Budget 2024

Irish Economy

Something for everyone

Economic Research **10 Oct 2023**

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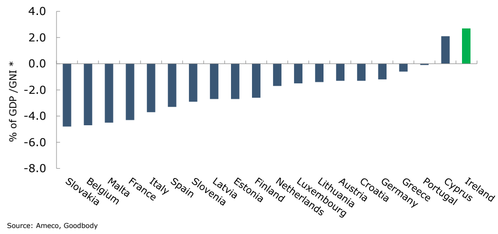
Budget surplus of 2.7% of GNI* despite budget giveaway

With an "embarrassment of riches" at his disposal, Minister for Finance Michael McGrath, in his first Budget, was able to provide something for everyone in Budget 2024 announced today. A falling debt burden and large budget surplus should please investors. Highlighting the extent of the resources available, this was done despite a large budget package of €14bn (4.6% of GNI*) being announced. A core spending increase of 6.1% is only modestly above its own 5% spending target. However, the additional "one-offs" (€7.5bn) do little to dampen inflation in the context of an economy with little or no spare capacity. Maintaining a greater level of prudence is difficult in the second half of an election cycle.

Budget balances across the euro area

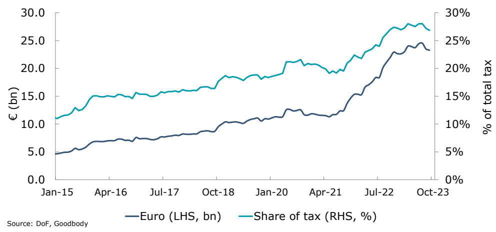


Source: Ameco, Goodbody

New sovereign wealth funds announced

Recognising the vulnerability of booming (but concentrated) corporation taxes (27% of total taxes), the Irish government followed through on its pledge to initiate two new investment funds to be partly funded by "excess" corporation tax receipts. The Infrastructure, Climate and Nature (ICNF) is expected to grow to €14bn and be used to ensure a stable level of capital spending on infrastructure in the event of a downturn in the public finances. The Future Ireland Fund (FIF) is to be used for longer-term pressures such as aging and climate change and may grow to €100bn by the middle of the next decade. Both developments are welcome.

Corporation tax accounts for 27% of total taxes

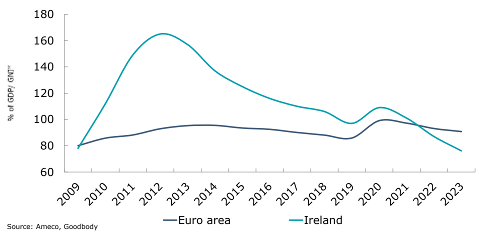


Source: DoF, Goodbody

Financial commitment to increasing housing supply is large

There is also clearly spending pressures in the short-term due to large population growth, wage pressures and infrastructure shortages, particularly in housing. It was announced today that the overall spending on housing will amount to a record €5bn in 2024. This will support the delivery of 9,300 new build social homes and a further 6,400 through the LDA and the HFA. In addition, it was also announced that the Help-to-Buy scheme will be extended to end-2025. Financial resources are not a constraint in aiding an increase in housing supply

Debt levels to continue to fall



Source: Ameco, Goodbody

A comfortable funding position entering 2024

Sovereign debt sustainability continues to improve despite a relatively large giveaway. Net debt may fall below 60% of GNI* by 2026, while the interest debt burden is expected to remain close to all-time lows of 1.2% of GNI*. With budget surpluses, a €28bn cash pool and only one bond worth €8bn redeeming in 2024, Ireland is in a very comfortable funding position in an era of rising interest rates. A funding target for 2023 of less than this year's range of €7bn-€11bn is likely, but the NTMA will be keen to maintain market access given the risks and historical precedent.

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Budget 2024 – Something for everyone

Budget 2024 was framed amidst an "embarrassment of riches" in the Irish public finances that are the envy of much of the rest of the euro area. The wider context was, however, a need to minimise procyclicality in a high inflation environment with an economy at full employment. This had to be done while also keeping an eye on the political implications of these fiscal decisions with an election just around the corner (by March 2025 at the latest).

