Budget 2023

Irish Economy

Punch & Judicious

Economic Research **28 Sep 2022**

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Budget surplus despite large giveaway

Normality has not been resumed yet to fiscal policymaking in Ireland after the COVID splurge, with the energy and cost-of-living crisis necessitating another aggressive set of policies to help households and businesses through what is likely to be a tough winter. Budget 2023 introduces a suite of temporary and (mainly) targeted measures to offset the energy shock. While the Budget package is large, it is not irresponsible. In other words, it packs a punch, but is judicious. Ireland will still run a budget surplus in 2022 (0.4% of GNI*) and 2023 (2.2% of GNI*) even allowing for the €11bn budget package announced today, although the risks to these forecasts, given the growing international concerns, lie to the downside.

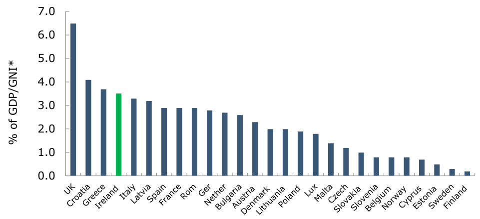
Budget balances across the euro area

Source: EC, DoF

Sensible decision to recognise vulnerability of corporate tax revenues

Headline budget aggregates in Ireland continue to be flattered by the boom in corporation tax revenues. These revenues are expected to top €21bn in 2022 and represent 26% of total tax revenues, up from 11% in 2014. These revenues are concentrated and unpredictable. The government has, somewhat belatedly, decided to transparently recognise this risk in the budget figures and to begin to move excess funds into a "rainy day" fund. This is a welcome development. Excluding estimated "excess" corporation tax receipts that may fall away over the coming years, the budget deficit is estimated at 3.1% of GNI* in 2022 and 1.4% in 2023. The latter figure is below the euro area average despite the large budget package announced today.

Government supports for energy crisis

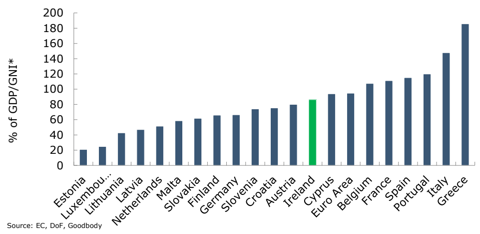


Source: Bruegel, DoF, Goodbody

Energy measures are more targeted, core spending must be managed too

The budget package was made up of €6.9bn in core measures and €4.1bn in temporary supports for businesses and households to deal with the energy price spike over the Winter months. These measures are different in scale and design to those recently introduced in the UK. They are largely targeted and incentivise energy conservation measures by consumers over the coming months through the price signal. While the latest measures are in a long line of "temporary" supports in recent years, core spending has also been growing strongly. Core spending is now above its long-term average (relative to GNI*). While spending measures have dominated recent budgets, Ireland must also concentrate of maintaining its attractiveness by way of competitive tax regime, particularly income tax among an internationally mobile workforce. This was only partly addressed in today's Budget.

Irish sovereign debt levels close to euro area average & falling



Source: EC, DoF, Goodbody

Low funding needs in 2023 amid rising bond yields

While the increase in bond yields has focused attention on the ability of certain countries to maintain debt sustainability over the coming years, Ireland is in a relatively strong position. This is due to an expected Exchequer surplus, large cash balances at the NTMA (€35bn) and a very low redemption need in 2023 (€7bn).

