

# **Economic and Fiscal Outlook**



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## **ECONOMIC AND FISCAL OUTLOOK**

The *Medium-Term Fiscal Statement (MTFS)* published on 4 November 2011 provided a great deal of detail on the emerging economic and fiscal outlook based largely on an assessment of the position as of late October.

In the interim, some key economic and fiscal data have been published. These data are reflected in the assessment in this section, which sets out an update of the economic and fiscal outlook underpinning *Budget 2012*.

### **ECONOMIC DEVELOPMENTS 2011**

*The Irish economy is set to return to growth this year...*

The latest economic data suggest that the Irish economy will return to growth this year. Real GDP recorded a robust expansion in the first half of 2011 – increasing by 1.9% and 1.6% in the first and second quarters respectively (quarter-on-quarter, seasonally adjusted).

As expected, external demand is driving the recovery. Exports increased by 5.5% on an annual basis in the first half of the year, supported by the substantial improvements in competitiveness that have taken place in recent years, a trend that is expected to continue. Encouragingly, export growth has broadened out to include parts of the indigenous traded sector, most notably agri-foods and tourism. However, the external environment has deteriorated in recent months and this will restrain export growth in the second half of the year, so that for the year as a whole exports are expected to expand by 4.6%.

Domestic demand, on the other hand, continues to weigh on overall activity. Despite the support of the car scrappage scheme, personal consumption is expected to contract by 2.5% this year, as households continue to rebuild balance sheets in an environment of declining real incomes, relatively low confidence and high uncertainty. Firms are also still working through imbalances built up during the boom, and with building and construction recording another large decline, investment is forecast to contract by 11% this year.

The volume of imports is projected to increase by 1.6%, broadly in line with the change in final demand. As a result the trade surplus is projected to increase further. Taking account of cross-border income flows as well as current international transfers, the current account of the balance of payments is expected to record a small surplus this year.

Reflecting these developments, real GDP growth of 1% is forecast for 2011. Given the composition of this growth rate, and the important role of the foreign-owned exporting sector, the pace of expansion in real GNP will be somewhat weaker at 0.4%.

*Conditions in the labour market remain poor...*

The export-led composition of growth means that the recovery is not being fully reflected in the labour market situation as of yet. Having said that, the pace at which the economy is losing jobs continued to slow during the first half of the year. Employment is nevertheless expected to contract by 1.9% for the year as whole. There has been a further fall in the labour supply – due to falling participation rates and net outward migration – but this has not been sufficient to offset the loss in employment. As a result, and taking account of the latest information, the unemployment rate is forecast to increase to 14.3% this year.

*Moderate consumer price inflation...*

This high unemployment rate confirms the considerable amount of slack in the economy at present. Combined with weak domestic demand, this has contributed to subdued consumer

price pressures. Measures of ‘core’ inflation are effectively flat, although higher commodity prices mean the headline rate of HICP inflation will average an estimated 1.2% this year.<sup>1</sup>

## **FISCAL DEVELOPMENTS 2011**

*The public finances are showing signs of improvement...*

Turning to the public finances, the underlying fiscal position is showing signs of improvement after three very difficult years, although the headline Exchequer position in 2011 is affected by the significant impact of State support for the banking sector.

*Latest available data show that the underlying Exchequer deficit is shrinking...*

The end-November Exchequer Returns show that the Exchequer recorded a deficit of €21.4 billion in the first eleven months of 2011. While this represents a year-on-year increase of just over €3 billion, the increase is the result of banking related payments, namely the €3.1 billion in Promissory Note payments and the €7.6 billion in recapitalisation related payments funded from the Exchequer in July.

Excluding these payments of almost €10.7 billion and, for consistency purposes, the €1 billion in Exchequer capital receipts from the sale of part of the State’s shareholding in Bank of Ireland, the underlying Exchequer deficit declined by over €1.6 billion in the period to end-November 2011 compared to the corresponding period last year. This confirms that progress is being made in tackling the large deficit that exists and in restoring the public finances to a more sustainable position.

€31.8 billion in tax revenue was collected in the period to end-November. This represents an increase of €2.3 billion (7.9%) on the amount collected in the corresponding period in 2010. This strong year-on-year growth rate owes much to the measures introduced in *Budget 2011* - most notably the Universal Social Charge (USC) - but also to receipts from the temporary levy on private pension funds which was introduced earlier this year to fund the Government’s *Jobs Initiative*.

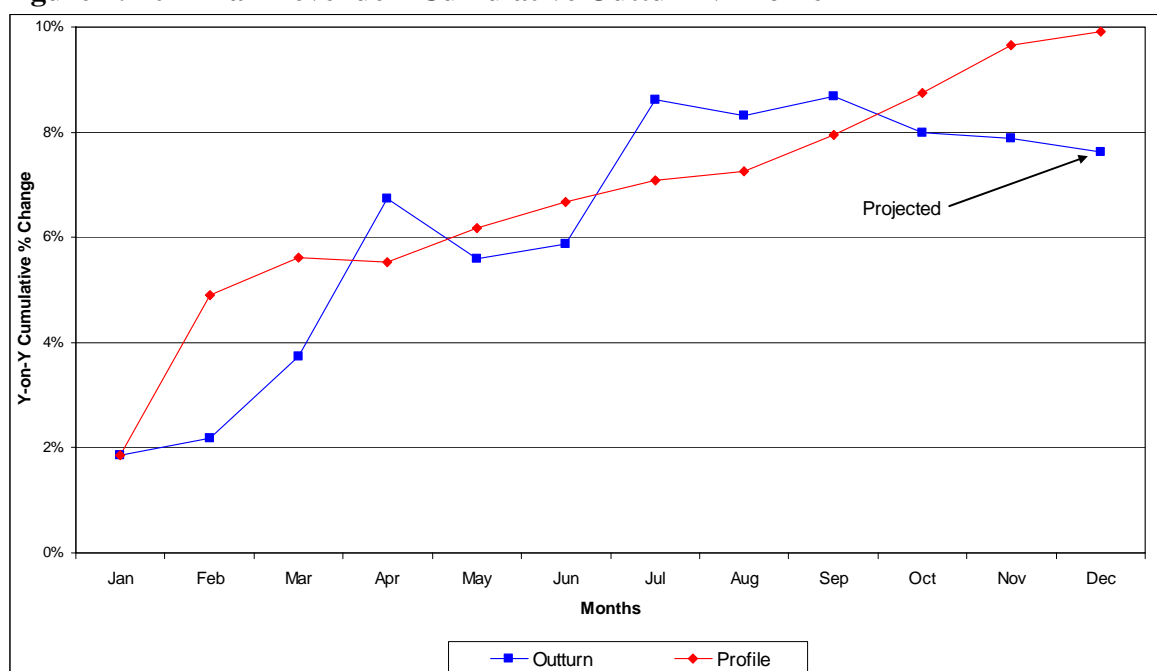
Compared to profile however, tax revenues at end-November were €20 million (1.6%) below expectations. November is the most significant month of the year in terms of tax revenue collection with almost €½ billion profiled for collection. Taxes in the month were €337 million lower than planned. Weaker than expected performances from income tax, corporation tax and to a lesser extent VAT were the main causes.

