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Irish Life

Budget 2015: Economic Commentary

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This document provides commentary on the Budget announced Tuesday 14th October 2014.

Irish Budget Economic Commentary

The economic and fiscal backdrop to the 2015 budget is the most favourable since the beginning of the financial crisis and contributed to the government's decision not to adopt the €2bn budget adjustment which had been planned for the 2015 budget a year ago. In pre-budget commentary, the government described the economic recovery as gaining momentum and widening with forecasts for this year and next being revised upwards.

This is evident in the recent GDP release for Q2 which showed the economy growing 7.7% y/y and 0.5% q/q. While the trade sector remained strong with the current account surplus at 6.3% of GDP in Q2, domestic demand is now contributing positively with consumption up 1.8% y/y in Q2 and investment up 18.5% y/y as core machinery and equipment spend grew 21.5% y/y. Domestic demand has been supported by an improving labour market where unemployment has fallen to 11.1% from a 2012 high of 15.1% while numbers employed have grown for seven consecutive quarters with over 1.9m employed for the first time since late 2009. With the resultant rise in consumer confidence, retail sales have shown consistent gains and are up 6.8% y/y or 3.7% y/y excluding autos.

The government prepared the budget on the basis of its updated GDP forecasts of 4.7% for 2014 and 3.6% for 2015. It assumed employment growth of 2.2% in 2015 with unemployment falling to 10.2% and domestic demand growing 3.3%.

Ahead of the budget, the stronger than expected growth in 2014 has placed government finances in a much better position than initially expected. At the end of September, this year's deficit was €1.44bn lower than forecast with revenues €1.35bn ahead of target as VAT, income tax, excise duties and corporate tax receipts have all surprised positively. Spending has however been 0.6% above target with this mainly due to health spending but the majority of other departments are below budget. Meanwhile, interest payments on debt have been well below expectations due to falling interest rates. As a result, prior to policy announcements in the budget, the government forecast the fiscal deficit at 3.7% of GDP this year compared to a forecast of 4.8% at the start of 2014 and predicted it to fall to 2.4% in 2015.

This enabled the government to announce reductions in taxes in today's budget with the various measures estimated to cost €585m next year. The main tax reductions relate to a €1,000 increase in the standard rate income tax band, increases in the income entry levels for the Universal Social Charge (USC) to just above €12,000, 0.5% reductions in both the 2% and 4% USC rates and a 1% reduction in the top rate of income tax to 40%. Income tax relief of up to €500 at the standard tax rate is also being made available in relation to water charges. The various measures announced are estimated to cost €585m in 2015 and will be partly offset by revenue raising measures of €167m. The government estimates that these budget measures, combined with other policies to boost R&D, agriculture and other sectors of the economy will add 0.3% to GDP growth in 2015, resulting in a new growth forecast of 3.9% for 2015 while the fiscal deficit is estimated to widen by 0.3% compared to its pre-budget estimate to 2.7% of GDP and compares to the required target of 2.9% of GDP.

Irish 10 year yields have fallen to 1.66%, down 0.06% today, with spreads against German yields narrowing to 82bps. Two credit rating agencies, S&P and Fitch have upgraded Ireland's credit rating back to an A rating at 'A-', citing the progress made in recent years. This reflects improving confidence in Ireland's recovery and fiscal position post the exit from the Troika programme.