BUDGET 2008

OVERVIEW

Although Ireland is in a much more favourable budgetary and economic position than most of its main trading partners, there is no room for complacency. **Growth in tax receipts has slowed considerably this year and the economy is facing into a period of much more subdued growth.** Controlling growth in current government spending is going to be very important over the next couple of years if the public finances are to remain in good shape. Delivery on most of the expensive promises made during the general election in relation to taxation and spending must await a renewed pick up in economic growth if we wish to avoid a serious deterioration in the public finances.

However, this does not mean that budgetary policy needs to turn restrictive. Indeed, it was of primary importance that today's budget provided a stimulus for the slowing economy next year, without being unduly imprudent. Indeed, given the combination of: growing risks of a global credit crunch; declining consumer confidence; the downturn in the housing market; and the general air of pessimism about the prospects for the Irish economy, **it was very important that today's budget acted to underpin confidence in the economy.** The Minister clearly had this objective in mind. In particular:

- The increase in gross current government spending is 8.2% in 2008, which is generous but, quite correctly, below the unsustainable rises of 10-12% in the last three years.

- Continued strong growth in public capital spending is provided for, with a rise of 12% in voted capital expenditure in 2008. Scaling back capital spending would have been the soft option when trimming the public finances as happened when growth slowed in 2003 and 2004. However, it would be the wrong option given that it impacts on the future growth potential of the economy, which is still burdened by a large infrastructural deficit.

- All income tax bands and credits were increased by some 4%, with personal tax rates left unchanged. There was a significant overhaul announced of the stamp duty regime on property and increases in the ceiling on mortgage interest relief aimed at boosting the subdued housing market.

- The Minister bit the bullet on deficit financing, setting a target of -€1.85 billion for the General Government budget balance in 2008, or -0.9% of GDP. However, this still keeps the public finances on a very stable path.

The move to a budget deficit should not be viewed as a cause for concern given the marked slowdown in the pace of economic activity, sharp fall in property related tax receipts, the very low level of the national debt and the fact that there is a very large current budget surplus. Indeed, fiscal policy should be counter-cyclical and thus stimulatory, if at all possible, during an economic slowdown. Thus, we would not have favoured an overly restrictive budget today and are not bothered by the deficit target.

The budget is positive from a business point of view. The 1.5% boost it provides to disposable income will help underpin consumer spending. The construction sector will welcome the large increase in capital spending and measures to stimulate the housing market. Overall, the budget should help sustain confidence and growth in the Irish economy.

Oliver Mangan/Jenny Pollock - 5th December 2007

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BUDGET 2008: KEY FEATURES

2008 BUDGET TARGETS

* **Exchequer Deficit** of €4,866m (-2.9% of GNP) in 2008, compared with government expectations for a 2007 deficit of €1,623m (-1.0% of GNP). **General Government Deficit** of €1,845bn (-0.9% of GDP) in 2008 against an expected 2007 surplus of a €900m (+0.5% of GDP).

* The Exchequer Deficit is projected at €5,825m in 2009 and €5,710m in 2010, with the General Government balance estimated at -1.1% and -1.0% of GDP, respectively, in these years.

* The General Government Debt as a percentage of GDP is projected to be 25.9% in 2008, increasing to 27.6% in 2009 and 28.7% in 2010, up from 25.1% in 2007.

* GDP growth forecast at 3%, employment growth at 1% and an HICP inflation rate of 2.4% in 2008.

EXPENDITURE MEASURES

Current Spending

* Gross Non-capital supply services expenditure rises by 8.2% to €57.7bn on the 2007 level.

* Budget day Social Welfare measures totalling €980m in a full year.

Elderly and Carers

* Old age pensions increased by €14 per week, bringing the Old Age Contributory Pension to €223.30 per week, effective from January 2008. Non-contributory pension increased by €12 per week to €212 per week.

* Qualified Adult Allowances (where adult 66 or over) increased to €200 per week to be paid with a State Contributory Pension.

* Maximum personal rate for Carer's Allowance and Carer's Benefit both increased by €14 per week.

Other Social Welfare Measures

* Personal social welfare rates increased by €12 per week with, for example, lowest adult rate up to €197 per week.

