Introduction

The Government published the draft Stability Programme Update 2020 (SPU) on 21 April – this year’s SPU is a 68-page document set out in six sections, which include a total of sixty-two tables, figures, boxes and annexes. Accompanying the SPU this year are five additional documents which range from presentations to chart packs to a methodological paper (on economic ‘Nowcasting’).

The SPU sets out a macroeconomic and fiscal scenario for the period 2020-2021 which incorporates the impact of the COVID-19 pandemic. The SPU would normally address the current year and the following four years. The macroeconomic forecasts underpinning the SPU were endorsed by the Irish Fiscal Advisory Council (IFAC) on 10 April.

The draft SPU will be submitted to the European Commission by 30 April in accordance with the requirements of the European Semester. The draft SPU is the central basis for the Dáil statements on the Irish economy to be held on 23 April. In the context of the very limited time available to TDs to review the large amount of data published by the Department of Finance both within the SPU itself and in the accompanying documents, the PBO has published this summary analysis in order to highlight the key points for consideration and debate.

Key points

- The central economic scenario set out in the draft SPU 2020 assumes that restrictions to constrain the spread of the virus will be in place for three months. The Department of Finance assumes that there will be severe economic disruptions in Q2 2020 due to these restrictions. It then assumes that the economy will bounce back, with economic growth returning to its pre-pandemic trend rate by 2021. There is an unusual degree of uncertainty attached to these economic forecasts and the assumptions underpinning them including that the restrictions last for three months, that there is no reoccurrence of these restrictions, and that there is a strong economic response once the restrictions are lifted.

- The COVID-19 pandemic is expected to be (and modelled by the Department of Finance as an) unprecedented but transient shock to the economy. In this context, the PBO sees as crucial the adoption of a counter-cyclical expansionary fiscal stance¹ to support the economy, mitigate economic hardship and bolster important public services. This will also provide the best possible basis for an economic rebound when the pandemic is brought under control. Failure to respond strongly and decisively could lead to a prolonged recession and permanent economic damage. Any attempt at future fiscal consolidation (spending cuts

¹ Reducing government spending and increasing taxes during an economic expansion and reducing taxes and increasing spending during a recession to stabilise the economic cycle.
or tax increases) in response to the crisis must be carefully managed to ensure that it does not depress domestic demand and undermine the recovery.

- The SPU 2020 indicates that Government will introduce an economic recovery plan shortly, which will detail the approach to repairing the economic harm caused by COVID-19. Forecasts of deficit and debt do not take account of the associated costs of these additional measures (as decisions have not yet been taken). This may have implications for the deficit and debt projections included in the SPU.

- The SPU 2020 treats the allocation of €70.4 billion from the Revised Estimates for Public Services 2020 (published in December 2019) as the baseline spending level for this year. This expenditure is then increased by €8 billion to €78.4 billion to account for the COVID-19 pandemic fiscal measures taken so far and the estimated impact (€1.3 billion) on income supports in Q3/4 of the unemployment projections. In that context, the PBO suggests that money could be re-allocated from non-priority areas to the more pressing priority of addressing the costs arising from Government’s pandemic measures.

- The gross debt-to-GNI* ratio is projected to increase to 125.1% by-end 2020. However, debt financing conditions are positive with interest spending expected to decrease in 2020 and 2021 (despite the stock of debt increasing). This is helped by the intervention of the European Central Bank and by the NTMA’s strategy of "locking-in" low interest rates and lengthening the average maturity of Ireland’s debt. Issuing debt to finance spending in the event of temporary budget deficits is a reasonable response while this positive financing environment prevails.

- SPU 2020 does not include an estimation of Ireland’s structural budget position (due to heightened uncertainties associated with current estimates of the output gap). To facilitate a decisive and strong fiscal action against the pandemic, the budgetary requirements that would normally apply under the European budgetary framework have been suspended. It is currently difficult to gauge how the emergency fiscal measures will be treated in terms of compliance with the EU fiscal rules.

