Meeting of the Budget Oversight Committee,

Stability Programme, April 2023 Update

Opening Statement by Minister for Finance, Michael McGrath T.D.

Wednesday 26th April 2023

Introduction

Chair, members of the Committee, let me begin by thanking you for the opportunity to be here today to discuss the *Stability Programme Update.*

The document was published in draft form on the 18th April 2023. In accordance with our legal requirements, the final version will be submitted to the European authorities on Friday.

By way of background, the annual update of the Stability Programme is prepared each spring by my officials in cooperation with Minister Donohoe's officials, and sets out my Department's best assessment of the economic and fiscal situation and outlook. The legal framework requires forecasts for the next three years at a minimum; on this occasion we have prepared economic forecasts that extend to 2030.

Following a rigorous process, the macroeconomic forecasts were endorsed by the *Irish Fiscal Advisory Council* on 6th April; the Council, in particular, welcomed the longer-term economic forecast horizon.

The Stability Programme is prepared on an existing policy basis. The analysis and projections are prepared on the basis of the policy position set out in *Budget 2023*, with the addition of policy measures officially announced in the intervening period – for instance the February package.

Government will formulate the broad parameters of its budgetary policy over the summer and this will be published in the *Summer Economic Statement*. Before that, Government will engage with stakeholders via the *National Economic Dialogue* which takes place on 12th June.

The Government has set out a medium-term fiscal framework that permits core public expenditure, net of any discretionary tax changes, to grow by 5 per cent per annum over the period 2021 to 2025. The SPU is prepared on a no policy change basis and therefore the 5 per cent rule has been applied in the figures.

In response to the war in Ukraine and the subsequent cost of living challenges facing households, the Government agreed last year as part of Budget 2023 to adjust the annual expenditure growth rate, going slightly beyond 5 per cent growth rate set out under the fiscal framework.

Decisions in relation core and non-core expenditure parameters for Budget 2024 will be considered as part of the Summer Economic Statement 2023.

Backdrop to the Stability Programme

Moving to the substantive issues, Chair, let me say a few words about the economic and fiscal context.

Despite the energy price shock and multi-decade high rates of inflation, the Irish economy has proven remarkably resilient. This is most evident in the labour market, with employment at a record high, and the rate of unemployment close to historic lows at 4.3 per cent in March. To put some numbers on the employment situation: there are 220,000, or 9 per cent more people in employment now than there were immediately before the pandemic.

Unlike some other economies Ireland's participation rate has also improved from pre pandemic levels. I think it is fair to say that this is truly remarkable.

Resilience is not just a feature of the Irish economy – demand in our main export markets has held up. However, the situation remains extremely fragile and I share the assessment of my officials that risks to the global economy are tilted to the downside.

Elevated geopolitical tensions and further global financial market fall-out from aggressive monetary policy tightening are just some of the forces that could de-rail the world economy.

Domestic short-term economic outlook

Against this background, my Department's forecast is for modified domestic demand (MDD) – a proxy for the domestic economy – to grow by 2.1 per cent this year and by 2½ per cent next year. For this year, the forecasts have been revised up relative to the autumn forecasts by just under one percentage point.

The improved outlook for domestic activity is reflected in a robust labour market, with employment just shy of 2.6 million - its highest level ever. Employment is expected to continue growing this year in line with domestic economic conditions while the unemployment rate is expected to remain low at under 4½ per cent this year.

Price pressures are easing somewhat. It now appears as though inflation, absent any further energy price shock, is on a downward trajectory. Headline inflation is forecast to be just under 5 per cent this year and 2½ per cent next year.

However, cost of living pressures remain. Non-energy or ‘core’ inflation is expected to ease more slowly, with elevated energy prices having passed through to many other sectors.

Government response

Against this backdrop, it is important that budgetary policy does not add fuel to the inflation fire. And I believe the Government has got the balance right – in February, Government implemented a further package of cost of living supports worth almost €1.3 billion.

This included the extension of reduced taxes levied on fuel and electricity, the extension of the 9 per cent VAT rate on hospitality, lump sum payments to recipients of long-term social welfare and a widening of the eligibility criteria for the TBESS business support scheme.

This built upon a wide range of measures put in place since *Budget 2022* to help to ease the burden of inflation on households and businesses. Taken together, Government has made available €12 billion, or almost 4½ per cent of GNI*, in direct measures to help to ease the burden of inflation on households and businesses.

This response has struck the correct balance between helping to absorb some of the impact of rising prices without adding to inflationary pressures.

It is also crucial that our fiscal response does not jeopardise the sustainability of our public finances over the medium term. That is why I have made clear that the February package of supports will be the last cost of living intervention until *Budget 2024* and why Government has taken the decision to gradually phase out the reduced rate of tax on fuel.

Medium-term outlook

Medium-term macroeconomic forecasts out to 2030 are also detailed in this year's SPU.

The production of these longer-term forecasts was motivated by reforms to the European Union's fiscal rules that are currently in the pipeline, as well as previous recommendations of the *Irish Fiscal Advisory Council*.

The key takeaway from the analysis is that over the second half of this decade, economic growth is set to slow. This is mainly due to an ageing population as well as slower productivity growth. My officials have been documenting this for some time.

Fiscal Developments

Turning to fiscal developments, my Department is now forecasting a general government surplus of €10 billion for this year, the equivalent of 3.5 per cent of national income.

This is based on the assumption of tax revenue amounting to almost €89 billion, a growth rate of almost 7 per cent.

While this is, of course, very much welcome, the headline surplus this year is heavily dependent on volatile ‘windfall’ corporate tax receipts, in other words receipts that cannot be explained by underlying economic conditions. Excluding the impact of these receipts, estimated at almost €12 billion this year, an underlying deficit of €1.8 billion is projected for this year. This is a better metric for assessing the resilience of our public finances.

Government is taking steps to address the risks around ‘windfall’ corporate taxes. A total of €6 billion has now been transferred to the *National Reserve Fund* to strengthen our economic and fiscal resilience.

Moreover, I will shortly bring advanced proposals on a longer-term focused national reserve fund; a scoping paper that sets out high level principles will be published very shortly by my Department.

Public indebtedness next year is projected at over €224 billion, or over 75 per cent of GNI*. It is important to stress that borrowing costs have increased significantly and the direction of travel is clear. Because of this, fiscal trade-offs are once again a feature of decision-making.

Conclusion

In conclusion, Chair, the past number of years have thrown up many challenges for the Irish people, with the onset of a once-in-a-lifetime pandemic followed by a once-in-a-generation energy price shock. Despite these challenges, the Irish people have continued to show incredible resilience.

Looking ahead, the Government will continue to protect those most adversely impacted by cost of living pressures and continue to invest – in a sustainable way – in vital public services.

Government will also manage the public finances in a way that equips the State to address the numerous fiscal challenges coming down the line in the years ahead.

I look forward to a fruitful and constructive exchange of views on the economic and fiscal outlook but, before that, I will now give the floor to my colleague, Minister Donohoe.

ENDS.