Childcare

* Child Benefit increased by €6 to €166 per month for the first and second child and by €8 per month for each of the third and subsequent children to €203 per month, effective from April 2008.

* Early Childcare Supplement, payable for all children under 6, increased by €100 to €1,100 per annum.

Health

* Additional €276m over pre-Budget estimates for range of healthcare developments, including in the areas of cancer care, the elderly, disabilities and children.

* Total provision in 2008 of nearly €16.2bn, an increase of over €1,100m on 2007. Of the total €16.2bn, over €700m is for capital programmes.

* Charge for patients attending A&E units increased by €6 to €66. Charges for stay in public hospitals also increased by 10%.

Capital Spending

* Allocations under the National Development Plan increased from the Pre-Budget Estimates by over €1bn in total.
* Total investment in 2008 on national roads network of €1.7bn.
* Investment in 2008 of €1bn on public transport system.
* €471m allocated in 2008 under NDP for water services infrastructure.
* €828m capital investment in education.
* Housing package of €1.7bn aimed at commencing or acquiring 9,000 new social housing units in 2008 and the provision of 5,500 new affordable homes.
* Gross voted capital expenditure is projected to rise to €8.6 billion in 2008, an increase of 8.2% on the 2007 level.

TAXATION MEASURES

PRSI & Income Tax

* Employee PRSI ceiling raised from €48,800 to €50,700, an increase of 4%.
* Employee weekly PRSI threshold increased from €339 to €352 (€18,304 p.a.).
* No change in top (41%) rate of tax cut or standard (20%) rate.
* Basic single person tax credit increased by €70 to €1,830 (+4%). Married person credit increased by €140 to €3,660.
* The standard tax band to be widened by €1,400 to €3,540 (+4%) for a single person; for a married couple with one income by €1,400 to €44,400; for a married couple with two earners by €2,800 to €70,800, subject to a limit on the transferability of individual bands of €44,400.
* Employee PAYE tax credit increased by €70 to €1,830 (+4%).
* Age exemption limits and other tax credits also increased.
* Health Levy threshold increased from €24,960 per annum to €26,000 per annum.

VAT and Excise Duties

* 30c on pack of 20 cigarettes, with corresponding amounts on other tobacco products, with effect from 6/12/2007.
* No other changes in VAT or Excise Duties apart from exemption for households from new EU imposed excise duty on electricity which becomes effective on 1/10/2008.

Other Personal Taxation

* Specified rate in respect of preferential home loans increased from 4.5% to 5.5%. Specified rate in respect of other loans increased from 12% to 13%.
* Annual stamp duty charged on credit cards reduced from €40 to €30, on combined ATM/Debit cards from €20 to €10 and on ATM or debit cards from €10 to €5. Stamp Duty on cheques increased from 15c to 30c.

Residential Property

* Ceiling on mortgage interest relief for first time buyers raised from €8,000 to €10,000 for a single person and from €16,000 to €20,000 for a married couple in line with commitment made in the summer.

* Reform of the Stamp Duty to marginal rate regime. Properties up to €125,000 exempt, 7% on next €875,000, 9% on balance.

* For buyers (mostly first time buyers) who avail of stamp duty relief and exemptions and who subsequently rent out the property, the claw back period for these reliefs is being reduced from 5 to 2 years.

* Tax exemption limit under rent-a-room scheme increased, from €7,620 to €10,000.

* Level of rent paid on which tax relief can be claimed increased by 11%.

Business Taxation

* Tax relief for film investment renewed for another four years to 31/12/2012.

* VAT registration threshold for SME increased.

* Increased thresholds for treatment as a smaller company or a start-up company for corporation tax purposes.

* R & D tax credit scheme enhanced to provide additional incentives for increased expenditure in R & D.

* Banks to make advance preliminary payment in December of each year of 80% of the Stamp Duty liability on financial cards due to be paid in the following year.

Green Measures

* Vehicle Registration Tax ratings to be modified to relate to levels of carbon dioxide emissions in line with commitment in Budget 2007. To take effect from 1/7/2008, series of 7 bands dependent on level of CO2 emissions. VRT rates range from 14% for the lowest rated cars to 36% for cars with the highest levels of CO2 emissions.

