Irish Economic Update

AIB Treasury Economic Research Unit

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Budget 2024

Strong Public Finances

Today's budget contained a fresh package of cost of living support measures totalling €2.7bn that will be rolled out over the winter months. These are mainly taking the form of direct household payments and energy credits. The Government is also providing an additional €6.4bn in other spending increases and tax cuts for next year. Core spending is to rise by 6.1% next year, including an 8.8% increase in capital spending. Thus, fiscal policy is set to remain supportive of economic activity. The Irish Fiscal Advisory Council, though, is concerned the budget may be overly pro-cyclical, although the degree of additional spending over what it would prefer, is small.

Furthermore, the public finances are in a very strong state. Although corporation tax receipts have come under some downward pressure as this year has progressed, the Dept. of Finance is still able to project budget surpluses of €8.8bn (3% of GNI) for 2023, €8.4bn (2.7% of GNI*) in 2024 and €14.2bn (4.4% of GNI*) in 2025. The net National Debt/GNI* ratio is also projected to continue declining, falling to 63% in 2023 and 60% by 2025, relatively low levels. Meantime, in order to address future spending pressures, especially from an ageing population, the Government is establishing two new Savings Funds to warehouse budget surpluses.*

2024 Budget: Key Points

- **Today's budget was set against the backdrop of a continuing high level of inflation, though it is well down from last year's peak,** with the annual HICP rate now running at 5.0%. Thus, there was pressure on the Government to introduce a fresh package of measures to help alleviate some of the continuing impacts of the cost of living crisis on households, especially in relation to ongoing very high energy bills.

- The Government faced a delicate balancing act in the budget of providing financial supports while, at the same time, avoid adding to inflationary pressures. Thus, there was a focus on targeted measures to provide support to those most impacted by the cost of living crisis, as well as some universal payments. **The cost of the package at €2.7bn, is also down from the €4bn in supports announced in last year's budget.**

- **The budget also provided for the usual broad array of increased spending across Government departments. In total, core government spending will rise by €5.3bn or 6.1% in 2024, which includes an 8.8% increase in capital expenditure.** The marked rise in tax receipts since 2020 slowed considerably this year, in particular corporation tax. Tax revenues are now projected to rise by 6.2% in 2023 and increase by 4.8% in 2024, after allowing for the cuts in income tax announced in today's budget.

- **The Dept. of Finance is expecting a general government budget surplus of €8.8bn, or 3% of GNI* in 2023,** up slightly from €8.5bn last year. **The budget surplus is forecast to be largely unchanged again in 2024 at €8.4bn (2.7% of GNI*), before rising to €14.2bn in 2025 (4.4% of GNI*),** pointing to strong, stable public finances. Furthermore, the Government is establishing two new Savings Funds to park these surpluses to help address future spending pressures, in particular from the ageing of the population and climate change.

- The public debt rose sharply in 2020-21 during the COVID-19 pandemic, which pushed the budget finances back into deficit. It has been in decline over the past two years, though, with the return of large budget surpluses. **Key public sector debt ratios are also in marked decline again.** The net National Debt metric takes into account large cash balances arising from pre-funding. **The net National Debt to GNI* ratio is forecast to fall to 63% this year from 69% in 2022. It is projected to decline to 60% by 2025.**

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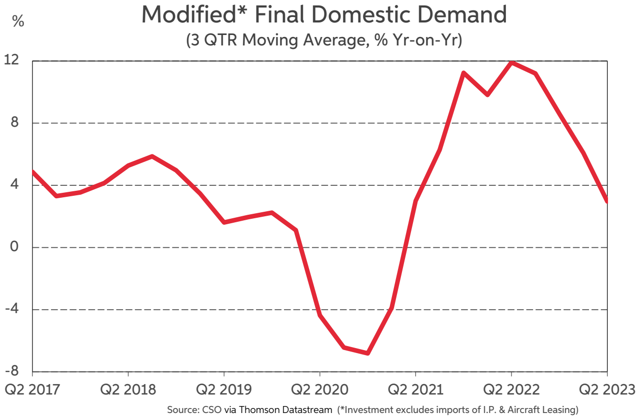
Sharp slowdown in Irish growth, but economy in good shape

