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Assessment of the 2018 Stability Programme for

Ireland

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

On 30 April 2018, Ireland submitted its 2018 Stability Programme (hereafter called Stability Programme), covering the period 2018-2021. It was presented to the Parliament on 17 April 2018.

Ireland is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the Medium-Term Budgetary Objective (MTO). As the debt ratio was 76.9% of GDP in 2015 (the year in which Ireland corrected its excessive deficit), exceeding the 60% of GDP reference value, Ireland is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (transitional debt rule). In this period it should ensure sufficient progress towards compliance with the debt reduction benchmark. After the transition period, as of 2019, Ireland is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 7 March 2018[1] and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

[1] European Commission (2018), Country Report Ireland 2018 (SWD(2018) 206 final)

2. MACROECONOMIC DEVELOPMENTS

Real GDP grew strongly in 2017, by 7.8%. While the headline figure was distorted by the activities of multinational companies operating in Ireland, various indicators point to a healthy domestic economy, in particular the robust growth in employment. Private consumption increased by a relatively subdued 1.9%, given the robust growth in household income, improving consumer confidence and modest inflation[2]. Gross fixed capital formation fell by 22.3% largely driven by a significant decline in investment in intellectual property (IP) assets and aircraft. However, these two components have a neutral impact on GDP as they are imported. Construction activity increased by 16.7%, though coming from a very low base. Net exports contributed 14.5 percentage points to GDP growth in 2017 due to a strong increase in exports of services, linked to multinationals' activities, and a drop in imports of IP services. According to the Stability Programme, solid and broad-based economic growth is expected to continue in 2018 and 2019, albeit at more moderate rates, with positive contributions from both net exports and domestic demand.

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	7,8	7,8	5,7	5,6	4,1	4,0	3,4	2,8
Private consumption (% change)	1,9	1,9	2,5	2,6	2,4	2,4	2,3	1,9
Gross fixed capital formation (% change)	-22,3	-22,3	6,5	8,5	6,0	7,4	5,2	4,7
Exports of goods and services (% change)	6,9	6,9	5,8	6,9	4,6	5,4	4,5	3,9
Imports of goods and services (% change)	-6,2	-6,2	4,6	6,6	4,4	5,9	4,8	4,4
Contributions to real GDP growth:								
- Final domestic demand	-6,2	-6,2	2,9	3,0	2,4	2,8	2,3	2,0
- Change in inventories	0,0	0,1	0,0	0,0	0,0	0,0	0,0	0,0
- Net exports	14,5	14,5	2,8	2,5	1,7	1,2	1,1	0,8
Output gap[1]	-0,5	-0,5	0,7	0,8	0,4	0,5	0,0	-0,7
Employment (% change)	1,9	2,9	2,2	2,7	1,8	2,3	1,9	1,7
Unemployment rate (%)	6,7	6,7	5,4	5,8	4,9	5,3	5,3	5,4
Labour productivity (% change)	5,8	4,8	3,4	2,8	2,2	1,7	1,5	1,1
HICP inflation (%)	0,3	0,3	0,8	0,8	1,1	1,0	1,4	2,6
GDP deflator (% change)	-0,3	-0,3	0,6	0,0	1,3	1,3	1,3	1,5
Comp. of employees (per head, % change)	2,9	2,0	2,5	2,6	2,7	2,8	3,2	3,1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3,4	12,5	3,3	12,2	3,4	11,4	10,9	10,2

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Commission 2018 spring forecast (COM); Stability Programme (SP).

The macroeconomic scenario underlying the Stability Programme takes into account the better-than-expected economic performance in 2017 and a positive impact of multinationals

[2] In recent years, there has been a pattern of upward revision in the private consumption preliminary indicators with the publication of final national account figures in July, which is expected also for 2017.

on the headline figures. Accordingly, real GDP growth in 2018 was revised upwards by 2.1 percentage points as compared to the scenario underlying the Draft Budgetary Plan of October 2018, and is now expected to reach 5.6%.

The macroeconomic assumptions for 2018 and 2019 in the Stability Programme are broadly in line with the Commission 2018 spring forecast. Both the Stability Programme and the Commission forecast assume that the activities of multinationals will have an impact on the headline figures, for instance through contract manufacturing[3] and services trade. The Stability Programme projects higher investment growth with investment in intangible assets and aircraft returning to more "normal" growth rates. This in turn results in stronger imports and a lower net trade contribution to GDP growth than in the Commission forecast. However, discounting the effects from the activities of multinational enterprises, underlying domestic activity is expected to remain robust in both the Stability Programme and the Commission forecast, driven by private consumption and investment in building and construction. As regards developments in the labour market, the two forecasts are also broadly in line, even though the Commission expects slightly lower unemployment rates for both years.

Similarly to the Commission forecast, risks to the macroeconomic projections underlying the Stability Programme are tilted to the downside. The most important source of uncertainty in both forecasts relates to the ongoing negotiation over the terms of the UK's withdrawal from the EU, but changes to the international taxation and trade environment also represent a challenge.

The output gaps as recalculated by the Commission based on the information in the Programme, following the commonly agreed methodology, suggest a negative gap in 2017 and positive ones in 2018 and 2019. The method has been adjusted to mitigate distortions of the potential output estimate due to the high GDP growth rate in 2017, which was partly driven by the activities of multinationals with limited impact on the domestic economy.[4] The output gap of the Programme taken at face value was positive in 2017 and remains higher than the recalculated gap until the end of the Stability Programme horizon, while displaying a similar narrowing trend over 2018-2020.[5]

Overall, the macroeconomic scenario underlying the Stability Programme is plausible.

