analysis indicates that in Ireland spending on pensions²⁴, health and long-term care will increase from 18 per cent of GDP in 2010 to 26 per cent of GDP in 2060.

Work is currently underway in preparing the next *Ageing Report 2015* which is expected to be finalised in spring 2015. This update will incorporate revised macroeconomic projections and demographic profiles driven by the recently published EUROPOP2013 projections²⁵. These revised population projections differ significantly for Ireland relative to the 2010 vintage, with the 2060 population now estimated to be some 1.3 million lower, predominantly driven by revised assumptions around migration²⁶.

²³ http://ec.europa.eu/economy_finance/publications/european_economy/2012/2012-ageing-report_en.htm

²⁴ Figures excluding private pensions

²⁵ EUROPOP2013 available at http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

²⁶ EUROPOP2013 model net migration flows based on a long term trend component which leaves migration levels largely unchanged from their 2013 levels out to 2037. These projections assume no migratory response to improving labour market conditions and follow harmonised cross-country assumptions rather than country specific considerations.

Table 15: Long-term spending projections

% of GDP unless otherwise stated	2010	2015	2020	2030	2040	2050	2060
Total age-related expenditure [1-5]	26.6	29.4	30.2	29.1	30.0	32.7	33.6
1. Total pension expenditure	9.3	10.6	11.5	11.4	12.5	14.3	15.0
Social security pensions	7.5	8.3	9.0	9.0	10.0	11.4	11.7
Gross occupational pensions (Public Service)	1.8	2.3	2.4	2.4	2.5	2.9	3.3
2. Health care	7.3	7.1	7.2	7.7	8.1	8.2	8.3
3. Long-term care	1.1	1.2	1.3	1.5	1.9	2.3	2.6
4. Education expenditure	6.3	6.9	7.1	6.5	6.0	6.5	6.4
5. Other age-related expenditures (Unemployment benefit)	2.6	3.6	3.1	2.0	1.5	1.4	1.3
Underlying Assumptions	2010	2015	2020	2030	2040	2050	2060
Labour productivity growth	1.8	2.2	1.8	1.5	1.5	1.5	1.5
Potential GDP (growth rate)	-1.5	1.9	3.3	2.7	1.8	2.0	2.3
Participation rate males	77.2	76.1	72.1	72.1	72.4	72.0	71.3
Participation rate females	62.0	63.4	63.9	63.9	64.2	63.0	63.1
Total participation rates aged 15-64	69.6	69.7	69.2	68.0	68.3	67.6	67.3
Share of population over 65 years old	11.5	13.0	14.6	17.7	20.3	22.9	21.9
Economic old age dependency ratio	26.9	31.6	35.2	40.3	47.7	57.7	55.1

Source: Economic Policy Committee and European Commission using Commission forecasts out to 2060. As reported in *2012 Ageing Report Economic and Budgetary projections for EU27 Member States 2010-2060*. Based on EUROPOP2010 population projections.

Note: Participation rates refer to 15-64 cohorts. Economic old-age dependency ratio refers to inactive population over 65 as a share of employed population aged 20 to 64.

6.3 Policy strategy

Because of the fiscal challenges posed by demographic trends a number of measures have already been introduced to address this issue in Ireland. For example:

Public Service Pay

Effective from 1 January 2010, public service pay was reduced by an average of 6.5 per cent. These cuts were progressive in nature with minimum reductions of 4 per cent imposed on those at the lower end of the earnings spectrum ranging to cuts of up to 30 per cent for those on higher pay scales. Further pay reductions have been applied through the Financial Emergency Measures in the Public Interest Act 2013, involving a progressive reduction in salary for those earning over €65,000 ranging from 5.5 per cent to 10 per cent. These reductions together with nominal pay freezes provided for out to 2016 will lower future projected occupational public service pension bill costs²⁷.

²⁷ A separate pension levy ("Pension-related Deduction" – PRD) was imposed in 2009 on public servants. While this levy does not reduce gross pension costs it yields some €950m annually to the Exchequer.

Public Service Pensions

In addition to the above, the Public Service Pension Reduction (PSPR) introduced on 1 January 2011 under the Financial Emergency Measures in the Public Interest Act 2010 reduced public service pensions based on a progressively structured set of income bands and reduced rates. This resulted in an average reduction of some 4 per cent in pensions in payment.

