ANALYSIS OF THE STATE BUDGET PROPOSAL FOR 2020

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Conselho das Finanças Públicas
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The Portuguese Public Finance Council is an independent body, set up by article 3 of Law no. 22/2011 of 20 May that introduced the 5th amendment to the Budgetary Framework Law (Law no. 22/2001 of 20 August, republished by Law no. 37/2013 of 14 June).The final version of its Statutes was approved by Law no. 54/2011 of 19 October.

The Council began its work in February 2012 and its mission is to conduct an independent assessment of the consistency, compliance with the stated objectives and the sustainability of public finances, while promoting fiscal transparency, so as to contribute to the quality of democracy and of political economic decisions and so strengthen the State's financial credibility.

This Report uses the information available up to 10 January 2020.

In the publications section at www.cfp.pt, a spreadsheet containing all the figures used to build the charts and tables in this Report is available for download.

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OVERALL REVIEW

In this report, the Portuguese Public Finance Council analyses the proposed State Budget for 2020 (State Budget Proposal /2020) in detail. The following lines provide a general assessment of the document.

The 2020 budget proposal configures what could be called a continuity budget. This idea of continuity appears in two complementary ways.

On the one hand, this budget continues the budgetary consolidation strategy of recent years. In 2019, according to the proposal we are now considering, the deficit would have been EUR 174 million, which is already close to balance. A budget surplus of EUR 533 million, or around 0.2 per cent of GDP, is forecast for 2020. This surplus follows the successive reductions in the budget deficit in recent years.

Nevertheless, there are risks in this budget proposal that should be noted. In addition to the pressures resulting from the State's current expenditure, the desire budget surplus depends, on the revenue side, on the achievement of the economic growth projected in the scenario, whose associated risks are downward and above all of an external nature. In the same way, there is a need for support for the financial sector, with the possibility of it exceeding the amounts already foreseen in the budget proposal.

The budget balance, or the moderate surplus that is expected, allows, in conjunction with economic growth, for a decrease in the weight of public debt in our economy. If the forecasts contained in the proposal are met, this debt will reach 116.2% of GDP by the end of 2020. This is certainly a high figure, but the continuation of its downward trend, of the order of 2.7 percentage points of GDP, can only be considered as good news. In addition to compliance with national and European rules, the reduction of the debt burden allows the release of public resources for purposes other than interest payments and is a condition for the release of budgetary space that may become important in more adverse times. In addition, the very dynamics of reduction have allowed for greater ease and lower cost in public financing, in a virtuous process that feeds itself.

This is a continuity budget in another, stricter sense. Regardless of their social and political quality, the new policy measures planned for 2020 are not particularly relevant from a financial point of view. They adversely affect revenue by some EUR 10 million, and expenditure is increased by EUR 99 million. In other words, they contribute negatively to the balance by about EUR 109 million. This relatively small figure contrasts with the significance of the carry-over of measures taken previously, EUR 800 million on the expenditure side and increased revenue by EUR 246 million. From this point of view, it is therefore a budget with few "innovations".

The reduction in the burden of government debt that we have already mentioned allows one of the budgetary rules, the government debt rule, to be complied with. On the other hand, CFP calculations point to some departure from the rules regarding the adjustment path of the structural balance towards the medium-term objective and, more significantly, the expenditure reference value. The latter depend, among other factors, on the measurement of the output gap, an unobserved variable, and on the classification of temporary and non-recurring measures, and they themselves certainly deserve to be revisited and discussed in their methodological and operational aspects.

The Portuguese Public Finance Council once again emphasizes the importance of the multi-annual perspective with regard to public accounts and, therefore, the implementation of the Budgetary Framework Law of 2015, which is currently postponed until April 2020. Program budgeting in a multi-annual context will make it possible to overcome the annual cash logic, with emphasis on inputs, which still prevails. The perspective of performance and results, combined with accounting transparency, will certainly allow the design of more efficient and more democratically controlled budgetary and public policies.

The Portuguese Public Finance Council endorsed, in a previous document, the macroeconomic estimates and forecasts underlying the proposed State Budget. It is true that recent economic growth, and which is expected for the near future, has allowed for the reduction and elimination of the budget deficit and the reduction of the government debt ratio. However, it should be noted that this growth has resulted more from the absorption of unemployment levels that in the recent past have been placed at abnormally high levels, than from increases in the productivity of productive factors that demonstrate unequivocal economic progress. In other words, current estimates for potential output growth in Portugal remain lower than what could be hoped for, in view of lasting real convergence towards production and income levels that characterise more advanced countries. If fiscal consolidation is a necessary condition for this convergence, higher growth will also contribute to an improved soundness of public accounts.