How did the government fare in managing these competing interests? In our view, it was a mixed bag. On a positive note, the government managed to keep core expenditure growth relatively close to its 5% target (6.1% core expenditure growth expected). This is an acceptable outcome in the context of the high inflation environment and the surge in need due to population growth.

However, the series of non-core expenditure measures has been repeated once again. While these were necessary as a contingency against a hard-Brexit, as a counterbalance to the COVID lockdowns and for supporting businesses and households against an energy price spike, there is less justification at a time of full employment, falling energy prices and disinflation. Some of the tax and spending measures are targeted (such as mortgage interest relief), but some are universal in nature (energy credits, child benefit bonus). This will augment inflationary pressures in an economy already at full capacity.

Growth backdrop

As expected, growth forecasts have been revised downwards relative to the April *Stability Programme Update* (SPU). GDP is now expected to grow by 2.0% in 2023 (from 5.6% in April), with GDP expected to grow by 4.5% in 2024. On the preferred Modified Domestic Demand (MDD) metric, growth of 2.1% is expected in 2023 (2.2% in April), followed by 2.2% in 2024 (2.5% previously). The forecast downgrade (relative to the estimates set out in the *Summer Economic Statement)* are reflective of both the slowing international environment and the weaker than expected outturn for the Irish economy in the first half of 2023. Although global growth forecasts for 2023 have risen since the start of the year, the headwinds for 2024, including the impact of higher interest rates, a weaker consumer as COVID savings dwindle and a Chinese slowdown.

Growth outlook – main aggregates

	April SPU '23		Budget '24	
	2023	2024	2023	2024
Economic Activity:				
Real GDP	5.6	4.1	2.0	4.5
Real GNP	5.1	3.6	1.0	4.0
Modified Domestic demand	2.1	2.5	2.2	2.2
Real GNI*	1.6	2.1	2.0	2.0
Prices:				
HICP	4.9	2.5	5.3	2.9
Core HICP	4.4	3.2	5.1	3.4
Labour Market:				
Employment	1.6	1.4	3.4	1.3
Unemployment	4.4	4.5	4.1	4.2

Source: DoF

Summary of fiscal outlook

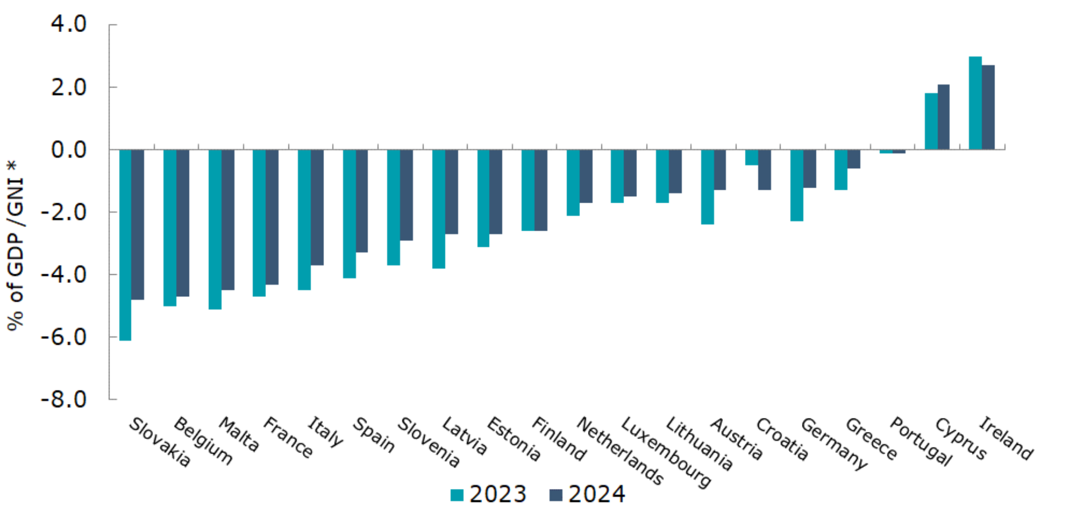
Relative to a pre-Budget estimate of a general government surplus of €12.5bn, the government is now projecting a surplus of €8.4bn in 2024 after today's budget measures. Relative to GNI*, this amounts to 2.7% and still compares favourably with the rest of the euro area. As it currently stands (but will be updated when full budget plans are released around the bloc), the average deficit in the euro area is estimated to be 2.5% of GDP in 2024, with Cyprus being only other country expected to be in surplus next year.

