

## Budget Distributes Gains from Economic Growth

### Main Provisions for 2001

- General government surplus of 4.3% of GDP
- Current budget surplus of 6.7% of GDP
- Income tax package of £1.2 billion in full year
- Standard and top tax rate cut by 2p
- Social Welfare and Child Benefit package of £850 million
- Real GDP projected to grow by 8.8% in 2001, inflation at 4.5%

### Assessment in Brief

With the economy growing by over 10% and inflation at near 7%, the question must be asked as to why the Minister for Finance decided to introduce a stimulatory budget today. The answer lies in the fact that prior to the measures announced today, the Minister had an opening current budget surplus of over £7 billion (7.75% of GDP) and an Exchequer surplus, after capital borrowing is taken into account, of almost £3.5 billion (almost 4% of GDP). Even after today's measures, the Government expects that the Exchequer surplus will be £2.5 billion or 2.8% of GDP. This could be exceeded as the year unfolds in 2001. Official Exchequer medium term forecasts point to the continuation of large Exchequer surpluses, even on the basis of a projected slowdown in the growth in real GDP.

While the fiscal and expenditure package will be regarded as overly expansionary from a demand side perspective, the benefits of the Budget should be judged also on the supply side of the economy and in efforts to reduce inflation expectations and wage demands and promote social inclusion. The package has been welcomed by the trade unions and should help to secure adherence to the PPF. The Minister for Finance was obligated under the terms of the PPF and the Programme for Government to provide further tax reliefs. The nature of these reliefs is always subject to widespread debate but the Minister has struck a reasonable balance between various taxpayers. However, while corporation tax rates will be cut to 20% in 2001, part of the benefit has been clawed back in the form of higher employer PRSI costs.

As a result of the indirect tax measures in today's Budget, inflation should fall in 2001 with the prospect that the annual rate of inflation could be down to 3%, or lower, by end year.

Wednesday, 6<sup>th</sup> December 2000

## PRINCIPAL FEATURES

### Key Objectives

The Budget's principal aims were to:-

- Maintain economic prosperity.
- Improve quality of life.
- Promote a fairer society.
- Reward work and enterprise.

Budget 2001 targets and goals are based on the over-riding principal of maintaining economic competitiveness and is dependent for its success on adherence to the terms of the PPF. Within this context, the budget attempts to focus on appropriate responses to inflation, addresses the issue of improvements in childcare and continues the Government's reform of the personal taxation system. By increasing the number of workers outside the tax net, the taxation measures are aimed at increasing the incentive to work and encouraging greater labour market participation.

### Economic Outlook for 2001

% Change	Dept. of Finance	AIB
Real GDP	8.8	8.0
Real GNP	7.4	7.0
Personal Consumption	8.5	8.0
Fixed Investment	8.3	8.0
Exports	11.5	11.0
Imports	10.8	11.0
CPI (avg.)	4.5	4.3
Employment ('000)	60	50

### Income Tax Measures

- Standard tax rate cut by 2% to 20%.
- Higher rate of tax cut by 2% to 42%.
- Entry point to tax net £144 a week.

	Single	Married
<b>Personal Allowances:</b>		
Up:	£800	£1,600
To:	£5,500	£11,000
<b>Standard Rate Tax Bands:</b>		
Up:	£3,000	£1,000
To:	£20,000	£29,000

### PAYE Allowances

Increased by £1,000 to £2000

### Taxation - Business Perspective

- Abolition of employers PRSI ceiling of £36,600.
- Standard corporate tax rate of 20% to apply from 1 January 2001.
- 12.5% ceiling for small and medium sized businesses increased to £200,000 trading income p.a. Under this measure only 13% of companies liable for tax will now pay at the top rate.

### Indirect Tax Measures

- Cut in standard rate of VAT of 1% to 20%
- Reduction of 6p on litre of diesel.
- Reduction of 3p on litre of unleaded petrol.
- No change in price of cigarettes.
- If passed on fully, the changes in VAT and excise duties will reduce the CPI by 0.5%

### Expenditure Measures

- 2% adjustment to the PPF.
- Social welfare package of £850 million.
- Three year £1 billion child benefit package.
- Child benefit rates up £25 for first and second child, £30 for third and subsequent children.
- Old age and related pensions increased by £10 per week.
- £5,299 million health spending allocation.
- £1 billion allocated to social housing next year.