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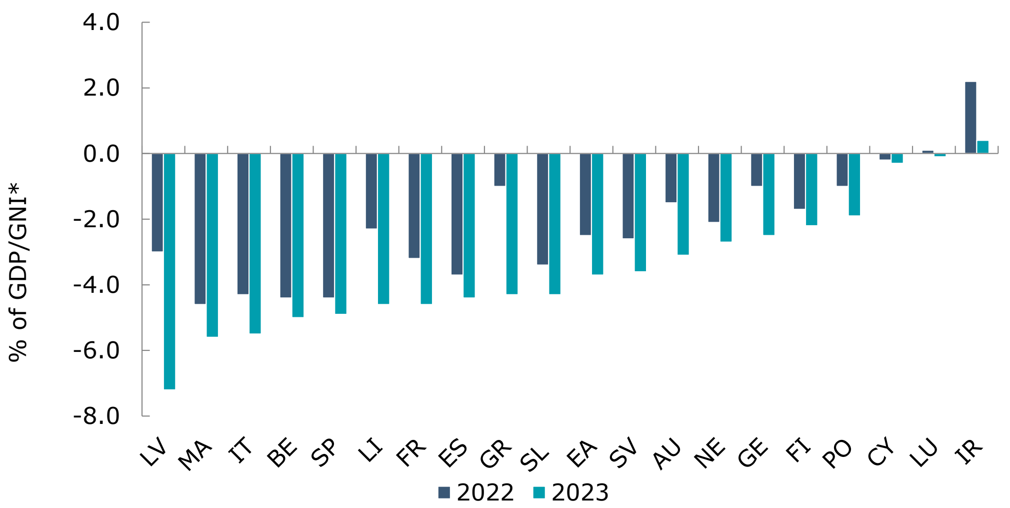
Boom in revenues

Ireland, like other countries, has become accustomed to announcing large fiscal packages in recent years. While 2023 was meant to mark a return to more "normal" policy, this will have to wait. In the *Summer Economic Statement* (SES) in July, the government announced that there would be a budgetary package of €6.7bn for 2023. This has been supplemented with an additional €4bn in measures in today's budget.

At a headline level, the Irish public finances were in relatively good shape in advance of the decisions announced today. In the first eight months of 2022, an Exchequer cash surplus of €6.3bn was recorded, with a general government surplus of €4.4bn (1.7% of GNI*) for 2022 expected prior to the announcements made today. As shown in the chart below, Ireland's fiscal position is estimated to be the best in the euro area both this year and next, even after the measures announced today.

Ireland's headline fiscal balance the strongest in the euro area



Source: European Commission, DoF, Goodbody

This headline balance is flattered somewhat by the boom in corporation tax revenues. These revenues are unpredictable, concentrated, and unreliable. Accounting for this, the Department of Finance (DoF) has for the first time published an estimate of the "windfall" element of these receipts and an estimate of the underlying budget deficit (GGB*). For 2022, the GGB* is -3.1%, with a deficit of 1.4% estimated for 2023. This adjusted deficit for 2023 is below the current estimate for the euro area overall.

Economic outlook downgraded but risks are still to the downside

The economic outlook is clearly deteriorating around the world, so it is no surprise that forecasts for 2023 have been downgraded by the Department of Finance in today's budget. The main influence here has been the large shift in the inflationary environment. Inflation (HICP) is now expected to average 8.5% and 7.1% in 2022 and 2023, respectively, up from 6.2 and 3.0% in April. Core inflation forecasts have also been revised up significantly. Core inflation is expected to average 5.3% in 2022, only falling to 4.6% in 2023 (3.9% and 3.3% previously).

On growth, the forecast for modified domestic demand (MDD) for 2022 has been upgraded (7.7% versus 4.2% previously) but has been downgraded from 3.9% to just 1.2% in 2023. While growth has consistently surprised to the upside in recent years, the risks to the near-term outlook are skewed to the downside given the synchronised global downturn that now appears to be in train.

Key forecasts underlying Budget 2023	2021	2022	2023	2024
GDP growth	13.6	10	4.7	3.3
Modified Domestic Demand	5.8	7.7	1.2	3.3
HICP	2.5	8.5	7.1	2.4
Core HICP	1.7	5.3	4.6	3
Modified Current A/c (% of GNI*)	11.1	8.4	7.7	7
Employment growth (%)	11	18.3	1.2	1.6
Unemployment rate	15.9	5.2	5.1	5
Budget balance (% of GNI*)	-3	0.4	2.2	3.7
Underlying budget balance (% of GNI*)	-5.1	-3.1	-1.4	0.6

Source: DoF, Goodbody

Household and energy supports key in Budget 2023

Budget 2023 contained a total of €11bn in new spending and taxation measures. The core package amounted to €6.9bn which was primarily focused on increased spending measures (€5.8bn), with the main element of the tax package (€1.1bn) being the increase to the higher-rate tax income tax band.

