

## Budget 2023

### Big Focus on the Cost of Living Crisis

*It has been very clear for some time that a key focus of Budget 2023 would be on alleviating some of the pressures on households and businesses arising from the sharp rise in energy costs and surging inflation, the so called cost of living crisis. The scope for the Government to provide supports has been greatly enhanced by the emergence of an unexpected budget surplus this year. The initial forecast in Budget 2022 was for a budget deficit of circa €8 billion. The Pre-Budget 2023 White Paper shows a budget surplus of €4.5 billion for this year.*

*Today's budget contains a package of cost of living support measures for households and businesses totalling over €4 billion that will be rolled out over the autumn and winter months. These are mainly taking the form of direct household payments and support payments for businesses. The Government also provided an additional €7 billion in spending and tax measures in 2023 in today's Budget. Thus, fiscal policy is set to remain supportive of economic activity. Despite the giveaways, the Government is projecting budget surpluses of €1 billion this year, €6.2bn in 2023 and €10.7bn in 2024. Meanwhile, GDP is now expected to grow by 10% in 2022, slowing to 4.7% and 3.3% in 2023 and 2024, respectively. Inflation is seen at 8.5% in 2022, 7.1% in 2023 and 2.4% in 2024.*

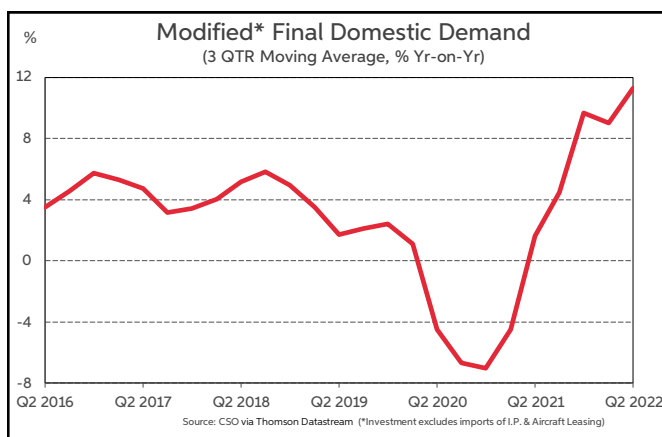
#### 2023 Budget: Key Points

- **Today's budget was framed against the backdrop of a sharp rise in inflation over the past twelve months**, with the annual HICP rate now running at 9%. This has been primarily driven by a steep rise in energy costs, which is spilling over to other areas, most notably higher food prices. This has given rise to a so called cost of living crisis as many households and business struggle to meet higher energy bills in particular.
- The Government had been promising over the summer that **today's budget would contain a package of measures to alleviate some of the pressure on those households and businesses hardest hit by the surge in inflation**. The Government faced a delicate balancing act in the budget of providing financial supports while, at the same time, avoiding adding to rising price and wage 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 is put at over €4bn, funded from this year's unexpected budget surplus.**
- **Of course the budget also provides for the usual broad array of increased spending across Government departments. In total, voted core government spending will rise by €5 billion or 6.3% in 2023.** Tax receipts have been unexpectedly buoyant this year, and are now projected to rise by 19% in 2022. This has pushed the public finances back into surplus. Tax revenues are forecast to increase by a further 6.6% in 2023. The Dept. of Finance now expects a general government budget surplus of €1bn, or 0.4% of GNI\* in 2022. The original budget target was a deficit of circa €8bn this year. It is projecting growing general government budget surpluses of €6.2bn in 2023 (2.2% of GNI\*) and €10.7bn in 2024 (3.7% of GNI\*).
- The level of total public debt rose sharply in the past couple of years as the COVID-19 pandemic pushed the budget finances back into deficit. Gross government debt stood at €237bn at end 2021, up from €218bn at end 2020 and €204bn at end 2019. It is put at circa €225bn in 2022. However, the actual National Debt, which takes into account significant holdings of cash balances, is lower. It stood at €202.5bn at end August, down from €207bn at end 2021 and is only slightly above its pre-COVID level of €200bn at end 2020. **Key public sector debt ratios are in marked decline once again. The gross government debt to GDP ratio is projected to fall to 45% this year, while the more relevant National Debt to GNI\* ratio is put at 73%.**