The impact of these pay and pension reduction measures is reflected in the accrued liability in respect of public service occupational pensions. As of December 2012 this is estimated at €98 billion. This figure represents the present value of all expected future superannuation payments to current staff (and their spouses) in respect of service to date, plus the liability for all future payments to current and preserved pensioners (and to their spouses). This figure is 16 per cent or €18 billion lower than the figure of €116 billion in respect of 2009.

In the long term, public service pensions' costs will also be further reduced on foot of the new single pension scheme for new entrants in operation since 1 January 2013. Under this new scheme, pensions will be calculated on the basis of career average earnings rather than final salary. Revisions to pension indexation permits post retirement pension increases linked to consumer prices rather than wage movements of existing public servants. This will permit a decoupling between wage increases and future price developments. The minimum public servant pension age will be increased on a phased basis and will rise from the 66 at scheme commencement in 2013 to 67, in line with the statutory state pension age of 67 by 2021 and 68 by 2028.

State Pensions

Social security related pension expenditure will also be restrained reflecting changes to State pension entitlements. Legislation enacted in 2011 will increase the eligible age for receipt of the State Pension to 66 years of age in 2014, rising on a phased basis to 67 in 2021 and to 68 by 2028. Further reforms increasing the number of years of required pensionable earnings from 5 to 10 years have also helped boost the future sustainability of social security related pensions.

Long-term care

The aim of the Nursing Homes Support Scheme introduced in October 2009 is to put the financing of individuals' long-term residential care needs on a fair and equitable basis, whereby people contribute towards the cost of their long-term nursing home care according to their means and can enter any nursing home (public, private or voluntary) subject to it having an available bed and being able to cater for their particular needs. The Scheme is reviewed every three years taking account of Government policy, demographic trends and the fiscal situation. The Review will examine the on-going sustainability of the Scheme, the cost of long-term residential public and private care, the balance of funding between residential long-term care and community-based services and the scope to extend the Scheme to community based services and other sectors (disability, mental health). It will also make recommendations for the future operation and management of the Scheme. Work on the Review is ongoing and is expected to be completed in the coming months.

Further issues under consideration in designing services and supports for the older population include not only residential provision but also community and home-based supports, together with new models of residential care.

6.4 Conclusion

Active policy measures have been undertaken over the past number of years to address age-related spending challenges including legislated step-increases in the state pension age over time, a multi-year nominal freeze in State pension payment rates, reductions in public service pay, reform of public service pension entitlements and moves to place long-term care expenditure on a more sustainable footing. Active labour market policies are likely to boost labour supply over the coming years and will support strengthening growth in potential output over the long run.

Chapter 7

The Excessive Deficit Procedure

7.1 Summary

Significant progress has been made in terms of implementing the recommendations addressed to Ireland in December 2010 under the Excessive Deficit Procedure. All of the interim deficit targets have been met and correction of the excessive deficit is now in sight.

7.2 Background

In April 2009, the Council adopted a decision under article 126(6) of the Treaty on the Functioning of the EU (TFEU) that, for the first time, an excessive deficit existed in Ireland, and adopted recommendations under 126(7) TFEU that *inter alia* Ireland correct its excessive deficit by 2013. A number of additional steps in the procedure were undertaken between April 2009 and July 2010 (for more detail see the April 2012 Update of Ireland's Stability Programme). In December 2010, as part of the programme of external financial assistance, the Council adopted revised recommendations to Ireland and extended the deadline for correction of the excessive deficit to 2015.

The December 2010 recommendations were essentially three-fold. The first requirement was for Ireland to implement budgetary measures to ensure that the annual fiscal deficit (excluding direct support for the banking sector) was at or below pre-determined annual ceilings over the 2011-15 period (see table 17 below). Secondly, in order to achieve these nominal targets, the Council recommended an improvement in the structural budget balance of at least 9½ per cent of GDP over 2011-2015. Finally, the Council recommended various institutional reforms in order to limit risks to the budgetary adjustment.

The Council requested the Irish authorities to report on the implementation of these recommendations in each Update of Stability Programme between 2011 and 2015. The purpose of this chapter is to fulfil this requirement.

7.3 Progress in implementing the Council's recommendations

Significant progress has been made in implementing the recommendations addressed to Ireland in December 2010.

In relation to the headline deficit, the outturn in each year over the period 2011 to 2013 was well below the ceiling imposed by the Council (see table 16). For this year, a deficit inside the ceiling was projected at the time of Budget 2014 and, as outlined earlier in this document, budgetary policy implementation remains consistent with achieving the projected deficit for this year and with bringing the deficit below 3 per cent of GDP next year. In other words, the correction of the excessive deficit within the timeframe set by the Council will be achieved.