Figure 1 shows the cumulative performance of tax revenues in 2011 as compared to the published profile.

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<sup>1</sup> The Harmonised Index of Consumer Prices (HICP) is the measure of inflation that is used for European comparisons.

**Figure 1: 2011 Tax Revenue – Cumulative Outturn v Profile**



Source: Department of Finance.

As Figure 1 shows tax revenues have weakened somewhat since the summer. This is not surprising given the more difficult economic conditions prevailing in the second half of the year.

As noted already, November's tax returns were somewhat weaker than anticipated. In light of an expected shortfall in December also, most notably in relation to capital gains tax, an overall tax revenue shortfall of €725 million is now being assumed for the year as a whole.

Tax revenues in 2011 are currently estimated at €34,175 million, a 7.6% increase on the 2010 outturn. While it must be acknowledged that much of this growth is the result of the reclassification of health levy receipts to form part of the USC and the stamp duty receipts from the *Jobs Initiative* pension levy, the fact that taxes are growing again is to be welcomed. This return to growth follows on from year-on-year declines of 14% in 2008, 19% in 2009 and 4% in 2010.

While net voted expenditure was €1 billion below target at end-November, it is expected that much of this shortfall will be made up in December. Nevertheless, net voted expenditure for the year as a whole, as per the *Comprehensive Expenditure Report 2012-2014*, is expected to be around €200 million less than was estimated in the *July Revised Estimates Volume*, evidence of the careful management of public expenditure which has characterised 2011.

The current working estimate of the Exchequer deficit for 2011 is €25.2 billion. The reduction in the underlying Exchequer deficit – excluding banking related payments in both 2010 and 2011, and the receipts from the sale of part of the State's shareholding in Bank of Ireland in 2011 – is likely to be almost €½ billion, a very significant improvement.

*On track to better EU/IMF Programme deficit target...*

This year's emerging General Government deficit, at 10.1% of GDP, is within the 10.6% target set as part of the EU/IMF Programme. This estimate is based on this year's banking recapitalisation payments being classified as financial transactions which means they are

not counted as part of the General Government deficit measure. This provisional classification will continue to be assessed in the coming months in light of ongoing discussions between the Department of Finance, the CSO and Eurostat<sup>2</sup>.

## ECONOMIC OUTLOOK 2012

### *External environment weakening...*

The external environment has deteriorated sharply since the summer as the sovereign debt crisis in the euro area has intensified. Against a backdrop of heightened uncertainty and a fall in sentiment levels, global activity has slowed and international organisations are revising down their short-term macroeconomic projections. This is particularly the case for advanced economies, which make up the bulk of Ireland's current export markets. The OECD, for example, now expects significantly weaker growth in the US, euro area and UK economies than was the case last May. Indeed, it is now forecasting euro area growth of just 0.2% next year.

**Table 1: External Assumptions**

	<u>2011</u>	<u>2012</u>	<u>2013</u>
<b>External GDP Growth (% change)*</b>			
UK	0.9	0.5	1.8
US	1.7	2.0	2.5
Euro area	1.6	0.2	1.4
Global economy	3.8	3.4	4.3
<b>Technical Assumptions (annual average)^</b>			
euro-sterling rate	0.87	0.86	0.86
euro-dollar rate	1.39	1.34	1.34
Brent crude (dollars per barrel)	111	106	101

\*Source of external growth forecasts is the OECD Economic Outlook No. 90, November 2011.

^Exchange rate figures are Department of Finance technical assumptions, involving the maintenance of unchanged rates from those prevailing at end-November. Oil price figures are based on market futures at end-November.

### *Moderate growth in Ireland expected for next year...*

In these circumstances, the pace of the recovery in Ireland is expected to strengthen only modestly, with real GDP increasing by 1.3% in 2012 (real GNP growing by 0.7%). This represents a 0.3 pp. downward revision from the forecast presented in early November, and partly reflects the weakening international outlook. Exports are now forecast to grow by 3.6% next year.

Domestic demand is likely to fall once again, albeit at a more modest pace than in 2011. The ongoing international difficulties are creating additional uncertainty with the result that private consumption is now forecast to contract by 1.3% next year. The factors that held back consumer spending in 2011 – declining real disposable incomes and an elevated savings rate (the latter reflecting balance sheet rebuilding, high unemployment and low confidence) – are assumed to persist into next year. Government consumption is expected to fall by 2.2%, reflecting the impact of budgetary consolidation. Investment is projected to decline by around 1%; uncertainty and corporate deleveraging will continue to restrain investment in machinery and equipment, while factors such as excess supply will weigh on building and construction investment.

<sup>2</sup> The 10.6% of GDP target would not be affected in the event that these payments were reclassified as capital transfers and therefore counted as part of the headline General Government deficit measure.

Imports are forecast to increase by 1.6%, in line with the outlook for final demand. Taking into account the other components, the current account of the balance of payments is forecast to widen further to 1.7% of GDP.

**Table 2: Economic Outlook - % change** (unless otherwise stated)

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
GDP	1.0	1.3	2.4	3.0	3.0
GDP level, €m ^	155,250	159,125	164,550	171,625	179,425
GNP	0.4	0.7	1.7	2.3	2.3
GNP level, €m ^	126,450	128,800	132,125	136,850	142,075
<i>Components of Aggregate Demand</i>					
Consumption	-2.5	-1.3	0.0	1.0	1.2
Government	-3.0	-2.2	-2.2	-2.3	-2.1
Investment	-11.0	-1.0	3.2	4.6	4.8
Change in stocks (% of GDP)	0.2	0.3	0.3	0.3	0.2
Exports	4.6	3.6	4.5	4.8	4.8
Imports	1.6	1.6	2.8	3.4	3.5
BoP Current Account (% of GDP)	0.5	1.7	2.5	3.3	3.7
<i>Price Developments</i>					
HICP	1.2	1.9	1.4	1.5	1.9
GDP deflator	-1.5	1.1	1.0	1.3	1.5
<i>Labour Market</i>					
Employment	-1.9	-0.2	0.8	1.2	1.6
Unemployment	14.3	14.1	13.5	12.9	11.6

Source: Department of Finance forecasts.