- **The rate of growth in the Irish economy has decelerated markedly this year from the breakneck speed seen in 2021 and 2022.** Just to recall, Irish GDP grew by 15.1% in 2021 and 9.4% in 2022, while Modified Final Domestic Demand (MFDD), expanded by 7.3% in 2021 and 9.5% last year. The first half of 2023 has seen a **sharp decline in the output of multi-nationals operating in the manufacturing sector and thus goods exports,** as well as weaker growth elsewhere in the economy.

- As a result, GDP growth slowed very sharply to just 0.2% year-on-year in H1 2023 from the very rapid rates seen in 2021-22. Growth in the domestic economy also slowed rapidly, with MFDD rising by 1.9% yoy in H1' 23. Consumer spending was the main contributor to growth, increasing by 3.75% yoy. **The real damage, though, is being done by export growth** which slumped to 1.4% yoy in H1 '23 from 14-15% in 2021-22, reflecting the aforementioned sharp fall in manufacturing output and goods exports.



- **Other data, though, point to the economy continuing to perform well this year.** Labour market figures show the **unemployment rate has fallen to a 4.1-4.2%** range in the first three quarters of 2023, down from 4.5% in 2022. Employment growth has remained strong, averaging 3.8% year-on-year in H1 2023, with the number at work at mid-year up by over 2% from its end 2022 level. Meantime, the IDA has reported that inflows of foreign direct investment remained elevated in the first half of 2023.

- In terms of the financial fundamentals, Ireland continues to enjoy a very large balance of payments surplus, the general government budget remains in strong surplus too, while **private sector balance sheets are characterised by low levels of debt and high savings. Inflation has also fallen sharply this year.** The HICP rate stood at 5.0% in September, down from a peak of 9.6% in summer 2022. Meanwhile, the core HICP rate has declined to 4.5% from 6.2% in March. Thus, although growth has come off the boil this year, the economy remains in very good shape.

- **Global growth is expected to remain subdued over the next couple of years** in the face of numerous headwinds, including a continuing restrictive monetary policy stance. Meanwhile, **capacity constraints are becoming more binding on the domestic front.** Thus, while the Irish economy is expected to expand in the period ahead, it is projected to be at a more moderate pace than in recent years, albeit GDP growth should be stronger than the low figure now expected for 2023.

- This is reflected in **the latest Dept. of Finance macro economic forecasts. GDP is projected to rise by 2% in 2023 and 4.5% in both 2024 and 2025.** Meanwhile, MFDD is forecast to grow by 2.2% in 2023 and 2024 and 2.5% in 2025. The labour market is expected to remain tight. Although jobs growth is set to moderate, the unemployment rate projected to remain very low at 4.2% next year and 4.3% in 2025. **In terms of inflation, the Dept. sees the HICP rate averaging 5.3% this year, down from 8.1% in 2023. It is seen falling to 2.9% in 2024 and to 2.4% by 2025.** Inflation will benefit from an easing in energy price inflation as large price increases in utility bills drop out of the annual rate and energy price cuts start to take effect. Food price inflation is also moderating. Meantime, core inflation is seen averaging 5.1% this year, falling to 3.4% in 2024 and 2.5% in 2025.

