Davy Research

Irish economy

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Budget 2017 as expected; Help-to-Buy unveiled

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DAVY VIEW

Budget 2017 measures were broadly as expected – a €1.3bn giveaway, split 3:1 in favour of spending rises over tax cuts. The deficit is expected to fall to 0.9% of Gross Domestic Product (GDP) in 2016 and 0.4% in 2017, with the debt/GDP ratio likely to decline to 76% by end-2016. The new Help-to-Buy scheme will provide a 5% tax rebate on the purchase price of newly built homes, worth up to €20,000 on homes capped at €600,000. Another positive for the housing market is an increase in mortgage interest deductibility on buy-to-let lending from 75% currently to 100%.

Budget giveaway worth €1.3bn, broadly as expected

The Irish government announced €1.3bn of Budget measures, worth just over 0.5% of nominal GDP, split 3:1 in favour of spending rises over tax cuts. This is based on expected GDP growth of 4.1% in 2016 and 3.5% in 2017.

The government now expects the deficit to fall to 0.9% of GDP in 2016 and to 0.4% in 2017. The debt/GDP ratio is likely to fall to 76% by end-2016. However, given the distortions affecting Irish GDP, Minister for Finance Michael Noonan indicated that the government will now target a 45% debt/GDP ratio to be achieved by the mid-2020s.

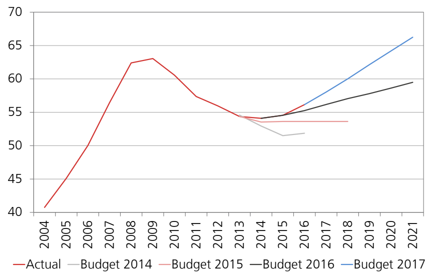
The key tax cuts were to the main Universal Social Charge (USC) rates of 1%, 3% and 5.5% – cutting each by 0.5 percentage points, helping those on incomes up to €70,000 and costing €335m. This will provide fresh impetus to consumer spending in 2017 and reduces the marginal rate of income tax to 49% for most Irish workers. To help fund the income tax giveaway, there were revenue-raising measures on tobacco, worth €65m per annum.

Help-to-Buy measures complemented by increase in mortgage interest deductibility for buy-to-let sector

The housing market received a range of favourable tax measures. The new Help-to-Buy scheme will provide a tax rebate worth 5% of the purchase price on newly built homes. However, the rebate will be worth up to €20,000 on homes capped at €600,000. The rebate will only be available to first-time buyers. The scheme is intended to run until the end of 2019. The Minister confirmed that the tax rebate can be included as part of the deposit required in meeting the Central Bank's rules on mortgage lending and will cost the exchequer €50m.

In addition, the Minister for Finance indicated that mortgage interest deductibility for buy-to-let landlords will be increased from 75% currently to 80% in 2017 and will rise by 5 percentage points per annum thereafter to 100%. This is in stark contrast to the UK, where full interest deductibility on buy-to-let mortgage lending is being reduced to just 20%.

Gross voted expenditure plans



Source: Department of Finance

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Budget 2017 broadly as expected

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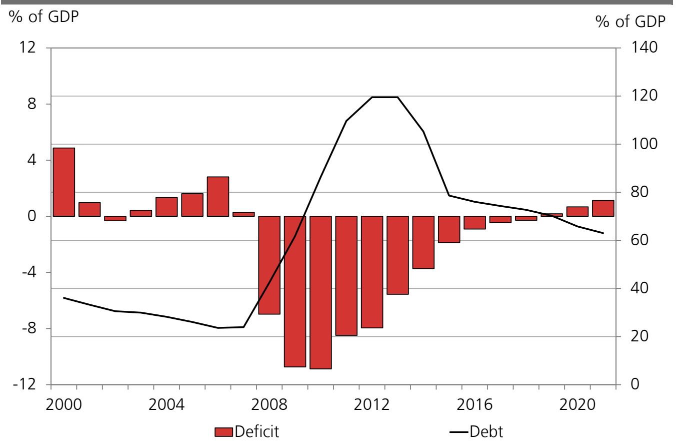
Government deficit expected to equal 0.4% of GDP in 2017

The government now expects the deficit to fall to 0.9% of GDP in 2016 and 0.4% in 2017. Although not overly optimistic compared to recent projections from the Central Bank, among others, the risk here is that Brexit could have a larger-than-expected impact on the Irish economy.