Main fiscal aggregates - Ireland

	April SPU '23		Budget '24	
	2023	2024	2023	2024
General government balance (€bn)	10.0	16.2	8.8	8.4
General government balance (% of GNI*)	3.5	5.4	3.0	2.7
General government balance, exc. Windfall CT (% of GNI*)	-0.6	1.5	-0.7	-0.9
Structural budget balance (% of GNI*)	0.9	1.1	1.5	0.8
General government debt (€bn)	223.5	224.4	222.7	222.2
Debt Ratio	78.8	75.4	76.1	72.3

Source: DoF

Ireland will run largest budget surplus in euro area in 2024



Source: AMECO, DoF

Ireland's headline fiscal aggregates are, however, inflated by the ongoing boom in corporation tax revenues. The Department of Finance has helpfully detailed the estimate of "excess" corporation tax revenue in recent budgets. For 2024, corporation tax revenue is expected to amount to €24.5bn (+4% yoy), with the "excess" estimated at €11.1bn. The vulnerabilities surrounding these tax revenues have been highlighted for the past few years, but have continued to hold up very well. There have been early warnings signs recently that the peak in corporate tax revenues has indeed been reached, with weak returns for both August and September. However, the budget forecasts point to relative stability in 2024. Excluding the excess corporate tax revenues, a budget deficit of €2.7bn (0.9% of GNI*) is expected. This represents a significant reduction on the estimate set out in the SPU.

Main elements of Budget 2024

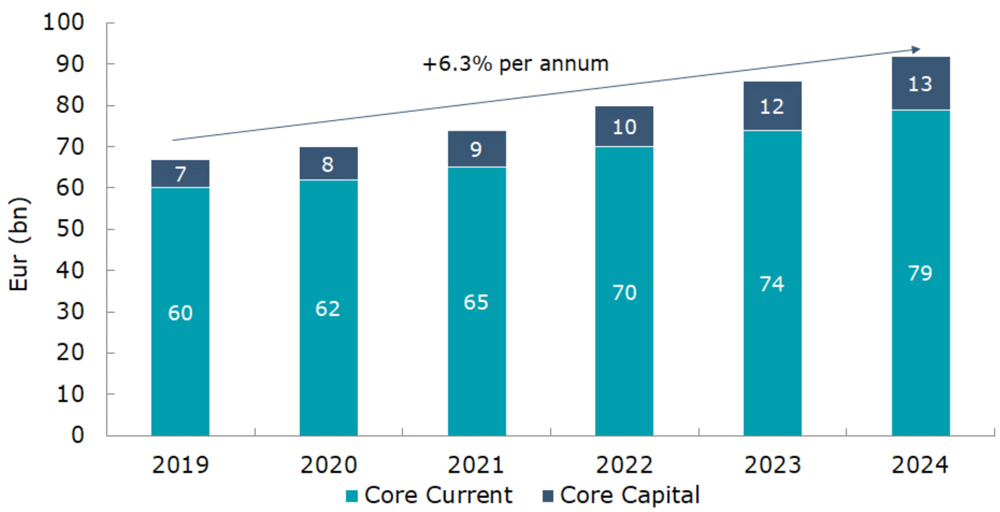
In total, the total package over 2023 and 2024 amounts to €14bn, made up of both temporary and permanent tax and spending measures. This is shown in the following schematic.

Budget 2024 – Total package of €14bn

Source: Dept of Finance

The tax package of €1.16bn is relatively small and goes towards increasing income tax and USC reliefs. Core spending is expected to grow by 6.1% in 2024, in line with the estimates set out in the Summer Economic Statement (SES). It does, however, represent a breach of the government's own 5% spending rule. As we have noted previously, we have some sympathy for the breach of the expenditure rule in the context of historically high inflation and significant population growth. Moreover, core capital spending is expected to grow at a faster pace of 8% in 2024 (+10% including non-core). Over the period since 2019, core expenditure has increased by €24bn to an estimated €91bn in 2024. This equates to an average annual increase of 5.5% for core current expenditure and 12% for core capital expenditure. Compared to Budget 2023, the estimate for core spending in 2024 is only 1% higher.

