An Roinn Airgeadais
Department of Finance

The economics of public debt and long-term sustainability

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Outline

- Starting point
- Debt developments
- Risks to the outlook/structural challenges
- Key takeaways

Starting point

Public debt

- Public debt (also known as Government debt) represents the stock of (total) outstanding debt of the public sector/government.

- Distinct from private (household) debt.

- Focus has been on gross debt (i.e. the total financial liabilities of the government) rather than net debt (financial liabilities less financial assets) – link between gross debt and debt servicing payments. But will be more focus on net debt (funds).

- Focus on debt as percentage of national income

Why is high debt potentially problematic?

- Vulnerable to increases in interest rate (debt servicing).
- Need to maintain market confidence.
- Could result in decreased ability to respond to problems.
- Inter-generational effects.

Current (but soon to be old) EU Fiscal Rules

- Under (normal circumstances) EU Fiscal Rules mean Member States must:

  - Avoid deficits above 3 per cent **of GDP**.

  - Reduce debt to 60 per cent **of GDP**.

- If debt above 60 per cent of GDP, MS must be compliant with **debt-reduction rule**, which sets out the pace at which government debt needs to be reduced by in reference to the 60 per cent rule.

Role of Debt in revised EU Fiscal Rules

- Treaty reference rates remain (deficit of 3 per cent of GDP, debt below 60 per cent of GDP)

- More medium-term focus
- Medium-term fiscal-structural plans, proposed by each MS but on the basis of guidance (reference adjustment paths) provided by the Commission

- **Aim:** ensure that debt converges to prudent levels

- Reference adjustment paths based on debt sustainability analysis

What drives changes in the debt ratio?

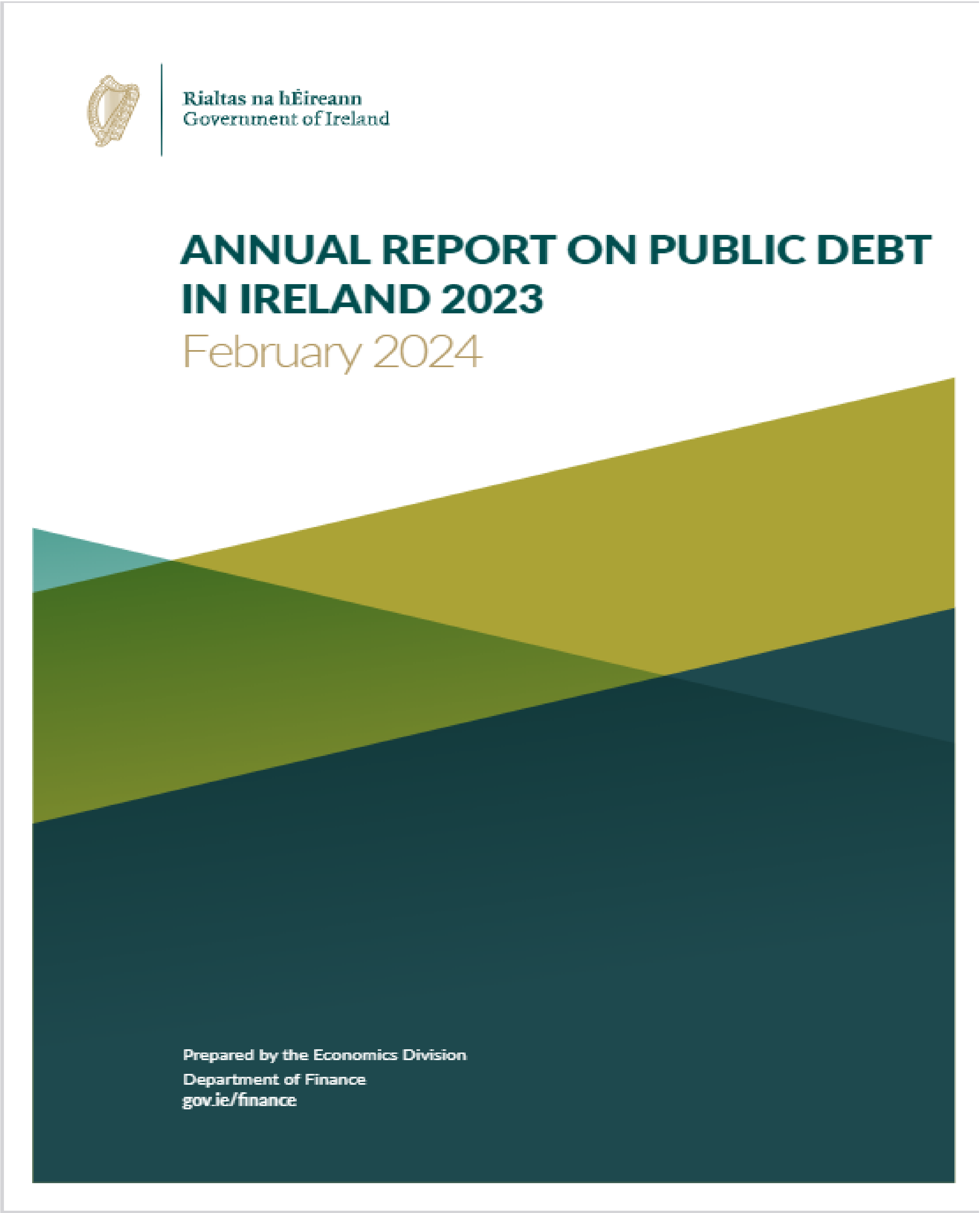
i ii iii

$$\Delta D = \frac{(r-g)}{(1+g)} * D_{t-1} + (-)PB_t + SFA_t$$

i. The interest-growth differential (r-g) multiplied by the debt-income ratio in the previous year (known as the *snowball*);
ii. the primary balance (PB) in the current year; and,
iii. the stock-flow adjustment (SFA) in the current year.

Debt developments

Annual Debt Report 2023


Rialtas na hÉireann
Government of Ireland

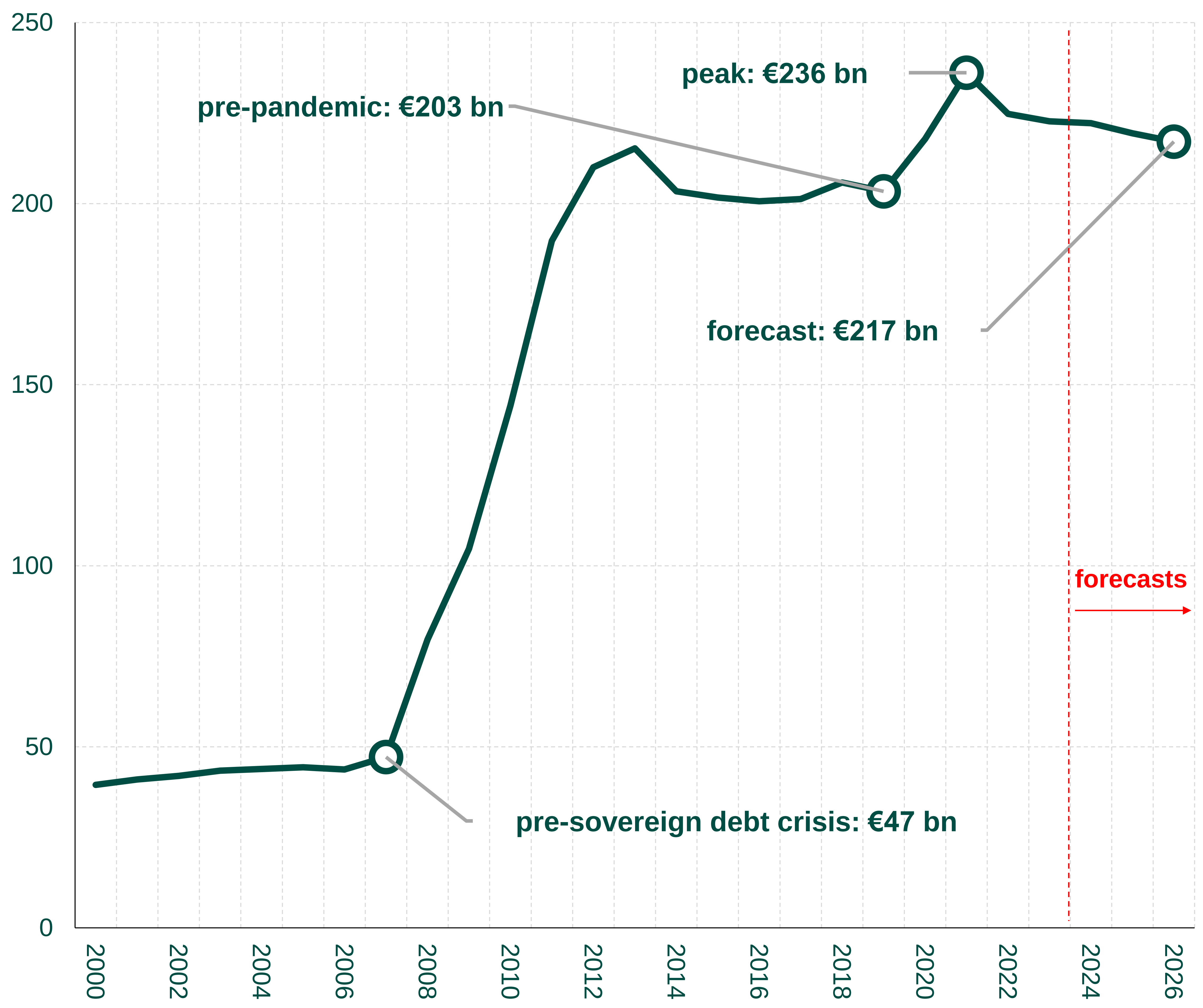
ANNUAL REPORT ON PUBLIC DEBT IN IRELAND 2023
February 2024