- SPU 2020 sets out that the Government expects to spend €8 billion on COVID-19 measures and to provide employment and unemployment supports in the second half of the year but does not address what direct support may be available to the Irish economy from the EU. As the PBO has previously noted, additional spending in response to COVID-19 will likely come directly from the Irish Exchequer rather than from EU sources.
Overview of economic forecasts

The SPU sets out the Department of Finance’s updated economic forecasts. These forecasts have been endorsed by the Irish Fiscal Advisory Council. Following guidance from the European Commission, projections are limited to two years: 2020 and 2021.

The headline forecasts outlined in the SPU assume that restrictions to constrain the spread of the virus will be effective and in place for only three months (therefore the shock to the economy is expected to be temporary). This modelling approach results in a severe economic disruption in the latter weeks of Q1 and for the majority of Q2. Economic activity starts to recover gradually from Q3 onwards. A summary of these forecasts is provided below.

**GDP** is forecast to fall by 10.5% in 2020. While it is expected to bounce back and grow by 6% in 2021, it will still be almost 12% lower than it would have been in the absence of a pandemic at the end of 2021. The SPU also provides forecasts for two additional scenarios where restrictions remain in place for longer. Under the “downside scenario” (restrictions last for 6 months) GDP falls by 13.8% in 2020 and in a “severe downside scenario” (restrictions last for 9 months) GDP falls by 15.3%. The forecasts also suggest that **Modified Domestic Demand** (which is a proxy for the domestic economy) will fall by more than GDP. Modified Domestic Demand is expected to fall by 15.1% (central scenario) this year and to grow by 8.2% next year.

Looking at the underlying components of GDP, consumer spending will fall due to both lower incomes and the restrictions that have been placed on non-essential retail outlets. It is forecast to fall by 14.2% in 2020 but is expected to grow by 8.7% in 2021. Modified Investment is forecast to fall by 37.3% in 2020 due to increased uncertainty and closing of construction sites. It is forecast to recover and grow by 22.5% in 2021. Public consumption is expected to increase by 9.1% this year due to the discretionary policy measures and the effects of automatic stabilisers. It should fall in

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2 Pre-COVID-19 Scenario.

3 Policies which take money out of the economy during an economic expansion and put more money into the economy during a recession without any additional government action. Examples include unemployment payments and progressive income taxes.
2021 (-3.2%), as some of the temporary exceptional spending is gradually unwound. Exports are forecast to fall by 7.7% this year and to rise by 7.5% next year.

The unemployment rate is forecast to peak in Q2 2020 at 22%. However, it is expected to fall to 13.5% in Q3 as restrictions are lifted and will continue to fall gradually in the subsequent months. The unemployment rate will still be elevated at 9.1% in Q4 2021. The number of people working in Ireland is forecast to fall by 9.3% this year. It is expected to recover in 2021 with growth of 5.5%. However, the number of people at work will still be 7.6% lower than what it would have been in a non-pandemic scenario. Pay per employee is forecast to fall by 7.6% this year and grow by 3.8% in 2021.

Source: CSO and Department of Finance SPU, F indicates a forecast

Estimates for potential output (an estimate for the natural productive capacity of the economy) and the output gap are not provided in this SPU, motivated by the difficulty in estimating them in an accurate manner at this point in time. While it’s assumed that the shock will have transient effects (with growth returning to its the pre-pandemic trend/potential rate), the longer the recession will last the more likely that there will be permanent losses in the potential productive capacity of the economy.
Overview of public spending

Voted Spending 2019

Total gross voted expenditure of €67.4 billion for 2019 was 1.2% (€0.8 billion) above the profile associated with the Revised Estimates for Public Services 2019. The bulk of this in-year increase is directly related to Government decisions to seek Dáil approval for Supplementary Estimates – notably for the Health Vote (€383 million). Gross voted current expenditure was therefore 1.3% (€757 million) above profile, with gross voted capital expenditure 0.3% (€24 million) above.

