Executive summary

Analysis of the General Government budget outturn in the 1st quarter of 2014

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This report analyses the budget developments of the general government sector in the 1st quarter of 2014, based on the general government financial and non-financial accounts data, published on 27th June 2014 by the Bank of Portugal (BoP) and by Statistics Portugal (Portuguese Statistical Authority) (INE) in national accounts and according to the Excessive Deficit Procedure (EDP).

The budget deficit stood at 5.9% of GDP in the 1st quarter, reflecting an improvement of 2.3 p.p. of GDP in year-on-year terms. This was due to the increase in revenue, especially tax revenue, and the fall of expenditure, achieved mainly in compensation of employees and, to a lesser extent, in social transfers. As for public debt, its ratio rose to 132.9% of GDP, greatly influenced by the increase in central government deposits. Without this effect the debt ratio would have recorded relative stabilisation.

It should be noted that these were the last general government accounts compiled according to the European System of Accounts 1995 (ESA95). From September onwards the methodological framework underlying the national accounts statistics will be replaced by the ESA2010 rules, which, together with the implementation of a base change in all sectors of the economy, will have important consequences in Gross Domestic Product (GDP) estimates and its components. In the general government sector, for example, new rules are expected for the classification of institutional units and the recording of pension fund transfers. A number of entities, including Comboios de Portugal (CP), Parpública and state owned hospitals under the form of corporations, will be included in the general government sector. These changes will have significant impacts on the budget aggregates and on the general government deficit and debt, not yet identified with precision. The implementation of these new statistical rules may imply revisions of the budget effort required to achieve the goal of a budget deficit of 4% of GDP in 2014, of an unknown magnitude.

For these reasons, the assessment of the budget outcome in the 1st quarter, *vis-à-vis* the annual goal, has greater limitations than usual. Only after the outcome for the 2nd quarter is published in September will the figures be compiled in line with ESA2010 (including the figures for the 1st quarter). The September notification under the EDP (in ESA2010) should include an updated forecast for 2014 which will provide a more conclusive assessment of the results achieved in the meantime.

In addition to methodological changes, several risk and uncertainty factors may have an impact on the budgetary performance in 2014, making it difficult to extrapolate the 1st quarter figures for the entire year:

- The sectoral measures on the expenditure side are still unknown with the exception of the cut in compensation payments, a risk that has already been highlighted in the CFP's analysis of the SB/2014 and of the FSD/2014;
- The delay in putting forward measures to offset the effect of articles 33, 115 and 117 of the SB/2014 Law which were considered unconstitutional, reduces the budget safety margin to offset budget deviations. In addition, article 2 of the recently presented Bill no. 239/XII does not fully make up for the direct financial effect of the previous measures (which have a gross impact of 857 M€ and a net impact of 747 M€);
- The first amendment to the SB/2014 includes measures whose constitutionality is under review (which have a gross impact of 196 M€ and a net impact of 186 M€);
- The financial restructuring of public transport corporations, CARRIS and Sociedade de Transportes Coletivos do Porto, S.A. (STCP), that took place in the 2nd quarter (in April) will involve an increase in spending of 0.7 p.p. of GDP, although the impact on the deficit may be reduced by revenue from a possible concession agreement, of an amount still unknown; the impact of this restructuring on the budget balance may, however, be reduced to zero if the two companies fall within the scope of general government under ESA2010;
- The risks highlighted in the FSD/2014 relating to State-owned enterprises, contingent liabilities and Public-Private Partnerships (the latter resulting from the restoring of financial balance) remain.

Even within a context of improved budget performance, the instability of the fiscal measures, in particular as regards the relative weight of the expenditure and revenue side adjustments, as well as the degree of uncertainty that still exists, undermine any firm expectations as to the direction of the fiscal consolidation. However, those expectations are crucial for a sustained recovery of investment and employment and to ensure compliance with the rules to which the nation is bound and the sustainability of public finances.