Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Gobharnóir / Governor

Mr Simon Harris T.D.
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Department of Finance
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Upper Merrion Street
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Dear Tánaiste,

RE: Budget 2027

I am writing to you in advance of the *Summer Economic Statement 2026* and *Budget 2027*, in line with the Central Bank's mandate to provide analysis and comment to support national economic policy development.

Ireland's small open economy and large international financial sector are operating in a particularly challenging context as the global economic backdrop continues to change. The shifting geopolitical and trade landscape, as well as ongoing structural economic transitions (climate, demography, technology), present both upside opportunities and downside risks to economic growth and the financial system.

We are living in a period where the frequency of large external shocks has increased. Our policy frameworks, and policy decisions themselves, must adjust to this new reality so as to build long-term resilience in the economy and public finances.

In my letter of 29 January, I highlighted the need to focus on building economic resilience and to prioritise five key areas:

- Growing the supply-side capacity of the economy, particularly housing, transport, energy and water infrastructure;

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- Strengthening the indigenous business sector to complement foreign direct investment and enhance economic resilience;

- Building fiscal buffers through prudent fiscal policy and rigorous expenditure control;

- Supporting household resilience by enabling greater retail participation in financial markets and improving access to debt and equity financing for domestic businesses; and

- Working with partners to strengthen Europe's economic infrastructure and to develop a new set of multilateral trading rules that deliver certainty and stability.

Looking ahead to *Budget 2027*, these priorities remain foremost. Achieving progress across them will entail trade-offs and require choices and commitments to be made on public expenditure and taxation, along with reforms to improve efficiency in the delivery of public capital expenditure and the crowding-in of private investment.

Economic outlook

The global economy continues to face challenges and heightened uncertainty from the Middle East conflict and the disruption in the Strait of Hormuz. Energy prices have surged and global supply chains have been disrupted. Modified domestic demand (MDD) growth is projected to moderate, reflecting the dampening effects of higher energy prices on real incomes and consumption. However, multinational-led AI-related investment in Ireland will support MDD growth over the forecast horizon. Inflation forecasts in the Central Bank's latest *Quarterly Bulletin* have been revised upwards, to 3.5 per cent this year and 2.9 per cent in 2027, with the outlook for energy prices substantially higher than projected in our March *Bulletin*.

Even with the recent US-Iran Memorandum of Understanding, there remains uncertainty as to when the disruption to the Strait of Hormuz shipping lanes is likely to be fully alleviated and the extent to which trade normalises. Our *Quarterly Bulletin* presents scenarios ranging from swift resolution (lower inflation, stronger growth) to prolonged disruption (higher inflation, weaker growth). Even in optimistic scenarios, inflation pressures persist.

Recent economic performance is also relevant for assessing the appropriate fiscal stance. The economy has grown rapidly since 2021 (annual average growth in real MDD of 5½ per cent), delivering sustained employment growth and low unemployment. Current cyclical conditions (as seen in the projections of continued growth in domestic activity combined with near-term inflation at above 2 per cent) do not support the need for a fiscal stimulus to boost demand.

At the euro area level, the ECB Governing Council raised interest rates by 25 basis points to address inflationary pressures. The coherence of monetary and fiscal policy is essential for macroeconomic stability. And with the Irish economy facing significant externally-driven price pressures and monetary policy tightening, fiscal policy should avoid contributing to the build-up of inflationary pressures. A broadly neutral stance is appropriate (as also indicated in the recent IMF Article IV consultation).

Concentration risks in Ireland's tax base

The State's revenue base is now much more reliant on corporation tax (CT) receipts than at any time in the past. CT increases have driven 40 per cent of all revenue growth since 2019 and its share of total general government revenue has increased from 12 per cent to 23 per cent (or one-third of all Exchequer tax revenue).

While CT receipts are likely to increase further in 2026, I am concerned about the long-term sustainability of the current high levels of revenue. Overall CT receipts are a function of conditions in the domestic and global economy alongside the interplay between the domestic policy regime, those of other key trading and investment partners, and the multilateral frameworks Ireland and many of those partners have agreed to. A significant proportion (estimated at around half) of Ireland's CT receipts cannot be explained by domestic economic developments and may be exceptionally vulnerable to external shocks and/or the activities of a small number of companies and changes in international tax regimes. The vulnerability is exacerbated by the exceptionally narrow nature of the CT tax base with data showing that 10 companies were responsible for 56 per cent of all CT receipts in 2025, up from 41 per cent in 2015. Moreover, two sectors – Information and Communication Technology and Pharmaceuticals – were responsible for at least half of all CT revenue in 2025.

A broader tax base is needed to help mitigate the risks from a possible loss of CT receipts and to fund known spending pressures. As outlined in the long-term projections from your Department, Government expenditure will need to rise over the medium term by 6 percentage points of national income to fund higher age-related pressures and costs related to climate change and the green transition. The Future Ireland Fund can part-finance this but further action is advisable. The tax base should be broadened so as to increase revenue as a share of national income (with the Commission on Taxation's 2022 report providing a menu of options for the Government to choose from).

Challenges managing Government expenditure

Current Government projections show expenditure growth outpacing revenue growth in the coming years. The underlying (excluding estimated windfall CT) general government balance is forecast to widen from a deficit of €7.1 billion in 2025 to €20.4 billion in 2030. If expenditure overruns persist, the underlying budget deficit could rise to €25.7 billion or 5.8 per cent of GNI* by 2030. This would deplete fiscal buffers, limiting capacity to respond to future negative shocks, while adding to domestic inflationary pressures.