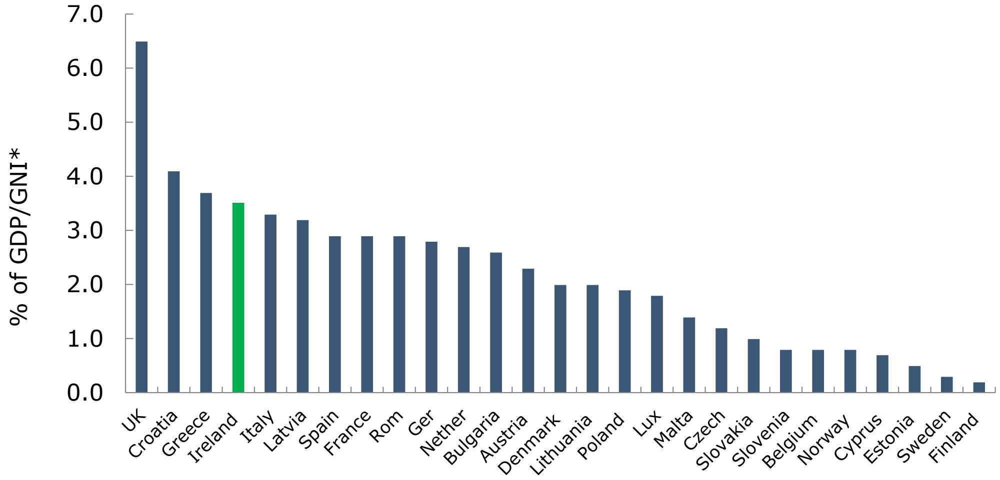
In addition to the core package, a cost-of-living package worth €4.1bn was also introduced. This includes household and business supports in both 2022 and 2023. €2.2bn will be provided to households through a range of targeted and untargeted supports. The primary energy support for businesses is in the form of an energy support scheme that will cover 40% of the increase in costs for firms up to €10,000 per month. Unlike the UK, the Irish government will not offset the full cost of the energy price increases, providing a price incentive for households and firms to reduce their energy use over the winter period.

Budget 2023 package of measures	Euro (bn)
Core package	**6.9**
Spending	5.8
Taxation	1.1
Cost of Living package	**4.1**
Net spending	2.2
D/ETE grants	0.2
Total cost-of-living expenditure measures	2.4
One-off tax measures	0.5
Temporary business energy support scheme	1.2
Total cost-of-living tax measures	1.7
Total Budget 2023 package	**11.0**

Source: DoF

In response to unprecedented energy inflation, the Irish government has allocated considerable funding towards the easing of the crisis to shield households and businesses. Including measures previously introduced in 2022, the Irish government has now provided €9.2 billion in a bid to alleviate the impact of soaring energy prices. This represents 3.5% of Irish GNI*. In comparison to other European nations the Irish government is adopting a relatively aggressive stance to mitigate the impact of the energy crisis, similarly to their response towards the Covid-19 pandemic, albeit behind that seen in the UK.