Voted Spending 2020

The Revised Estimates for Public Services 2020 (REV2020), published on 18th December 2019, set out an overall Government Expenditure Ceiling of €70.4 billion. These Estimates were not voted on before the dissolution of Dáil Éireann which means that only 80% of each Vote’s 2019 net allocation may be spent in 2020.

The SPU treats the REV2020 allocation of €70.4 billion as the baseline spending level for this year.

This expenditure is then increased by €8 billion to €78.4 billion to account for the:

1. COVID-19 pandemic fiscal measures taken so far; and
2. Estimated impact on income supports in Q3/4 of unemployment projections.

In relation to (1) above the fiscal measures amounting to €8 billion are:

- almost €2 billion to the Health Vote (no.38);
- approx. €4 - €4.5 billion (over a 12-week period) to the Employment Affairs and Social Protection Vote (no.37);
- approx. €200 million for the Business, Enterprise and Innovation Vote (no.32);
- €1.3 billion in income supports in Q3/4.

The estimate for Vote no.37 takes into account that the introduction of the Temporary Wage Subsidy Scheme (TWSS) and enhanced Pandemic Unemployment Payment (PUP) will reduce the level of spending on the standard Sick Pay and Illness Benefit Scheme over this 12-week period.

The SPU notes that “Following Government formation, the Estimates for individual Departments will need to be refreshed and consolidated, and in some cases re-structured, to reflect the changed overall allocations, taking into account the impact on expenditure of the Covid-19 crisis.”

In that context, the PBO in Publication 14 of 2020 suggested more explicitly that “other Votes [excluding Health and Employment Affairs and Social Protection] may not need their previously indicated allocation for this year and that money could be re-allocated to help address costs arising from the pandemic.”

The SPU (p.37) states that “Expenditure in the year-to-date reflects the impact of the Covid-19 crisis. Gross voted expenditure at the end of the first quarter was 7.1% (€1,135 million) above profile with

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4 See Publication 74 of 2019, PBO Analysis of the Supplementary Estimates for Public Services 2019.
5 SPU, p.36.
6 Ibid.
7 Ibid.
8 See Table 1 of PBO Publication 7 of 2020.
9 The PBO assumes that the difference between the total allocation announced in the SPU and provision made to date of €6.7 billion relates to estimates of what will be required to provide income supports in the second half of 2020.
all additional spending occurring in March. This reflects extra spending in Health and on income supports directly related to the Covid-19 crisis, and also as part of contingency arrangements, accelerated draw down of funds by Government Departments to ensure that they and bodies under their aegis are in a position to meet all liabilities promptly. However, the SPU does not detail how much of the extra spending to March is related directly to the pandemic and how much is related to “accelerated draw down of funds”.

PBO Publication 14 of 2020 (Figures 3 and 4) illustrates the extent to which Vote Groups had spent versus profile. Setting aside Health, Children and Youth Affairs, Employment Affairs and Social Protection, other Vote Groups such as Housing, Planning and Local Government, and Education and Skills had spent significantly over profile at end-March.

Impact on the Social Insurance Fund (SIF)
While not considered and approved as part of the annual Estimates process by the Dáil the SIF is presented in the Revised Estimates along with the Employment Affairs and Social Protection Vote. The SPU (p.41) forecasts that PRSI receipts will be reduced by the pandemic by approx. 12% in 2020. This suggests that the originally estimated excess of income over expenditure of approx. €2 billion will be largely annulled.

Voted Spending 2021
The updated fiscal projections published by the Department of Finance (9 January 2020) set out gross voted expenditure for 2021 of €73.4 billion - an increase of €3 billion (4.25%) on the overall expenditure amount set out in REV 2020. That amount is the assumed expenditure baseline position in the SPU, with a technical adjustment made of €1.5 billion for additional Live Register related expenditure arising from the revised labour market forecasts. The SPU cautions (p.37) that this spending in 2021 is subject to review, particularly in relation to Health Spending that may be required again in 2021 depending on the status of the pandemic.