Table 16: Requirements and path for the general government balance

% of GDP	2011	2012	2013	2014	2015
EDP ceiling for general government balance	-10.6	-8.6	-7.5	-5.1	-2.9
Underlying general government balance*	-8.9	-8.2	-7.2	-4.8	-2.9

Source: Department of Finance and CSO.

*Excluding support for the banking sector.

Estimates of the fiscal effort based upon changes in the structural balance need to be treated with caution, particularly in an Irish context. On a 'bottom-up' basis, however, discretionary consolidation measures implemented over the 2011-2014 period amount to around 9½ per cent of GDP.

Significant improvements have been made to the budgetary architecture, including the establishment on a statutory basis of the Irish Fiscal Advisory Council and the introduction of a Medium-Term Budgetary Framework (see chapter 5 for more detail).

In summary, therefore, the Council recommendations are being complied with and Ireland remains on track to correct the excessive deficit within the required timeline.

Annex 1

Supplementary Data

Table A1: Explanation of net differences between the Exchequer borrowing requirement and general government balance, 2013-2018

€ million	2013	2014	2015	2016	2017	2018
(a) Exchequer balance	-11,497	-8,700	-5,935	-2,865	-2,815	-705
(b) Exclude equity and loan transactions	-1416	70	0	-1885	-15	-15
(c) Adjust for interest accrual	-189	-100	50	155	-200	-125
(d) Adjust for tax accruals	38	195	205	195	200	205
(e) Adjust for other accruals	514	75	15	-120	-40	-45
(f) Impact of NPRF	586	350	380	380	395	405
(g) Other government bodies	-91	-110	-135	-125	0	0
(h) Net lending/borrowing of NCSSBs	224	135	180	225	210	190
(i) Surplus of the Social Insurance Fund	8	0	0	0	0	0
(j) Net lending of Local Government	44	0	0	0	0	0
(k) General government balance (=a to m)	-11,778	-8,090	-5,235	-4,050	-2,265	-85
(l) Financial sector measures	25	50	100	100	0	0
(m) Underlying balance	-11,755	-8,040	-5,135	-3,950	-2,265	-85
(n) Underlying balance as % of GDP	-7.2	-4.8	-2.9	-2.2	-1.2	0.0
(o) Nominal GDP	164,050	168,375	174,450	181,925	190,575	199,600

Source: Department of Finance, Department of Public Expenditure and CSO estimates

Notes:

Rounding may affect totals

Table A1 shows a reconciliation from the Exchequer balance to the general government balance. The general government balance measures the fiscal performance of all arms of Government, i.e. central government; Local Authorities; Vocational Education Committees and non-commercial State sponsored bodies, as well as funds such as the SIF and the NPRF which are managed by Government agents. It thus provides an accurate assessment of the fiscal performance of a more complete 'Government' sector.

The general government balance does not reflect the position of commercial State sponsored bodies as these agencies are classified as being outside the general government sector. It is calculated in accordance with ESA95, a consistent standard developed by the EU to facilitate budgetary comparisons between EU Member States in accordance with their obligations under the Maastricht Treaty.

a. The Exchequer Balance is the traditional domestic budgetary aggregate which measures the net surplus or deficit position of the Exchequer account. It is the difference between total receipts into and total expenditure out of the Exchequer account of the Central Fund.

b. Equity and loan transactions are excluded from the balance on the basis that they affect the composition but not the level of assets and liabilities.

c. Interest expenditure by general government is calculated on an accruals basis and includes interest rate swaps.

d. & e. Adjustments required in respect of certain transactions recorded on an accruals basis including tax accruals, Departmental balances, EU transfers and the impact of the capital carryover.

f. This is the net lending/borrowing of the NPRF. This fund is within the general government sector and transactions within the sector do not have an impact on the general government balance.

g. Transfers between units within the general government sector do not affect the general government balance.

h, i & j. These adjustments add the net lending/borrowing of other government bodies and local government to arrive at a full concept of general government.

l. This reflects potential deficit worsening expenditure of payments into the financial sector. For the purposes of assessing adherence to EDP general government balance targets, this expenditure is therefore excluded.