Energy supports for households and businesses compared

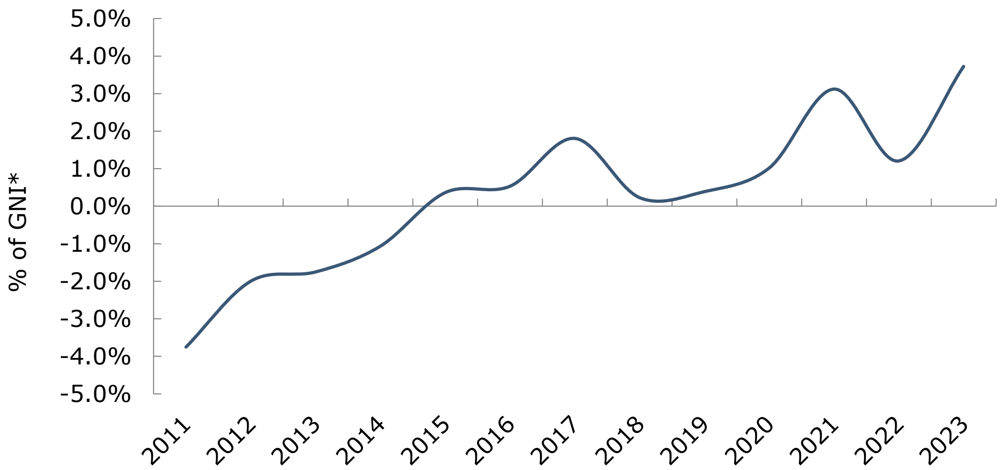


Source: Bruegel, DoF, Goodbody

How big is this budget day package?

There are several ways, such as the change in the structural balance, that the fiscal stance can be compared. In the chart below, we have taken the approach of comparing the pre-budget position with the balance that applies after the budget measures are taken account of. Combining the additional measures to be introduced both in 2022 and 2023, the total change in the deficit position in each year amounts to €9bn or 3.7% of GNI*. This is indeed large in an historical comparison. Ireland was traditionally poor at implementing counter-cyclical fiscal policy. While the economy remains strong, there is reason for the Irish government to be leaning against the wind as a more difficult 2023 approaches, thus a relatively expansionary budget (when one accounts for excess corporate tax revenues) makes sense.

Budget measures are large in an historical context

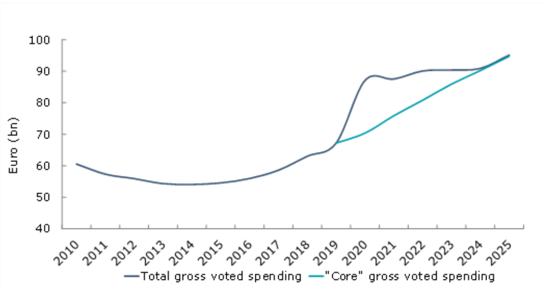


Source: CSO, Goodbody

Keeping an eye on "temporary" spending measures

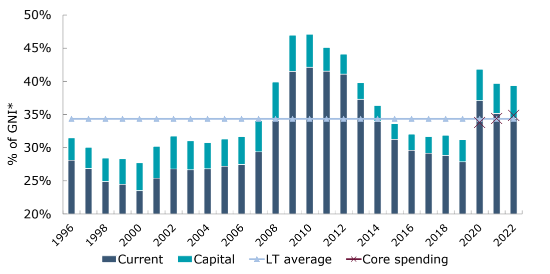
With Brexit, COVID and now the energy crisis, the Irish government has introduced a range of "temporary" supports to deal with various crises over recent years. Sensibly, the Department of Finance breaks out voted spending between "core" and "temporary" components. These are shown in the chart below. Temporary COVID spending resulted in a ballooning of public expenditure over the pandemic. However, core spending has also been growing relatively strongly, and the government decided today to make a temporary adjustment to its medium-term expenditure strategy to reflect the spending pressures resulting from the spike in inflation. This sees core spending rising by 6.5% in 2022 and 6.3% in 2023. This is above the sustainable growth in the economy but is understandable given the pressures on pay and public services. There are some areas of public spending, particularly health, where there are consistent overspending and poor outcomes. In the context of an aging population, this provides risks to the public finances over the medium-term.

Temporary spending has boomed...