3. Recent and Planned Budgetary Developments

3.1. Deficit Developments in 2017 and 2018

The headline government balance improved from -0.5% of GDP in 2016[6] to -0.3% of GDP in 2017 on the back of a continued strengthening in the economy. Revenue was up 3.8% in

[3] Contract manufacturing refers to the production of goods abroad on behalf of Irish-domiciled entities for exporting.

[4] A dummy has been included for total factor productivity in 2017.

[5] Differences between the face value and the recalculation are mostly due to the additional dummy for non-accelerating wage rate of unemployment in 2017 included in the Programme, leading to a later closure of the face value output gap.

[6] The 2016 balance has been revised by +0.2% of GDP since the previously published tables under the Excessive Debt Procedure in October 2017 to reflect updated data sources as well as a change to methodology for the treatment of the sale of mobile phone licences and the treatment of the Approved Housing Bodies.

2017, driven by the strong performance in corporate and value added taxes (VAT). Government expenditure, excluding one-offs, increased compared to the previous year by 3.2%. A fall in the interest burden facilitated the deficit reduction.

The deficit outturn of 0.3% of GDP in 2017 was below the target of 0.4% of GDP laid out in the 2017 Stability Programme. The difference largely reflects the stronger-than-expected economic growth in 2017. However, the deficit-to-GDP ratio was in line with the 2018 Draft Budgetary Plan. The revenue-to-GDP and the expenditure-to-GDP ratios were lower than expected, by 0.4 and 0.3 percentage points respectively due to the denominator effect.

For 2018, the Stability Programme projects the headline general government deficit to fall to 0.2% of GDP. This is slightly above the target of 0.1% included in the 2017 Stability Programme, but in line with the 2018 Draft Budgetary Plan. In absolute terms, nevertheless, the deficit is now expected to be EUR 240 million higher than at the time of the 2018 Draft Budgetary Plan. The deficit-to-GDP ratio did not change due to the increase in nominal GDP compared to the Draft Budgetary Plan. These projections take into account Budget 2018 and the statistical reclassification of approved housing bodies within the general government sector. The expenditure-to-GDP ratio is projected to drop to 25.6% in 2018, a reduction of 0.5 of a percentage point compared to the previous year, while the revenue-to-GDP ratio is projected to decline by 0.3 of a percentage point to 25.4%. In particular, the Stability Programme's target for taxes on production and imports in 2018 is EUR 610 million below the Budget 2018 estimates, mainly due to more up-to-date data accounting also for statistical reclassifications. However, for the same reason, other taxes are above the Budget 2018 estimates. On the expenditure side, the Stability Programme's target for government gross fixed capital formation in 2018 is EUR 600 million above Budget 2018 estimates, mainly due to the reclassification of approved housing bodies.

3.2. MEDIUM-TERM STRATEGY AND TARGETS

The MTO of -0.5% of GDP reflects the objectives of the Pact. The 2018 Stability Programme projects a decline in the headline deficit, with a strong adjustment envisaged in 2020 (see Table 2). It expects the headline balance to reach a surplus of 0.3% of GDP in 2020 and 0.4% of GDP by the end of the Programme's horizon. The structural deficit is estimated to reach 0.4% of GDP in 2019, above Ireland's MTO. The Stability Programme projects total government expenditure's share in GDP to decline to 25.2% in 2019 and to drop further to 24.3% by the end of the Programme's horizon. At the same time, the revenue-to-GDP ratio is projected to decline more gradually to 25.1% in 2019 and 24.7% by 2021. Therefore, the bulk of the adjustment is expected on the expenditure side.

On the basis of the information in the Programme, the recalculated structural deficit[7] is estimated at 0.6% of GDP in 2018, up from 0.1% of GDP in 2017 and in line with the recalculated estimates in the 2018 Draft Budgetary Plan. The recalculated structural deficit is projected to reach 0.4% of GDP in 2019 - thereby achieving Ireland's MTO - and to turn into surplus over the forecast horizon.