The deficit forecasts are conditioned on tax revenue growing by 5.2% in 2017, only marginally slower than the 5.6% growth expected this year. In comparison, gross current expenditure is expected to rise from €61.7bn this year to €63.0bn in 2017 – representing 2.0% nominal growth. So, on balance, the overall budgetary position still appears cautious heading into more uncertain times.

Figure 1: Irish government debt and deficit



Source: Department of Finance

Table 1: Key fiscal aggregates

	2015	2016	2017	2018	2019	2020	2021
Real GDP	26.3	4.2	3.5	3.8	3.6	3.0	2.8
Nominal GDP	32.4	2.8	4.5	4.6	4.5	4.2	4.1
Deficit, % GDP	-1.8	-0.9	-0.4	-0.3	0.2	0.7	1.1
Debt, % GDP	78.6	76.0	74.3	72.7	70.2	65.8	63.0
Tax revenue, €bn	45.6	48.1	50.6	53.6	56.5	59.4	62.4
Gross current spending, €bn	60.6	61.7	63.0	64.3	65.6	66.8	67.6
Gross capital, €bn	3.8	4.2	4.5	5.3	6..0	6.7	7.3

Source: Department of Finance

The debt/GDP ratio is expected to fall to 76% by end-2016 and to 74.3% in 2017

The debt/GDP ratio is expected to fall to 76% by end-2016 and to 74.3% in 2017. However, given the distortions now affecting Irish GDP, the debt/GDP ratio is arguably artificially pushed downwards. Hence, Minister for Finance Michael Noonan has indicated that the government will now target a 45% debt/GDP ratio to be achieved by the mid-2020s – well beyond Ireland's responsibilities under the Stability and Growth Pact.

Modest cuts in income taxes the headline measure

The key tax measures were almost exactly as leaked to the media in the run-up to the Budget. Each of the 1%, 3% and 5.5% USC rates were cut by 0.5 percentage points – costing the exchequer €335m. This leaves the marginal rate of income tax at a still eye-watering 49% on incomes up to €70,000. Above that level, the marginal rate remains at 52% – still a potential impediment to attracting highly skilled workers. The Help-to-Buy scheme will cost an additional €50m.

To fund the tax giveaways, an extra 50c will be levied on cigarettes – expected to yield €65m. Although the Minister did not outline the changes to Section 110, the measures are expected to increase tax revenues by €50m and tax evasion and compliance measures by €80m.

Table 2: Key tax measures (€m)

	Yield/Cost in 2017
Tax cuts	
Universal Social Charge cuts	335
Income tax (Home Carer, Earned Income credits)	48
Help-to-Buy scheme	50
10% capital gains tax, entrepreneur relief	15
Capital acquisitions tax	22
Revenue measures	
Tobacco products tax	65
Section 110 and funds changes	50
Tackling offshore tax evasion	30

Source: Department of Finance

The new Help-to-Buy scheme, available to only first-time buyers, will provide a tax rebate worth 5% of the purchase price on newly built homes

Housing market receives favourable treatment

The housing market received a range of favourable tax measures. The new Help-to-Buy scheme will provide a tax rebate worth 5% of the purchase price on newly built homes. However, the rebate will be worth up to €20,000 on homes capped at €600,000. The rebate will only be available to first-time buyers. The scheme is intended to run until the end of 2019. The Minister confirmed that the tax rebate can be included as part of the deposit required in meeting the Central Bank's rules on mortgage lending and will cost the exchequer €50m.

In addition, the Minister for Finance indicated that mortgage interest deductibility for buy-to-let landlords will be increased from 75% currently to 80% in 2017 and by 5 percentage points per annum thereafter to 100%. This is in stark contrast to the UK, where full interest deductibility on buy-to-let mortgage lending is being reduced to just 20%. In addition, the income ceiling for the 'Rent-A-Room' scheme will rise by €2,000 to €14,000, intended to help the supply of rental accommodation.