Table A2.1: General government budgetary forecasts 2013-2018

	ESA	2013	2013	2014	2015	2016	2017	2018
		€m	% of GDP					
Net lending (EDP B.9) by sub-sector								
1. General government (=6-7)	S.13	-11,778	-7.2	-4.8	-3.0	-2.2	-1.2	-0.0
p.m.: Underlying balance		-11,755	-7.2	-4.8	-2.9	-2.2	-1.2	-0.0
2. Central government	S.1311	-11,830	-7.2	-4.8	-3.0	-2.2	-1.2	-0.0
3. State government	S.1312							
4. Local government	S.1313	44	0.0	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	8	0.0	0.0	0.0	0.0	0.0	0.0
General government (S.13)								
6. Total Revenue	TR	58,866	35.9	36.2	36.3	35.7	35.2	35.0
7. Total Expenditure	TE	70,644	43.1	41.0	39.3	37.9	36.3	35.0
8. Net lending/borrowing (=6-7)	B.9	-11,778	-7.2	-4.8	-3.0	-2.2	-1.2	-0.0
9. Interest expenditure	D.41	7,681	4.7	4.7	4.8	4.9	4.9	4.8
10. Primary balance (=1+9)		-4,097	-2.5	-0.1	1.8	2.6	3.7	4.8
11. One-off and other temporary measures		-616	-0.4	0.2	-0.1	-0.0	0.0	0.0
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		41,399	25.2	26.1	26.4	26.3	26.2	26.2
12a. Taxes on production and imports	D.2	18,993	11.6	11.6	11.8	11.7	11.5	11.3
12b. Current taxes on income, wealth etc.	D.5	21,592	13.2	13.9	14.2	14.3	14.4	14.6
12c. Capital taxes	D.91	814	0.5	0.6	0.3	0.3	0.3	0.3
13. Social contributions	D.61	10,216	6.2	6.0	5.9	5.9	5.8	5.7
14. Property Income	D.4	2,710	1.7	1.5	1.3	1.1	0.9	0.8
15. Other		4,541	2.8	2.6	2.7	2.5	2.3	2.2
16. (=6) Total revenue (=12+13+14+15)	TR	58,866	35.9	36.2	36.3	35.7	35.2	35.0
p.m.: Tax burden		52,051	31.7	32.4	32.6	32.4	32.2	32.2
Selected Components of Expenditure								
17a. Compensation of employees	D.1	18,423	11.2	10.9	10.3	9.9	9.4	9.0
17b Intermediate consumption	P.2	8,300	5.1	4.9	4.7	4.6	4.6	4.4
18. Social payments (18 = 18a+18b)		28,559	17.4	16.6	15.5	14.8	13.9	13.3
18a. Social transfers in kind supplied via market producers	D.63	4,516	2.8	2.6	2.5	2.4	2.4	2.3
18b. Social transfers other than in kind	D.62	24,043	14.7	13.9	13.1	12.4	11.5	11.1
19=9 Interest expenditure	D.41	7,681	4.7	4.7	4.8	4.9	4.9	4.8
20. Subsidies	D.3	1,495	0.9	0.8	0.9	0.8	0.8	0.8
21. Gross fixed capital formation	P.51	2,723	1.7	1.6	1.5	1.5	1.4	1.3
22. Capital Transfers	D.9	1,953	1.2	0.6	0.5	0.5	0.4	0.4
22. Other		1,509	0.9	0.9	1.1	1.1	1.0	1.0
23=7 Total expenditure (=17+18+19+20+21+22)	TE	70,644	43.1	41.0	39.3	37.9	36.3	35.0
p.m. : Government consumption	P.3	29,464	18.0	17.9	16.5	15.9	15.2	14.5
GDP at current market prices (€ billion)	B.1*g		164	168	174	182	191	200

Sources: CSO, Department of Finance and Department of Public Expenditure and Reform

Table A2.1 sets out the general government deficit for the years 2013-2018 in terms of selected components of general government receipts and expenditures. Note that the revenue and expenditure forecasts for 2016-2018 reflect the adjustment path necessary to achieve the MTO which is the overarching fiscal policy of the Government. Specific policy decisions which will be made in the context of annual budgets are not reflected in these forecasts.

Notes to table A2.1:

- Item 1: Net lending by general government is identical with the general government balance.

- Item 9 & 19: Interest expenditure by general government is calculated on an accruals basis and includes interest rate swaps.