* Annual motor tax increased by 9.5% for cars below 2.5lt and 11% for cars above 2.5lt from 1/2/08. Proposals to be brought forward to link motor tax rates to CO2 emissions for new cars from 1/7/2008.

* Existing incentives on hybrid and flexible fuel cars extended to 1/7/2008. From this date, additional relief on the VRT payable under the new CO2 emission related system.

* Revised scheme of capital allowances and leasing expenses for cars used for business purposes linked to CO2 emissions, for cars purchased on or after 1/7/2008.

* VAT to be reduced on seeds and bulbs for biofuels.

* Commission of Taxation to examine introduction of a carbon tax.

Other Measures

* No changes in capital gains taxes - except for an increase in the relief from both stamp duty and capital gains tax on a transfer of a site to a child for purpose of building a principal residence. Exemption threshold on site value increased from €254,000 to €500,000.

* New simplified rules for VAT on property. VAT change on residential property unchanged.

* Further provision for the Farm Waste Management Scheme.

* Several measures on farmers taxation arising from reform of the Common Agricultural Policy and growth in the adoption of innovative farm business structures.

* Additional €84m of overseas aid, bringing the total Overseas Development Aid allocation in 2008 to €914m.

* Tax code amended to assist the take up of the fishing vessel decommissioning scheme.

BUDGET ASSESSMENT

Budget Deficit Target Of €1.85 Billion In 2008

The table below sets out the principal features of the 2008 budget arithmetic. Net spending on current supply services is forecast to rise by 9.3% next year. On the other side of the balance sheet, tax receipts are forecast to rise by 3.3% in 2008. The tax changes announced in the budget will cost €527 million in gross terms but this is more than offset by the impact on the buoyancy of tax receipts of the budget giveaways, which boosts tax revenue by €661 million. Overall, the current budget surplus is projected to fall to €4.75 billion in 2008, from €7 billion in 2007.

BUDGET 2008

(€ Million)	2007 Projected Outturn	2008 Budget Target	% Change
Current Spending	**40,938**	**44,827**	**9.5**
of which			
(i) Central Fund	3,990	4,437	11.2
(ii)Supply Services	36,948	40,390	9.3
Current Revenue	**47,999**	**49,594**	**3.3**
of which			
(i) Tax	47,325	48,910	3.3
(ii) Non-Tax	674	684	1.5
Current Budget Surplus	**7,061**	**4,767**	
Capital Borrowing	**8,684**	**9,633**	
Exchequer Bal.	**-1,623**	**-4,866**	
(% of GNP)	(-1.0%)	(-2.9%)	
General Gov. Bal.	**900**	**-1,845**	
(% of GDP)	(+0.5%)	(-0.9%)	

Source: Dept of Finance

On the capital side, net voted expenditure is forecast to rise by 10.7%. Capital receipts are expected to be broadly unchanged next year. As a result, capital borrowing is projected to rise to €9.6 billion from €8.7 billion in 2007.

Overall, the government is forecasting an Exchequer deficit of €4.9 billion in 2008, compared to a deficit of €1.6 billion in 2007. The Minister is targeting a General Government deficit of €1.85 billion next year, or 0.9% of GDP. This compares to a surplus in 2007 of €900 million (0.5% of GDP).

Another Year Of Sluggish Tax Receipts Forecast

How realistic are the Minister's budget targets? Spending has come in under target in recent years for a variety of reasons. This trend could be maintained in 2008, with savings on debt interest payments possible in particular. The main errors in budget forecasts, though, are usually on the revenue side, especially tax receipts.

Tax receipts overshot target by €3.9 billion in 2006 and €1.75 billion in 2005 but undershot target by €1.75 billion this year. Much of the forecast errors have been in property taxes, namely capital taxes and stamp duties. These were boosted by the exceptional buoyancy of the housing market in 2005/06 but were depressed by the downturn in housing activity in 2007. Corporation tax receipts also greatly exceeded target in 2006 but undershot target in 2007.