^ GDP and GNP level figures are rounded to the nearest €25 million.

#### *Labour market likely to stabilise...*

Net employment is expected to fall slightly next year, by 0.2%. This further contraction in employment – despite a modest strengthening in the pace of economic expansion – partly reflects the less labour-intensive nature of export-led growth. It also reflects a tendency for firms to be more conservative when making hiring decisions in the early stages of recovery, a factor likely to be amplified by the high level of uncertainty at present. The labour force is projected to decline at a faster rate, so that a modest decline in the unemployment rate is assumed – the unemployment rate is forecast to average 14.1% next year.

It is to be stressed that these labour market forecasts take account only of policies which have already been announced; they should in no way be seen as Government targets. The Government will publish its first annual Action Plan for Jobs in the New Year which will contain a series of measures to be implemented during 2012 and will provide further support to the labour market. The impact of these measures will be taken into account in the next update of the Department's macroeconomic forecasts.

#### *Consumer price inflation to remain contained...*

Weak domestic demand and considerable spare capacity in the economy mean that underlying or 'core' inflation should remain muted next year. However, the impact of the indirect tax changes announced in the Budget, together with the increase in domestic energy costs implemented in September and October of this year, will have a significant effect on headline inflation in 2012. In overall terms, therefore, HICP inflation is forecast to average 1.9% next year. Taking account of interest rate changes, inflation measured by

the Consumer Price Index is projected to average 1.8% next year, compared to some 2.6% this year.<sup>3</sup>

The effect of the increase in VAT, together with a minor improvement in the terms-of-trade means that the GDP deflator – the widest measure of prices in the economy – has been revised upwards from that published in early November. As a result, the nominal level of GDP in 2012 is broadly unchanged, notwithstanding the downward revision to the real GDP growth forecast.

#### *Comparison of forecasts...*

Table 3 compares the Department’s main macroeconomic forecasts for 2012 with those from other agencies. The level of uncertainty surrounding the short-term international economic outlook has increased significantly in recent months, particularly in the euro area. As a result, the range of GDP forecasts extends from 0.9% to 1.8% with the Department’s projection in the middle of this range. At the lower end, the ESRI, OECD and European Commission anticipate growth of around 1%. The Central Bank, IMF and *Reuters* consensus, on the other hand, are somewhat more optimistic than the Department, although the forecasts by the Central Bank and IMF are not as recent as others.

**Table 3: Comparison of Macroeconomic Forecasts for Ireland for 2012**

		Annual % Change			
		<u>GDP</u>	<u>GNP</u>	<u>HICP</u>	<u>Employment</u>
Department of Finance	<i>December 2011</i>	1.3	0.7	1.9	-0.2
Reuters Consensus	<i>December 2011</i>	1.5	0.8	1.6	n.a.
ESRI	<i>November 2011</i>	0.9	-0.3	1.9	-1.2
OECD	<i>November 2011</i>	1.0	n.a.	0.8	n.a.
European Commission	<i>November 2011</i>	1.1	n.a.	0.7	-0.6
Central Bank	<i>October 2011</i>	1.8	0.7	0.7	0.1
IMF	<i>September 2011</i>	1.5	n.a.	0.6	0.5

*Source: Institutions listed.*

## **FISCAL OUTLOOK 2012**

On foot of the significant new policy measures being implemented as part of *Budget 2012* and the expected carry-forward from measures introduced in *Budget 2011*, tax revenue is forecast to grow by 4.8% in 2012. Table 4 sets out the estimated year-on-year growth rate for each of the eight individual tax-heads.

<sup>3</sup> Interest rates directly impact on the CPI but not on the HICP.

**Table 4: Projected Exchequer Tax Revenues 2011-2012**

	<u>2011</u>	<u>2012</u>	<u>Forecast Y-on-Y</u> <u>Change</u>
	€m	€m	%
Customs	240	245	+2.1
Excise Duties*	4,690	4,815	+2.7
Capital Gains Tax (CGT)	310	355	+14.5
Capital Acquisitions Tax (CAT)	240	295	+22.9
Stamp Duties	1,400	1,350	-3.6
Income Tax	13,835	15,000	+8.4
Corporation Tax	3,730	3,770	+1.1
VAT	<u>9,730</u>	<u>9,995</u>	+2.7
<b>Total</b>	<b>34,175</b>	<b>35,825</b>	<b>+4.8</b>

*Source: Department of Finance.*

*Figures rounded to the nearest €5 million.*

*\*Excise Duties include Carbon Tax and for 2012 the estimated €46.5 million in revenues from the changes to Motor Tax rates.*

#### *Reductions across the board in voted expenditure...*

The gross voted current expenditure of Government Departments is now forecast at €1.9 billion in 2012, a reduction of 2¼% on the estimated 2011 outturn but still over €16 billion more than will be collected in tax revenues next year. In light of the need to continue to reduce expenditure to bring it more in line with resources, reductions will be implemented right across the board and in virtually all Ministerial Vote Groups.

Reductions will also be made to voted capital expenditure with provision for gross voted spending of just over €3.9 billion. In addition, there is provision for a capital carryover of €15 million into 2012.

This reduction in capital expenditure must be seen in the context of the very significant improvements that have been made to the infrastructure stock over the past decade. There is therefore no longer the need for the same volume of capital expenditure. However, there are sectors where investment will be required to address remaining deficits to meet urgent economic and social needs and it is also necessary to fund the maintenance of the existing stock of infrastructure to maximise returns. The focus of the €4 billion or so (3.1% of GNP) that will be spent is on supporting those sectors and projects which will best contribute to sustainable job creation.

#### *2012 General Government deficit estimate in line with target...*

The 2012 Exchequer deficit is projected to be €18.9 billion which is higher than the estimate in the *MTFS*. The main reason for this is the provision which is now being made for €1.3 billion in Exchequer funding to complete the recapitalisation of Irish Life & Permanent. Provision is also now being made for higher than previously expected Exchequer funding to the Insurance Compensation Fund.

Under the terms of the EU/IMF Programme, the General Government deficit must be no more than 8.6% of GDP in 2012. The current estimate of the 2012 deficit adheres to this target, one the Government is steadfastly committed to.