The changes in Voted spending between 2019 and 2021 are set out in Table 1. It should be noted Gross Voted spending includes monies collected by Votes as Appropriations-in-Aid. If this money is not collected, then there will be a shortfall in Vote budgets to be addressed.

Table 1: Voted spending 2019-2021

<table>
<thead>
<tr>
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<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tbody>
<tr>
<td>Current</td>
<td>60,050</td>
<td>70,205</td>
<td>65,850</td>
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<tr>
<td>Capital</td>
<td>7,365</td>
<td>8,165</td>
<td>9,050</td>
</tr>
<tr>
<td>Total</td>
<td>67,415</td>
<td>78,370</td>
<td>74,900</td>
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<tr>
<td>Less COVID-19 measures</td>
<td>n/a</td>
<td>8,000</td>
<td>To be determined</td>
</tr>
<tr>
<td>Total (excl. COVID-19 measures)</td>
<td>67,415</td>
<td>70,370</td>
<td>74,900</td>
</tr>
</tbody>
</table>

Source: PBO, based on Table 10 of the SPU 2020.

9 The SPU states that “Social Contributions – mainly PRSI receipts” will be reduced by 12%. The PBO assumes that this is a reduction on the pre-pandemic estimate provided in the REV2020 for the SIF.
10 The SPU addresses both Voted and non-Voted Exchequer spending but as the PBO sets out in Publication 26 of 2019, General Government Expenditure - How its composition constrains decisions about government spending, most Exchequer spending is Voted (90% in 2020).
Revenue forecasts

Figure 3: Tax revenue forecast for 2020: MTFS vs SPU (€m)

Source: PBO based on analysis of SPU 2020

- The appropriate pre-COVID-19 baseline for comparison of tax revenue forecasts included in SPU 2020, is set out in the Medium-Term Fiscal Strategy (MTFS). The MTFS was published in January 2020 as an update to figures included in Budget 2020 (which were underpinned by a disorderly Brexit scenario).
- The overall decline in tax revenue, relative to the pre-COVID-19 baseline provided by the MTFS, is 21.9%. Tax revenues are projected to be approximately €49 billion for the year (the lowest level since 2016, when receipts were €48 billion).
- Most of the decline is from Income Tax (-10.2%), followed by VAT (-5.7%). This reflects the downward revision to the Department’s estimates for employment, wages, and personal consumption for 2020.
Total tax revenue is projected to fall for 2020, relative to 2019, by 16.4%. This decline is broad-based, with sizeable decreases across all tax categories. Among the larger taxes, Income Tax and VAT are projected to decline the most, by 20.4% and 18.6% respectively.

For 2021, underpinned by the Department’s central assumption of a gradual recovery from Q3 2020 out to end-2021, tax revenues are projected to increase by 9.4% in 2021. This is driven by a rebound in all tax categories, most notably for Income Tax (9.2%), VAT (12.8%) and Excise (9.6%), reflecting an anticipated improvement in labour market conditions and consumption patterns relative to 2020.

Total tax revenue for 2021 is predicted to be €54 billion (an increase of 9.4% relative to 2020), marginally below the 2018 level (of €56 billion).
The broad-based decline in tax revenues is expected to result in a deterioration in General Government Revenue (GGR) for 2020, of 17%. The Government’s fiscal response to COVID-19 is expected to result in an increase in General Government Expenditure (GGE) for 2020 of 11%, resulting in a deficit of approximately €23.1 billion.

In line with the Department’s recovery scenario, GGR is expected to increase by 9.5% in 2021, while the unwinding of emergency fiscal supports is expected to drive GGE down by 2.5%, with an expected deficit of €13.8 billion.