Source: DoF, Goodbody

...but "core" spending has also grown rapidly



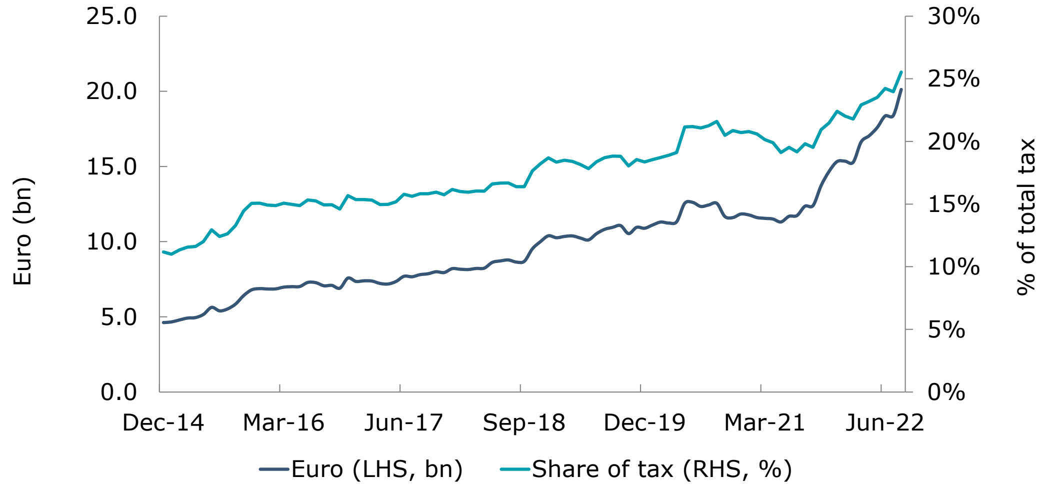
Source: DoF, CSO, Goodbody

Welcome decision to reinstate the "Pensions Reserve Fund"

The Irish government announced today that it would reinstate the Pensions Reserve Fund (previously the NPRF). This is essentially a rainy-day fund that will be funded by calculated excess corporate tax receipts. €2bn will be allocated to the fund in 2022, with a further €4bn earmarked for 2023. As a reminder, the NPRF reached c.€20bn at the time of the GFC and was subsequently used to partly recapitalise the banking system at the insistence of the Troika. Our hope and expectation is that it will be used to fund the rising costs of pensions over coming years or investment in the productive capacity of the economy.

The boom in corporate tax receipts has been both a blessing and a risk over recent years. It is positive to see the government be both transparent about these risks and proactive about banking at least some of these excess funds. As the following chart shows, corporation tax is estimated to rise to €22bn this year, but is highly concentrated among a small number of large multinationals.

Corporation tax accounts for 25% of total but is highly concentrated & vulnerable



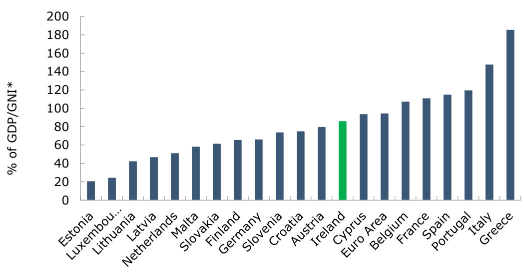
Source: DoF, Goodbody

Sovereign funding requirements are small in the period to end-2023

When measured relative to an appropriate denominator (GNI*) Irish debt levels (86%) are now estimated to be below the euro area average (95%) in 2022. The ratio is expected to fall further to 73% by 2025, with the nominal level of debt stabilising at c.€225bn. The net debt ratio, due to significant cash assets in the NTMA and the assets in the Ireland Strategic Investment Fund (ISIF), is substantially lower than these headline gross debt ratios. At the end of August, the NTMA states that it is maintaining €35.5bn in cash and liquid assets. At the end of 2022, the net debt ratio is estimated to be 73% of GNI*, falling to 58% of GNI* by 2025.

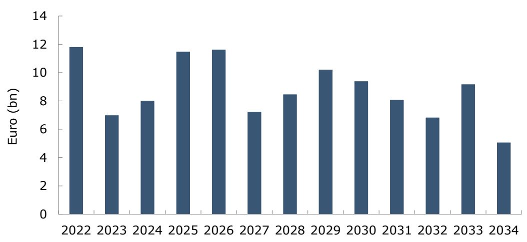
The recent increase in bond yields has rekindled concerns about sovereign debt funding around Europe. Ireland does not appear to have these concerns in the short-term. A €5bn bond maturing in October 2022 can be easily redeemed using the cash balances, while there is only one bond maturing in 2023 (€7bn in March 2023). With an Exchequer cash surplus of €1.7bn forecast for next year, Ireland is in a relatively comfortable funding position.