#### *General Government debt forecast to peak at 119% of GDP in 2013...*

General Government debt is the standard measure of gross indebtedness used for comparative purposes within the EU. It includes the debt of the Exchequer, the extra-

budgetary funds, the non-commercial state-sponsored bodies, Promissory Notes as well as the debt of local authorities. As it is a gross measure, it does not allow for the offsetting of liquid assets held.

At end-2007, General Government debt stood at 25% of GDP, well below the European average. By end-2011 it is projected to stand at around 107% of GDP. The reasons for such a significant level of increase have been well documented and include the very substantial level of support provided by the State to the banking sector.

Based on a long-term debt refinancing requirement of around €½ billion in March 2012 and an EBR of €18.9 billion, the overall funding requirement for the State in 2012 is now estimated at just under €4½ billion. This funding will be provided through existing resources, from further draw down of funds available under the EU/IMF Programme and from market borrowing (including retail) as appropriate.

General Government debt is projected to increase further, to 115% of GDP at end-2012, and to peak, in percentage of GDP terms, at 119% in 2013. Table 13 in Annex II sets out more detail in relation to the debt projections.

### **IMPACT OF CONSOLIDATION ON THE FISCAL POSITION IN 2012**

Implementing consolidation through the imposition of tax increases and reductions to expenditure will have a negative effect on economic activity. Table 5 shows that the estimated loss in tax revenue arising from the introduction of €3.2 billion in new revenue raising and expenditure reducing policy measures is €75 million – so called “negative buoyancy”. This loss in tax revenue has been factored into the overall budgetary arithmetic set out in Table 10.

While acknowledging the negative economic impact that consolidation has, it must be remembered that the consolidation process has been underway since mid-2008 and that despite the very significant level of adjustment implemented in 2011, economic growth has returned this year for the first time since 2007.

**Table 5: The Impact of the Budget on the Fiscal Position 2012**

	€m	€m
<b><u>Total Budget Package (New Measures)<sup>4</sup>:</u></b>		<b>3,222</b>
<b><u>New Tax Measures:</u></b>		<b>1,015</b>
VAT		559
Excise Duty (including Carbon Tax & Motor Tax)		178
Household Charge*		160
Capital Gains Tax		81
Capital Acquisitions Tax		51
DIRT		35
Other (including USC/Reliefs/& Exemptions/Compliance etc.)		20
Stamp Duty		-64
Corporation Tax		-5
<i>Impact on Tax Projections of New Budgetary Measures</i>		-775
<b><u>PRSI*:</u></b>		<b>57</b>
<b><u>Expenditure Measures:</u></b>		<b>2,150~</b>
Current		1,395
Capital		755
	<b>WHITE</b>	<b>BUDGET</b>
	<b>PAPER</b>	<b>2012^</b>
	€m	€m
<b><u>Current Revenue</u></b>		
Tax Revenue	35,585	35,825
Non-Tax Revenue	2,496	2,495
<b>Current Revenue</b>	<b>38,081</b>	<b>38,320</b>
<b><u>Current Expenditure</u></b>		
Net Voted Current Expenditure	42,154	40,515
Non-Voted Current (Central Fund) Expenditure	9,069	8,985
<b>NET Current Expenditure</b>	<b>51,223</b>	<b>49,500</b>
<b>CURRENT BUDGET BALANCE</b>	<b>-13,142</b>	<b>-11,180</b>
<b>CAPITAL BUDGET BALANCE</b>	<b>-8,424</b>	<b>-7,680</b>
<b>EXCHEQUER BALANCE</b>	<b>-21,566</b>	<b>-18,860</b>

Sources: Department of Finance & Department of Public Expenditure and Reform.

\*While the Household Charge and PRSI measures are part of the revenue raising consolidation being announced in Budget 2012, the revenues/savings these measures will generate are captured in the estimates of expenditure presented in the Comprehensive Expenditure Report 2012-2014. Therefore they do not form part of the €35,825 million post-Budget 2012 tax revenue projection.

~The current and capital expenditure savings are consistent with the aggregate figures as per the Comprehensive Expenditure Report 2012-2014.

^Rounding can affect totals.

## ECONOMIC OUTLOOK 2013-2015

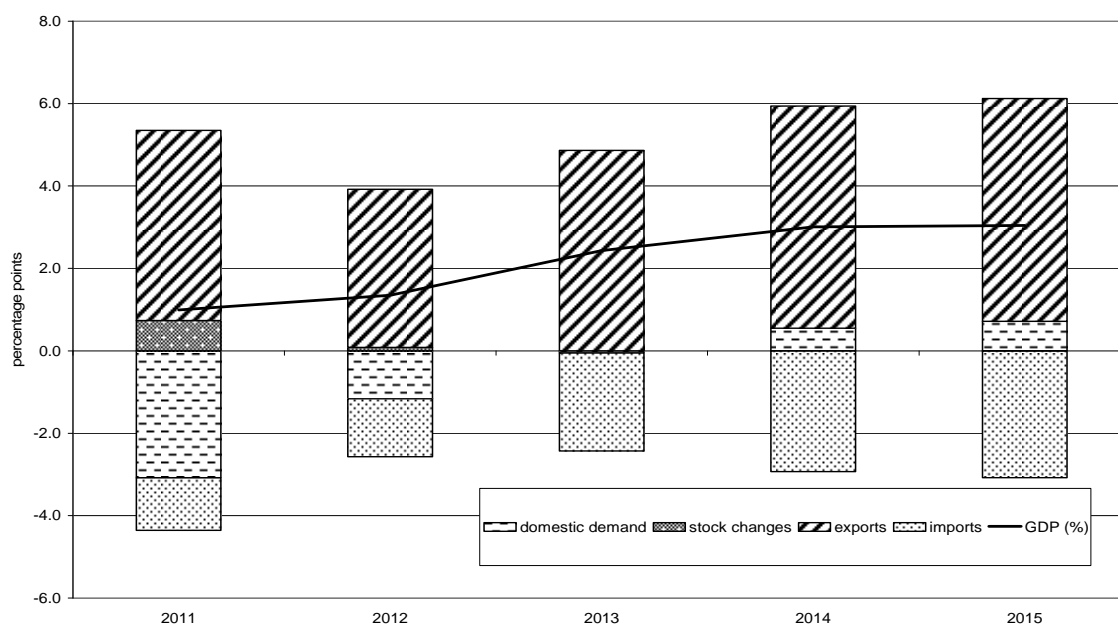
*The pace of growth should accelerate over the medium term...*

