Ireland - Stability Programme - December 1999 Update

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Appendix 4 The General Government Balance and the Impact of Pensions Prefunding and Other Associated Once Off Costs

Executive Summary

This document updates Ireland's Stability Programme, which was first published in December 1998, and sets out the Government's economic and budgetary objectives for the period 2000-2002.

- The primary macroeconomic objective of Budget 2000 and the updated Stability Programme is the continuation of sustainable economic and employment growth, supported by low inflation, wage moderation and prudent budgetary policies.

- Stability orientated policies remain the priority. Macroeconomic stability is seen as essential to maintaining Ireland's capacity for economic and social progress.

- In this context, over the period 2000-2002, a General Government Surplus is projected for each year averaging 3% of GDP. This meets the medium term objective of the Stability and Growth Pact of keeping budgetary positions close to balance or in surplus in normal economic conditions. This is the projected General Government Surplus before taking account of the costs associated with the part pre-funding of future state pensions and other once-off pensions costs associated with the sale of Telecom Eireann.

- The Government has begun to address the long term challenge of population ageing and the associated Exchequer costs in the decades ahead. Part of the proceeds from the sale of Telecom Eireann plus an annual 1% of GNP is being set aside towards these future costs. After taking these factors into account, the forecast General Government Surplus, as a percentage of GDP, is 1.2% in 2000 and is 2.5% in 2001 and 2.6% in 2002, on an ESA 95 basis.

- The Government has also decided to use part of the proceeds from the recent sale of Telecom Eireann to pay off, in 1999, all Exchequer pension liabilities arising from the service given by employees of both Telecom Eireann and An Post (the Post Office) before their establishment as commercial entities in 1984. After taking this into account, the forecast General Government Surplus, as a percentage of GDP, is 1.4% in 1999, on an ESA 95 basis.

- Accordingly, after taking account of these prefunding and other pensions transactions, the General Government Surplus is projected to average 2.1% over the next three years.

- Over the same period, General Government Debt as a percentage of GDP is projected to continue to fall, reaching 36% by 2002.

- The updated Stability Programme is framed against a background of continuing strong economic growth, underpinned by a recovering international economic environment, but with the pace of growth decelerating.

- GDP is forecast to increase at an annual average rate of 6½% over the three years 2000-2002 compared with growth of 8 ½% in 1999. GNP growth1, a more accurate reflection of national income in Ireland, is anticipated to average 5¾% over the period 2000-2002. The prospective continued moderation in Ireland's economic growth

reflects the emergence of supply side constraints, particularly with regard to labour, as unemployment has fallen rapidly.

- Despite continued strong economic growth, inflation should remain moderate. While external developments and domestic pressures, particularly in non-traded sectors of the economy, together with indirect tax increases on tobacco, are expected to raise the consumer price index (CPI) in 2000 to 3%, inflation should average below 2½ % over the updated Programme period.

- Relatively strong employment growth is expected to continue with the numbers employed increasing by about 2½% on average over the next three years while the unemployment rate will continue to fall.

- The Government's budgetary and investment plans are designed to address the challenges facing the economy over the medium term. Critically, they incorporate a range of reforms to encourage increased labour force participation and measures to tackle other supply side pressures, key investment needs in the economy, and social inclusion priorities.

1There is a relatively large gap between GNP and GDP in Ireland because of profit repatriations of the multinational sector and foreign debt servicing costs. GNP amounts to only about 87 per cent of GDP.

Chapter 1 - Economic Policy Context

1.i Introduction

1.1 This document updates Ireland's Stability Programme 1999-2001, which was submitted in December 1998, and includes a new set of macroeconomic projections out to 2002. It takes account of the measures adopted in Budget 2000 and the National Development Plan 2000-2006 published in November 1999.

1.2 This update has been prepared in conjunction with Budget 2000 and is being presented to Dáil Éireann on Budget day, 1 December 1999. As such it also provides an economic background to Budget 2000. It has been prepared in accordance with Council Regulation 1466/97 of 7 July 1997.

1.3 This Chapter reviews recent economic performance and presents macroeconomic projections for the period 2000-2002. Chapters 2 and 3 set out the Government's budgetary and economic policies.

General Policy Context

1.4 Ireland's economic progress in the 1990s has been outstanding. GNP grew in real terms by an average of 7.6% per annum between 1994 and 1999. This growth has led to a significant increase in employment with the numbers employed increasing by over 30%. The unemployment rate has fallen from over 15% in 1993 to around 5¼ % today.

1.5 Side by side with significant economic progress, sound budgetary management has allowed the General Government Balance, as a percentage of GDP, to move from a deficit of 2.2% in 1993 to surpluses of 1% in 1997, 2.5% in 1998 and an estimated 3.5% in 1999,

on an ESA 79 basis. At the same time, General Government Debt has fallen from 93% of GDP in 1993 to about 47% by 1999, on an ESA 79 basis.

1.6 This economic progress has allowed living standards to increase and converge towards average EU levels. By 1999, Ireland's GNP per head has reached over 90% of the EU average compared to 79% in 1994 and this process of convergence is likely to continue over the medium term.