[7] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the programme, using the commonly agreed methodology.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**25,7**	**25,2**	**25,4**	**24,9**	**25,1**	**24,8**	**24,7**	**-1,0**
of which:								
- Taxes on production and imports	8,2	8,0	8,0	8,0	8,0	8,0	8,0	-0,2
- Current taxes on income, wealth, etc.	10,4	10,4	10,6	10,5	10,5	10,5	10,6	0,2
- Social contributions	4,3	4,2	4,2	4,1	4,2	4,1	4,1	-0,2
- Other (residual)	2,8	2,5	2,6	2,3	2,4	2,2	2,0	-0,8
Expenditure	**26,1**	**25,4**	**25,6**	**25,0**	**25,2**	**24,5**	**24,3**	**-1,8**
of which:								
- Primary expenditure	24,1	23,7	23,9	23,4	23,6	23,0	22,9	-1,2
of which:								
Compensation of employees	7,0	6,8	6,8	6,6	6,7	6,5	6,3	-0,7
Intermediate consumption	3,3	3,6	3,4	3,5	3,3	3,2	3,0	-0,3
Social payments	9,8	9,2	9,3	8,8	8,9	8,6	8,4	-1,4
Subsidies	0,6	0,6	0,6	0,6	0,6	0,5	0,5	-0,1
Gross fixed capital formation	1,9	2,1	2,2	2,4	2,3	2,3	2,3	0,4
Other (residual)	1,6	1,5	1,6	1,6	1,7	1,5	1,9	0,4
- Interest expenditure	2,0	1,7	1,7	1,7	1,6	1,5	1,4	-0,6
General government balance (GGB)	**-0,3**	**-0,2**	**-0,2**	**-0,2**	**-0,1**	**0,3**	**0,4**	**0,7**
Primary balance	**1,6**	**1,5**	**1,5**	**1,5**	**1,5**	**1,7**	**1,8**	**0,2**
One-off and other temporary	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,1
GGB excl. one-offs	**-0,3**	**-0,2**	**-0,2**	**-0,2**	**-0,1**	**0,3**	**0,4**	**0,6**
Output gap[1]	-0,5	0,7	0,8	0,4	0,5	0,0	-0,7	-0,2
Cyclically-adjusted balance[1]	-0,1	-0,6	-0,6	-0,4	-0,4	0,3	0,8	0,8
Structural balance[2]	**-0,1**	**-0,6**	**-0,6**	**-0,4**	**-0,4**	**0,3**	**0,8**	**0,8**
Structural primary balance[2]	1,9	1,1	1,1	1,3	1,2	1,8	2,2	0,3

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

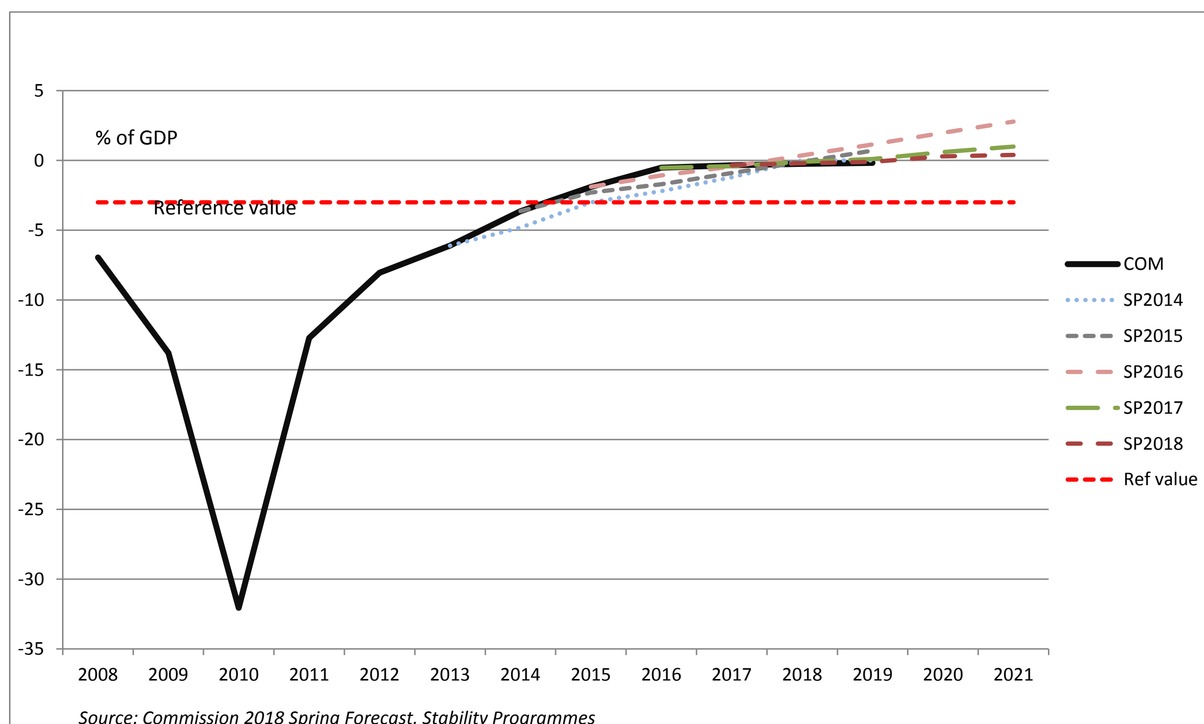
Source :

Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.

Planned improvements in the headline balance of 0.1%, 0.4% and 0.1% of GDP in 2019, 2020 and 2021, respectively, compare to planned improvements of 0.2%, 0.5% and 0.4% of GDP in the 2017 Stability Programme (see Figure 1). In particular, gross fixed capital formation is now expected to be higher, also due to increases in capital expenditure announced in the National Development Plan[8]. Targets for the (recalculated) structural balance have been delayed compared to the 2017 Stability Programme, when the aim was to reach the MTO in 2018. This has been delayed until 2019 due to a better-than-anticipated GDP outturn for 2017, which affects estimates of the positive output gap in 2018.

[8] http://www.per.gov.ie/en/national-development-plan-2018-2027/

Figure 1: Government balance projections in successive Programmes (% of GDP)



The structural deficit is expected to widen to around 0.6% in 2018, before narrowing to 0.4% of GDP in 2019, broadly in line with the recalculated Programme estimates.