With the global economy expected to regain momentum in the second half of next year, Irish GDP growth should continue to strengthen in 2013 and subsequent years. Activity is

<sup>4</sup> Consistent with the MTF5, a further €0.6 billion in revenues are expected to be raised in 2012 as a result of the full-year impact (the "carry-forward") of measures introduced in Budget 2011.

also likely to broaden out over this period. This is typical of the recovery path of a small open economy, where export strength filters through to investment, employment and, finally, consumption over the medium term. Nevertheless, exports are expected to remain the driving force behind the expansion throughout the forecast horizon, supported by ongoing competitiveness improvements.<sup>5</sup> Domestic demand will make only a limited contribution to the growth rate, given the ongoing impact of fiscal consolidation and balance sheet repair in the private sector. As a result of the latter, household savings are expected to decline at a slow pace. Over the period 2013-2015, real GDP is forecast to average 2.8% per annum (the equivalent figure for GNP is 2.1%). These medium-term projections take account, in so far as is possible in an economy like Ireland's, of the trend growth rate and the estimated amount of slack in the economy.

**Figure 2: Contributions to GDP Growth 2011-2015**



Source: Department of Finance.

#### *Labour market will improve somewhat...*

The economy is expected to be creating jobs on a net basis by the end of next year, and a return to employment growth on a full-year basis is anticipated thereafter. The measures set out in the Government's Jobs Initiative will provide support in this regard. As the recovery gains momentum over the medium term, the rate of employment growth should accelerate. Nevertheless, like most other forecasters, the Department is projecting that the unemployment rate will remain at a relatively elevated level over the medium term.

#### *Comparison of medium term forecasts...*

Comparison forecasts for the period 2013-2015 are presented in Table 6. Few detailed forecasts are available for this period, but those that are – from the Troika and the *Reuters* consensus – are consistent with the Department in anticipating average real GDP growth of 2.8% per annum over this period.

<sup>5</sup> In this regard it is worth pointing out that there is a slight downward revision to the inflation forecasts in 2013 and 2014 compared to the figures published in early November as the proposed VAT increases have been brought forward.

**Table 6: Comparison of Macroeconomic Forecasts for Ireland for 2013-2015**

		% change, average per annum			
		<u>GDP</u>	<u>GNP</u>	<u>HICP</u>	<u>Employment</u>
Department of Finance	<i>December 2011</i>	2.8	2.1	1.6	1.2
Reuters Consensus	<i>December 2011</i>	2.8	2.6	n.a.	n.a.
Troika*	<i>September 2011</i>	2.8	n.a.	1.6	1.3

Source: Institutions listed.

\*European Commission – Economic Adjustment Programme for Ireland summer review.

#### *Risks to the outlook...*

The scenario presented above is the baseline one. Economic forecasting is, of course, an inexact science, and as noted already, the level of uncertainty is heightened at present. Some of the identifiable risks to the baseline scenario – both upside and downside – are outlined below.

Firstly, there are the usual risks related to developments in our main trading partners and movements in commodity prices, exchange rates and interest rates. In particular:

- The trajectory for interest rates in the short-term may prove more favourable than assumed in these projections, which would boost households' income and support consumer spending over the coming months;
- Weaker than expected global growth, or a more prolonged global downturn, would have a negative impact on foreign demand for our goods and services and lead to slower export growth. Simulations undertaken using the ESRI's HERMES model suggest that a 1% reduction in world GDP growth would lower the real level of Ireland's GDP by 0.9% in the first year and 1.3% in the fifth (see Table 7 below). The effects are broadly symmetrical, meaning stronger than expected global growth would boost the level of real GDP by similar orders of magnitude;
- The outlook for export growth is also subject to risks related to the composition of the products that we export. The composition of Irish exports is relatively concentrated and changes in demand or supply conditions for specific products can potentially have a large impact (both positive and negative).

**Table 7: Effect on the Level of Real GDP of Changing Assumptions**

(% change from base)	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
1% change in world growth	+/-0.9	+/-1.5	+/-1.7	+/-1.5	+/-1.3
1% pt change in savings rate	+/-0.3	+/-0.3	+/-0.3	+/-0.3	+/-0.3

Source: Department of Finance.

In addition to the above, there are risks stemming from the unusual circumstances that currently prevail on the external front. Obviously, the euro area sovereign debt crisis, and the global financial market instability that it is giving rise to, is a major factor. On the other hand, a strong policy response at European level could create the potential for some upside risk on this front.

Domestically, the scale and speed of balance sheet repair on the part of firms and households remains uncertain. A key feature of the current set of macroeconomic forecasts is that the household savings rate remains relatively high over the medium term. While there is clearly a deleveraging aspect to this, there is also a precautionary element. If confidence was restored and uncertainty was to dissipate more rapidly than currently anticipated, the savings rate could fall at a faster pace. Again, the HERMES model is used

to assess the impact of a faster unwinding of household savings on growth. It shows that a sustained 1 pp decline in the savings rate would boost the level of real GDP by 0.3% both immediately and after five years (see Table 7). Once again, the results are broadly symmetrical.

## **FISCAL OUTLOOK 2013-2015**

### *Rate of tax revenue growth to accelerate...*

Through the implementation of further consolidation over the 2013-2015 period as outlined in the *MTFS* and on the basis that growth in the economy will average 2.8% in real GDP terms on an annual basis, the General Government deficit will be below 3% of GDP by 2015. The Government is absolutely committed to ensuring this target is achieved.

Over the period 2013-15 nominal economic growth, the important measure from a tax revenue generation perspective, is forecast to average 4.1% per annum (in GDP terms). Boosted by the implementation of further, though declining, levels of adjustment on the revenue side, growth in tax revenues is expected to average around 6½% per annum over the period.

Economic growth will be largely export-driven, particularly so in the early part of the forecast period. As this type of growth is unlikely to generate as much in tax revenues as domestically-driven growth, total taxes in 2015 are forecast to be over €4 billion or around 8½% below their 2007 peak.

### *Revenue measures 2013-2015...*

The revenue measures adopted in *Budget 2012*, at around €1.7 billion inclusive of carry-forward, exceed slightly the target of €1.6 billion set in the *MTFS*. In delivering *Budget 2012* the Government did not increase income tax but instead placed the burden on indirect taxes such as VAT, excise duties, carbon tax and local taxes. This is based on the view that the primary focus has to be on job creation and, as far as possible, taxes on employment should be kept to a minimum.

