Meeting of the Budget Oversight Committee,

Wednesday 4th May 2022

Opening Statement of the Minister for Finance,

Paschal Donohoe T.D. re:

Stability Programme, April 2022 Update

Introduction

I thank the Chairperson and the Committee for the opportunity to be here today to discuss the *Stability Programme Update*.

The Stability Programme Update – SPU – sets out the Government's macroeconomic and fiscal forecasts out to 2025.

The SPU was published in draft form on the 13th April 2022 and in accordance with our legal requirements, the final version of the SPU was submitted to the European authorities on Friday 29th April 2022.

I want to stress that forecasts outlined in the SPU are produced on a purely technical basis, reflecting existing government policies, while also allowing for the inclusion of new expenditure to provide for the re-settling of Ukrainian refugees.

Policy formulation will take place over the summer months, with the *Summer Economic Statement* setting out the broad economic and

fiscal parameters for the Budget. As well as the Summer Economic Statement, we will also have the *National Economic Dialogue* in June and the *Tax Strategy Group* meeting, both of which will facilitate a constructive discussion amongst a range of stakeholders on the key socio-economic issues facing our country.

All of this will feed into preparation of the Budget next October.

Backdrop to the SPU

At the start of the year, we took a very significant step forward with the removal of Covid-related restrictions and, for a brief moment, it seemed that the Irish economy was starting to return to some degree of normality.

Shortly afterwards, however, this outlook was upended, as a serious and disturbing new crisis arose with Russia's unlawful and immoral invasion of Ukraine.

Chair, the Russian invasion of Ukraine is, first and foremost, a humanitarian crisis. Along with the unjust loss of life, millions of people have been forced to flee their homeland – over 5.3 million people have left Ukraine at this point, with a further 7.7 million displaced within the country.

As well as the humanitarian crisis, the economic, financial and other sanctions introduced, represent a large 'supply-side' shock to the global economy, and I think it's fair to say that European Union Member States are at the coal-face.

Whilst the impact from the war in Ukraine represents the most immediate risk to our economy, we cannot lose sight of the other challenges on the horizon, particularly the ongoing threat which Brexit poses. The UK Government's decision to postpone the further implementation of import controls means that the full impact of Brexit will not be evident immediately; this will not, however, lessen the impact on the Irish economy.

War in Ukraine/Cost of living

The economic consequences of the war in Ukraine will ripple out across the global economy. According to the latest IMF forecasts, the war in Ukraine is expected to wipe close to 1 percentage point off global growth this year.

Whilst Ireland's direct trade links with both Russia and Ukraine are very small, we are nevertheless highly exposed to the indirect effect arising from the conflict and we are already seeing the fall-out from the war.

It is perhaps most evident in consumer price inflation, which has risen sharply – reaching a multi-decade high of 7.3 per cent in April. My Department expects inflation to peak in the second quarter before easing slightly over the rest of the year. We – along with others – anticipate a significant easing in inflation is anticipated for next year, with the headline rate projected to average 3 per cent for the year as a whole.

Taking all of this into account, my Department has incorporated a 2¼ percentage point reduction in its growth forecast since the time of the Budget. We are now projecting Modified Domestic Demand growth this year of 4¼ per cent.

These projections are based on current market expectations regarding oil and gas prices and, as members will be aware, prices can fluctuate, both upwards and downwards.

Policy

The Government recognises the real hardship rising prices create for households across this country. We have responded swiftly to provide support where we can, with a wide range of tax and expenditure measures, worth over €2 billion.

On top of the €1 billion in measures announced in *Budget 2022*, there have been three further cost-of-living packages. This includes the latest measures agreed recently at Cabinet at which the following were agreed:

- an additional three weeks' payment of the fuel allowance,
- a temporary reduction in VAT on gas and electricity,
- the scrapping of the public service obligation levy which is placed on energy bills,
- and an extension of the reduction in excise duty announced last month to mid-October.

Ultimately, however, the causes of current inflationary pressures are not within our control, and there is a limit to what Government can do to offset rising energy costs. Government can help to share the burden, but Government cannot fully absorb the burden.

Labour Market

On a positive note, employment growth surprised on the upside over the past year or so, and the number in employment is now at its highest level ever of 2.4 million. The rapid recovery in the labour market is due, in no small part, to the various measures the Government put in place to support workers during the pandemic, most notably the *Employment Wage Subsidy Scheme*. These helped

to maintain the employer-employee link that is so important. With the pandemic now running out of road, it is appropriate to exit these labour market supports and that is what we are doing.

Fiscal Developments

Allowing for all the above factors, my Department is now forecasting a general government deficit of €1.9 billion for this year. This would result in a combined deficit of almost €30 billion since the start of 2020.

The expenditure ceiling set out in *Budget 2022* was €85.6 billion for 2023. This provides for a 5 per cent increase in 'core', i.e. non-Covid, expenditure next year. An additional contingency fund of €3 billion has also been included to address the humanitarian consequences of the Ukrainian conflict.

Combining all these elements, we are currently forecasting a marginal surplus of approximately €1 billion – around a half a per cent of national income – for next year.

But again, these figures all come with a large caveat; there is a huge level of uncertainty with the situation in Ukraine, how it might evolve

over the coming months, and how it could impact on the public finances.

In addition, it is essential to make the point that public debt still remains high and – at just over €235 billion this year – is a source of vulnerability and must be managed.

I would also stress that borrowing costs are now on a rising trajectory – the interest rate on 10-year money has increased by 1 percentage points in just two months - and quantitative easing is coming to an end.

This highlights the importance of managing our public finances in a prudent manner.

Conclusion

In conclusion, Chairperson, I think the Committee will agree that the Irish people have shown great resilience through the pandemic.

Once again, we will need to be resilient in the face of serious external challenges and the rising cost of living.

While the Government will continue working to minimise the fall-out on those who are least-equipped to respond, it must be stressed that resources are limited. Government will share, but cannot assume in entirety, the burden of higher energy and commodity prices.

With that in mind, I look forward to a fruitful and constructive exchange of views on the economic and fiscal outlook and the opportunity to take into consideration the perspective of Committee members here today.