- Item 12a: Taxes on production and imports include VAT; customs, excise and stamp duty; local authority rates; the non-household part of motor tax; the stamps collected by the Risk Equalisation Fund; and the local property tax.
- Item 12b: Current taxes on income and wealth comprise income tax; capital gains tax; corporation tax; the banking levy introduced in Budget 2014; and the household part of motor tax and of television licences.
- Item 12c: Capital taxes comprise capital acquisitions tax and the pension funds and bank levies.
- Item 13: Social contributions consist mainly of contributions to the Social Insurance Fund. Imputed social contributions are also included.
- Item 14: Property income is made up of investment or dividend income.
- Item 15: Other receipts include miscellaneous receipts such as Departmental receipts (appropriations in aid), rents and receipts from abroad, receipts by non-commercial State sponsored bodies and miscellaneous capital receipts.
- Item 17a: Compensation of Employees includes wages and salaries as well as an estimate of the amount that would have to be contributed if public sector pensions were actually funded schemes.
- Item 17b: Intermediate consumption is current spending on goods and services by government units.
- Item 19: Social transfer payments include pensions; child benefit; payments for medical goods; transfers to the rest of the world; and other unrequited payments to households. Social transfers in kind include such items as free travel on public transport and fuel allowances.
- Item 22: Gross fixed capital formation is acquisitions less disposals by government of capital formation such as construction and machinery.
- Item 23: Other expenditure includes transfer payments to non-government bodies and capital grants. It also includes acquisitions less disposals of non-produced assets such as royalties, mobile phone licences and the licence to operate the National Lottery.

Memo items:

Tax burden: the sum of total taxes (D.2, D.5 and D.91), social contributions (D.61) and EU taxes.

The underlying balance: the net lending of general government adjusted for the effect of certain expenditures into the financial sector.

Government consumption: This is comprised of expenditures on compensation of employees; goods and services; social transfers in kind; plus depreciation; less miscellaneous receipts. This aggregate is government's contribution to expenditure on GDP.

Table A4: Projected movement in general government debt 2013-2018

€ billion	2013	2014	2015	2016	2017	2018
Opening general government debt	192.5	202.9	204.4	209.3	210.8	213.5
Exchequer borrowing requirement	11.5	8.7	5.9	2.9	2.8	0.7
Change in Exchequer Deposits	-0.2	-7.1	-1.0	-0.5	0.1	0.0
Net lending of local government and NCSSBs	-0.5	-0.4	0.1	-0.3	-0.3	-0.2
Change in collateral held	-0.5	0.1	-0.2	-0.2	-0.2	-0.0
Other	0.2	0.2	0.1	-0.4	0.2	0.1
Closing general government debt	202.9	204.4	209.3	210.8	213.5	214.1
General government debt to GDP ratio	123.7%	121.4%	120.0%	115.9%	112.0%	107.2%

Sources: CSO, Department of Finance and NTMA (National Debt data provider)

Notes: Rounding may affect totals

Table A5: Breakdown of revenue

	2013	2013	2014	2015	2016	2017	2018
	€ billion	% of GDP					
Total revenue at unchanged policies ¹	59.0	35.9	36.2	35.9	35.4	34.8	34.6
Discretionary revenue ²	1.4	0.9	0.5	0.4	0.0	0.0	0.0

Source: Department of Finance

Notes:

1 Total general government revenue on the basis already implemented up to and including Budget 2014.

2. Discretionary revenue measures include PRSI adjustments and are inclusive of carry-over from previous years. The 2013 figure is as per Budget 2013. Discretionary revenue figures for 2015 are set out in the Medium-Term Fiscal Statement (MTFS) OF November 2012. The precise level and make-up of the discretionary revenue measures to be introduced by Government will be decided at a later stage.

Table A6: Expenditure developments

	2013	2013	2014	2015	2016	2017	2018
	€ million	% of GDP					
Expenditure on EU Programmes fully matched by revenue from EU funds	400	0.2	0.2	0.2	0.2	0.2	0.2
Expenditure fully matched by mandated revenue increases	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-discretionary changes in unemployment benefit expenditure*	183.1	0.1	0.0	-0.1	0.0	0.0	0.0

Source: Department of Finance calculations and Department of Public Expenditure and Reform

*Broad methodology for calculation is set out in SPU 2013

Table A7: Contingent liabilities

% of GDP	2012	2013
Public guarantees	70.5	41.4
<i>of which linked to the financial sector</i>		
Eligible Liabilities Guarantee	44.4	12.2
Exceptional Liquidity Assistance	9.8	-
National Asset Management Agency & National Asset Resolution Limited	15.5	28.2
other	0.8	0.9