The approach to 2013 to 2015 will be informed by the same principles. Conditions permitting, there will be no increases in the main income tax bands, rates or personal credits. The emphasis will be on all forms of indirect taxation and a substantial broadening of the tax base generally. The strategic objective is to ensure that the burden of taxation is spread in a manner that is both fair and sustainable in the longer term through the taxation of, for example, immobile assets rather than employment.

This approach will not preclude base broadening in the area of income tax. This could include curtailment, reduction or abolition of a variety of income tax reliefs, a substantial broadening of the PRSI base (announced as part of *Budget 2012*) and a further reduction in the tax related costs of private pension provision. Table 8 gives an outline of possible indicative sources of additional revenue over the next three years.

**Table 8: Indicative Revenue Raising Measures 2013-2015**

€ million	2013		2014		2015		Total
	<i>c/f</i>	New	<i>c/f</i>	New	<i>c/f</i>	New	
Direct & Capital Taxes	71	415	195	300	130	330	1,441
Indirect Tax	149	420	65	100	20	100	854
Local Tax		125		440		120	685
Sub-Total	220	960	260	840	150	550	
<b>Total (inclusive of c/fwd)</b>		<b>1,180</b>		<b>1,100</b>		<b>700</b>	<b>2,980</b>

Source: Department of Finance.  
Rounding can affect totals.

As set out in the *MTFS* revenue measures amounting to a cumulative €4.65 billion for the period 2012 to 2015 are envisaged. Taking account of the *Budget 2012* measures Table 8 sets out the indicative path to achieve this overall total.

**Table 9: Revenue Consolidation Targets 2012-2015**

€ billion	2012	2013	2014	2015	Total
MTFS Target	1.6	1.25	1.1	0.7	4.65
Post-Budget	1.7	1.2	1.1	0.7	4.65

Sources: Department of Finance.  
Rounding can affect totals.

The Government will seek, insofar as is practically possible, to implement the measures in a fair and equitable manner that will not unduly hamper the economic recovery that is underway.

*General Government deficit below 3% of GDP by 2015...*

The fiscal projections in Table 10 show the steady improvement in the Exchequer position from a forecast deficit of €18.9 billion in 2012 to €7 billion in 2015. Based on the current assessment, this is viewed as being sufficient to bring the General Government measure of the deficit below the 3% of GDP target by 2015. Tables 11 and 12 in Annex I set out the public finance forecasts on a General Government basis.

**Table 10: Public Finance Forecasts 2011-2015**

<i>€ millions</i>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<b><u>CURRENT BUDGET</u></b>					
<b><u>Expenditure</u></b>					
Gross Voted Current Expenditure	53,070	51,880	50,590	48,715	47,355
Non-Voted (Central Fund) Expenditure	<u>6,550</u>	<u>8,985</u>	<u>9,720</u>	<u>10,565</u>	<u>10,945</u>
<b>Gross Current Expenditure</b>	<b>59,620</b>	<b>60,865</b>	<b>60,310</b>	<b>59,280</b>	<b>58,300</b>
less Expenditure Receipts and Balances	<u>11,475</u>	<u>11,365</u>	<u>11,445</u>	<u>11,600</u>	<u>11,910</u>
<b>Net Current Expenditure</b>	<b>48,145</b>	<b>49,500</b>	<b>48,865</b>	<b>47,680</b>	<b>46,390</b>
<b><u>Receipts</u></b>					
Tax Revenue	34,175	35,825	38,350	41,020	43,175
Non-Tax Revenue	<u>2,560</u>	<u>2,495</u>	<u>1,855</u>	<u>1,660</u>	<u>1,535</u>
<b>Net Current Revenue</b>	<b>36,735</b>	<b>38,320</b>	<b>40,205</b>	<b>42,680</b>	<b>44,710</b>
<b>CURRENT BUDGET BALANCE</b>	<b>-11,410</b>	<b>-11,180</b>	<b>-8,660</b>	<b>-5,000</b>	<b>-1,680</b>
<b><u>CAPITAL BUDGET</u></b>					
<b><u>Expenditure</u></b>					
Gross Voted Capital	4,635	3,935	3,375	3,255	3,255
Non-Voted Expenditure	<u>11,960</u>	<u>5,865</u>	<u>4,165</u>	<u>4,160</u>	<u>4,175</u>
<b>Gross Capital Expenditure</b>	<b>16,595</b>	<b>9,800</b>	<b>7,540</b>	<b>7,415</b>	<b>7,430</b>
less Capital Receipts	<u>315</u>	<u>305</u>	<u>335</u>	<u>320</u>	<u>320</u>
<b>Net Capital Expenditure</b>	<b>16,280</b>	<b>9,495</b>	<b>7,205</b>	<b>7,095</b>	<b>7,110</b>
<b>Capital Resources</b>	<b>2,485</b>	<b>1,815</b>	<b>1,780</b>	<b>1,870</b>	<b>1,770</b>
<b>CAPITAL BUDGET BALANCE</b>	<b>-13,795</b>	<b>-7,680</b>	<b>-5,425</b>	<b>-5,225</b>	<b>-5,340</b>
<b>EXCHEQUER BALANCE</b>	<b>-25,205</b>	<b>-18,860</b>	<b>-14,085</b>	<b>-10,225</b>	<b>-7,020</b>
<b>GENERAL GOVERNMENT BALANCE</b>	<b>-15,615</b>	<b>-13,650</b>	<b>-12,385</b>	<b>-8,505</b>	<b>-5,215</b>
<i>% of GDP</i>	-10.1	-8.6	-7.5	-5.0	-2.9
<b>Nominal GDP (rounded to nearest €25m)</b>	155,250	159,125	164,550	171,625	179,425