### Savings Initiatives

- These initiatives are aimed at reducing spending over the medium term, thereby contributing to a slowdown in domestic demand.
- 20% DIRT tax on savings in credit unions
- Abolition of 0.1% Stamp Duty on life assurance policies.
- Same rate of tax to Irish and certain foreign life assurance products.

### Medium Term Fiscal Targets

% of GDP	2000	2001	2002	2003
<b>Current a/c surplus</b>	7.4	7.0	8.0	9.2
<b>Capital a/c deficit</b>	2.7	2.8	3.8	3.7
<b>Contingency</b>	-	-	-0.4	-0.8
<b>GG Surplus</b>	4.7	4.3	3.8	4.6
<b>GG Debt</b>	39	33	28	24

## COST OF BUDGET DAY MEASURES

The table below outlines the cost of the current expenditure and taxation measures announced by the Minister for Finance, Charlie McCreevy, in Budget 2001.

The net position on the current expenditure side, after deducting departmental balances and other adjustments, is that post-budget spending is £456 million above the opening position. The net effect of the taxation proposals outlined today is to reduce the opening level of revenue by £460 million. This includes an offsetting figure of £791 million for revenue buoyancy due to the expansionary nature of the Budget. The overall effect of the taxation and expenditure measures is to reduce the opening current budget surplus of £7,061 million, which was published in last Saturday's **White Paper on Receipts and Expenditure** by £916 million (1.0% of GDP) to £6,145 million (6.7% of GDP). Adding the post-budget capital borrowing requirement of £3,607 million, the overall post-budget position is that the Exchequer is forecasting an overall current and capital surplus (i.e. the Exchequer balance) of £2,538 million (2.8% of GDP) for 2001.

### Cost of Budget Day Adjustments (£ Million)

Net Current Expenditure		Taxation	
<u>Opening Position</u>	17,921	<u>Opening Position</u>	24,982
<i>Less Departmental Balances</i>	-20	<i>Less Income Tax Reliefs</i>	-727
<i>Plus Net Revisions to 2001 Estimates</i>	+62	<i>Less Indirect Tax Measures</i>	-354
<i>Less other adjustments</i>	-170	<i>Less Other Taxes</i>	-169
<i>Plus Social Welfare Increases</i>	583	<i>Add Revenue Buoyancy</i>	791
Post-Budget Forecast	18,377	Post-Budget Forecast	24,522

1.	Opening Current Budget Surplus	7,061
2.	Projected Post-Budget Current Surplus	6,145
3.	Opening Capital Exchequer Borrowing	3,569
4.	Projected Post-Budget Capital Exchequer Borrowing	3,607
(1-3)	Opening Exchequer Balance	3,492
(2-4)	Projected Post-Budget Exchequer Balance	2,538

The gap between the adjusted opening Exchequer balance for 2001 of £3,534 million (i.e. £3,492 million as per the White Paper, plus departmental balances and other opening adjustments) and the projected closing Exchequer balance for 2001 of £2,538 million is £996 million. This is equivalent to 1.1% of GDP in 2001 and 1.8% in a full year. This is more expansionary than the post budget targets set in the 2000 Budget (0.7% of GDP in 1999 and 1.2% of GDP in a full year).

## ASSESSMENT

### Budget Seeks to Distribute Fruits of Growth

In announcing the details of his Budget, the Minister for Finance, Charlie McCreevy, said that it had four basic objectives as follows:-

- to maintain economic prosperity
- to improve quality of life
- to promote a fairer society
- to reward work and enterprise

The Minister also emphasised that the budgetary targets and goals were based on the overriding need to keep the economy competitive. It is very difficult in a single budget to achieve multiple objectives, as outlined by the Minister. However, Budget 2001 is the Minister's fourth budget and the government seems intent on delivering a fifth budget before a general election in 2002. Some will see this as an election budget because the scale of the measures adopted by the Minister is extremely large.

For instance, the income tax package will cost £1.2 billion in a full year and the full cost of the measures in respect of the Department of Social Community and Family Affairs is £850 million. The full year cost of the VAT and excise duty changes is almost £350 million.