## Buoyant economy set to lose some momentum

■ **The Irish economy has rebounded very strongly from the COVID-19 crisis**, helped by the substantial pandemic related supports provided by the Government for households and businesses during 2020-21, as well as a marked pick-up in foreign direct investment. Having grown strongly in 2021, GDP rose by 11% yoy in the opening half of 2022. Exports continued to perform well, rising by 14% yoy in H1 2022. Modified final domestic demand rose by 11.7% yoy from its depressed levels in the opening half of 2021, when much of the economy was in lockdown. Of particular note has been the surge in investment in recent quarters, in particular machinery and equipment, as well as house building.

■ **A primary driver of the very strong growth in the economy has been high levels of foreign direct investment.** Ireland had a record year for inflows of foreign direct investment in 2021. The IDA has reported that this was exceeded in the first half of 2022, while the pipeline remains relatively positive for the second half of the year, despite a difficult global backdrop. It may well be that Brexit is resulting in increased flows of FDI into Ireland, with the UK no longer in the EU.



■ Whatever the reason, **buoyant FDI is resulting in very strong growth in exports, employment, investment and tax revenues.** Employment in mid-2022 was 11% higher than pre-COVID levels three years earlier. Meanwhile, the labour force expanded by 10% over the same period, driven by a marked rise in participation rates and continued strong net inward migration. The Dept. of Finance is now forecasting that GDP will rise by x% in 2022. Such very strong growth in the economy and labour market was not expected and capacity constraints are starting to emerge. The unemployment rate has fallen to a twenty year low of 4.2-4.3%. The electricity grid is struggling to meet the rising demand for power. Indeed, housing, water, energy and transport infrastructure are all under increasing strain.

■ Turning to next year, the combination of capacity constraints, a deteriorating global economic backdrop with much of Europe likely to be in recession, rising interest rates and tightening financial conditions, as well as the negative impact of real household incomes of high inflation, are **expected to see a marked slowdown in the pace of growth in the Irish economy. Nonetheless, it is still expected to perform relatively well**, on continued inflows of FDI, an expansionary fiscal policy and high levels of private sector savings. The Dept. of Finance is projecting GDP growth of 4.7% in 2023, while modified domestic demand is forecast to expand by 1.2%. **The economy is expected to continue performing well during in 2024**, with both GDP and MFDD forecast to grow by 3.3%. The unemployment rate is forecast to remain low and stable at circa 5%.

### DEPT OF FINANCE ECONOMIC FORECASTS

(%)	2021	2022(f)	2023(f)	2024(f)
<b>GDP</b>	<b>13.6</b>	<b>10.0</b>	<b>4.7</b>	<b>3.3</b>
<b>GNP</b>	<b>14.7</b>	<b>8.9</b>	<b>4.2</b>	<b>2.8</b>
<b>Mod Dom Demand</b>	<b>5.8</b>	<b>7.7</b>	<b>1.2</b>	<b>3.3</b>
Private Cons	4.6	5.5	1.8	4.6
Gov Expd.	6.5	2.9	-1.5	-1.1
Mod. Fixed Inv.	8.2	17.7	2.2	3.8
Exports	14.1	12.5	5.5	3.9
Mod. Imports	9.7	12.5	3.9	4.1
HICP	2.5	8.5	7.1	2.4
Employment	11.0	18.3	1.2	1.6
Unemploy. Rate	15.9	5.2	5.1	5.0

Source: Dept. of Finance, September 2022

■ **In terms of inflation, the DoF sees the HICP rate averaging 8.5% this year and remaining elevated at 7.1% in 2023, with the rate then falling back to 2.4% in 2024 and to 1.8% by 2025.** In this regard, Brent oil prices have fallen back below \$90 a barrel from above \$120 earlier in the summer. Meanwhile, natural gas prices have also fallen back recently, as concerns ease about supplies over the coming winter. Thus, inflation should peak this autumn, but it could remain high next year if concerns persist about the supply of gas to Europe in 2023. Core inflation is seen averaging 5.3% this year, before falling gradually thereafter to 2.6% by 2025.