Core spending increases have been been close to medium term economic potential



Source: DoF

Expenditure breakdown compared – Biggest changes in non-core spending

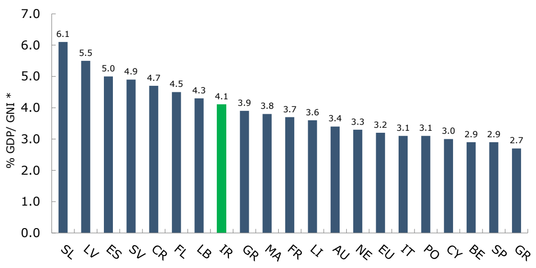
	Budget 2023				Budget 2024				
	2022	2023	2024	2025	2022	2023	2024	2025	2026
Voted expenditure	90.1	90.4	90.9	95.1	88.8	93.1	96.6	96.9	101.9
Core expenditure	80.8	85.9	90.2	94.7	80.0	85.9	91.2	95.7	100.5

Source: DoF

High level of capital spending is welcome

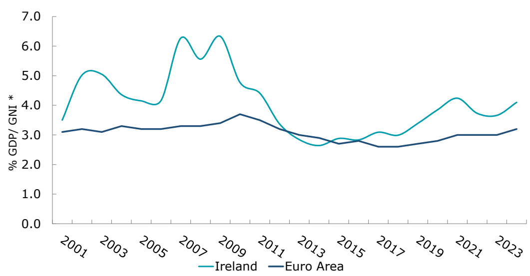
The 5.5% growth in core spending is only slightly above the medium-term growth potential of the Irish economy. The much faster growth in capital spending is required in our view given the large infrastructural deficits in the country in housing and energy infrastructure in particular. In relative terms, capital spending (relative to GDP/GNI*) in Ireland is high at 4.1%. The new Infrastructure, Climate and Nature Fund (ICNF), detailed below, should help in maintaining capital spending at a high level.

Capital spending is high in EA context…



Source: AMECO, Goodbody

…and relative to history

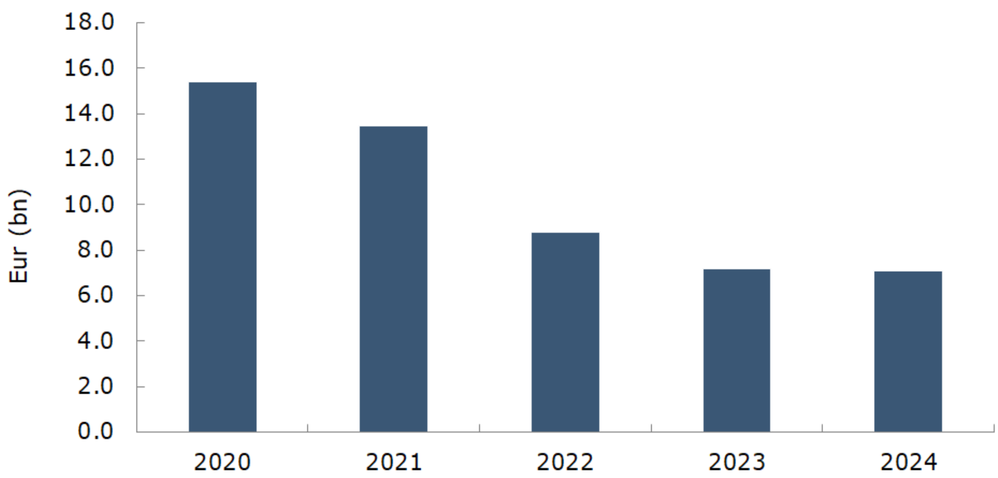


Source: AMECO, Goodbody

Risk that "temporary" spending becomes permanent

On top of the core spending elements, 2024 will represent the fifth consecutive year of significant non-core spending. Non-core and temporary spending in 2024 will amount to €5.4bn, relative to €7.1bn in 2023. The Cost-of-Living package amounts to €2.3bn and will paid over 2023 and 2024. The biggest cost is the €450 energy credit for all households over the next six months. Ireland has not seen the scale of energy price reductions seen in other jurisdictions. While some are clearly unavoidable, such as spending on the cost of Ukrainian refugees, there is a risk that "one-offs" such as in relation to COVID will simply get included in core spending over time.