The Dept forecasts seem quite cautious for next year, even with the economy slowing down. The total tax take is forecast to rise by just 3.3%. The Dept may well have been influenced in this regard by the weakness of tax receipts this year. Stamp duties are forecast to fall by over 10% next year but even excluding this factor, the tax take is projected to rise by a still modest 4.4%.

Indeed, we feel that given the continuing weakness of housing activity, stamp duty receipts will fall by more than the Dept is forecasting: the Dept in its 2008 White Paper sees these taxes falling by €245 million next year but stamp duty receipts have been running well over €100 million per month below year earlier levels in recent months. Stamp duty receipts only began to decline around mid-2007 so they seem likely to fall by €500-600 million in the opening half of 2008 alone, excluding any impact from the changes announced in the budget.

On the other hand, the Dept's 2008 White Paper forecasts for growth in VAT and income tax receipts of +4.7% and +4.2%, respectively, seem rather low given the forecast of consumer spending growth of 3.8% in volume terms, while the total wage bill is likely to rise by close to 6%. Excise duties were forecast to rise by just 1.2% before today's budget changes, which suggests the Dept expects car sales to be sluggish next year. Corporation tax receipts are difficult to estimate and are forecast to rise by 5%.

WHITE PAPER TAX REVENUE PROJECTIONS

(€ million)	2007 Projected Outturn	2008 Opening Position	Chg. %
Excise Duties	5,814	5,885	1.2
VAT	14,545	15,225	4.7
Income tax	13,605	14,170	4.2
Corporation Tax	6,350	6,665	5.0
Capital Taxes	3,528	3,580	1.5
Stamp Duties	3,195	2,950	-7.7
Other	285	301	5.6
Total	**47,325**	**48,776**	**6.7**

Source: Dept of Finance

Overall, tax revenues have proven very difficult to forecast in recent years and with the economy now slowing, taxes revenues are going to be even more difficult to predict next year. We see downside risks to the Dept's forecasts on stamp duty next year but VAT and income tax revenue could exceed target. A clear trend on Excise duties should emerge early in the year based on the strength of new car sales. Overall, we think the Dept is right to be cautious and project low growth in tax receipts next year.

Minister Faced With Worsening Budget Arithmetic

The Minister started today with an opening Exchequer deficit of €3.8 billion. At a broader level, he had an opening General Government deficit of €0.4 billion. These deficits are in contrast to the opening budget surpluses that Irish Finance Ministers have generally enjoyed over the past decade, indicating that the Minister had a difficult task today. Furthermore, because of a change in the budgetary process, the Minister was in a less favourable opening position today as he had to include spending commitments for new services in the budget. These were generally included in the Book of Estimates published ahead of the budget in previous years. Thus, the Minister had limited room for manoeuvre today. Nevertheless, the Budget was reasonably generous.

On the revenue side, the increases in income tax credits and bands will cost €400 million. However, this will be partially offset by higher indirect taxes which will bring in an extra €100 million. Furthermore, some of the social welfare rises and tax cuts will flow back into the Exchequer coffers in higher tax revenues. Overall, then, the net effect of today's budget is to increase tax receipts by €134 million, as the table shows.

ANALYSIS OF MAIN BUDGET DAY CHANGES (€M)

	2004	**2005**	**2006**	**2007**	**2008**
Social Welfare	608	834	1,065	1,467	957
Other Current	65	37	446	388	724
Capital Expd.	50	334	469	23	45
Tax Changes	-17	-578	-763	-1,107	-527
Buoyancy Effect	181	333	488	662	661
Net Tax Change	+164	-245	-275	-445	134

Source: Dept of Finance

On the spending side, the Minister introduced a social welfare package that will cost €980 million in a full year. Other spending increases on the current budgetary side amounted to €724 million, including €316 million in health and €84 million in overseas aid. On the capital side, the additional spending increases amounted to €45 million as the Minister had already set aside some €1 billion in his Pre-Budget Outlook for new capital spending increases.

Mildly Stimulatory Budget Provides Modest Boost To Incomes

Overall, as a result of today's measures, the Minister increased his opening General Government deficit by €1.4 billion, pointing to a mildly expansionary budget. The increases in social welfare payments and reductions in income taxes will total some €1.4 billion in 2008. This will boost household disposable income by close to 1.5%, providing some support to household spending power. Following today's budget, gross current voted government expenditure is set to rise by 8.2% in 2008. On the capital side, underlying voted expenditure will rise by 12%. Overall, the income tax cuts and sizeable spending rises point to a mildly stimulatory budget.