Prepared by the Economics Division
Department of Finance
gov.ie/finance

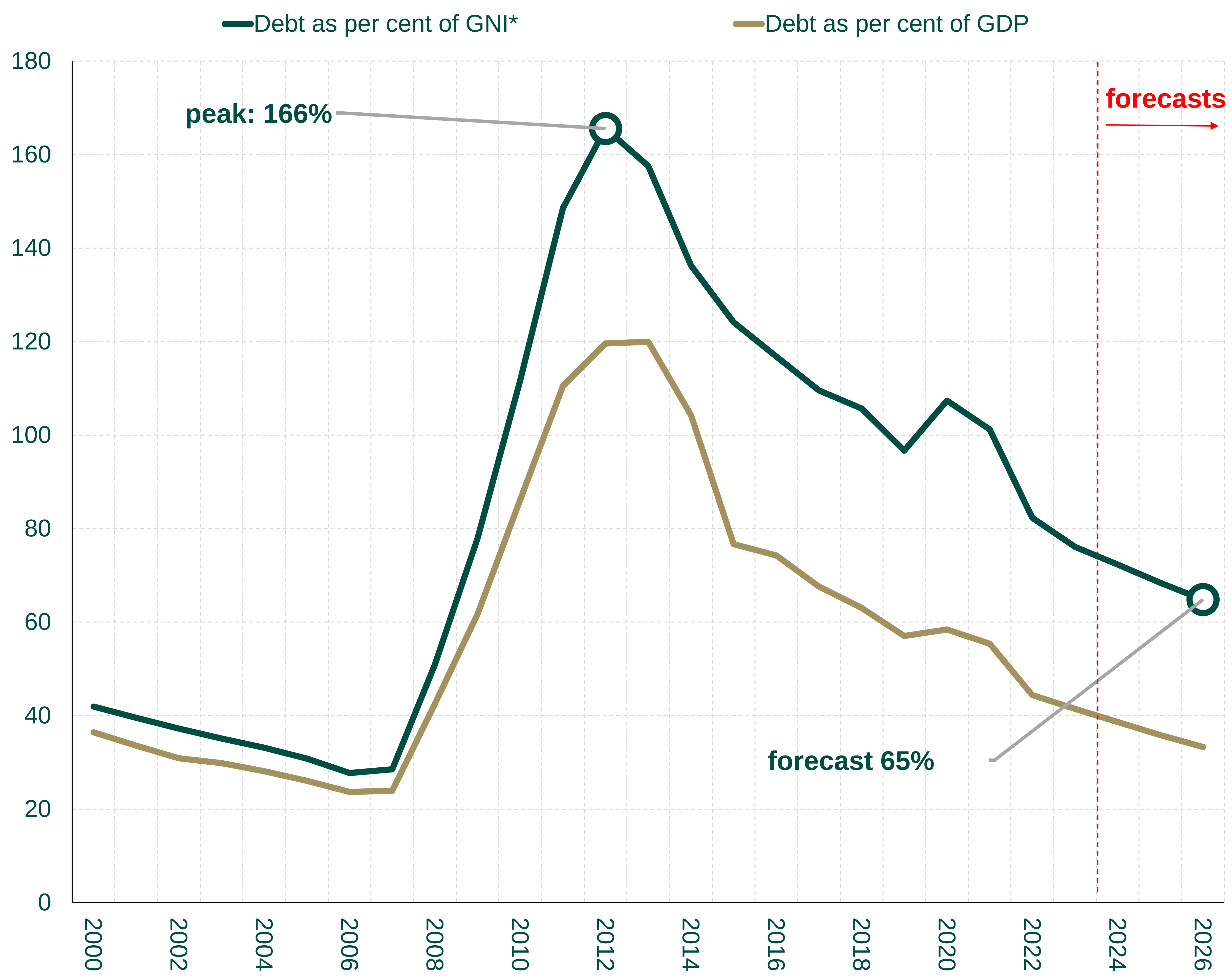
https://www.gov.ie/en/publication/31437-annual-report-on-public-debt-in-ireland-2023/

Debt developments

Gross public debt, € bn



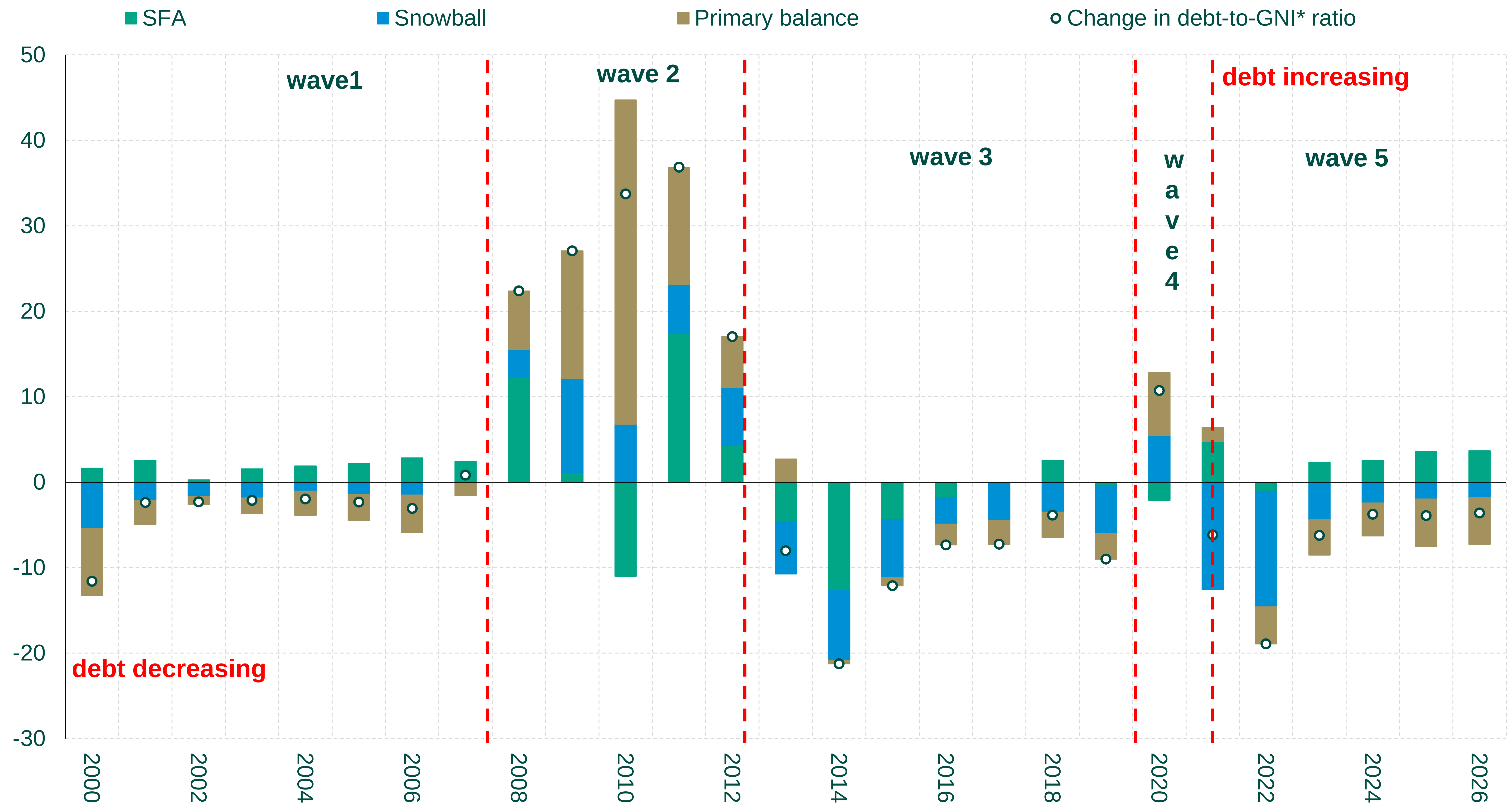
Debt as a share of national income, per cent



Evolution of debt ratio – 5 distinct phases

$$\Delta D = \frac{(r-g)}{(1+g)} * D_{t-1} + (-)PB_t + SFA_t$$

change in public debt ratio, per cent of GNI*



Change in debt ratio

$$\Delta D = \frac{(r-g)}{(1+g)} * D_{t-1} + (-)PB_t + SFA_t$$

	∆ debt	snowball	primary balance	SFA
∆ debt-GNI*				
2022	-18.9	-13.5	4.3	-1.0
2023	-6.2	-4.4	4.1	2.3
2024	-3.8	-2.4	3.8	2.6
2025	-3.9	-2.0	5.5	3.6
2026	-3.6	-1.8	5.5	3.7

Interest rates (borrowing costs)

- Borrowing costs are a key determinant of sustainability.

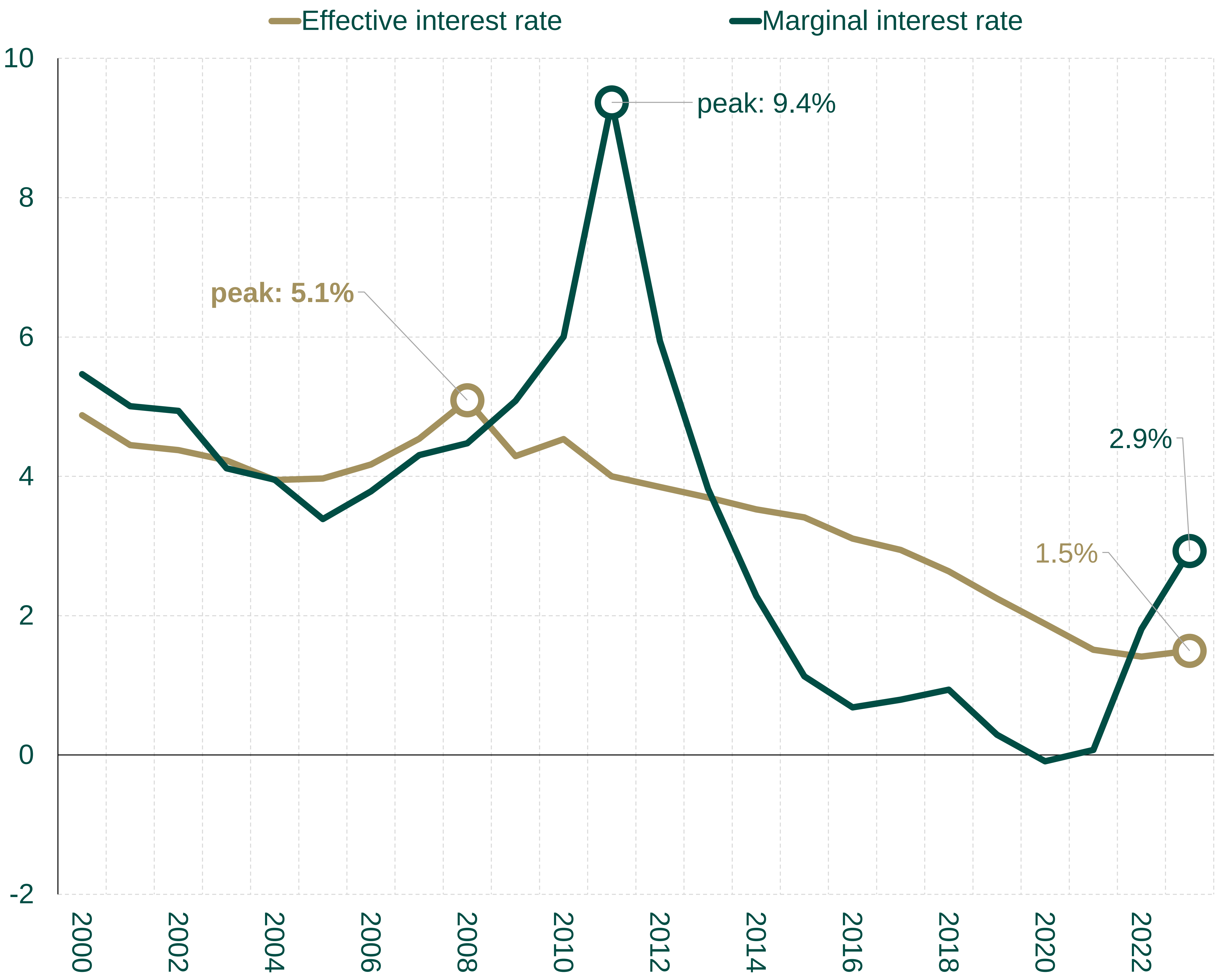
- Increase in yields demanded by lenders during the financial crisis driven by fears surrounding the creditworthiness of the State.

- Over last decade, National Treasury Management Agency (NTMA) able to take advantage of low interest rate environment by issuing debt with long maturities at low yields.