## Return to budget surpluses as economy rebounds very strongly

- **The Government initially set a target for a budget deficit this year of circa €8bn, but very strong growth in the economy and thus tax revenues has seen a budget surplus emerge unexpectedly.** The DoF now expects a surplus of €1 billion in 2022 (0.4% of GNI\*), even after providing an additional €4bn in funding for measures to deal with alleviating some of the pressures on households and businesses from the cost of living crises.
- **The general government budget balance is expected to remain in positive territory in the coming years. The Government is targeting surpluses of €6.2bn (2.2% of GNI\*) in 2023 and €10.7bn in 2024 (3.7% of GNI\*).** ( Note the Exchequer surplus is significantly lower than this in 2023 because of large transfers to the Social Insurance Fund and National Reserve Fund). Meanwhile, the current budget surpluses have become very large, with Ireland's quite sizeable Exchequer capital spending programme now being fully financed from State revenues rather than government borrowings.

- **The opening Exchequer surplus for 2023, which is before any new policy measures or changes were announced in the budget, was close to €10bn.** There were almost €6bn of new spending measures announced in the budget today and income tax cuts costing over €1bn. This reduces the projected surplus to €1.7bn in 2023, after also allowing for contingency measures.

- The greatest uncertainty around the Dept.'s budget projections is usually in relation to tax receipts. They have performed much better than expected in 2021 and 2022. **Tax revenues are now forecast at €81.5bn in 2022, up 19% or €13bn on the 2021 figure of €68.4bn and far above their levels of €57.2bn in 2020 and €59.3bn in 2019.** This reflects the strong rebound in the economy in 2021-22 as well as buoyant corporation tax receipts. These have increased from €12bn to €21bn in the last two years.

BUDGETARY PROJECTIONS : 2022 - 2024			
(€ bn)	2022	2023	2024
Net Current Expenditure	70.9	71.1	70.9
Net Current Revenue	84.0	89.1	93.5
Current Budget Balance	13.1	18.0	22.6
Capital Budget Balance	-12.2	-15.7	-12.4
<b>EXCHEQUER BALANCE</b>	0.3	1.7	10.2
<b>GEN GOV BALANCE</b>	1.0	6.2	10.7
<b>% of GNI*</b>			
Gen Gov Balance	0.4	2.2	3.7
Interest Expd	1.3	1.4	1.3
Primary Balance	1.6	3.6	5.0

Source: Dept. of Finance September 2022

- **The Dept. sees tax receipts rising by a further 6.6%, or €5.5bn, to €87bn in 2023.** This is not surprising 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 2023. The Dept. is forecasting a far more modest rise of 8% in corporation tax receipts for 2023 than in 2021-22. They are concerned that the sharp rise in revenues from this tax head in recent years will not be sustained. Indeed, **the Dept. estimates that up to €10bn of the €21bn in corporation tax receipts in 2022 could be 'windfall' in nature.** Forecasting corporation tax receipts is set to become even more difficult given that **there is a major overhaul of the global corporate tax system taking effect in 2023 that will have a significant impact on Irish tax receipts.** Overall, though, the continued strong rise in the inflow of foreign direct investment in 2021-22, is supportive of the Dept.'s forecast for a further increase of 8% in corporation tax receipts next year. Meanwhile, the limited tax raising measures announced in the budget were modest hikes in carbon tax and tobacco excise. In terms of personal tax cuts, the main change was a significant widening of the 20% income tax band and increases in tax credits.
- As highlighted by the Central Bank and Irish Fiscal Council, the Government **measures today needed to be designed so that they don't add to excess demand and inflationary pressures in the economy.** Hence the calls that the supports to help counter the inflationary shock should be both targeted and temporary were possible. The measures announced today in this regard are to cost €4bn, including €1.5bn for businesses, and are being financed from the 2022 budget surplus. **The Government resisted pressure to bring in an even larger package,** arguing there was a need to keep funds in reserve for 2023 given the downside risks to world growth and the possibility that more measures may be required next year if energy costs remain very high.