These expected deficits will add significantly to the national debt, with an additional borrowing of €27.5 billion by 2021 (relative to 2019).
As a percentage of GDP, the GGB for 2020 is expected to be 8.1 percentage points lower relative to the pre-COVID-19 baseline provided in the MTFS. A deficit of 7.4% of GDP is predicted, or 13.3% of GNI*.

As a percentage of GDP, the GGB for 2021 is expected to be 8.3 percentage points lower relative to the MTFS baseline. A deficit of 4.1% is predicted, or 7.3% of GNI*.

In percentage terms, the deficit is expected to improve over 2020 to 2021, driven by both a recovery in national income (GDP and GNI*) and a reduction in the size of the deficit itself (from €23.1 billion to €13.8 billion).

Source: PBO based on analysis of SPU 2020
Public debt developments

Figure 7: Public debt developments, 2009 - 2021

The gradual improvements in public debt sustainability in recent years will be halted by the impact of the pandemic on the public finances and the economy. The gross debt-to-GNI* ratio is projected to increase to 125.1% or €217.5 billion in 2020 (from 99.2% or €204 billion in 2019) due to the financing of the deficit and the reduction in domestic economic activity. This debt ratio is expected to slightly decrease in 2021 to 121.6%. Looking at the debt-to-GDP ratio (69.1%), Ireland will break the 60% Maastricht Treaty threshold in 2020.

While public indebtedness remains high, debt financing conditions are positive with interest spending expected to continue decreasing (to 1.97% of GNI* in 2021). The strong intervention by the European Central Bank through the Pandemic Emergency Purchase Programme is allowing bond yields to remain low. Furthermore, the NTMA has adopted a strategy of "locking-in" low interest rates and lengthening the average maturity of the debt. As noted in the document, so far this year, the NTMA issued €11 billion of Government bonds with weighted average maturity longer than 10 years and a weighted average yield of 0.3%. There are also discussions at the EU level in respect of the design of common long-term debt instruments ("corona-bonds") to fund emergency spending due to the COVID-19 outbreak.

Source: CSO and Department of Finance SPU for 2020-2021, F indicates a forecast
Fiscal rules

SPU 2020 does not include an estimation of Ireland’s structural budget position (due to heightened uncertainties associated with current estimates of the output gap). To facilitate a decisive and strong fiscal action against the pandemic, the budgetary requirements that would normally apply under the European budgetary framework have been suspended. The pandemic, which is an external and symmetric shock to the European economy, can be considered as an unusual circumstance beyond the control of Members States. This allowed the Commission to activate the ‘General Escape Clause’ of the Stability and Growth Pact (SGP).

Under the preventive arm of the SGP, this will allow Member States to depart from their adjustment path towards their medium-term budgetary objective (MTO), while for the corrective arm of the SGP, this provides an extension to the deadline for the implementation of corrective deficit procedures by Member States, provided effective action is taken as recommended by the Council. This is intended to give Members States some leeway in their fiscal response to COVID-19.

It is difficult at this point in time to gauge what how the emergency funding and borrowing needed to tackle the crisis will treated in terms of compliance with the EU fiscal rules, or the rules set out under the Fiscal Responsibility Act 2012. Potentially, this could be treated as once-off spending without fully affecting structural indicators such as the structural balance, which in turn would lessen the need for a fiscal consolidation. However, as noted in the SPU, by breaking the 3% of GDP deficit threshold, which is enshrined in the Treaty on the Functioning of the European Union, the Department expects that an Excessive Deficit Procedure may be launched at a later stage. A longer than anticipated downturn presents further complications, with the potential for a structural component to the deficit to emerge.

12 In Ireland’s case, this is a deficit of 0.5% of GDP in structural terms. Under the European Commission’s CAM-based approach, the Medium-Term Fiscal Strategy publication had projected compliance out to 2025, with a structural balance of 0.3% and 0.4% for 2020 and 2021 respectively.