The General Government budget balance is forecast to move from a surplus of 0.5% of GDP in 2007 to a deficit of 0.9% in 2008. However, account needs to be taken of the slowing economy. In cyclically adjusted terms, the Dept estimates that the General Government budget balance will be reduced by 1% of GDP in 2008, again suggesting that this is a mildly stimulatory budget.

The boost to incomes from the income tax package are modest enough, although it is being augmented for families with children by higher child benefit payments. For a two income couple with two children under the age of 6 years on a combined wage of €75,000, the personal tax cuts and increases in child benefit payments will boost their take home pay by €1,145, equivalent to a rise

BUDGETARY CHANGES TO INCOME TAX/PRSI/CHILD BENEFIT
IMPACT ON PAYE TAXPAYERS (1)

	--- Single Person --		---- Married Couple (2) -----			--- Married Couple (3) ---		
Income €	Total Gained €	Gain as % of Net Income	Total Gained €	Of which Child Benefit	Gain % of Net Income	Total Gained €	Of which Child Benefit	Gain % of Net Income
26,000	660	2.9	308	308	1.0	828	308	2.7
40,000	434	1.4	1,108	308	2.5	648	308	1.6
55,000	363	0.9	588	308	1.1	871	308	1.7
75,000	368	0.7	1,145	308	1.7	876	308	1.4
120,000	358	0.5	1,105	308	1.2	866	308	1.0

1. Full rate PRSI contributors. 2. Married couple, two earners, two children under 6 years of age. 3. Married couple, one earner, two children under 6 years of age

Source: Dept of Finance

of 1.7% in their disposable income. For a single person earning €40,000, the increase in take home pay amounts to €434 or 1.4% of disposable income. In the case of a married couple with one income of €55,000 and two children under 6, the boost will amount to €871 or 1.7% of their disposable income.

Support For The Depressed Housing Market

The increase in the ceiling on mortgage interest relief for first time buyers will also provide a significant boost to the disposable income of some households. It will help ease affordability pressures on this sector of the housing market. The size of the changes are quite significant for first time buyers. In line with earlier commitments, the ceiling on mortgage interest relief is being increased from €16,000 to €20,000 for a couple and from €8,000 to €10,000 for a single person (at the standard rate of 20%). This will boost the disposable income of a couple by up to €800 and by up to €400 for a single person.

It means that for a first time buyer couple, all of their mortgage interest on a €410,000 house with a 90% mortgage will now qualify for tax relief compared with a house priced at €330,000 previously. This mortgage interest relief is available to all first-time buyers who are in the first seven years of their mortgage.

It will be most beneficial to the Dublin housing market, where the average house price paid by a first time buyer is close to €350,000, compared to around €250,000 in the rest of the country. It also shifts the balance in terms of housing demand more in favour of the first time buyer and away from the investor. Indeed, it creates a more level playing field, especially in the more expensive sectors of the market, as investors can write off all their mortgage interest costs against rental income. The increase in mortgage interest relief, though, is quite a targeted measure and as such is likely to have only a limited impact on housing activity.

Thus, the housing industry will also welcome the move by the Minister to overhaul the stamp duty regime for non-first time buyers in the second hand housing market. The Minister announced a major change in the current system which was seen as very unfair and excessive. No stamp duty will apply to the first €125,000 of the purchase price with the balance up to €1 million charged at 7% and the excess over €1 million charged at a higher rate of 9%. The effective stamp duty payment will fall at all levels at a gross cost of €190 million to the Exchequer. Turnover has declined sharply in the second hand house market during the past year and it is hoped that the cut in stamp duty will provide a much needed fillip for the sector.

A Helpful Budget For The Economy

Overall, from a corporate perspective, the reaction to the budget is likely to be favourable. Despite the deterioration in the public finances, the Minister has avoided the option of a tight budget and instead has gone for a mild fiscal stimulus, which should help sustain economic growth. Given the growing risks of a global credit crunch, declining consumer confidence, the downturn in the housing market, and the general air of pessimism about the prospects for the Irish economy, it was very important that today's budget acted to underpin confidence in the economy and support economic activity.