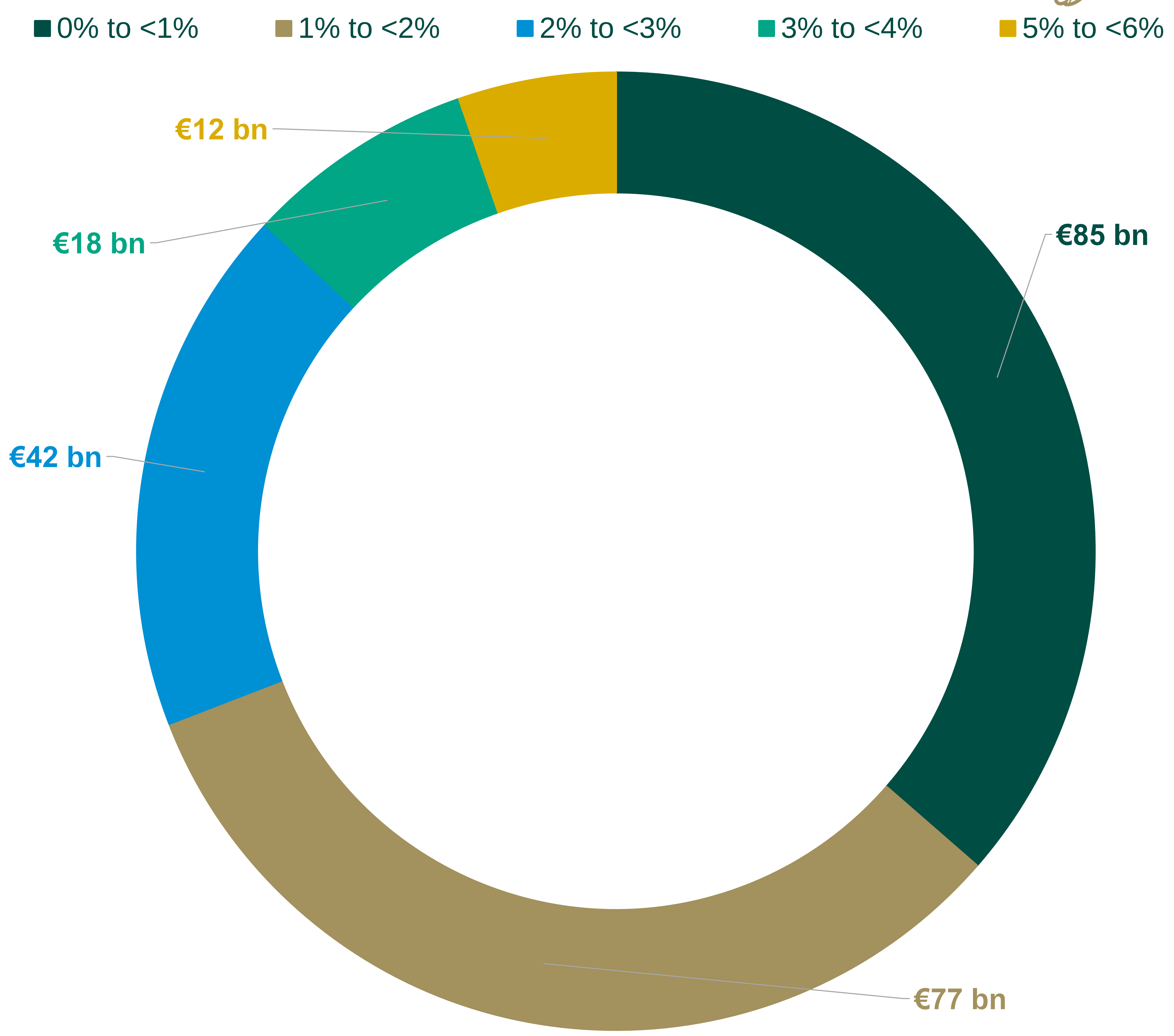
- As a result, despite increases in the marginal cost of borrowing over last two years, the average interest rate continued to fall: the effective interest rate last year was 1.5 per cent, down from just under 4 per cent a decade earlier (and from a peak of over 5 per cent in 2008).