*Source: Department of Finance & Department of Public Expenditure & Reform.*

*Figures in Table 10 rounded to nearest €5 million.*

*Rounding can affect totals.*

## Annex I

**Table 11: General Government Budgetary Forecasts 2011-2015**

	ESA	<u>2010</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
		€m						
					per cent of GDP			
<i>Net lending (EDP B.9) by sub-sector</i>								
<b>1. General government (= 6 - 7)</b>	S.13	- 48,837	-31.3	-10.1	-8.6	-7.5	-5.0	-2.9
<b>2. Central government</b>	S.1311	- 7,955	-30.7	-9.9	-8.5	-7.4	-4.8	-2.8
<b>3. State government</b>	S.1312	n/a	n/a	n/a	n/a	n/a	n/a	n/a
<b>4. Local government</b>	S.1313	33	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
<b>5. Social security funds</b>	S.1314	-915	-0.6	0.0	0.0	0.0	0.0	0.0
<i>General government (S.13)</i>								
<b>6. Total Revenue</b>	TR	53,956	34.6	34.9	34.5	34.7	34.8	34.6
<b>7. Total Expenditure</b>	TE	102,793	65.9	44.9	43.1	42.2	39.8	37.5
<b>8. Net lending/borrowing (= 6 - 7)</b>	B.9	- 48,837	-31.3	-10.1	-8.6	-7.5	-5.0	-2.9
<b>9. Interest expenditure</b>	D.41	4,891	3.1	3.3	4.2	5.6	5.8	5.7
<b>10. Primary balance (= 1 + 9)</b>		- 43,946	-28.2	-6.7	-4.4	-1.9	0.8	2.8
<b>11. One-off and other temporary measures</b>		- 30,949	-19.8	0.0	0.3	0.0	0.0	0.0
<i>Selected components of revenue</i>								
<b>12. Total taxes (12=12a+12b+12c)</b>		34,463	22.1	23.7	24.0	24.7	25.2	25.4
12a. Taxes on production and imports	D.2	17,796	11.4	11.4	11.3	11.3	11.2	10.8
12b. Current taxes on income, wealth etc.	D.5	16,430	10.5	12.1	12.5	13.2	13.8	14.4
12c. Capital taxes (CAT)	D.91	237	0.2	0.2	0.2	0.2	0.2	0.2
<b>13. Social contributions</b>	D.61	11,751	7.5	6.8	6.5	6.4	6.3	6.2
<b>14. Property Income</b>	D.4	2,704	1.7	1.5	1.7	1.6	1.5	1.4
<b>15. Other</b>		5,039	3.2	2.9	2.4	1.9	1.8	1.7
<b>16. (=6) Total revenue (=12+13+14+15)</b>	TR	53,956	34.6	34.9	34.5	34.7	34.8	34.6
<b>p.m.: Tax burden</b>		46,614	29.9	30.8	30.8	31.4	31.9	31.9
<i>Selected Components of Expenditure</i>								
17a. Compensation of employees	D.1	18,321	11.7	11.8	11.3	10.8	10.2	9.6
17b. Intermediate consumption	P.2	9,436	6.0	6.0	5.6	5.3	4.7	4.3
<b>18. Social payments (18 = 18a+18b)</b>		28,029	18.0	17.3	16.9	15.7	14.5	13.6
18a. Social transfers in kind supplied via market producers	D.63	3,299	2.1	2.1	2.1	2.0	1.9	1.7
18b. Social transfers other than in kind	D.62	24,730	15.9	15.2	14.8	13.7	12.7	11.9
<b>19=9 Interest expenditure</b>	D.41	4,891	3.1	3.3	4.2	5.6	5.8	5.7
<b>20. Subsidies</b>	D.3	839	0.5	0.6	0.5	0.5	0.5	0.4
<b>21. Gross fixed capital formation</b>	P.51	5,840	3.7	2.7	1.5	1.6	1.5	1.4
<b>22. Other</b>		35,437	22.7	3.2	3.0	2.7	2.5	2.4
<b>23=7 Total expenditure (= 17a+17b+18+19+20+21+22)</b>	TE	102,793	65.9	44.9	43.1	42.2	39.8	37.5
p.m. : Government consumption (nominal)	P.3	26,169	17.0	18.4	17.5	16.2	14.5	13.7

*Sources: Department of Finance, Department of Public Expenditure, CSO and NTMA estimates. Rounding may affect totals.*

**Table 12: Explanation of Net Difference between Exchequer Balance and General Government Balance (GGB)**

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
(a) Exchequer Balance	-18,745	-25,205	-18,860	-14,085	-10,225	-7,020
(b) Interest adjustments	-1,190	-1,045	30	-1,835	-1,720	-1,675
(c) Exclude equity and loan transactions	285	7,015	1,910	165	55	145
(d) Net borrowing/lending of non-commercial State sponsored bodies	165	100	70	105	85	45
(e) Adjustments for Transactions between the Exchequer, Government Departments/ Offices and Extra-Budgetary Funds	-490	-205	-235	-65	-60	-40
(f) Impact of the National Pensions Reserve Fund	1,955	440	265	295	305	310
(g) Accrual Adjustments	915	400	285	150	170	135
(h) Promissory Notes issued to Financial Institutions	-30,850	3,085	3,085	3,085	3,085	3,085
(j) Net (Borrowing)/Surplus of Central Government (= a to h)	-47,955	-15,415	-13,450	-12,185	-8,305	-5,015
(k) Net Surplus of the Social Insurance Fund	-915	0	0	0	0	0
(l) Net (Borrowing)/Surplus of Local Government	35	-200	-200	-200	-200	-200
(m) General Government Balance (= j + k + l)	-48,835	-15,615	-13,650	-12,385	-8,505	-5,215
(n) General Government Balance as % of GDP	-31.3%	-10.1%	-8.6%	-7.5%	-5.0%	-2.9%
(p) Nominal GDP (rounded to nearest €25m)	156,000	155,250	159,125	164,550	171,625	179,425

Sources: Department of Finance, Department of Public Expenditure, CSO and NTMA estimates.  
Rounding may affect totals.

**Notes to Tables 11 & 12:**

- The breakdown between revenues and expenditure in the years 2012-2015 takes account of the proportionate adjustment indicated in the *Comprehensive Expenditure Report 2012-2014*, *Budget 2012* and the *MTFS*.
- Interest expenditure reflects the accrued interest payable on Promissory Notes issued to financial institutions and a Eurostat ruling that there would be no interest payable on these Promissory Notes for the years 2011 and 2012<sup>6</sup>.
- 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.
- The General Government Balance (GGB) 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 Social Insurance Fund and the National Pensions Reserve Fund which are managed by Government agents. It thus provides an accurate assessment of the fiscal performance of a more complete "Government" sector.
- The GGB does not reflect the position of commercial State sponsored bodies as these agencies are classified as being outside the General Government sector. The GGB is calculated in accordance with ESA95, a consistent standard developed by the EU to facilitate budgetary

<sup>6</sup> A very minor amount of interest accrues to 2011 and 2012 in respect of the €250 million Promissory Note committed to EBS.

comparisons between EU Member States in accordance with their obligations under the Maastricht Treaty.