3.3. MEASURES UNDERPINNING THE PROGRAMME

As indicated above, for 2018, the headline deficit of 0.2% of GDP projected in the Stability Programme takes into account a package of measures already included in the 2018 Draft Budgetary Plan. Beyond 2018, it also reflects the expenditure increases set out in the *National Development Plan*. Specifically in relation to 2019, the Stability Programme describes pre-committed expenditure increases of around EUR 2.6 billion (EUR 1.5 billion for additional capital spending, EUR 0.4 billion to provide for demographic-related costs, EUR 0.4 billion for public sector pay and EUR 0.3 billion for carry-over costs associated with measures introduced in 2018). The Stability Programme suggests that there are EUR 3.7 billion in expenditure resources not allocated in 2019-2021.

No further detail on the possible new measures beyond 2018 is provided in the Stability Programme. The government may further clarify its budgetary strategy in the Summer Economic Statement, which sets out the broad parameters for the fiscal outlook and constraints over the medium term. The measures that have already been set out are accounted for in the Commission 2018 spring forecast.

3.4. DEBT DEVELOPMENTS

Ireland's general government debt-to-GDP ratio has been steadily falling since its peak at just below 120% in 2012. This has been the result of strong nominal GDP growth and declining headline deficits, including also the mechanical effect of the exceptionally large surge in 2015 GDP. In 2017, the debt ratio dropped by 4.8 percentage points to 68.0% (see Table 3). In

particular high nominal GDP growth, as well as a decrease in the headline deficit and asset operations, including use of income from the sale of government's shares in state-owned-banks, contributed to the drop. The Stability Programme projects a government debt-to-GDP ratio of 66.0% and 63.5%, respectively, in 2018 and 2019.

Table 3: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**98,7**	**68,0**	**65,6**	**66,0**	**63,2**	**63,5**	**60,2**	**58,7**
Change in the ratio	-7,5	-4,9	-2,4	-2,0	-2,4	-2,5	-3,3	-1,5
Contributions[2]:								
1. Primary balance	**0,6**	**-1,6**	**-1,5**	**-1,5**	**-1,5**	**-1,5**	**-1,7**	**-1,8**
2. "Snow-ball" effect	**-5,2**	**-3,1**	**-2,3**	**-1,9**	**-1,7**	**-1,7**	**-1,4**	**-1,1**
Of which:								
Interest expenditure	3,4	2,0	1,7	1,7	1,7	1,6	1,4	1,4
Growth effect	-7,0	-5,3	-3,6	-3,6	-2,5	-2,5	-2,0	-1,6
Inflation effect	-1,7	0,2	-0,4	0,0	-0,8	-0,8	-0,8	-0,8
3. Stock-flow adjustment	**-2,6**	**-0,1**	**1,4**	**1,4**	**0,8**	**0,8**	**-0,1**	**1,4**
Of which:								
Cash/accruals diff.				0,4		0,3	0,3	-0,1
Acc. financial assets				-0,5		-0,4	-0,3	-0,3
Privatisation				0,0		0,0	0,0	0,0
Val. effect & residual				0,0		0,0	0,0	0,0

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

However, the stock of public debt remains high and is planned to increase by EUR 10.1 billion over the period 2017-2021.[9] Moreover, the impact of multinational companies on Ireland's macroeconomic indicators means that public debt sustainability needs to be assessed against complementary indicators, such as a debt-to-modified GNI[10] ratio. These show that Ireland's stock of public debt remains high by historical and international standards.

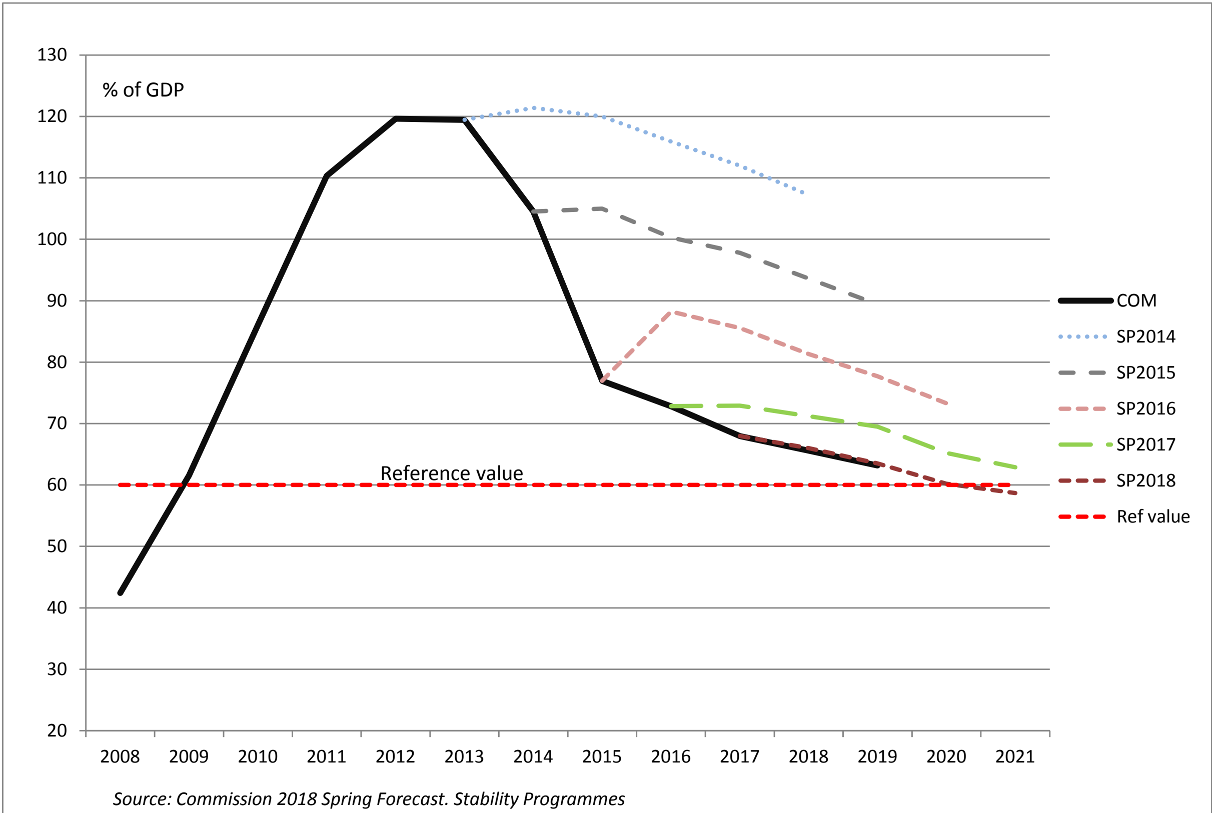
[9] In particular, 2018 changes in liquid financial assets reflect an increase in the funding requirement, owing primarily to large bond redemptions, notably in 2019-2020.