Structural aspects of debt – borrowing costs

Effective interest rate low but rising

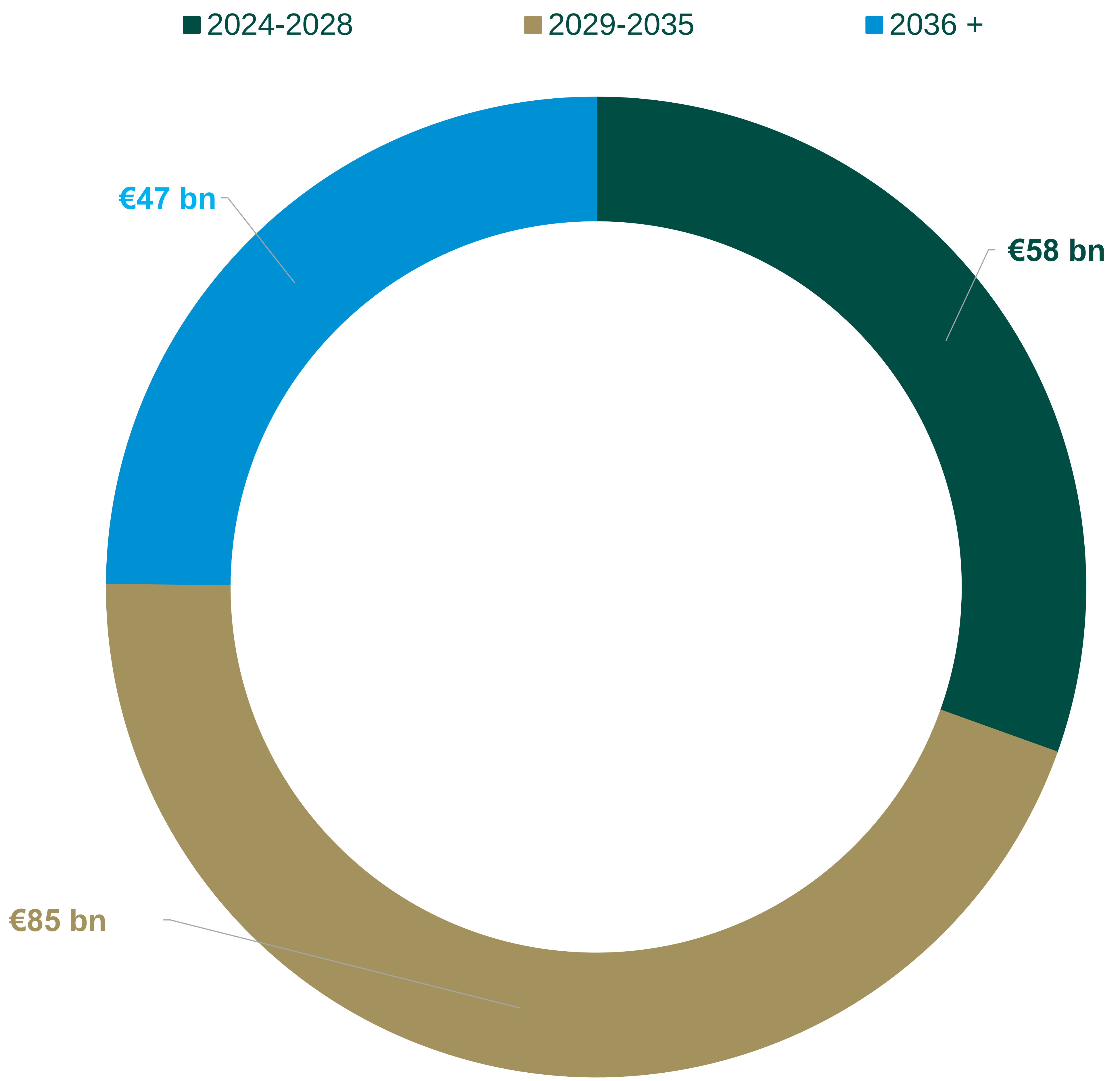


Gross national debt by interest rate at end-December

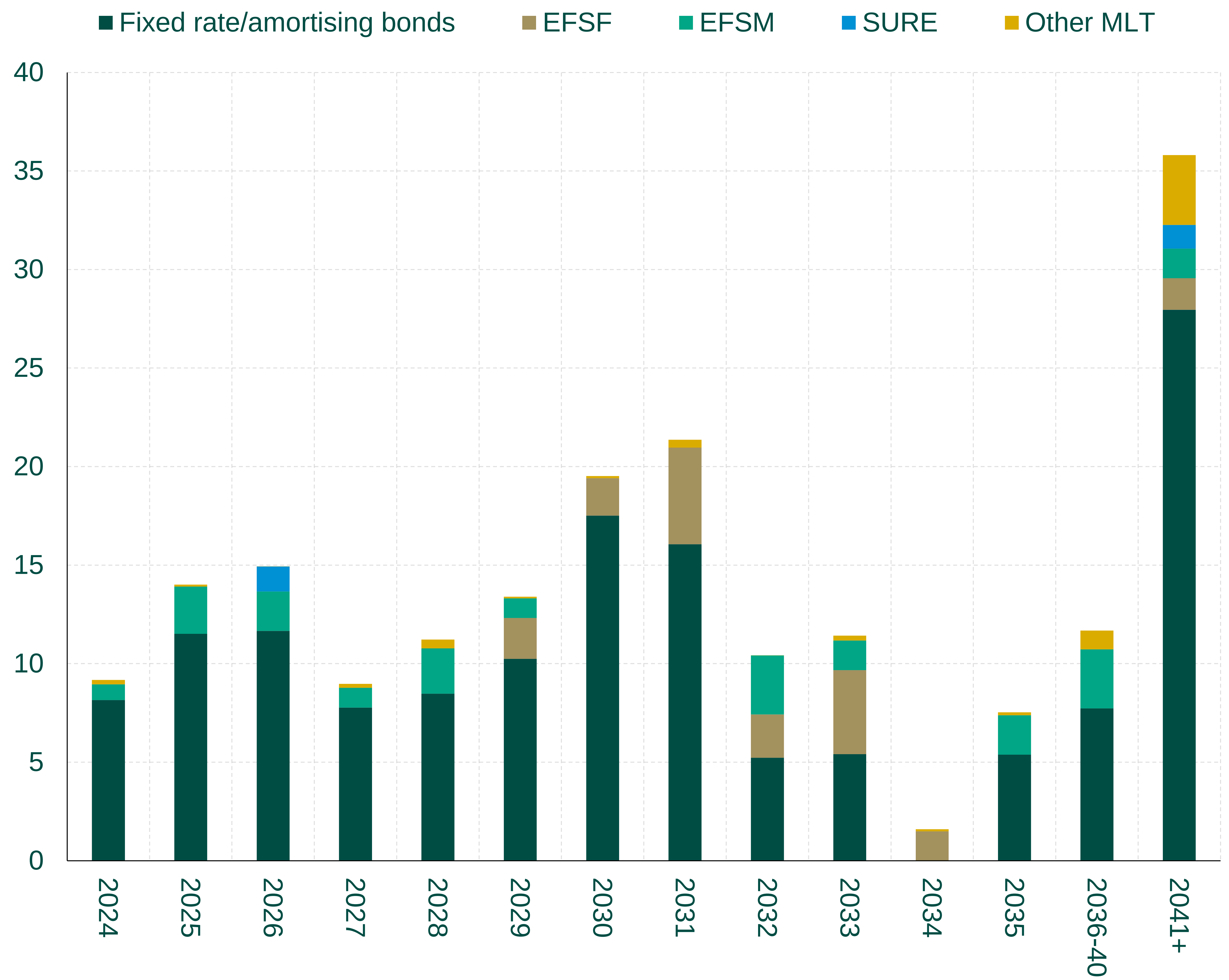


Structural aspects of debt – maturity

Maturity profile of medium and long-term debt

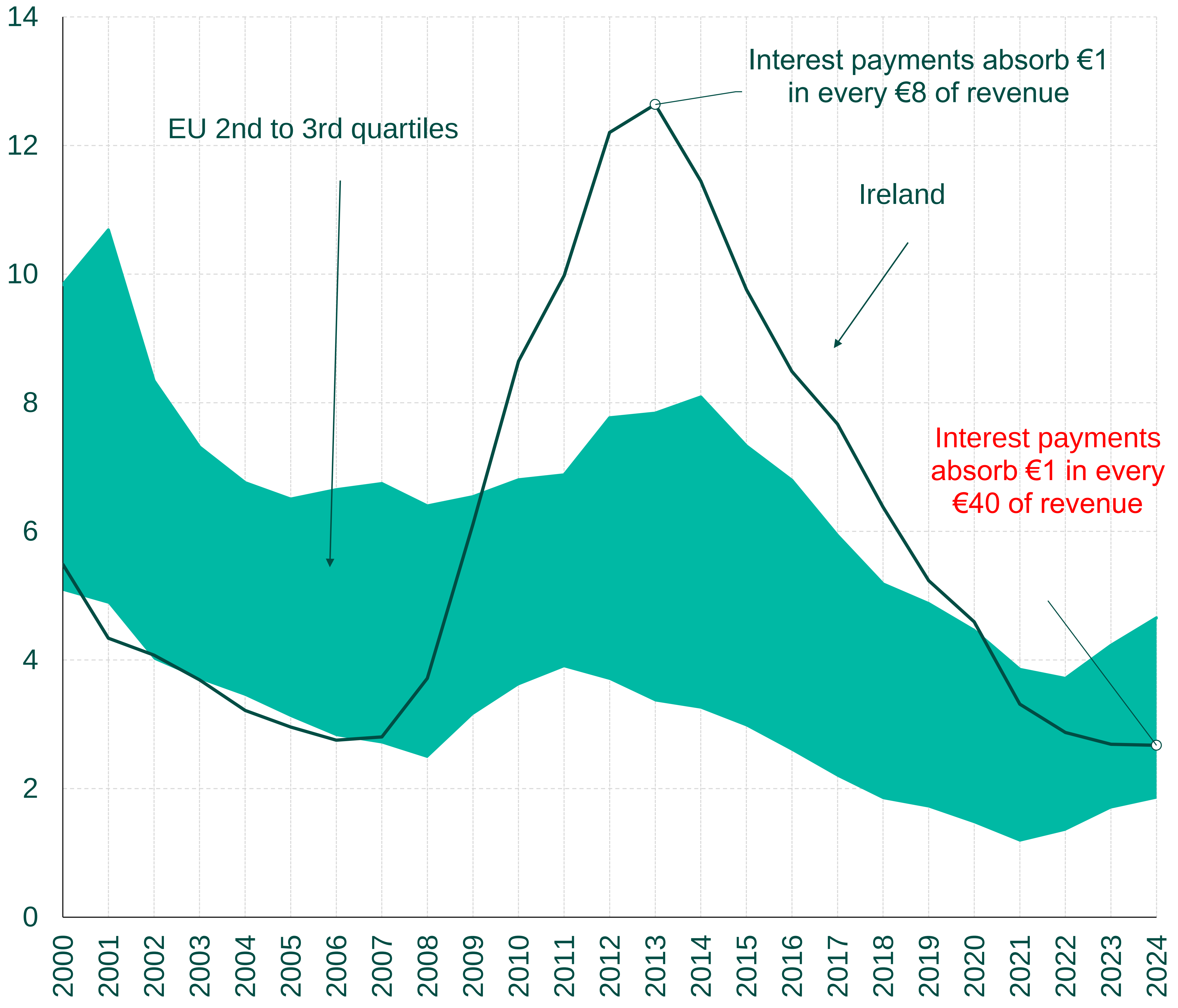


Weighted average maturity c. 10 years

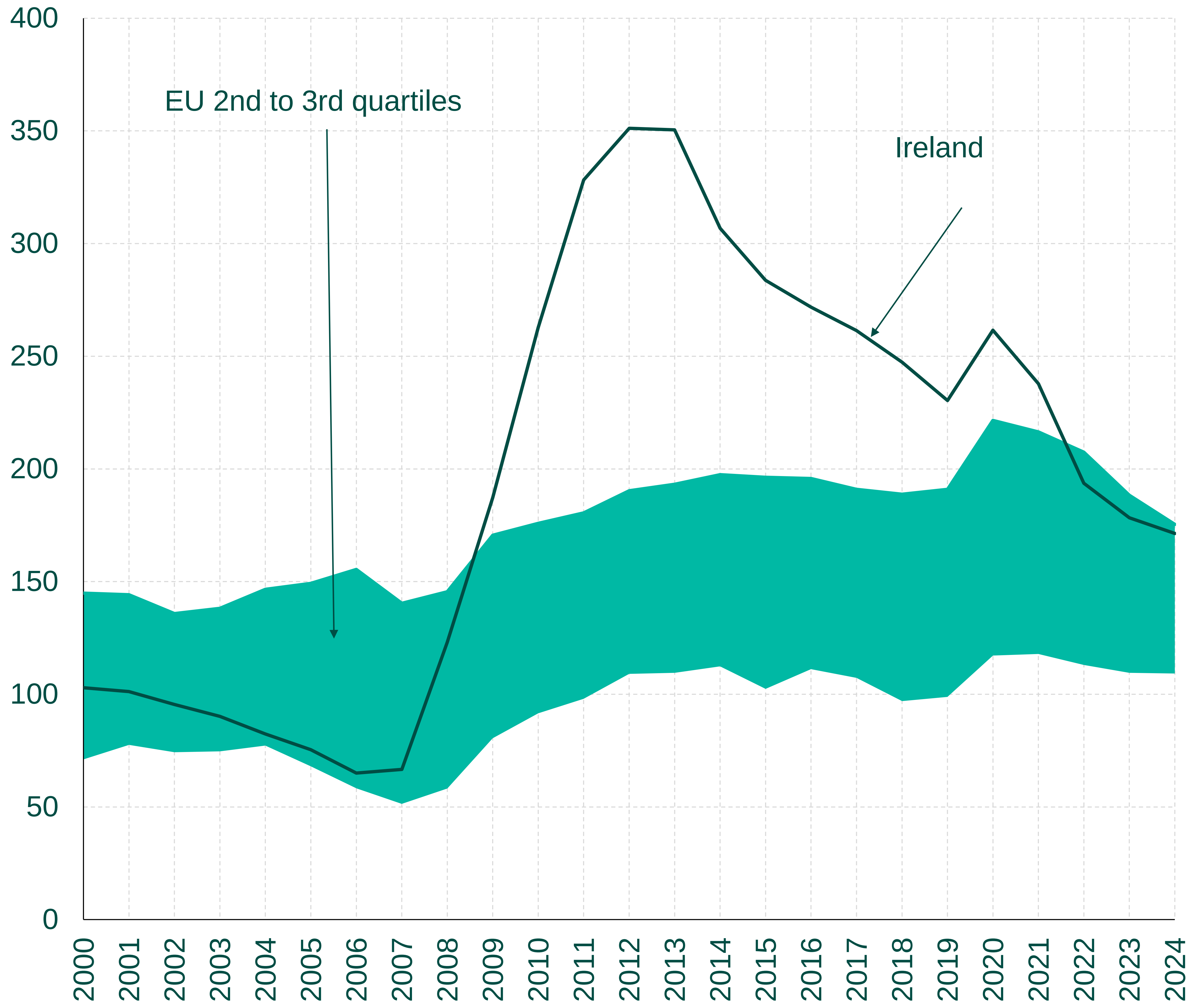


Debt burden

Interest-to-revenue, per cent