- b) This adjustment reflects the requirement, under ESA95 rules, that changes in the assets of the Capital Services Redemption Account and capital gains or losses on foreign exchange contracts, swaps, etc., should be excluded from the interest recorded for the purposes of calculating the GGB. An adjustment for interest accrued but not paid on small savings is also included, as is an adjustment for FISIM. Accrued interest payable on the Promissory Notes issued to financial institutions is also included.
- c) Equity and loan transactions are excluded from the GGB on the basis that they affect the composition but not the level of assets and liabilities.
- e) Transfers between units within the General Government sector do not affect the GGB.
- f) The National Pensions Reserve Fund (established in 2001) is within the General Government sector and transactions within the sector do not have an impact on the GGB. These figures include income earned on the investments made by the NPRF. There is no provision for a 1% of GNP payment from the Exchequer into the NPRF for the years 2011 to 2015.
- g) This adjustment is required in respect of certain transactions recorded on an accruals basis in calculating the GGB. These include tax accruals, Departmental balances, EU transfers, and the impact of the capital envelopes facility, which allows a carryover of up to 10% of Departmental capital spending into the following year in accordance with Section 91 of the Finance Act 2004.
- h) This reflects the amounts committed in Promissory Notes to certain financial institutions in 2010. These amounts are paid in equal instalments of 10% of the principal sum. The full GGB effect of the Promissory Notes principal sum is shown in 2010, and as the Exchequer pays this money to the financial institutions, the effect of this is removed from the GGB in subsequent years.

## Annex II

**Table 13: General Government Debt Developments 2011-2015**

<i>% of GDP</i>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Gross debt	107	115	119	118	115
Change in gross debt (=1+2+3)	14.8	7.3	4.5	-1.2	-3.3
<i>Contributions to change in Gross Debt Ratio:</i>					
1. General Government Deficit	10.1	8.6	7.5	5.0	2.9
2. Stock-flow adjustment	4.3	1.3	0.8	-1.3	-1.1
3. Nominal GDP	0.4	-2.6	-3.8	-4.9	-5.1
<i>Composition of GGB</i>					
4. General Government Balance	-10.1	-8.6	-7.5	-5.0	-2.9
5. Interest expenditure	-3.3	-4.2	-5.6	-5.8	-5.7
6. Primary balance ( = 4 - 5 )	-6.7	-4.4	-1.9	0.8	2.8
<i>Composition of Stock-flow Adjustment</i>					
7. Change in Exchequer deposits	-0.9	-0.4	1.1	-1.7	-1.5
8. Interest adjustments	-0.3	0.0	-0.8	0.1	0.0
9. Net banking recapitalisation	4.2	0.8	0.0	0.0	0.0
10. Accrual adjustments	0.3	0.2	0.1	0.1	0.1
11. Impact of NPRF	0.3	0.2	0.2	0.2	0.2
12. Other	0.8	0.5	0.2	0.1	0.2
<i>Memorandum Item:</i>					
Average interest rate (%)	3.6	4.0	5.1	5.1	5.0

*Sources: Department of Finance and NTMA estimates.*

*Rounding can affect totals.*

## Annex III

### Cyclically-Adjusted Budget Balance

A frequently used tool in the analysis of fiscal policy is the structural budget balance – the balance that would prevail if transitory elements in the headline balance owing to economic fluctuations are removed. Unfortunately, decomposing the headline General Government balance (GGB) into its temporary and permanent components is subject to considerable uncertainty, as neither component can be directly measured and must be estimated.

This is problematic as the approaches available for this purpose are all subject to some limitations. For open economies such as Ireland's, these limitations are particularly marked, while the very significant structural shocks that the Irish economy has experienced in recent years are a further complicating factor. These are important caveats and should be borne in mind when looking at Table 14.<sup>7</sup>

**Table 14: Cyclical Developments**

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
<i>Economy</i>					
1) Real GDP growth (%)	1.0	1.3	2.4	3.0	3.0
2) Potential GDP growth (%)	-0.5	-0.2	1.0	1.3	1.8
<i>Contributions:</i>					
- labour	-1.6	-1.4	-0.4	-0.3	0.1
- capital	-0.1	-0.1	0.0	0.0	0.1
- total factor productivity	1.2	1.3	1.5	1.5	1.6
3) Output gap <sup>^</sup>	-3.8	-2.3	-1.0	0.7	1.9
<i>Public Finances (% of GDP)</i>					
4) Net lending of general government	-10.1	-8.6	-7.5	-5.0	-2.9
5) Interest expenditure	3.3	4.2	5.6	5.8	5.7
6) One-off measures	0.0	0.3	0.0	0.0	0.0
<i>Structural Fiscal Developments (% of GDP)</i>					
7) Cyclical budgetary component (=0.4*3)	-1.5	-0.9	-0.4	0.3	0.8
8) Structural budget balance (=4-6-7)	-8.6	-8.0	-7.1	-5.3	-3.7
9) Structural primary balance (=8+5)	-5.3	-3.8	-1.5	0.5	2.0

*Source: Department of Finance calculations using the EU's common methodology where relevant.*

*Rounding can affect totals.*

<sup>^</sup> *For illustrative purposes and for simplicity, the 2012 output gap can be approximated from the output gap in 2011 (-3.8%) and the difference between the actual growth rate in 2012 and the potential growth rate (i.e. + 1.5 pp). A similar approximation can be done for later years.*

Table 14 decomposes the General Government Balance into its temporary (cyclical) and permanent (structural) components. The starting point is identifying the cyclical position of the economy, which is estimated on the basis of a harmonised production function methodology developed jointly by the European Commission and Member States. The idea is to estimate the difference between aggregate demand and aggregate supply. The latter - potential output - is determined on the basis of available quantities of capital and labour, along with estimates of trend total factor productivity (TFP). The difference between aggregate demand and supply, which is known as the output gap, establishes the cyclical

<sup>7</sup> See the Pre-Budget Outlook, November 2009, and the Stability Programme Update, April 2011, for a discussion of some of the shortcomings associated with this type of decomposition in an Irish context.

position of the economy. The elasticity of the budget balance with respect to the economic cycle is estimated to be 0.4 in the case of Ireland.

On the basis of this approach, a significant part of the 2012 deficit would appear to be structural in nature. While this would accord with the general view that a large part of the deficit will not be eliminated with economic recovery, the exact size of the structural element is, of course, highly uncertain. Moreover, further out the forecast horizon, the production function methodology implies a positive output gap – that overheating pressures are emerging, which does not appear realistic. This, in turn, has implications for estimates of the size of the structural deficit in later years, and warrants caution in the interpretation of the figures.