As a result of these changes, the Exchequer's opening surplus on current and capital account of £3.5 billion will be reduced to just over £25 billion (2.7% of GDP). On the basis of the EU's general government measurement, the post-budget surplus in 2001 will be £3.9 billion or 4.3% of GDP. This compares with a surplus of £3.8 billion (4.7% of GDP) in 2000.

Many commentators have argued that the Exchequer should run an enlarged budget surplus in 2001 in view of the strength of the economy and the rise in the rate of inflation to almost 7%. The Economic and Social Research Institute, in its latest quarterly commentary, argued in favour of a neutral budget. The ESRI would acknowledge, however, that the Government should meet its commitments under the terms of the Programme for Prosperity and Fairness.

### SUMMARY BUDGET 2000 – 2001 (£m)

	2000 Outturn	2001 * Opening Position	Post Budget 2001 Target	% Change Post Budget 2001 over '00Outturn
<b>Current Spending</b>				
Central Fund ( <i>Incl. National debt interest</i> )	3,131	3,080	2,680	-14.4
Supply Services	13,303	14,841	15,697	18.0
<i>Of which:-</i>				
- Pay	6,839	7,615	N/A	
- Non Pay	6,011	7,226	N/A	
<b>Total Current Spending</b>	16,434	17,921	18,377	11.8
<b>Current Revenue</b>				
Tax	21,492	24,450	23,990	11.6
<i>Of which :-</i>				
- Income Tax	7,273	8,316	7,780	7.0
- VAT & Excise Duty	9,328	10,566	10,684	14.5
- Corporation Tax	3,007	3,396	3,388	12.7
Non-Tax	440	532	532	20.9
<b>Total Revenue</b>	21,932	24,982	24,522	11.8
<b>Current Budget Surplus</b>	5,498	7,061	6,145	11.8
<b>Capital Borrowing</b>	(3,020)	(3,569)	(3,607)	19.4
<b>Exchequer Surplus</b>	2,478	3,492	2,538	2.4
<b>(% of GDP)</b>	(3.1)			
<b>Gen. Govt. Balance</b>	4.7	N/A	4.3	
<b>(% of GDP)</b>				

\* As per White Paper on Receipts and Expenditure

## ASSESSMENT

### Inflation to Fall in 2001

The ERSI acknowledges that the appropriate stance of fiscal policy depended on whether the economy is considered to be in a conventional economic cycle or in a transition between stages of development. The ERSI felt that we should be cautious, as there was fundamental uncertainty on this issue. However, the government took the view that the economy retains the potential for further strong growth over the medium term and that issues of social inclusion and fairness had to be addressed at this stage of our economic development. Tackling these issues should provide a sounder basis for further economic expansion over the medium term.

As regards the inflationary issues of an expansionary budget, the ERSI estimated in its latest quarterly commentary that a package of £500 million cuts in income taxes would add about 0.05% to inflation in the first year and about 0.15% over a three year period. Based on these estimates, the income tax package in yesterday's Budget of over £1.2 billion in a full year would add about 0.12% to inflation over the next year and 0.36% over the next three years. These are hardly significant inflation effects and ignore the positive effects which could come from a dampening of wage pressures as a result of the improvements in take home pay arising from the Budget.

Yesterday's Budget, of course, also contained measures to reduce Irish inflation. The Minister announced that the standard VAT rate of 21% would be reduced by 1 percentage points to 20% with effect from January 2001. Excise duties on drink and tobacco will remain unchanged. The effect of the indirect tax cuts will be to reduce inflation by 0.50 percentage points in 2001, assuming that all the cuts are passed on to the consumer. Based on these measures, the annual rate of inflation in 2001 is officially forecast at 4.5% compared with an estimated outturn of 5.5% for 2000. The Minister's forecasts for 2001 could turn out to be too pessimistic, however, depending on the trend in oil prices. The Budget contained no measures to control the rise

in house prices. Indeed, the rise in disposable incomes as a result of the Budget could put upward pressure on house prices in 2001 but the market is peaking.