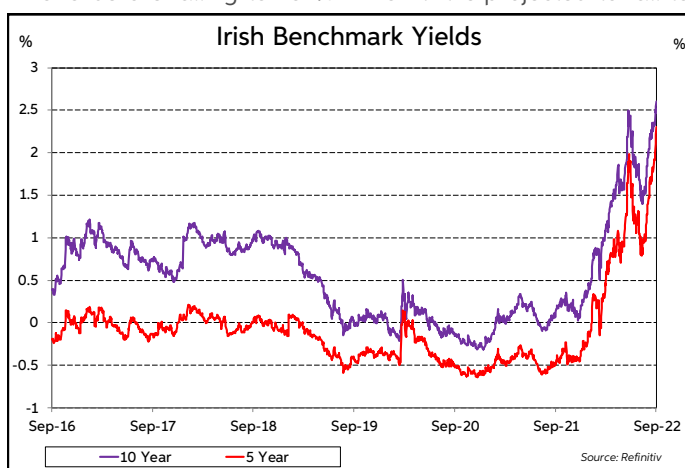
- **Overall gross public spending is projected to remain broadly static at €90-91bn in the period 2022-24.** Temporary spending measures (Covid, Ukraine, Energy Supports) roll off in 2023-24. Core spending, though, is forecast to rise by 6.3% in 2023 and 5% in 2024. In terms of the budget today, there was a package of social welfare increases amounting to €1 billion, including a rise of €12 a week in core welfare payments, as well as additional resources for numerous areas including education, child care and the health service.

### Limited amount of bond issuance in 2023

- **Ireland's general government gross debt/GDP ratio had been in marked decline since 2013** when it stood at 120%. It fell to 57.2% at end 2019 before rising slightly to 58.4% in 2020. It then fell to 55.4% in 2021. However, greatly inflated GDP figures since 2015 overstate the rate of improvement and underestimate the size of the actual debt burden. A better measure is the level of the Government Debt to GNI\* (Modified Gross National Income which excludes the distortionary effects in GDP caused by multi-nationals). On this basis, the gross debt ratio rose from 94.6% in 2019 to 104.7% in 2020 before falling to 101% in 2021. It is projected to fall to 86.3% in 2022 and 81.5% in 2023.

- Government debt is a gross figure and somewhat misleading as it includes significant pre-funding, which is held in cash balances. **The National Debt metric takes these cash and some other balances into account. It stood at €202.5bn at end August, down from €207bn at end 2021.** The Dept. estimates that the net national debt to GNI\* ratio will fall to 73% this year from 82% in 2021, and to 63.5% by 2024.

- **The NTMA has just two bonds maturing in 2023, which amount to €9bn in total size.** It continues to run very high cash and other balances, which stood at over €37bn at end August 2022. The Exchequer will have a deficit of circa €5bn over the final four months of the year, while a €5.3bn bond matures in October. These will reduce cash balances, while some short-term funding may not be rolled over. **Nonetheless by end year, cash balances could still be above €25bn.**



- With a projected Exchequer surplus of €1.7bn in 2023 and these large cash balances, it means that **next year's maturing debt of €9bn is already well pre-funded.** The NTMA can be expected to remain active in the market next year to maintain cash balances at a comfortable level, thereby helping to prefund 2024's maturing debt which again will amount to €9bn. However, total issuance is likely to be relatively small.
- **The NTMA has done well to have such high levels of cash balances in place at a low funding cost** given the marked jump in bond yields in 2022. 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 well insulated from the sharp upward move in global bond yields this year. **The forecast general government budget surpluses of €6.2bn in 2023 and €10.7bn in 2024 are also reassuring given there are some doubts about the sustainability of up to €10bn in corporation tax receipts** which the Dept. is concerned may prove 'windfall' in nature. These surpluses help future-proof the public finances from any significant downturn in these tax receipts.

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