Table 1 - Economic and Budgetary Indicators 1993-1998 2

	1993	**1994**	**1995**	**1996**	**1997**	**1998**
% Volume Change						
GNP	2.6	6.3	8.0	7.2	9.0	8.1
GDP	2.6	5.8	9.5	7.7	10.7	8.9
Personal consumption	2.9	4.3	3.7	6.5	7.3	7.4
Public consumption	-0.4	4.1	2.9	2.8	4.8	5.9
Fixed investment	-4.1	12.0	22.9	15.9	18.9	16.7
Exports	9.1	14.7	19.6	11.8	17.0	20.5
Imports	7.0	15.1	16.1	12.0	16.1	23.2
Current Account (% GNP)	4.1	3.0	2.9	3.1	2.8	1.1
Consumer Prices (% change)	1.5	2.4	2.5	1.6	1.5	2.4
GDP Deflator (% change)	5.2	1.7	2.7	2.3	3.5	5.6
Unemployment (% labour force)	15.5	14.1	12.1	11.5	9.8	7.4
Employment (% change)	1.9	3.6	4.6	3.7	4.6	5.7
Employment ('000's)	22	43	57	48	62	82
General Govt. Balance Deficit(-) Surplus(+) as (%GDP)	-2.2	-1.7	-2.1	-0.2	1.0	2.5
General Govt. Debt (% GDP)	93	86	78	69	60	49

* ESA79 Basis; Sources: CSO and Department of Finance

1.ii Economic Review : 1999

1.7 1999 was another year of strong growth. GNP growth of 7½% is now expected compared with the 6% forecast in the December 1998 Stability Programme. This higher level of economic activity has led to an improved budgetary position. A surplus of 3.2%3 is now anticipated compared with a projected surplus of 1.7% in the December 1998 Stability Programme, on an ESA 95 basis. The Table below compares, on an ESA 95 basis, the December 1998 Stability Programme projections with the estimated outturn.

Table 2 - Economic & Budgetary Indicators 1999 : Forecast & Estimated Outturn

	1999 Forecast	**1999 Outturn**
% Volume Change	6.0	7.4
GNP	6.7	8.4
GDP	2.0	1.6
Consumer Prices	6.8	5.5
Unemployment Rate (as a % of labour force)	45	74
Employment ('000)		
General Government Surplus (as a % of GDP)	1.7	3.23
General Government Debt (as a % of GDP)4	52	52

* ESA 95 Basis

2 All Tables are sourced from Department of Finance unless otherwise stated.

3Before impact of discharging once off pensions liabilities of 1.9% of GDP in 1999

4Includes impact of a Securities Exchange Programme which added 4% to the Debt/GDP ratio in 1999

Domestic Demand

1.8 Domestic demand has remained buoyant For the fourth consecutive year personal consumption is growing very strongly. The Retail Sales Index shows an increase of 9¼% for the first nine months of 1999. Car sales also continue their exceptional growth and are expected to be about 20% higher for the year as a whole. VAT and excise duty receipts confirm this buoyant picture. Thus, it is expected that the volume of personal consumption will expand by 7 ¾ % this year.

1.9 Gains in employment and rapid increases in real disposable incomes continue to support consumer spending. The latest Labour Force Survey indicates that employment grew by 6.4% in the year to March-May 1999. For the year as a whole, employment is now expected to increase by around 4¾% compared with the December 1998 Stability Programme forecast of 3.1%. Despite the emergence of capacity constraints, employment in construction is still growing, up by 8.5% in the twelve months to September 1999.

1.10 The latest earnings data show some acceleration. In the year to June 1999 weekly earnings in industry rose by 4.8% while weekly earnings in the public sector (excluding

health) rose by 5.9%. Hourly construction earnings rose by 4.7% in the year to June 1999. However the increase in weekly earnings was just 1.6% reflecting a 3% decrease in the number of hours worked. The latest weekly earnings data in Banking, Insurance and Building Societies show an increase of 6.3% in the year to June 1999. For the year as a whole, it is expected that non-agricultural per capita earnings will increase by 5 - 51/2 %.

1.11 Growth in fixed investment was extremely strong in 1998 at 16.7%. The available data, albeit limited, suggest further growth in 1999. The construction sector continues to expand with the number of new dwellings built up again this year. Investment in machinery and equipment is expected to show slower growth than in 1998, partly due to slower trends in foreign direct investment (FDI). In total, fixed investment is forecast to grow by around 10½% in volume terms in 1999.

External Developments

1.12 Turning to external developments, export growth is well down on the exceptional increase of 20.5% in 1998. Around the beginning of 1999 there was a noticeable slowdown which reflected weak demand conditions in our markets. This slowdown is also shown by the results of the NCB Purchasing Managers' Index which declined towards the end of 1998. However exports have recovered steadily during the year. Export growth of goods and services of about 14% is expected for 1999 as a whole.

1.13 Given the strength of estimated final demand, the growth of visible imports to date in 1999, according to available data, is unexpectedly weak, though the recent trend is stronger. For the first eight months of the year, imports are up around 5%. In contrast, service imports are up over 25% for the first six months of 1999. It is expected that growth in imports will continue to strengthen in the second half of the year and that data for the first half of the year will be revised upwards. An increase in the volume of imports of goods and services of about 14% is expected. The current account will show a surplus of less than ½% of GNP in 1999.