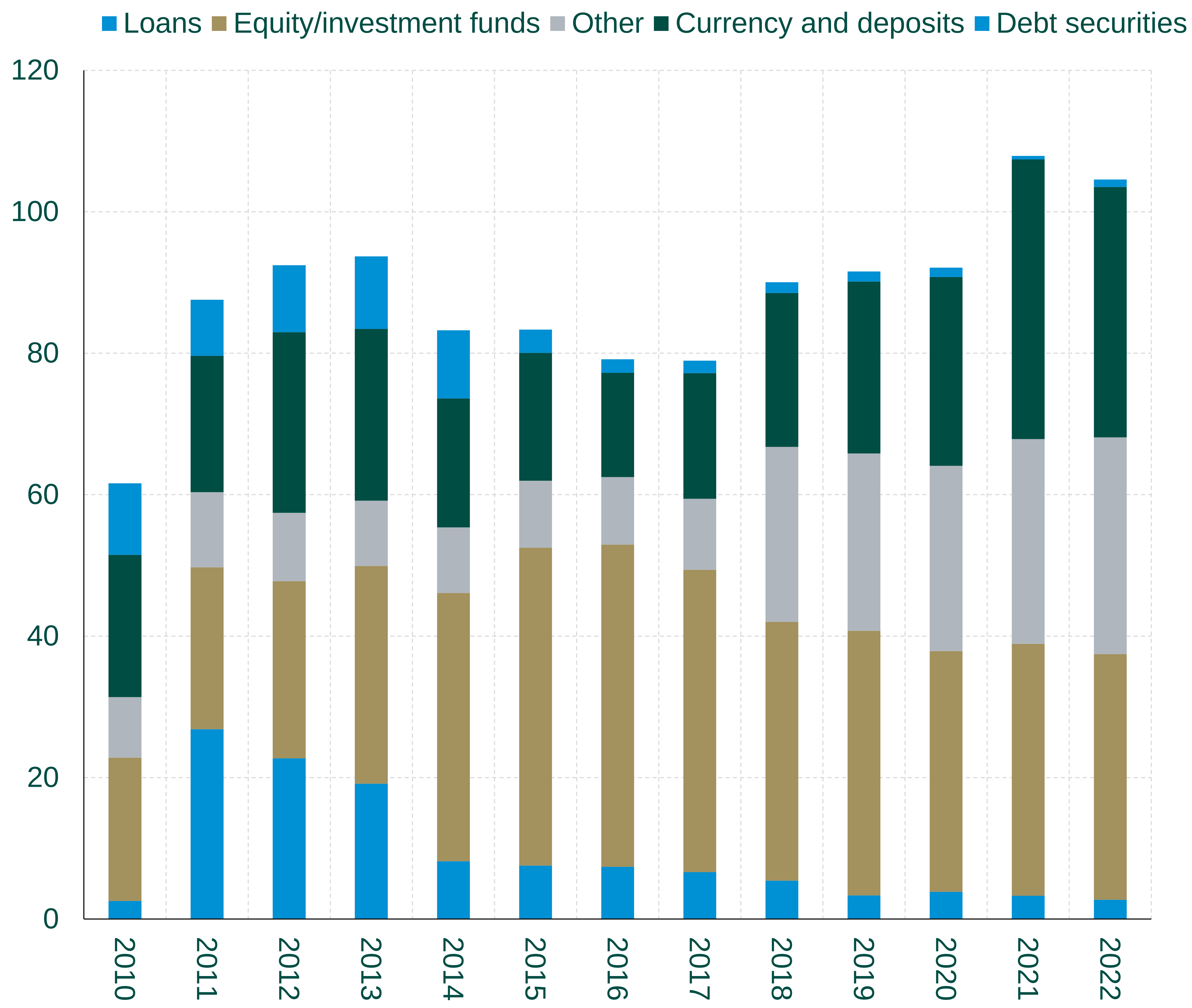


debt-to-revenue, per cent

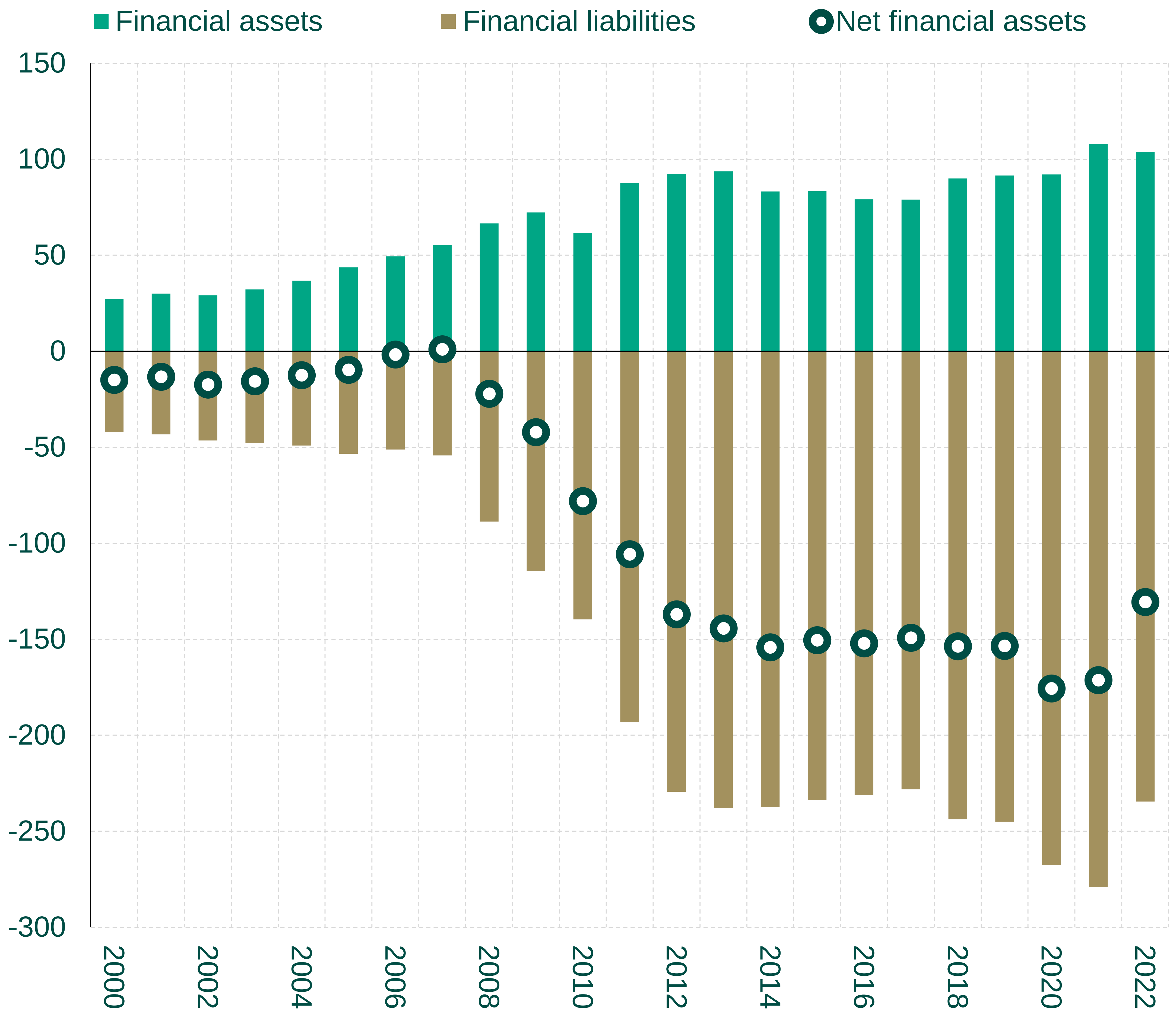


Net debt

General government financial assets, € bn

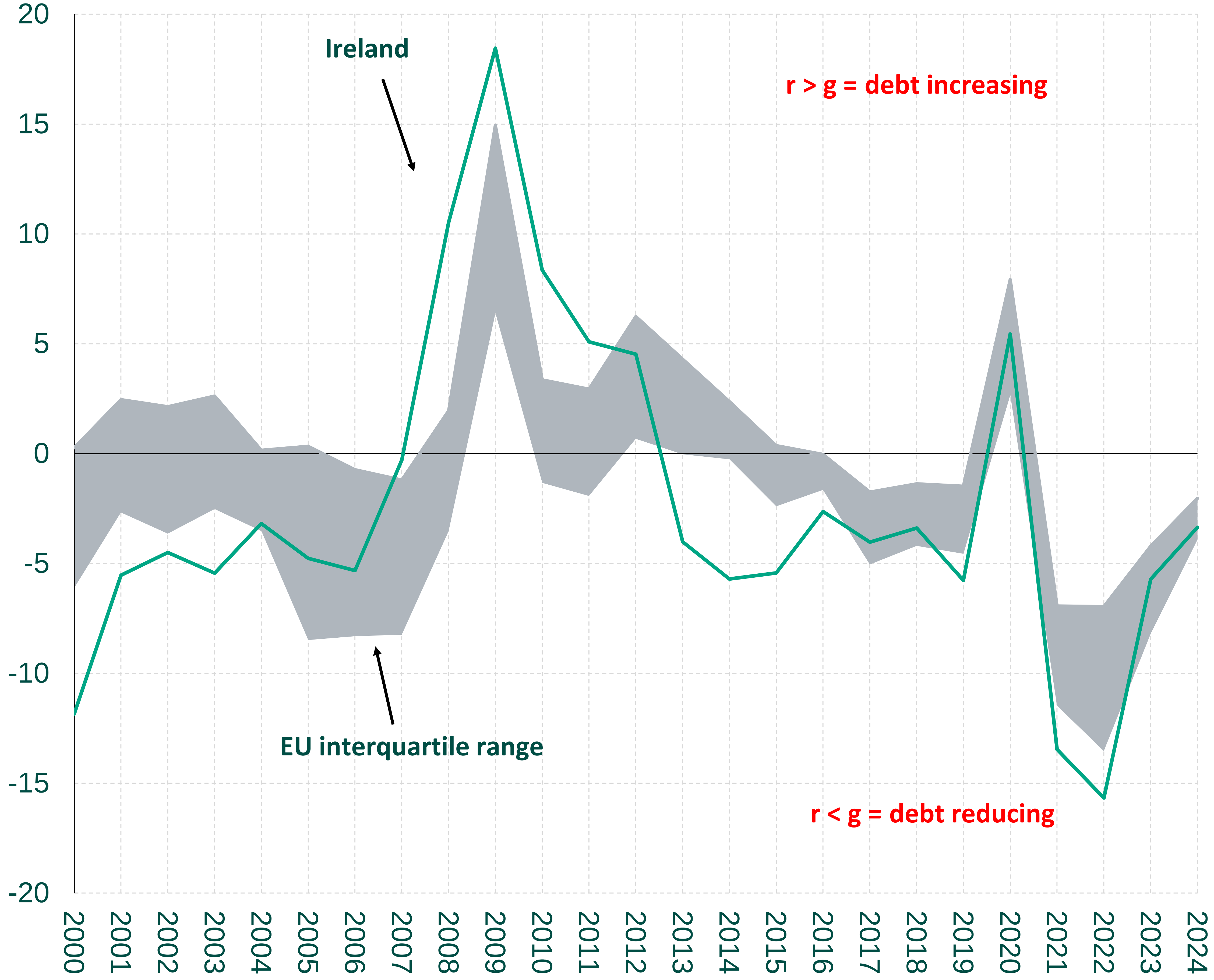


Net debt, € bn

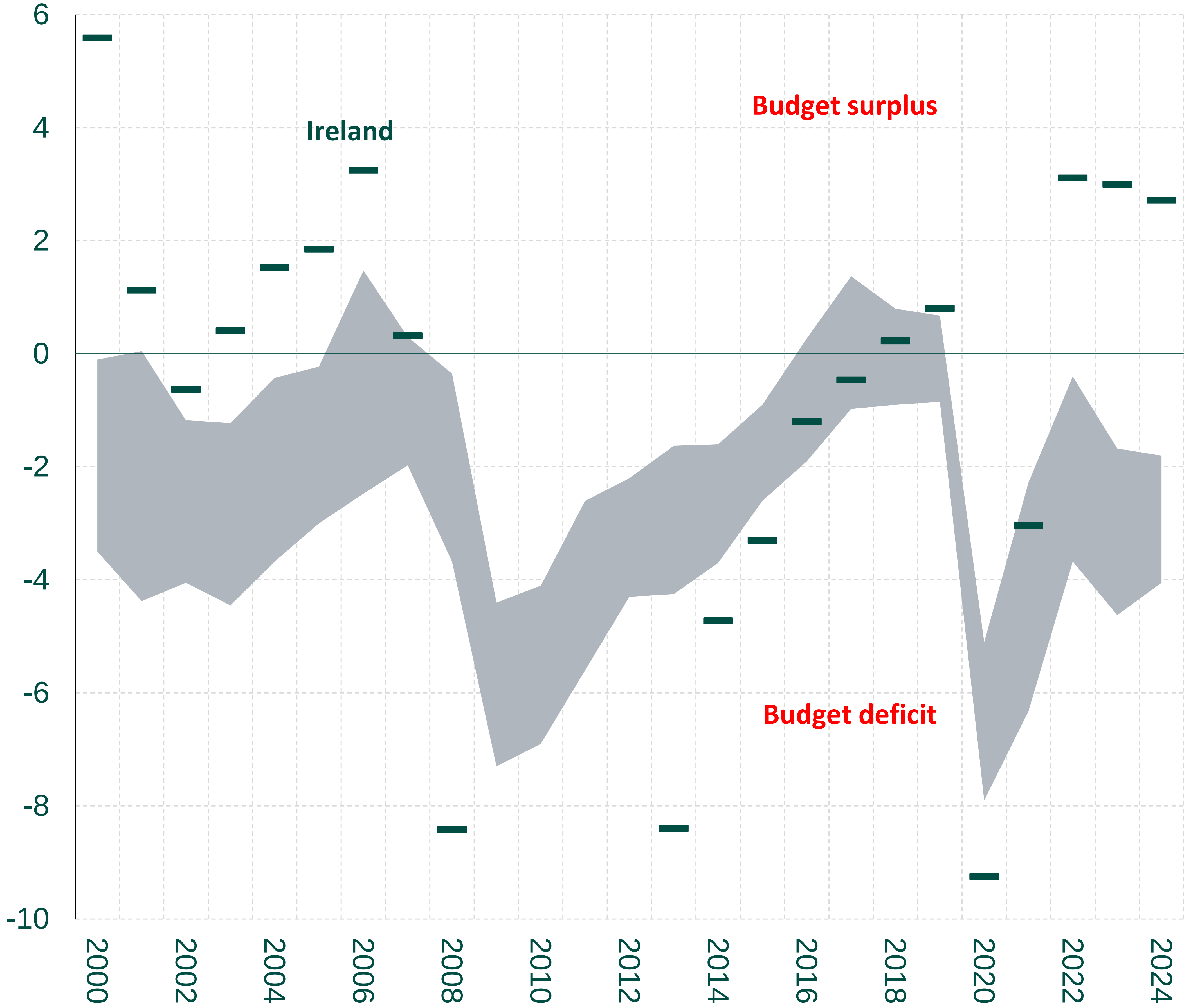


r-g in EU/euro-area

r-g, 2000-2024



Budget balances over time, per cent of GDP



Risks to the outlook/structural challenges

Structural challenges: impact on debt dynamics (i.e. on r – g)