[10] The Modified Gross National Income (also known as GNI*), provided by the Irish statistical authorities, more accurately reflects the income standards of Irish residents than GDP. It differs from actual GNI in that it excludes *inter alia* the depreciation of foreign-owned, but Irish-resident, capital assets (notably intellectual property and assets associated with aircraft leasing) and the undistributed profits of firms that have re-domiciled to Ireland.

According to the Commission 2018 spring forecast the general government debt-to-GDP ratio is projected to continue declining to 65.6% and 63.2% in 2018 and 2019 respectively, contingent on continued stable medium-term economic growth and primary surpluses.

Prudently, the Programme's debt projections do not include potential sales of equity shares in a number of financial institutions. Downward revisions of the debt path compared to the earlier Stability Programmes are mainly due to the more favourable outturns for economic growth (see Figure 2).

Figure 2: Government debt projections in successive Programmes (% of GDP)



3.5. Risk assessment

Despite the recent strong performance of the Irish economy, the Commission 2018 spring forecast considers the risks to the macroeconomic outlook to be tilted to the downside, mainly due to external factors, to which Ireland is particularly exposed as a small and very open economy (see section 2).

Similarly, risks to the baseline fiscal forecast are also on the downside, mainly reflecting the external risks, but also increasing concerns about the durability of the recent performance in some revenue categories. In particular, the growing share of corporate income tax in total revenue (now at 16.2%) poses a potential risk to Ireland’s public finances as the respective tax base is heavily influenced by relocation decisions of a small number of large multinational enterprises. In this context, it has to be noted that the Stability Programme's headline deficit forecasts for 2018 and beyond rely on the continuation of strong revenue growth rates – a

3.9% average annual growth over 2018-2021[11] – and lower interest payments, decreasing at an average annual rate of 4.2% over the same period. In the medium term, maintaining such trends is likely to be challenging taking into account the increasingly unpredictable external environment, including potential changes in bond market conditions[12]. Furthermore, considerable spending (current and capital) may be needed simply to address changes in the structure of the population. Risks also arise from the potential under-achievement of legally binding climate change and renewable energy targets, which would imply a financial cost or sanctions, which cannot be quantified at present.

The Commission 2018 spring forecast, under the usual no-policy-change assumption, projects a headline deficit 0.2% of GDP for 2019, 0.1% of GDP above the government's projections. By extrapolating trends and relationships consistent with past policy orientations, taking into account carry-overs of previously adopted measures and more conservative assumptions on interest spending, the Commission forecast points to higher expenditure in absolute terms in 2019 than the Stability Programme. At the same time, it is important to note that the deficit forecasts in previous Stability Programmes have proven to be more conservative than the actual deficit outturns, although mainly due to higher-than-expected economic growth.

Ireland's still high level of public debt makes government debt projections very sensitive to variations in economic growth and to the expected size of budgetary adjustment. The potential sales of shares the government still retains in the three major domestic banks would reduce public debt. The Programme's projections are broadly in line with the Commission 2018 spring forecast.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1: Council Recommendations addressed to Ireland

On 11 July 2017, the Council addressed recommendations[13] to Ireland in the context of the European Semester. In particular, in the area of public finances the Council recommended to Ireland "to pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact. Use any windfall gains arising from the strong economic and financial conditions, including proceeds from asset sales, to accelerate the reduction of the general government debt ratio."

The Council noted that in "2018, in light of its fiscal situation and, in particular, of its debt level, Ireland is expected to further adjust towards its medium-term budgetary objective of a structural deficit of 0.5 % of GDP. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement

[11] Revenue from current taxes on income and wealth, in particular, is projected to increase by 8.1%, 4.2%, 4.9% and 4.9% in 2018, 2019, 2020 and 2021 respectively.

[12] However, interest rate risk for the Irish sovereign is fairly low, not least due to the favourable maturity profile of Ireland's government debt.