Hence, it is good news that the budget is broadly positive from a business point of view. The 1.5% boost it provides to personal disposable income will help underpin consumer spending. The construction sector will welcome the large increase in capital spending. Exchequer financed capital spending is to rise by over 12%, while the increase in the total Public Capital Programme is 21% in 2008. The moves to ease the burden of stamp duty and increase the ceiling on mortgage interest relief will also be welcomed by the construction and property sectors as they should benefit the sluggish housing market.

Notwithstanding the stimulatory nature of the budget, the General Government deficit target of 0.9% of GDP is relatively small and the Minister is still targeting a large current budget surplus. Indeed, the budget deficit is being used to part fund Exchequer capital spending, which will still be mainly financed out of tax receipts in 2008. Overall, after this budget, the public finances remain in good shape. Turning to 2009 and 2010, the Dept of Finance is forecasting a continuing modest budget deficit at around 1% of GDP, with the General Government debt remaining very low also, at 28.7% of GDP by 2010, indicating that the public finances are expected to remain in very good shape.

GDP Growth Of Around 3% Forecast For 2008

There is a broad consensus amongst forecasters that the Irish economy will slow sharply next year after growth of close to 5% in 2007. AIB's GDP forecast for growth of 3.3% next year is in line with the view of official agencies, which generally see growth at between 3.0-3.5%. The main factor behind the slowdown in the economy is a sharp fall in housebuilding activity that is already well in train. Our forecasts are based on housing completions declining by some 30% in 2008. Given that investment in new dwellings accounts for close to 10% of GDP, the fall in new housing output could knock some 3% off GDP next year.

Of course, the decline in housing output will have knock on consequences for other areas of the economy such as consumer spending. Indeed, consumer spending is expected to slow anyway next year due to subdued growth in employment, a waning SSIA impact and higher interest rates. A less expansionary fiscal policy is also on the cards for 2008. Meanwhile, the export environment is turning less favourable, with growth in Europe set to slow and the euro appreciating rapidly in recent months.

Another notable feature of the forecasts is the strong deceleration in growth in employment forecast for next year. This is generally seen at between 1.1-1.5%, down from around 3.4% this year. As a result, forecasters expect the unemployment rate to pick up to around the 5.2-5.6% level, compared to a rate of around 4.5% in 2007.

The risks are to the downside in relation to the consensus view of around 3% growth for the Irish economy next year. First, there may be an even sharper decline in housing completions than currently envisaged. Second, conditions on global financial markets have worsened again over the past month, especially in credit markets. An extended period of seizure in credit markets would represent a very real threat to the growth prospects for all economies in 2008.

Turning to inflation, forecasters expect that Irish inflation will decelerate rapidly next year as the mortgage rate hikes in the earlier part of 2007 drop out of the annual comparison. The CPI rate is expected to average between 3.0 and 3.4% next year, down from close to 5% in 2007. AIB's 2008 HICP forecast of 2.9% is above the official forecasts, which range from 2.2 to 2.5%. This may reflect the fact that we have built in larger increases in our inflation forecasts for the volatile food and energy components, which have risen sharply in recent times.

2008 IRISH MACRO ECONOMIC FORECASTS (%)

	AIB	D/Finance	ESRI	Central Bank	EC
GDP	3.3	3.0	2.7	3.5	3.5
GNP	3.2	2.8	2.9	3.25	NA
Private Cons	3.5	3.8	4.0	3.75	3.4
Gov Expd.	3.0	3.6	3.5	3.5	3.5
Fixed Inv.	-5.7	-1.6	-1.2	-0.5	-0.5
Exports	6.0	5.6	5.1	6.0	5.8
Imports	4.0	4.5	5.1	4.75	4.7
CPI	3.2	N.A.	3.4	3.0	NA
HICP	2.9	2.4	2.5	2.25	2.2
Employment	1.2	1.1	0.6	1.5	1.3
Unemployment Rate	5.2	5.6	5.6	5.25	5.3

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