4D’s

Demographic change

- $\downarrow r_t \downarrow g_t$ Negative impact on labour force & reduced savings
- $\downarrow PB_t$ Higher age-related public expenditure

Decarbonisation

- $\downarrow PB_t$ Finance green investment, labour market displacement & reduce tax revenues
- $?\, r_t\, ?\, g_t$ Shift from ‘brown’ to ‘green’ economy

Digitalisation

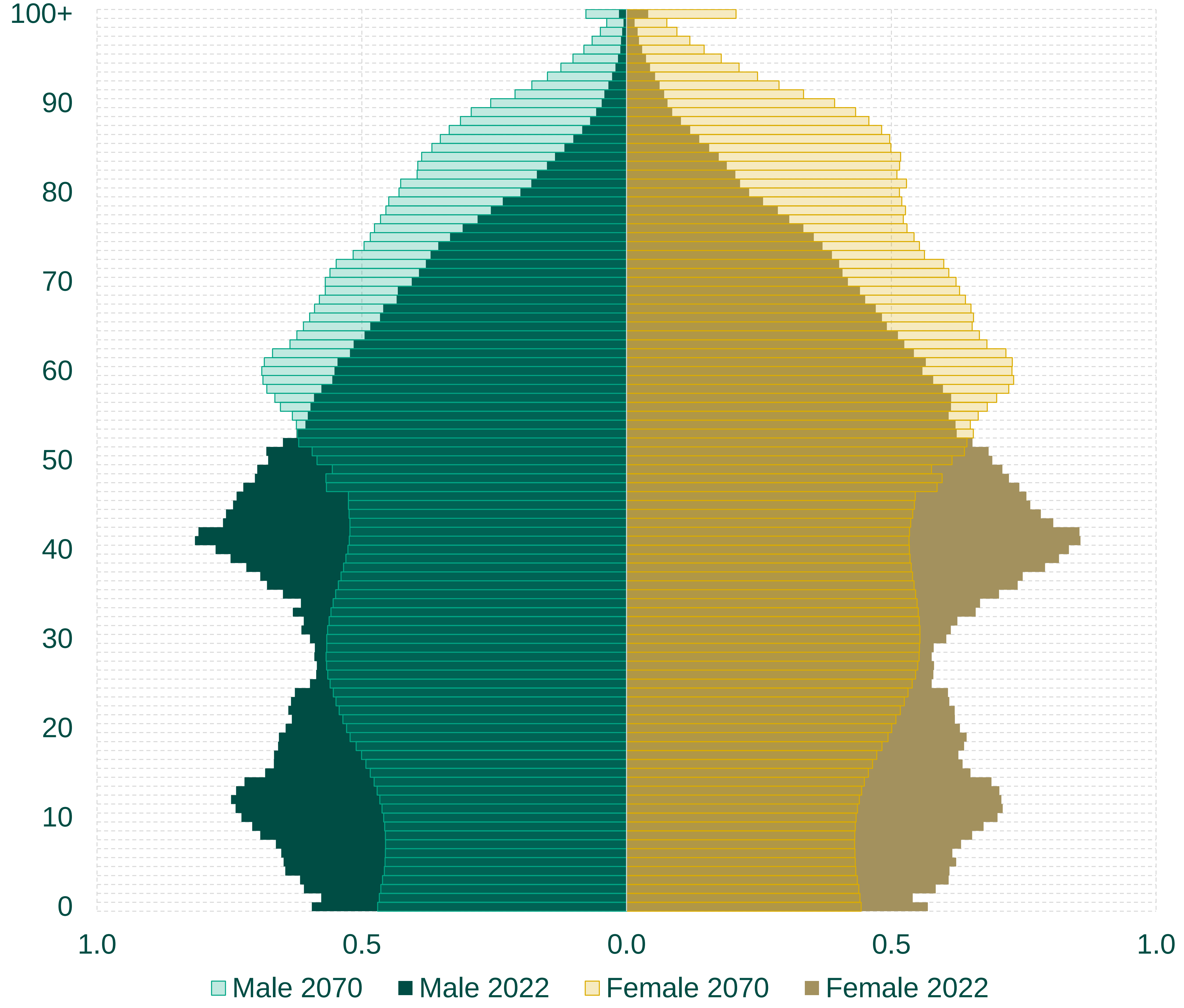
- $\uparrow g_t$ Higher productivity (capital deepening)
- $\downarrow PB_t$ Labour market displacement
- $\uparrow PB_t$ Increase tax revenues through higher productivity

De-globalisation

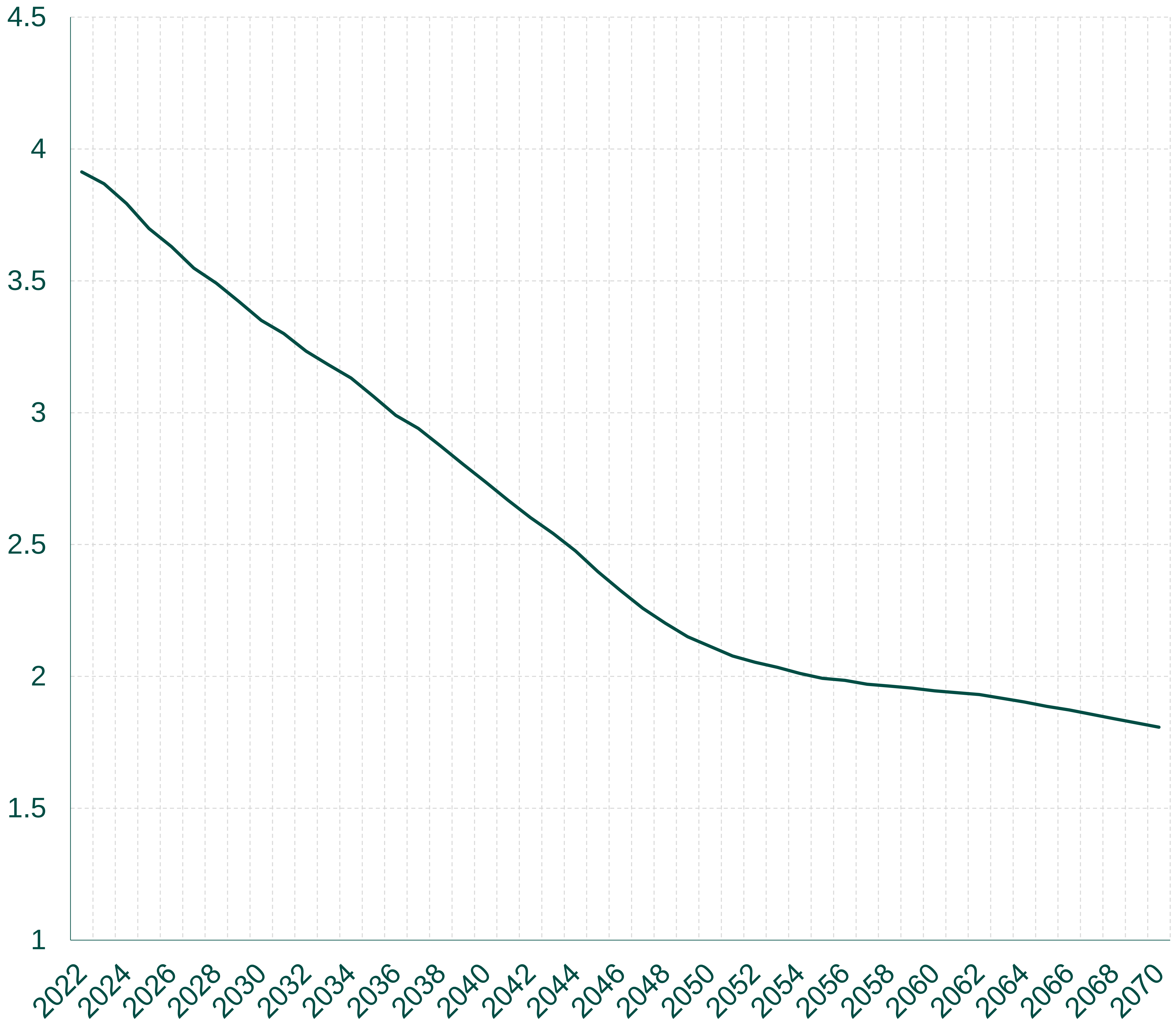
- $\uparrow r_t \downarrow g_t$ Slower productivity growth & higher interest rates (dwindling of global savings pool)
- $\downarrow PB_t$ Reduce tax revenues through slower productivity