[13] Council Recommendation of 11 July 2017 on the 2017 National Reform Programme of Ireland and delivering a Council Opinion on the 2017 Stability Programme of Ireland (OJ C 261, 9.8.2017, p. 26-30).

of a nominal growth rate of net primary government expenditure[14] which does not exceed 2.4 % in 2018. It would correspond to an annual structural adjustment of 0.6 % of GDP.[…] As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Ireland's public finances. "

4.1. Compliance with the debt criterion

Having corrected its excessive deficit in 2015, Ireland is in the transition period as regards the debt criterion for the three years following the correction. The estimated change in the structural balance in 2017 was higher than the required Minimum Linear Structural Adjustment (MLSA). For 2018, the Programme's projections point to a similar result, by a margin of more than 5% of GDP above the required adjustment. This is broadly in line with the Commission 2018 spring forecast, according to which the change in the structural balance is also expected to exceed the required MLSA in 2018 (projected deterioration of 0.6% of GDP vs. allowed deterioration of 6.2% of GDP). Therefore, Ireland is expected to make sufficient progress towards compliance with the debt criterion in 2018.

As of 2019, Ireland should comply with the debt reduction benchmark. Based on the Stability Programme, Ireland is expected to meet the debt reduction benchmark in 2019, as its debt-to-GDP ratio is expected to be below the debt benchmark, with a gap to the debt benchmark of -4.5% of GDP. The Commission 2018 spring forecast confirms compliance with the debt benchmark in that year.

[14] Net government expenditure comprises total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

Table 4: Compliance with the debt criterion

	2017	2018		2019	
		SP	COM	SP	COM
Gross debt ratio	**68**	**66,0**	**65,6**	**63,5**	**63,2**
Gap to the debt benchmark [1,2]				-4,5	-5,0
Structural adjustment [3]	0,7	-0,5	-0,6		
To be compared to:					
Required adjustment [4]	-1,9	-5,8	-6,2		

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

Source :

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.2. Compliance with the MTO or the required adjustment path towards the MTO

Based on the outturn data and the Commission 2018 spring forecast, the ex-post assessment suggests that Ireland overachieved its MTO in 2017, with a structural balance of -0.1% of GDP.

In 2018, according to the information provided in the Stability Programme, the expenditure benchmark points to a deviation of 0.6% of GDP from the requirement of a nominal rate of growth of net primary government expenditure that does not exceed 2.4%. Similarly, the two-year average deviation is above the applicable significant deviation threshold of 0.25% of GDP. The recalculated change in the structural balance (-0.5% of GDP) is below the 0.6% of GDP required to ensure sufficient progress towards the MTO based on the frozen requirement for 2018. Also over 2017 and 2018 taken together, the structural balance pillar points to a risk of significant deviation (of 0.4% of GDP) based on the frozen requirement for 2018. Similar conclusions can be drawn based on the Commission 2018 spring forecast. The expenditure benchmark points to some deviation in 2018 and significant deviation in 2017 and 2018 taken together, while the structural balance points to a significant deviation both in 2018 and 2017 and 2018 taken together based on the frozen requirement for 2018. This calls for an overall assessment. Given the very open nature of the Irish economy and the volatility of potential GDP estimates, the expenditure benchmark provides a more appropriate yardstick for fiscal policy. However, it does not capture the additional revenue linked to the continued non-indexation of income tax bands, which is considered to be of a permanent nature. Taking this into consideration, the expenditure benchmark pillar would be below the applicable

significant deviation thresholds.[15] As the expenditure benchmark is considered to reflect more appropriately Ireland's underlying fiscal effort, the overall assessment points to a risk of some deviation from the expenditure benchmark in 2018 and 2017 and 2018 taken together.[16]

The country-specific recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes would need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. However, in light of the fact that Ireland is not found at risk of a significant deviation in 2018, such a qualitative assessment does not need to be carried out at this stage.

While the structural balance points to a significant deviation over 2018 and 2019 taken together based on the Stability Programme, in 2019, the MTO is projected to be met by a small margin. Based on the Commission 2018 spring forecast, conclusions for 2019 are similar. The MTO is projected to be met by a small margin. In turn, the assessment points to compliance with the requirements.

[15] Difference compared with the recalculated Programme estimates is *inter alia* due to an expenditure item in 2017 related to the policy decision to refund domestic water charges, which is considered in the Stability Programme as a one-off and temporary measure, and hence produces higher growth of net primary government expenditure in 2018.

[16] At present, the government expenditure matched by EU-fund revenue as provided by the Department of Public Expenditure and Reform are not fully consistent with the aggregate revenue data ("Other current revenue") shown in the official Central Statistic Office's release. Ireland's data on current and capital transfers from EU institutions remain unavailable.

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-0.1	-0.6		-0.4	
Structural balance based on freezing (COM)	-1.1	-0.6		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		At or above the MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Required adjustment[4]	Compliance	0.6		Compliance	
Required adjustment corrected[5]		0.6			
Change in structural balance[6]		-0.5	-0.6		
One-year deviation from the required adjustment [7]		-1.1	-1.1		
Two-year average deviation from the required adjustment [7]		-0.4	-0.6		
Expenditure benchmark pillar					
Applicable reference rate[8]		2.4			
One-year deviation adjusted for one-offs[9]		-0.6	-0.3		
Two-year deviation adjusted for one-offs[9]		-0.5	-0.4		
PER MEMORIAM: One-year deviation [10]		-0.5	-0.3		
PER MEMORIAM: Two-year average deviation [10]		-0.5	-0.4		

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.