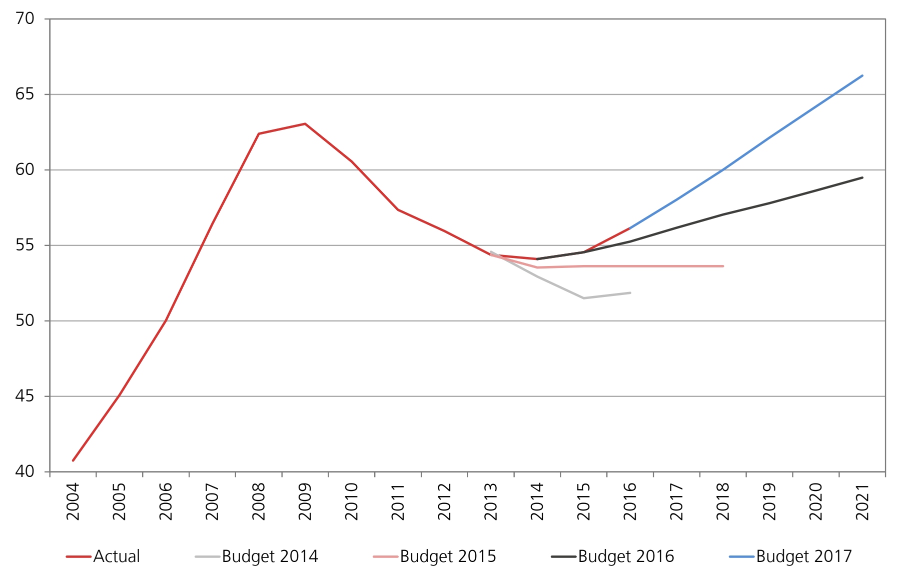
Spending will be 3.3% higher in 2017 than the level previously expected for 2016

An extra €1.3bn of spending

The Budget 2017 announcements add to the extra spending already announced in 2016 – largely additional expenditure on Health. Overall, this means spending will be 3.3% higher in 2017 than the level previously expected for 2016. This continues the upward trend of slippage on medium-term expenditure targets as tax revenue has beaten expectations. Perhaps the difference in 2016 is that tax revenues are only broadly in line with Budget targets and highly reliant on potentially unreliable corporation tax revenues.

Figure 2 shows how medium-term expenditure plans have been revised up through various Irish government budgets. This provides worrying evidence that expenditure discipline is being lost. In just 12 months, the level of gross expenditure in 2017 has been revised up by 3.3%. The level of spending expected in 2021 has been revised up by €6.7bn to €66.2bn, or by 11.4%, hardly indicative of budgetary discipline.

Figure 2: Gross voted expenditure plans



Source: Department of Finance

The perennially overspending Department of Health continues to succeed in gaining additional funding

The perennially overspending Department of Health continues to succeed in gaining additional funding. In total, Health spending is set to increase by €497m in 2017, bringing total spending to €14.6bn. This is another 3.5% rise over and above the substantial increases in Health expenditure already announced in 2016. For now, there appears to be little effort to curb the lack of budgetary discipline in this area.

The new spending plans envisage adding 4,500 extra 'front-line' public service staff. So the contribution of the public sector to overall employment growth will not be insignificant. Among the government departments, Housing received substantial funds, including €50m for the Local Infrastructure Housing Activation Fund and an extra €105m for the Housing Assistance Payment.

Much of the political controversy had surrounded the implementation of a €5 increase in the state pension. In the event, the Department of Social Protection has managed to acquire an additional €300m in funding. This will fund not only the state pension but increases in a range of benefit payments such as the Carer's Allowance, Disability Allowance and Jobseeker's Allowance. In addition, the Department of Children and Youth Affairs will now pay means-tested subsidies for childcare.

Table 3: Key spending measures (€m)

	Yield/Cost in 2017
Children: Affordable Childcare Programme	32
Education:	130
Health: Waiting List Initiative, care allowances	103
Housing: *Current* Housing Assistance Payment, Homeless Services	165
Capital: Social Housing, Local Infrastructure Fund	294
Social Protection:	
State pension	125
Working age income supports	131

Source: Department of Finance

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