DEPT OF FINANCE ECONOMIC FORECASTS

(%)	2022	2023(f)	2024(f)	2025f)
GDP	**9.4**	**2.0**	**4.5**	**4.5**
GNP	**3.9**	**1.0**	**4.0**	**4.0**
Mod Dom Demand	**9.5**	**2.2**	**2.2**	**2.5**
Private Cons	9.4	3.3	3.2	2.3
Gov Expd.	3.5	1.7	1.4	0.1
Mod. Fixed Inv.	15.9	-0.2	0.1	5.0
Exports	13.9	2.1	5.3	4.8
Mod. Imports	18.9	2.1	4.1	3.5
HICP	8.1	5.3	2.9	2.4
Employment	6.6	3.4	1.3	1.3
Unemploy. Rate	4.5	4.1	4.2	4.3

Source: Dept. of Finance, October 2023

Budget finances projected to remain in significant surplus

- A General Government surplus target of €6.2bn was initially set for this year in Budget 2023. This was revised up to €10bn in the Stability Programme Update last April following a much better than expected budgetary outturn for 2022. The past six months, though, have seen a slowdown in tax revenues, especially corporation tax receipts, as well as spending overruns emerge in some Departments. **Thus, the Dept. of Finance now expects the budget surplus to be in the region of €8.8bn in 2023 (3.0% of GNI*).** This is broadly unchanged from the surplus of €8.5bn recorded in 2022 (3.1% of GNI*).

- **The General Government budget balance is expected to remain in significant surplus in the coming years. The Government is targeting surpluses of €8.4bn (2.7% of GNI*) in 2024, rising to €14.3bn in 2025 (4.4% of GNI*).** It is assumed there will be a big fall-off in temporary spending measures in 2025. Note the Exchequer surplus is significantly lower because of large transfers of government monies to the new National Savings Funds. Meanwhile, the current budget surplus has become very large, at close to €17.5bn in 2023. Hence, Ireland's sizeable Exchequer capital spending programme is being fully financed from government revenues rather than State borrowings.

- The opening Exchequer surplus for 2024, which is before any new policy measures or changes were announced in today's budget, was €9.4bn. The new spending measures unveiled in the budget today, tax cuts and transfer of €4.3bn to the Savings Fund reduces **the projected Exchequer surplus to €1.8bn in 2024**.

- The greatest uncertainty around the Dept.'s budget projections is usually in relation to tax receipts. They have grown very strongly in recent years. **Tax revenues are forecast at €88.35bn in 2023, far above their levels of €57.2bn in 2020 and €59.3bn in 2019.** This reflects the strong post-COVID rebound in the economy in 2021-22 as well as very buoyant growth in **corporation tax receipts. These have almost doubled from €12bn in 2020 to a projected €23.5bn in 2023.**

BUDGETARY PROJECTIONS : 2023 - 2025

(€ bn)	2023	2024	2025
Net Current Expenditure	73.0	75.1	75.0
Net Current Revenue	90.4	93.7	99.3
Current Budget Balance	17.4	18.6	24.3
Capital Budget Balance	-15.2	-16.8	-20.2
EXCHEQUER BALANCE	2.2	1.8	4.0
GEN GOV BALANCE	8.8	8.4	14.3
% of GNI*			
Gen Gov Balance	3.0	2.7	4.4
Interest Expd	1.1	1.1	1.1
Primary Balance	4.1	3.8	5.5

Source: Dept. of Finance October 2023

- **The Dept. sees tax receipts rising by a further 4.8%, or €4.3bn, to €92.6bn in 2024.** This may prove cautious given the quite solid nominal growth that is being forecast for the economy next year. Of the main tax heads, income tax, VAT and excise duties are forecast to register good growth in 2024. Meanwhile, the rate of corporation tax for very large companies is to be increased next year from 12.5% to 15%, in line with BEPS Pillar 2. This should give a big boost to corporation tax receipts. However, the Dept. is forecasting a rise of only 4% in corporation tax for 2024, though we think the 2023 outturn may be below its latest projection.