5. Fiscal sustainability

Ireland does not appear to face fiscal sustainability risks in the short run.[17]

Based on Commission 2018 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, at 68.0% of GDP in 2017, is expected to decrease (to 50.8% in 2028), thus falling below the 60% of GDP Treaty threshold. Sensitivity analysis shows similar risks.[18] Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a more clearly decreasing path, reaching 46.1% of GDP in 2028.

The medium-term fiscal sustainability risk indicator S1[19] is at -0.7 of a percentage point of GDP, as the favourable initial budgetary position compensates for the projected increase in ageing costs, thus indicating low risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at -1.9 percentage points of GDP, leading to an even lower medium-term risk. Overall risks to fiscal sustainability over the medium-term are, therefore, low.

The long-term fiscal sustainability risk indicator S2 is at 3.1 percentage points of GDP. In the long term, Ireland therefore appears to face medium fiscal sustainability risks, due to the projected increase in ageing costs, contributing by 3.9 percentage points of GDP. Full implementation of the Programme would put the S2 indicator at 2.1 percentage points of GDP, though this would not change the long-term risk classification.[20] In February 2018, a Roadmap for Pension Reform 2018-2023 was published, aimed at addressing the long-term sustainability of the state pension system, including by committing to linking future changes in the State pension age to life expectancy, following the already planned increases of the statutory retirement age in 2021 and 2028.

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[17] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

[18] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

[19] See the note to Table 6 for a definition of the indicator.

[20] The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

Table 6: Sustainability indicators

Time horizon			Commission Scenario		Stability / Convergence Programme Scenario	
Short Term			**LOW risk**			
S0 indicator [1]			0,3			
Fiscal subindex			0,1	LOW risk		
Financial & competitiveness subindex			0,3	LOW risk		
Medium Term			**LOW risk**			
DSA [2]			LOW risk			
S1 indicator [3]			-0,7	LOW risk	-1,9	LOW risk
of which						
	Initial Budgetary Position		-2,0		-2,9	
	Debt Requirement		0,3		-0,1	
	Cost of Ageing		1,1		1,1	
	of which					
		Pensions	0,5		0,6	
		Health-care	0,2		0,2	
		Long-term care	0,2		0,2	
		Other	0,2		0,2	
Long Term			**MEDIUM risk**		**MEDIUM risk**	
S2 indicator [4]			3,1		2,1	
of which						
	Initial Budgetary Position		-0,8		-1,8	
	Cost of Ageing		3,9		3,9	
	of which					
		Pensions	1,5		1,6	
		Health-care	0,8		0,8	
		Long-term care	1,6		1,6	
		Other	0,0		-0,1	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

6. FISCAL FRAMEWORK

The national numerical fiscal rules meant to guide the Irish budget planning and execution are embedded in the Fiscal Responsibility Act (FRA) adopted in 2012. The balanced-budget rule and the debt rule, accompanied by adjustment paths, refer back to the EU fiscal rules in the SGP (see art. 2 of the FRA). In recent years, Ireland has always achieved or over-achieved its fiscal targets set in accordance with the national rules.

The 2018 Stability Programme confirms Ireland's commitment to a fiscal adjustment strategy towards achieving a reduction in the structural budget deficit. However, in its Fiscal Assessment Report of November 2017, the Irish Fiscal Advisory Council (IFAC) voiced concerns regarding a lack of clarity concerning a credible plan for the medium-term and compliance with the growth rate of government expenditure, net of discretionary measures and one-offs, over the two-year assessment for 2017 and 2018 based on Budget 2018. An update of this Fiscal Assessment Report, after the Stability Programme 2018, is expected to be published before the summer.

The 2018 Stability Programme reports several initiatives to improve the quality of public finances, with specific emphasis on expenditure and parliamentary scrutiny of budgets, which have been introduced in recent years.[21] This includes the publication of the first round of a three-year cycle spending review in July 2017, with the second round of this review currently taking place. As highlighted in the 2018 Country Report, the review signals progress in enhancing the quality of expenditure.

Pursuant to Article 4(1) of the Regulation (EU) No 472/2013 (part of the 'Two-Pack'), Ireland considers the Stability Programme to be its national medium-term fiscal plan. In its capacity as Ireland's national medium-term fiscal plan, the Programme does not include specific indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact. These indications are not provided in the Irish National Reform Programme either.

The task of assessing the macroeconomic forecast underpinning the annual budget plans and the Stability Programme is assigned to the Irish Fiscal Advisory Council (IFAC), according to the Fiscal Responsibility Acts of 2012 and 2013.[22] The IFAC endorsed the set of macroeconomic forecasts underpinning the 2018 Stability Programme as being within the range of appropriate projections. It has verified the Department of Finance’s mechanical

[21] These refer to publication of the Public Spending Code, Performance Report and Mid-Year Expenditure Report, the continued expansion of Irish Government Economic and Evaluation Service, the Equality Budgeting initiative, and the establishment of the Oireachtas Select Committee on Budgetary Oversight and the Parliamentary Budget Office.

[22] The IFAC is an independent statutory body established by the Fiscal Responsibility Act with a mandate to independently provide an assessment of, and to comment publicly on, whether the government is meeting its own stated budgetary targets and objectives (in particular through assessments of annual budgets and the Stability Programmes). Its five board members are appointed based on competence and experience for a four-year term that can be renewed once. The IFAC is granted "all such powers as are necessary for, or incidental to, the performance of its functions", which would include access to data and freedom of communication, which has been exercised in practice since its establishment.

application of the adjusted Commonly Agreed Methodology to estimate trend supply-side variables. The letter of endorsement was signed on 10 April.[23]

7. SUMMARY

In 2017, Ireland achieved its MTO, with a structural balance of -0.1% of GDP.