Source: Department of Finance, CSO

Table A8: Budgetary plans

% of GDP	2013	2014	2015	2016	2017	2018
1. General government balance	-7.2	-4.8	-3.0	-2.2	-1.2	0.0
2. Structural balance	-6.2	-4.7	-2.8	-2.1	-1.2	0.0
3. Cyclical budgetary component	-0.6	-0.3	-0.1	-0.1	0.0	0.0
4. One-offs and other temporary measures	-0.4	0.2	-0.1	-0.1	0.0	0.0
5. General government balance	-7.2	-4.8	-3.0	-2.2	-1.2	0.0
6. Total revenues	35.9	36.2	36.3	35.7	35.2	35.0
7. Total expenditure	43.1	41.0	39.3	37.9	36.3	35.0
Amounts to be excluded from the expenditure benchmark						
7a. Interest expenditure	4.7	4.7	4.8	4.9	4.9	4.8
7b. Expenditure on EU programmes fully matched by EU funds revenue	0.2	0.2	0.2	0.2	0.2	0.2
7c. Cyclical unemployment benefit expenditure*	0.1	0.0	-0.1	0.0	0.0	0.0
7d. Effect of discretionary revenue measures	0.9	0.5	0.4	0.0	0.0	0.0
7e. Revenue increases mandated by law	0.0	0.0	0.0	0.0	0.0	0.0
8. Tax burden	31.7	32.4	32.6	32.4	32.2	32.2
9. Gross debt	123.7	121.4	120.0	115.9	112.0	107.2

Source: Department of Finance

*Broad methodology for calculation is set out in SPU 2013

Table A9: Macroeconomic assumptions

	2013	2014	2015	2016	2017	2018
1 Real GDP growth	-0.3	2.1	2.7	3.0	3.5	3.5
2. Nominal GDP growth	0.1	2.6	3.6	4.3	4.7	4.7
3 GDP deflator growth	0.4	0.5	0.9	1.2	1.2	1.2
Potential GDP growth	0.4	1.5	2.2	2.9	3.3	3.5
Output gap	-1.3	-0.7	-0.3	-0.1	0.0	0.0
Employment growth	2.4	2.2	2.0	2.0	1.9	1.9
Hours worked	0.5	0.6	0.5	0.4	0.2	0.2
Unemployment rate	13.0	11.5	10.5	9.7	8.9	8.0
Gross fixed capital formation	4.2	15.4	12.4	7.5	7.5	6.0
Compensation per employee*	0.5	1.1	1.6	2.1	2.1	2.2

Source: Department of Finance

*Based on AMECO HWCDW definition. Differs from non-agriculture wages per head reported in table 5.

Annex 2
Ireland's National Reform Programme
Summary of Progress

[Text to be provided in the final version of the SPU that is submitted to the Commission]

Annex 3

Irish Fiscal Advisory Council's Endorsement of the Macroeconomic Forecasts



Comhairle Chomhairleach Bhuiséadach na hÉireann
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Cearnóg Whitaker
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07 April 2014

Dear Secretary General Moran,

The Ministers and Secretaries (Amendment) Act 2013 amended the Fiscal Responsibility Act 2012 to include a macroeconomic forecast endorsement function for the Irish Fiscal Advisory Council as follows:

“(4) 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, . . .” [Ministers and Secretaries (Amendment) Act 2013, p. 5.]

The [Memorandum of Understanding](#) (MOU) between the Department of Finance and the Council as amended in 2014 sets out the agreed modalities of the endorsement function in relation to the Budget and the Stability Programme Update (SPU):

“An endorsement would be provided via a formal letter from the Chair of the Council to the Secretary General of the Department of Finance. . . This letter would be made public.”

The key set of variables taken into account in the endorsement are those listed in Section 2 of the MOU. Medium-term forecasts are subject to a greater degree of uncertainty than forecasts for the current and following year. The medium-term forecasts are informed by a set of supply-side estimates in the SPU based on the methodology commonly agreed between EU member states and the European Commission.

The Irish Fiscal Advisory Council endorses as within the range of appropriate projections the set of macroeconomic forecasts prepared by the Department of Finance for SPU 2014 for the years 2014 to 2018. These forecasts were provided to the Council on 4 April 2014.

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

Yours Sincerely

John McHale
Chair, Irish Fiscal Advisory Council

Comhairle/Council: John McHale (Chair) · Sebastian Barnes · Alan Barrett · Donal Donovan · Róisín O'Sullivan.