- There are also concerns that the sharp rise in revenues from this tax head in recent years will not be sustained. **The Dept. estimates that up to €10.8bn of the €23.5bn in corporation tax receipts in 2023 could be 'windfall' in nature.** Furthermore, there will be a revenue loss from corporates at some stage in the coming years when BEPS Pillar 2 is implemented. It seeks to reallocate some of the taxable profits of certain large firms to countries where their sales take place. Thus, forecasting corporation tax receipts is becoming even more difficult with the major overhaul of the global corporate tax system, which starts to take effect next year.

- Meanwhile, some tax raising measures were announced in the budget in the form of higher carbon taxes and tobacco duties. In terms of **personal tax cuts**, the main changes were a widening of the 20% income tax band, modest increases in tax credits and a cut to the lowest USC rate. The cost of these tax cuts amounts to €1.3bn.

Fiscal Advisory Council critical of breach of spending rule limit

- **Overall, gross voted spending is projected to rise by 3.7% or €3.4bn to €96.5bn in 2024. This includes** temporary spending measures (Ukrainian refugees, Cost of Living) of the order of €5.4bn. Core spending is forecast to rise by €5.3bn in 2024 after an increase of €5.9bn in 2023. In terms of the budget today, there was a package of social welfare increases amounting to €1.1bn, including a rise of €12 a week in core welfare payments, as well as additional resources for areas such as child care, and a targeted mortgage interest relief package.

- The **Government's own National Spending Rule** is to limit the growth in core spending net of new tax measures to **no more than 5%** each year. The spending plans as set out in the Dept.'s Stability Programme Update last April were broadly in line with this target. However, **Budget 2024 has provided for a 6.1% increase in core spending next year. This has drawn strong criticism from the Irish Fiscal Advisory Council saying it adds to the pro-cyclical stance of fiscal policy and could lead to more persistent inflationary pressures**. In its view, there will now be an overly expansionary stance to fiscal policy in the coming years.

- **The Government has countered that the spending breach is small** at just over €1bn, and is justified given higher inflation and because the population and economy have grown more rapidly than expected, putting pressure on infrastructure and public services. **It notes most of the additional spending is on capital projects to ease capacity constraints in the economy.** The Fiscal Council may be on stronger grounds in being critical of the continued use of one-off or temporary spending measures, which are thus classed as non-core, given that some are becoming multi-annual expenditure items, especially in regard to supports for refugees.

Limited amount of bond issuance again in 2024

- **The forecast general government budget surpluses of €8.4bn in 2024 and €14.2bn in 2025 are reassuring given there are some doubts about the sustainability of up to €11bn in corporation tax receipts,** which the Dept. is concerned may prove 'windfall' in nature. The large surpluses help future-proof the public finances from any significant fall-off in these tax receipts or a downturn in the global economy. The Government is establishing two new Savings Funds to park these surpluses to help address future spending pressures.

- General Government debt is a gross figure and thus somewhat misleading as it includes significant pre-funding, which is held in cash balances. **The net National Debt metric takes these cash and some other liquid balances into account. The Dept. estimates that the net National Debt to GNI* ratio will fall to 63% this year** from 69% in 2022 and 83% in 2021. The ratio is forecast to decline further to 60% by 2025.

- **The NTMA has just one bond maturing in 2024, which amounts to €9bn in size.** It continues to run very high cash and other balances, which stood at €32bn at end September. With a projected Exchequer surplus of €1.8bn in 2024 and large cash balances, it means that **next year's maturing debt of €9bn is already well pre-funded**. The NTMA, though, can be expected to be active in the market next year to maintain cash balances at a comfortable level, thereby helping to prefund 2025's maturing debt, which amounts to €11.5bn. However, total issuance is likely to be relatively small. It is worth noting that much of Ireland's debt is now long dated. Combined with high cash balances and the emergence of budget surpluses, it means that **the Irish sovereign is quite well insulted from the sharp upward move in global bond yields over the past couple of years.** Indeed, the Dept.'s latest debt interest payments projections show that these are expected to remain at a relatively low level over the next number of years, again underlining the strength of the public finances.