Large "non-core" spending to continue in 2024



Source: DoF, Goodbody

Ireland has been able to maintain prudent headline budgetary aggregates over recent years due to consistent surprises in taxes, particularly corporation tax (27% of total taxes). However, the Budget contained some warning signs on this front, with overall tax revenue forecasts being €1.8bn lower than the estimates set out in the SPU. This is a timely reminder of the dangers of relying on ongoing tax revenues in the context of a small-open economy and concentration risks in corporation tax.

Tax revenue forecasts

	April SPU'23:		Budget '24		% Change	
Receipts	2023	2024	2023	2024	2023	2024
Tax revenue	88.9	94.4	88.3	92.6	-0.58	-1.84
: income tax	32.8	34.9	33.0	34.3	0.13	-0.61
: VAT	20.4	22.4	20.4	21.8	0.00	-0.59
: corporation tax	24.3	25.1	23.6	24.5	-0.75	-0.57
: excise duties	5.8	6.3	5.7	6.2	-0.13	-0.10
: stamp duties	1.6	1.7	1.8	1.8	0.13	0.05
: motor tax	0.9	0.9	0.9	0.9	0.01	-0.04
: customs	0.6	0.6	0.6	0.6	0.03	0.02
: capital gains tax	1.8	1.9	1.8	1.9	0.00	-0.01
: capital acquisitions tax	0.6	0.7	0.6	0.7	0.01	0.01
Non-tax revenue	1.9	1.5	2.1	1.1	0.12	-0.37
Net current revenue	90.8	95.9	90.4	93.7	-0.46	-2.21

Source: Goodbody

Ireland's new funds recognise both short- and long-term funding requirements

As speculated in recent months, two new funds are to be set up using the expected surpluses over the coming years. Both are welcome in the context of Ireland's chequered history with stable capital spending and the increased costs associated with the aging of the population.

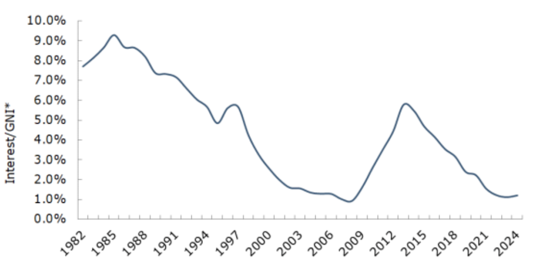
Infrastructure, Climate and Nature Fund – This fund will be used as a reserve to tap into, in the event of a downturn in the public finances that would threaten funding of vital capital infrastructure, including in climate. It will be initially seeded with €2bn from the National Reserve Fund (NRF will be liquidated), followed by €2bn per annum up to a maximum of €14bn. The rules by which the funds will be utilised have yet to be finalised but will be managed by the NTMA.

Future Ireland Fund – This will be used to pay for longer terms costs of the aging of the population, digitalisation and climate transition. Although uncertain, these increased costs are expected to amount to an additional €7-8bn per annum by the end of the decade. An initial €4bn will be put into the FIF in 2024, after which it is expected that €4-€5bn will be invested annually. Again, the details have not been worked out in terms of its investment mandate, but the Minister for Finance noted that the fund could reach €100bn by the middle of the next decade.

Impact on debt, sustainability and issuance

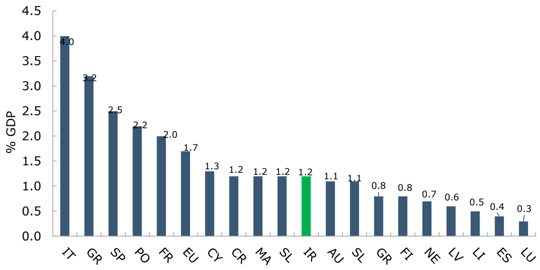
Ireland's debt dynamics continue to improve at a steady pace, with Ireland's debt level expected to fall in nominal terms and relative to GNI* over the coming years. Debt is expected to fall to 72% of GNI* in 2024, down from a recent peak of 109% of GNI* in 2020. This compares to a euro area average of 91% currently. The interest burden is expected to remain low over the forecast horizon due to a combination of fiscal surpluses and higher coupon debt maturing. As shown in the chart below, interest payments are close to all-time lows at 1.2% of GNI*.