Demographics

Population pyramid, 2022 v 2070

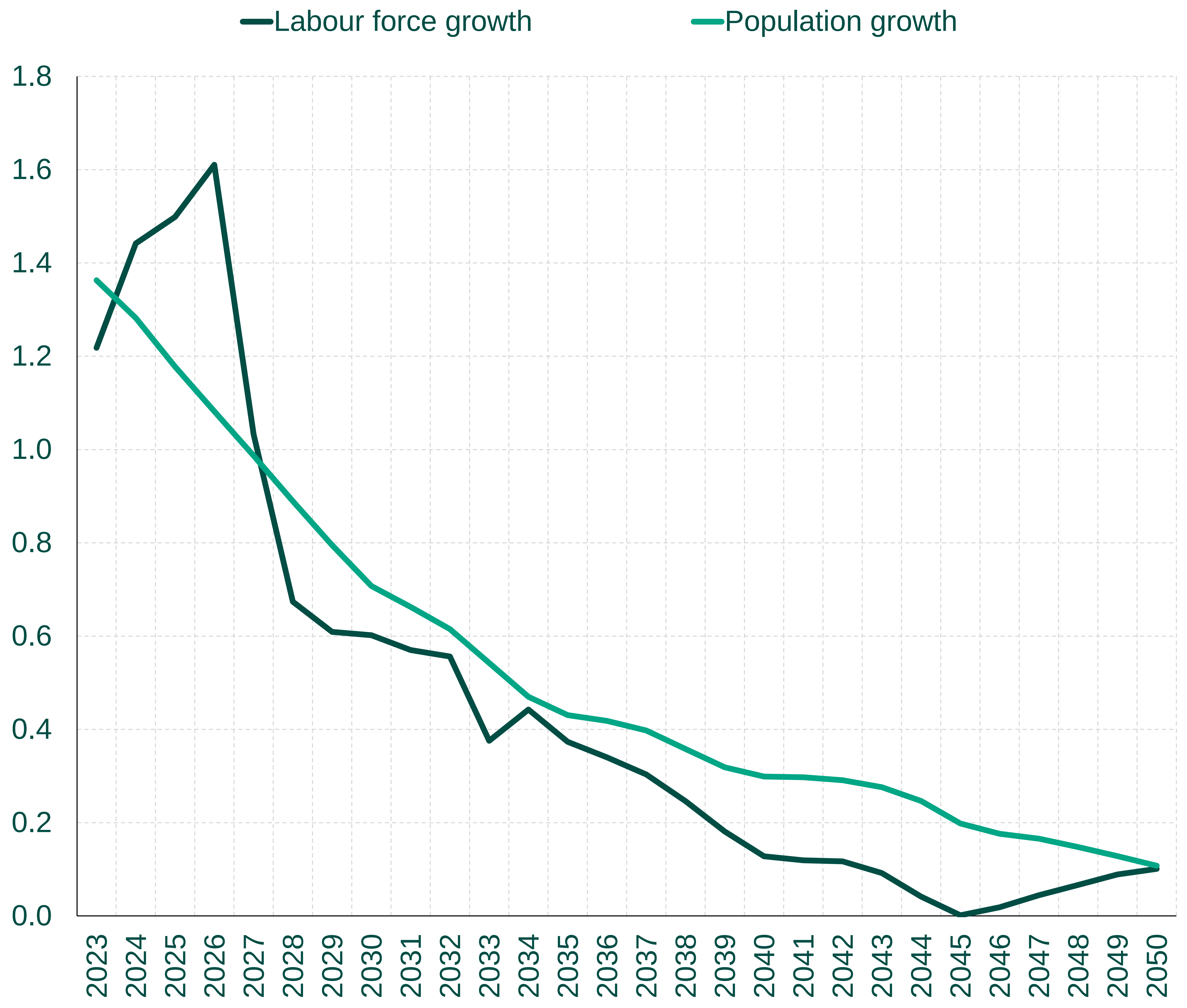


Inverse old age dependency ratio

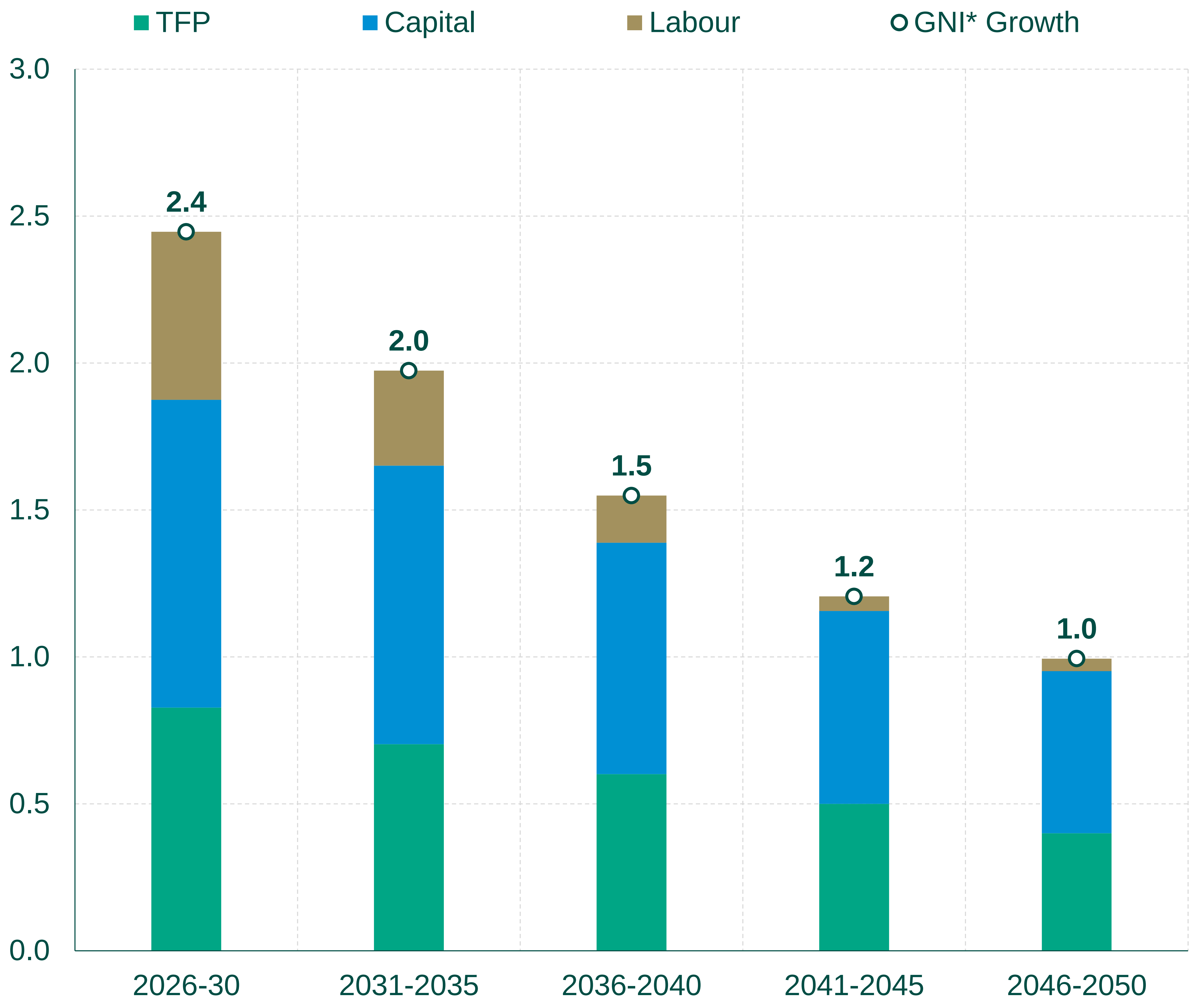


Long-term growth assumptions

Population and labour force growth, 2023-2050, per cent

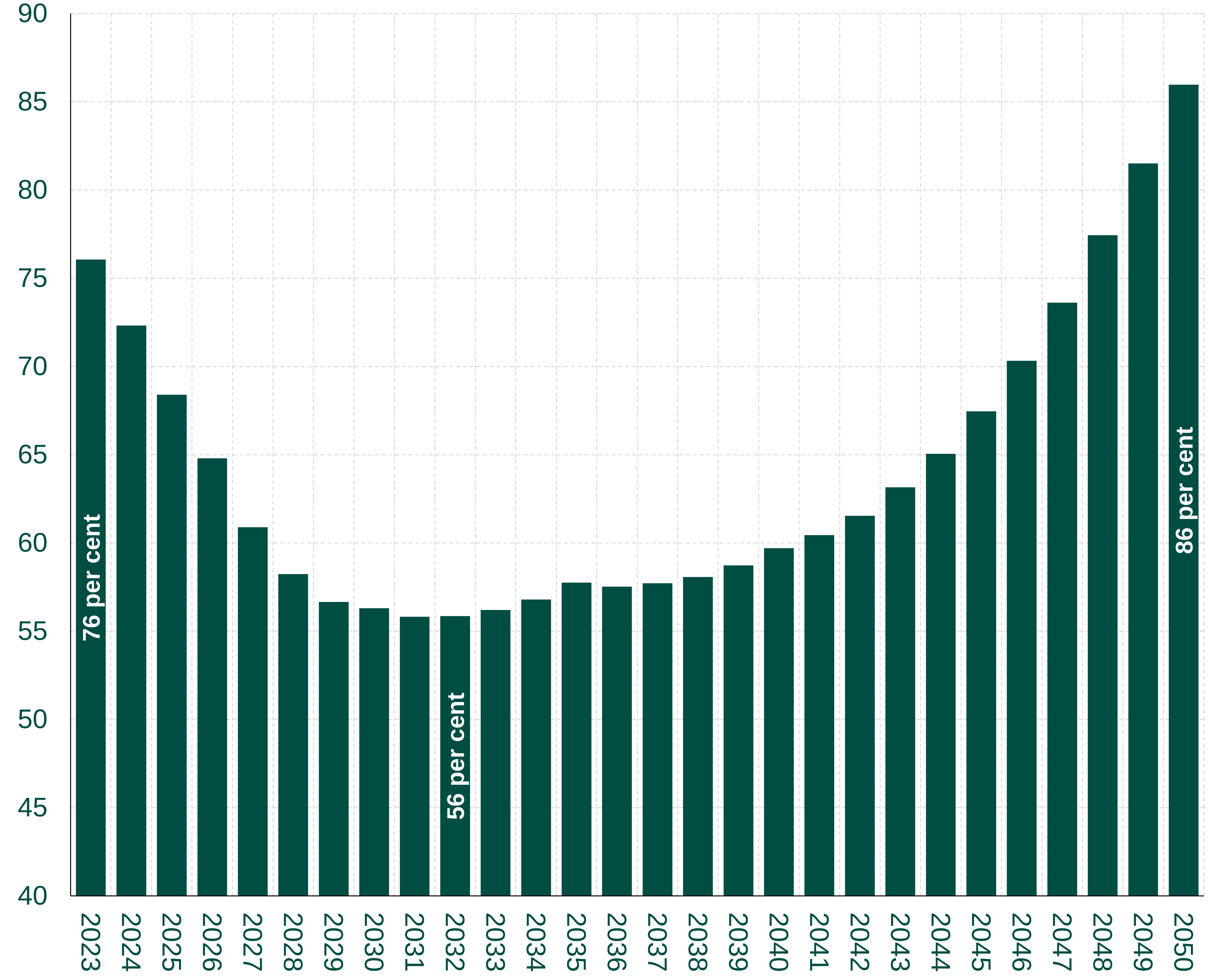


Combined CT and output shock

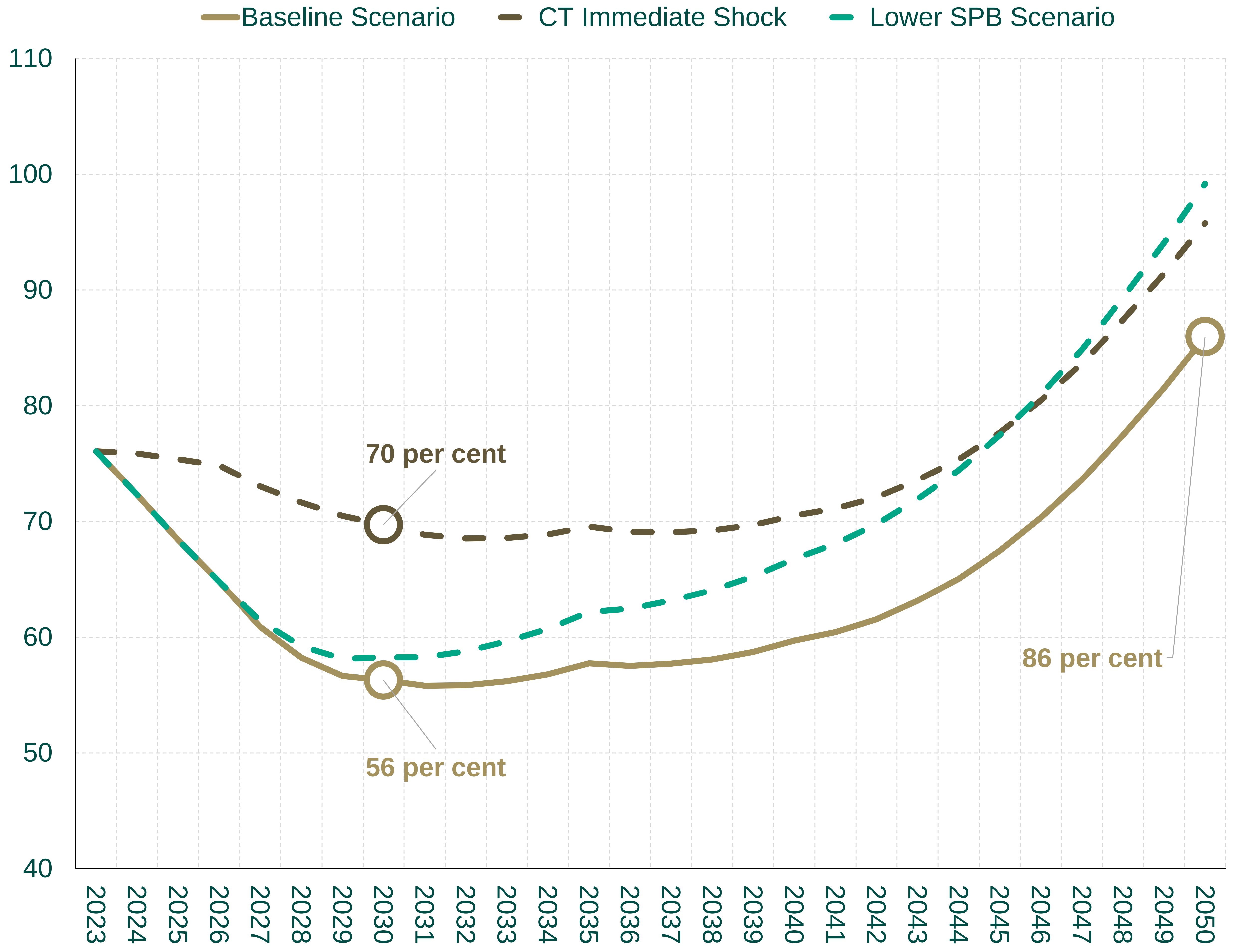


Debt sustainability analysis – key part of fiscal toolkit

Debt-GNI*: no policy change basis

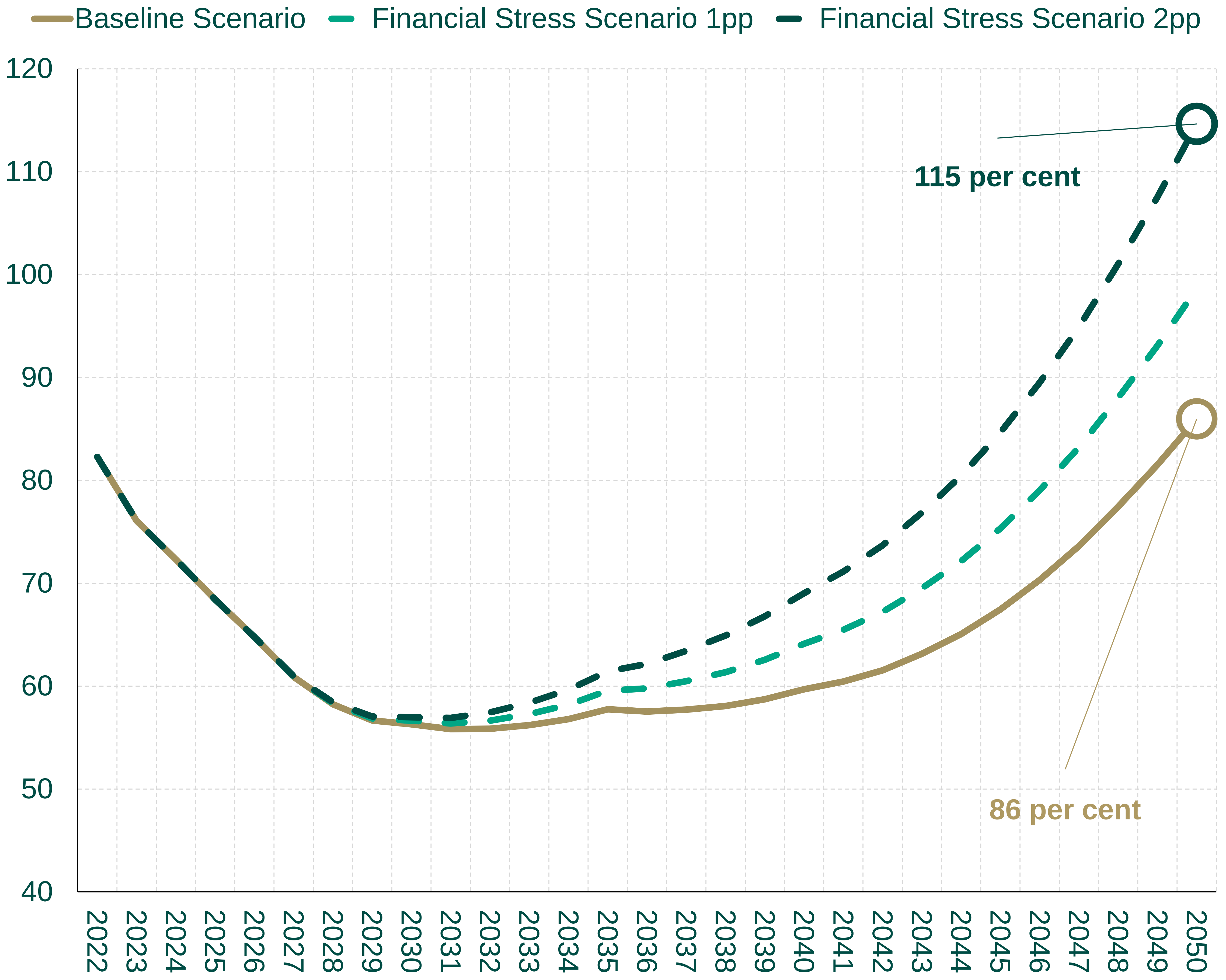


Shocks to baseline scenario: per cent GNI*

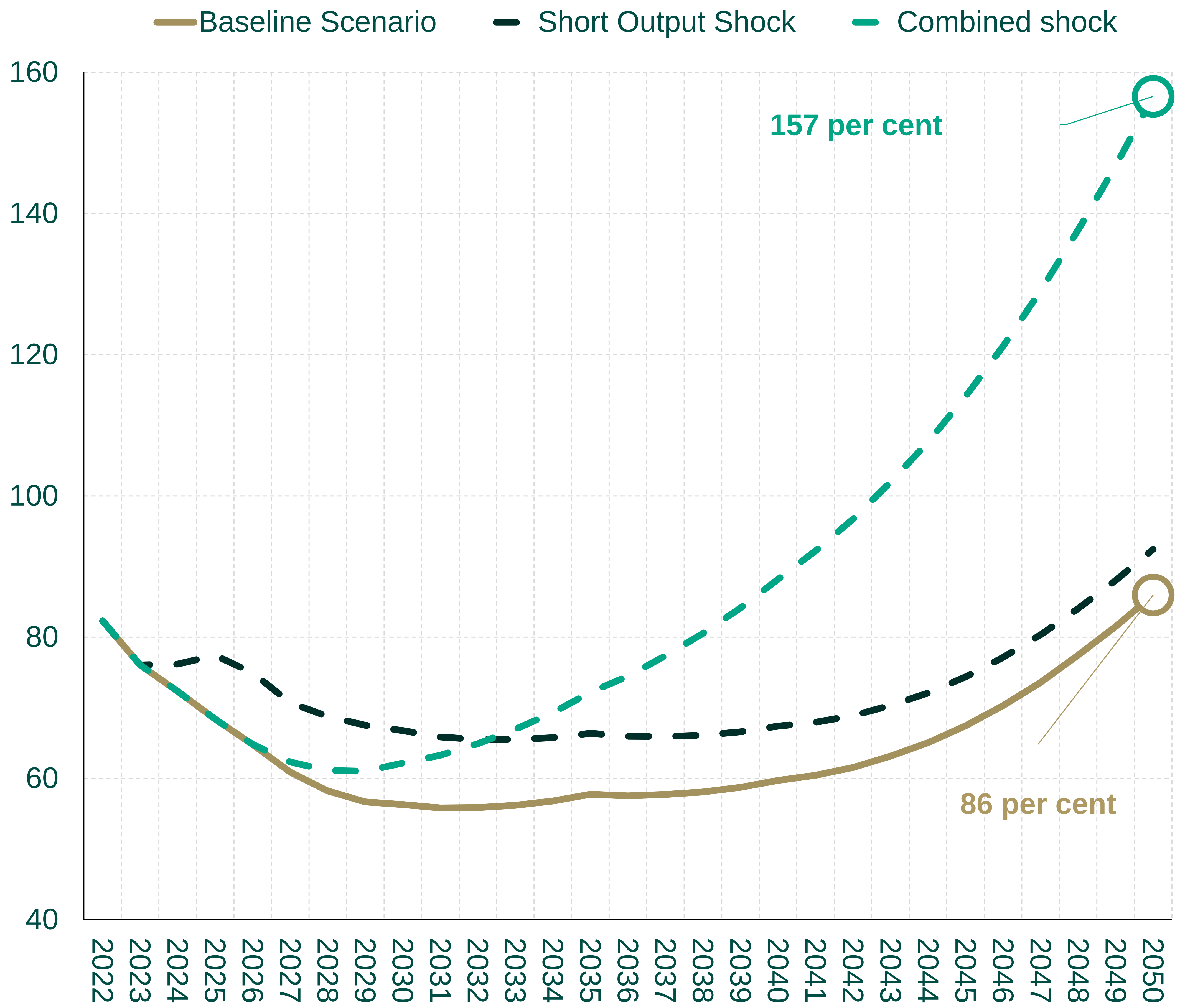


Debt sustainability analysis – key part of fiscal toolkit

Interest rate scenarios, per cent GNI*



Shocks to output, per cent GNI*



Key takeaways

Key takeaways

- Public debt ratio is on a downward trajectory but the level of debt remains high.

- The structure of Irish public debt – with the vast majority of debt locked in at fixed rates, coupled with a relatively long maturity profile – insulates the public finances from the changing interest rate environment in the short-term.

- However, the need to re-finance maturing debt over the medium-term will likely result in larger debt servicing costs.

- With significant challenges on the horizon, debt must be carefully managed - r-g relationship very important.

Any questions?

Disclaimer and other information:

The views expressed in this presentation are those of the presenter and do not necessarily reflect the views held by the Department of Finance, the Minister for Finance or the Government of Ireland.

Some of the figures contained in this presentation are estimates based on the latest available forecasts as published by the Department of Finance in its autumn forecasts (October 2018).

Outturn data are sourced from a variety of sources including the Department of Finance, Central Statistics Office, European Commission (AMECO) and Central Bank of Ireland.

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