Debt levels in line with EA average



Source: NTMA

Modest debt redemptions in 2023



Source: NTMA

Budget Implications for PLCs

There was a small number of announcements that are relevant to our PLCs under coverage.

Housebuilders – Shane Carberry & Dudley Shanley

There were two announcements in Budget 2023 that are relevant to the housebuilders. Firstly, the Help-to-Buy scheme was extended for a further two years under its current rules. Along with the recently launched First Home scheme, these represent significant supports for First Time buyers, in line with the government's strategy of supporting home ownership. Separately, the government announced a levy on concrete blocks that it says will raise €80m in revenues to pay for the cost of Mica redress in parts of the country. The levy will be set at a rate of 10% of the cost of the concrete product, ex VAT, and will come into force from 3rd April 2023. Given this will be an additional cost for builders and developers, this is expected to increase building costs. This is a modest cost that the builders will aim to pass on to buyers.

Real Estate – Colm Lauder

Residential Tenant Tax Credit - A well flagged proposal from Government sources over the last few weeks, which was confirmed by the Minister for Finance this afternoon, is the introduction of a tenant tax credit for residential property. The policy will see the introduction of a new annual tax credit of €500 for renters in the private rented sector for those who are not in receipt of any other State housing support (such as the Housing Assistance Payment – HAP). The value of the credit will be doubled (to €1,000) in the case of married couples. It is proposed that the credit may be claimed "in year" in the years 2023 to 2025 and that, in addition, it may be claimed for 2022 from early in 2023. To put this into context, for a single person this equates to approx. 2.5% of the average annual IRES tenant rent (€1,688pcm as of June 2022) or 5% for a couple. A minor relief which will have little impact on the market, but welcome from an affordability perspective. Given that rent controls remain (annual growth cap of 2%) this is unlikely to feed through to increasing rents for in-situ properties, though may well be taken into account for new properties entering the market as units are priced.

Taxation policy changes for Irish Real Estate Funds (IREFs) and REITs - While not included in the main Budget text, the Minister for Finance did mention in his speech that he is "committing to commencing a review of the REIT and IREF regimes". However, the Minister acknowledges the role institutional investment has played in the provision of housing in recent years. This review will consider those structures and how best they can continue to support housing policy objectives. The Minister also outlined that he intends to "commence a review" of the use of Section 110 regimes and to establish a working group to consider the taxation of funds, life assurance policies and other investment products. No timeline or further details are yet available.

Banks – John Cronin & Ronan Dunphy

Budget 2023 was largely uneventful in terms of a direct impact on the Irish banking sector, although the scale of the various fiscal supports for households and businesses is clearly positive from an asset quality standpoint in the context of economy-wide inflationary pressures. The main point of note for us was that the bank levy has been extended to 2023 and the expected aggregate yield of €87m remains unchanged for next year. While we did not envisage a fundamental change to the levy, and we continue to believe that it is extremely unlikely that the current coalition government will undertake radical measures like we have seen in Spain, for example, there had been some speculation that the size of the levy could be increased up to €150m, i.e., the aggregate yield before the departures from the market of Ulster Bank and KBC Bank Ireland. As such, the absence of change on this point will be met with a degree of relief by the banking sector and its shareholders, although the Minister's comment that he "*will consider the long-term future of this levy*" following the publication of the report of the Retail Banking Review (due in November) should also be noted.

Elsewhere, the extension of the Help to Buy scheme for first-time buyers through to the end of 2024 is supportive for mortgage lending volumes, even though the extension did not come as a surprise and near-term concerns around mortgage affordability in the face of sharply rising interest rate expectations will continue to weigh.

Hotels – Nuala McMahon

As flagged, the temporary reduction in the VAT rate for hospitality (to 9% from 13.5%) will end as scheduled at the end of February 2023. This was widely expected by industry.

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