Interest costs remain close to lows…



Source: NTMA, DoF

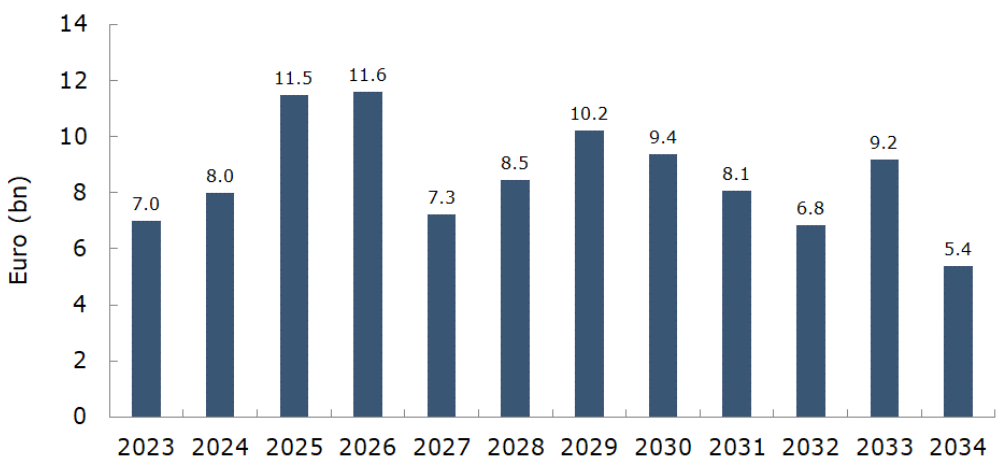
…and well below EA average



Source: AMECO, Goodbody

The introduction of the two new funds will create gaps between exchequer borrowing requirements and the general government balance and between gross and net debt over the coming years. For example, in 2024, an Exchequer surplus of €1.8bn is expected, but this translates into a general government surplus of €8.4bn. The transfer of €4.3bn to the FIF and ICNF plays a big role here. This has an influence on the borrowing requirement over the coming years. In 2023, the NTMA raised €7bn in debt funding, the very bottom of its stated range. The NTMA will announce details of its 2024 funding requirement in December. With €28bn in cash and liquid assets available at the end of September 2023 and only one bond amounting to €8bn redeeming in March 2024, the NTMA could decide on a lower funding range for 2024. However, it has previously noted its intention to keep market access open in light of the experience of the late 2000s when Ireland needed access to international funding markets suddenly after the sovereign crisis, but issued very little debt in the years prior to it.

Bond redemptions are low in 2024 before increasing in 2025 and 2026

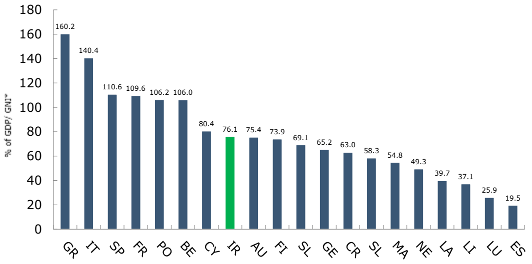


Source: NTMA

Net debt may fall below 60% of GNI* by 2026

The gap between gross and net debt in Ireland will grow over the coming years as the value of the two new funds increases. It appears that this is not yet reflected in the government's estimates as the gap between the two measures narrows over the forecast horizon. In 2023, net debt is estimated at 63%, with gross debt at 76%. At the end of 2025, net debt is expected to be 60% of GNI*, relative to gross debt of 68%. Based on a potential additional €14bn in the two new funds, net debt could be c.55% of GNI* by the end of 2026.

Gross General Government Debt 2023



Source: AMECO, Goodbody

Gross General Government Debt EU vs Ireland '09 -23

Source: AMECO, Goodbody

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