Taking the overall package into account, the strategy adopted in Budget 2001 is broadly correct. Irish inflation rose to 6.8% in October 2000. Data for November 2000 will be published by the Central Statistics Office on 15<sup>th</sup> December. The annual rate of inflation is expected to peak at 7% in November. With last year's tobacco tax increase falling out of the annual rate of inflation, the CPI should show a fall to an annual rate of closer to 6% by December 2000. With the help of yesterday's budget cuts in VAT, the annual rate of inflation should continue to decline in the course of 2001 reaching 3%, or lower, by end year. Such a prospect will be helped by the improvement in the value of the euro against other major currencies and by the prospect that euro interest rates could be close to their peak. In contrast to 2000, therefore, when rising mortgage interest rates, higher energy costs and a weakening exchange rate all fuelled Irish inflation, a more benign outlook awaits us in 2001. Charlie McCreevy's Budget, though stimulatory in a strictly macro economic sense, should help to reduce inflation and thus speed up the process of restoring Ireland's more traditional inflation climate.

A disappointing feature of the Budget was the decision to remove the employers' PRSI ceiling. This will raise £169 million in a full year. Among other measures, the measures to promote savings were very limited but the Minister may have a second look at this area in the Finance Bill.

## KEY BUDGETARY AND ECONOMIC TRENDS

	1997	1998	1999	2000	2001(f)*
Current Budget Balance - £ million	604	2,091	3,439	5,506	6,145
% of GDP	1.1	3.5	5.0	5.0	6.7
Exchequer Balance - £ million	-235	747	1,192	2,447	2,538
% of GDP	-0.4	1.2	1.7	3.0	2.8
EU Definition of Govt. Balance as % of GDP	0.8	2.5	3.9	4.7	4.3
EU Definition of General Govt. Debt / GDP Ratio	60	49	50.1	39	33
Primary Budget Surplus (Exchequer Balance less Debt Service Cost) as % of GDP	4.8	5.5	6.4	6.7	6.1
% Change Vol. - Consumer Spending	7.4	7.8	7.7	8.5	8.5
- GDP	10.7	8.6	9.8	10.7	8.8
- GNP	9.3	7.8	7.8	8.6	7.4
Level of GDP - £ billion	52,760	60,582	69,052	80,625	91,750
Consumer Price Index (%)	1.5	2.4	1.6	5.5	4.5
Change in Employment ('000)	62	82	97	74	60
- Average GBP/IEP	0.927	0.860	0.836	0.775	0.82
- Average USD/IEP	1.518	1.426	1.35	1.18	1.28
- Average 3 month money (%)	6.05	5.46	2.96	4.35	5.20

\*The 2000 and 2001 figures are the official estimates and forecasts as set out in the Budget. The currency and interest rate forecasts for 2001 are produced by AIB Group Treasury.

**Produced by AIB's Economic Services Unit (Tel: 8740222)**

Chief Economist, AIB Group Treasury : JOHN BEGGS  
 Senior Economist, AIB Corporate & Commercial Treasury : GERALDINE CONCAGH  
 Production Editor, AIB Corporate & Commercial Treasury : RITA CULLEN  
 Phone: (01) 874 0222 Reuters PAGE AIBE Fax: 679 9590  
 Websites: www.fxcentre.com AND www.johnbeggs.com

**AIB Corporate & Commercial Treasury**

Head of Corporate & Commercial Treasury: John Rice

\*Corporate Treasury: Mick Purcell\*Commercial Treasury: Brian Colgan\*Institutional Treasury: Niall Wallace\*

Marketing Manager : Susan Kelly

Tel: (01) 874 0222

Dublin Corporate & Commercial Treasury Teams		
Agribusiness	John O'Riordan	670-0450
IFSC Business	Seirse O'Reilly	670-0137
International	Conor O'Neill	670-0170
International	Brian Moran	670-0170
Semi States	Brian Kelleher	670-0160
Retailing & Energy	Tom McAuliffe	670-0412
Domestic Institutions	Enda Homan	670-1997

Dublin and Cork Commercial Teams	
DUBLIN - Tel: 670-0176	AREA SOUTH
Brendan Cotter	021-271383
Brendan Donovan	Aidan Andrews
Seamus Strappe	
Websites :	
www.johnbeggs.com & www.fxcentre.com	

You can view John Beggs' Budget Breakfast Speech online at [www.fxcentre.com](http://www.fxcentre.com)

This publication is for information purposes only and is not an invitation to deal. The information is believed to be reliable but is not guaranteed. Any expressions of opinions are subject to change without notice. This publication is not to be reproduced in whole or in part without prior permission. This publication has been approved for publication in the U.K. by

Allied Irish Banks P.L.C.