To maintain existing levels of public services out to 2030 and to increase public investment as envisaged in the revised National Development Plan, the Central Bank estimates expenditure growth of around 5 per cent per annum would be required. Relative to current government projections, maintaining spending growth at this lower rate would deliver larger headline budget surpluses out to 2030 and be consistent with one-third of estimated windfall CT being saved between 2028 and 2030, compared with just 20 per cent in the government's projections. Higher expenditure growth above that consistent with maintaining existing levels of public services could be enabled while still achieving these outcomes, if additional revenue-raising measures were introduced, including broadening the tax base.

The State's borrowing costs are rising. Interest expenditure is projected to double by 2030. We know how vulnerable a small open economy can be to rapid changes in market sentiment. Reducing public debt as a share of national income should remain a key focus of national economic policy.

Delivering public investment

Government investment has doubled in nominal terms since 2019 and is projected to exceed 7 per cent of GNI* in the coming years. This investment has the potential to have a transformative impact on Irish society, helping to address known deficits in national infrastructure, crowd-in higher private investment and boost the economy's long-run growth potential in the face of structural headwinds to growth. Addressing infrastructure deficits in a timely manner would also help to reduce inflationary pressures over the medium term. Actions to reduce fossil fuel dependency will build resilience to future geopolitical shocks and contribute to achieving emission reduction targets.

Achieving value for money is difficult in an economy at full employment and in the face of externally-driven cost shocks. Expenditure discipline, combined with prioritising public projects that yield the largest spillovers to the private sector and enhance potential output is key to delivering productivity and competitiveness gains from the planned investment.

The need for an effective fiscal framework

With the exception of the pandemic, when an effective counter-cyclical fiscal stance was pursued, Ireland's fiscal stance has been predominantly pro-cyclical over the last half century. Expansionary bias in good times – although the underlying 'deficit bias' can be temporarily masked by revenue windfalls – and fiscal contractions during downturns contribute directly to damaging boom-bust cycles.

A credible and binding domestic fiscal framework is needed to mitigate against the risk of repeated boom-bust cycles. This should provide a principles-based anchor to guide budgetary policy. The specific design of a fiscal anchor is a matter for Government but I suggest four guiding principles:

- it should promote **sustainable** growth in spending, allowing for consistent increases in state services and public expenditure that improve the capacity of the economy. This requires a medium-term operational anchor linking spending growth to the underlying potential growth of the economy and the State's sustainable revenue-raising capacity, ensuring that potentially vulnerable revenues are not used to fund permanent increases in spending, and prioritising capital over current expenditure;

- it should **smooth** the economic cycle rather than amplify it. While automatic stabilisers, such as unemployment benefits, naturally respond to the cycle, an anchor should prevent discretionary tax and/or spending changes from acting in a procyclical way;

- it should be clearly defined and favour **simplicity** reflecting the unique difficulties in measuring the output gap for the Irish economy, and be applied to broader concept of general expenditure rather than Exchequer spending; and

- it should balance **flexibility with discipline**. There should be limited, transparent deviations for exceptional shocks, but any deviation must be temporary and accompanied by a clear plan to return to compliance.

The reformed EU fiscal framework introduced in 2024 contains many beneficial elements including an enhanced multi-year perspective and a single operational anchor in the form of a net expenditure rule. This addresses some of the criticisms of the previous EU framework, in particular its insufficient focus on medium-term sustainability and excessive complexity. I welcome the Government's publication of its Medium-Term Fiscal and Structural Plan (MTFSP) at the end of last year (in line with the requirements of the new framework). Moving towards medium-term budgetary planning is a positive step towards building economic resilience.

Nevertheless, the rate of net spending growth set out in the MTFSP is higher than the estimated potential growth rate of the economy and could amplify rather than smooth - the economic cycle. Moreover the discipline that the EU framework can provide is muted in an Irish context, partly because the rules are defined using GDP, but also because they do not account for windfall corporation tax revenue. As a result, Ireland's domestic fiscal framework needs to be strengthened so that it reflects the core principles set out above. I encourage you to use the opportunity offered by the need to enshrine the requirements of the new EU fiscal rules into Irish law to ensure that Ireland develops and implements an effective and binding domestic fiscal framework.

Conclusion

Above average growth since 2021 has benefitted the public finances. Combined with surging CT revenue, the headline budgetary position has been in surplus since 2022, despite large expenditure increases and some tax cuts.

However, this favourable headline position rests on somewhat unstable foundations.

Relatively favourable economic conditions and the headline budgetary positions present a window of opportunity to strengthen the fiscal framework. But this window will not remain open indefinitely. The combination of a narrow revenue base, persistent expenditure overruns, and climate and demographic pressures demand decisive action now.

Ireland's economic performance presents reasons for optimism but also clear reminders of the need for vigilance. As you said to the Oireachtas Budget Oversight Committee, we cannot take the progress we have made for granted and need to take a cautious approach to our public finances. Sound policy decisions today can help steer the economy through a turbulent international environment, deliver sustainable economic progress and build the resilience that the country needs.

Yours sincerely,

Gabriel Makhlouf