In 2018, Ireland's Stability Programme plans a growth rate of government expenditure, net of discretionary revenue measures, which is significantly above the applicable expenditure benchmarks rates both in 2018 and 2017 and 2018 taken together. The structural balance indicator shows a significant deviation based on the frozen requirement. Given the very open nature of the Irish economy and the volatility of potential GDP estimates, the expenditure benchmark provides a more appropriate yardstick for fiscal policy. However, it does not capture the additional revenue linked to the continued non-indexation of income tax bands, which is considered to be of a permanent nature. Following an overall assessment, there is a risk of some deviation in 2018 and 2017 and 2018 taken together according to the Commission 2018 spring forecast.

In 2019, the MTO is projected to be met by a small margin. This is confirmed by the Commission 2018 spring forecast. Hence, the assessment points to compliance in 2019.

Compliance with the transitional debt rule is ensured in 2017 and 2018, as well as with the debt reduction benchmark in 2019.

[23] http://www.fiscalcouncil.ie/wp-content/uploads/2018/04/Endorsement-Letter-April-2018.pdf

8. ANNEXES

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	6,3	1,6	3,0	25,6	5,1	7,8	5,7	4,1
Output gap [1]	2,0	0,9	-2,3	0,8	0,3	-0,5	0,7	0,4
HICP (annual % change)	4,1	1,8	0,5	0,0	-0,2	0,3	0,8	1,1
Domestic demand (annual % change) [2]	5,7	1,7	0,9	9,2	21,3	-7,9	4,2	3,6
Unemployment rate (% of labour force) [3]	4,6	6,8	14,2	10,0	8,4	6,7	5,4	4,9
Gross fixed capital formation (% of GDP)	24,6	27,1	18,7	20,3	31,8	23,4	23,8	24,4
Gross national saving (% of GDP)	24,1	21,3	19,0	32,1	36,0	36,6	36,4	36,5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**1,4**	**-3,2**	**-12,5**	**-1,9**	**-0,5**	**-0,3**	**-0,2**	**-0,2**
Gross debt	**31,6**	**35,5**	**108,0**	**76,9**	**72,8**	**68,0**	**65,6**	**63,2**
Net financial assets	**-11,5**	**-9,0**	**-69,8**	**-57,5**	**-55,4**	**n.a**	**n.a**	**n.a**
Total revenue	34,0	35,2	33,7	27,0	26,6	25,7	25,2	24,9
Total expenditure	32,5	38,4	46,2	28,9	27,1	26,1	25,4	25,0
of which: Interest	1,4	1,3	3,7	2,6	2,2	2,0	1,7	1,7
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**3,5**	**2,7**	**10,1**	**12,5**	**2,6**	**4,3**	**4,8**	**5,2**
Net financial assets; non-financial corporations	**-86,2**	**-106,5**	**-147,4**	**-204,7**	**-212,0**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**-10,7**	**-5,6**	**4,6**	**-6,7**	**15,4**	**n.a**	**n.a**	**n.a**
Gross capital formation	11,6	12,4	13,7	16,9	28,0	19,0	18,7	18,6
Gross operating surplus	35,9	33,1	38,5	53,3	53,1	54,4	55,2	55,8
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**-6,7**	**-6,1**	**1,6**	**-0,1**	**-0,5**	**-0,9**	**-1,4**	**-1,8**
Net financial assets	**86,8**	**58,2**	**76,4**	**74,0**	**76,2**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	35,0	37,7	34,3	24,8	24,8	24,4	24,1	23,9
Net property income	2,2	0,9	1,4	1,7	1,5	1,7	1,9	2,2
Current transfers received	12,7	15,0	18,3	12,2	11,8	11,0	10,4	9,9
Gross saving	2,9	4,6	4,6	2,4	2,3	2,4	2,3	2,2
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**0,8**	**-5,2**	**-1,1**	**10,4**	**1,5**	**3,4**	**3,3**	**3,4**
Net financial assets	**20,9**	**62,9**	**136,3**	**194,9**	**176,0**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	15,2	9,9	17,8	33,1	22,0	32,1	32,6	32,9
Net primary income from the rest of the world	-14,2	-13,8	-16,6	-20,9	-17,4	-18,4	-19,4	-19,9
Net capital transactions	0,5	0,1	-0,7	-0,5	-1,8	-9,1	-8,6	-8,1
Tradable sector	48,0	42,6	47,8	56,9	55,5	n.a	n.a	n.a
Non tradable sector	40,5	45,9	43,5	36,0	37,1	n.a	n.a	n.a
of which: Building and construction sector	6,7	6,9	2,1	2,4	2,6	n.a	n.a	n.a
Real effective exchange rate (index, 2000=100)	92,9	112,1	94,4	68,9	69,1	67,8	68,2	67,5
Terms of trade goods and services (index, 2000=100)	106,6	103,8	100,2	102,6	102,4	100,5	100,0	100,0
Market performance of exports (index, 2000=100)	90,3	92,6	101,6	145,4	146,2	150,4	151,6	152,1

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

[2] The indicator on domestic demand includes stocks.

[3] Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

Source:
AMECO data, Commission 2018 spring forecast