Higher growth and productivity depend on a more favourable environment for investment in a context of increasing international competitiveness. This will require progress in taxation, education and vocational training, the selectivity of public investment, the efficiency of the judicial system and, in general, the quality of spending and of public administration . The definition of structural, growth-oriented public policies, would greatly benefit from the multi-annual and strategic terms of the budget.

In conclusion, in the legislature that is now truly beginning with the 2020 budget, in addition to maintaining the necessary budgetary discipline efforts (first and foremost with a view to a more expressive reduction of government debt in GDP), the strengthening of the Portuguese economy's productivity should definitely be placed at the centre of the attention of the country's political leaders and economic agents.

EXECUTIVE SUMMARY

The State Budget Proposal for 2020 (State Budget Proposal /2020) revises to 0.2% of GDP the budget surplus forecast advanced in April in the 2019-2022 Stability Programme. This objective corresponds to a positive budgetary balance 0.1 p.p. of GDP lower than that presented in the previous budgetary programming document, reflecting the greater impact of one-off expenditures.

The elimination of the fiscal imbalance foreseen for 2020 continues the path of improvement of the nominal balance, ensuring a budgetary position compatible with the Medium-Term Objective (MTO) of a structurally balanced budget. To this end, the MFF forecast points to a transition from a nominal deficit of EUR 174 million in 2019 to a surplus of EUR 533 million in 2020, equivalent to an improvement of 0.3 p.p. of GDP. The positive evolution of the balance, as a percentage of GDP, is mainly based on the reduction of the interest burden on debt and on the reduction of the unfavourable impact of temporary effects in a context of stabilisation of the economic environment and absence of new measures with significant financial impact. The possible need for support to the financial sector beyond that envisaged by the FS constitutes a fiscal risk that should be noted.

The effects of the discretionary measures that the government proposes to introduce in 2020 have a net negative contribution to the budget balance. This contribution is justified not only by the greater expression of measures on the expenditure side, which are mostly expansionary in nature, but also by the revenue that does not ensure measures to offset or mitigate that unfavourable effect. On the contrary, the latest update of the Stability Programme resulted in a set of policy measures that would have a positive effect on the balance, and which are now not considered in the draft budget law, among others, the measures concerning the revision of tax benefits and the revision of expenditure on social benefits. The negative contribution of the permanent policy measures is also accentuated by the carry-over effect of measures approved in previous years, which will imply an increase in costs for the 2020 fiscal year.

Structural Adjustment

Discounting the effect of the economic cycle and temporary and non-recurring measures, the structural balance underlying the Proposed State Budget for 2020, as recalculated by the CFP, is estimated to be negative at 0.1% of GDP. This result, close to the Medium-Term Objective (MTO), reflects a programmed improvement in the structural balance of 0.2 p.p. of GDP in 2020, in the context of a neutral stance of fiscal policy. The distance to that objective, although it is within the limit that an ex post assessment by the European Commission (EC) may consider that a Member State is in the neighbourhood of its MTO, signals, in the context of this ex ante assessment, the existence of a risk of deviation. The nature of this risk remains when taking the average of the deviations calculated for the years 2019 and 2020.

The expected development does not meet the expenditure benchmark. The planned nominal growth of primary expenditure net of discretionary measures and temporary and non-recurring measures calculated by CFP points to 4.2%, which exceeds the maximum recommended increase of 1.7% (expenditure reference rate), leading to a deviation from the planned growth of that primary expenditure of -0.9% of GDP in 2020. This deviation is higher than the permitted 0.5% margin, pointing to a risk of significant deviation in 2020.

In terms of compliance with the structural part of the fiscal rules, considering the overall reading provided by the two pillars assessing the adjustment path, it is concluded that the pace of adjustment envisaged for 2020 points to the risk of deviation from the Council recommendation and the requirements of the preventive arm of the Stability and Growth Pact. The expectation of compliance with the MTO can only be confirmed in the framework of an ex-post evaluation to be carried out by the EC in the spring of 2021. It is recalled that compliance with the MTO requires at the same time that the projection of the structural balance to be achieved at that time points to that (balanced structural) position being maintained in subsequent years. Should these developments not be confirmed, a general assessment by the European authorities will be required to determine whether there has been a deviation from the recommended adjustment path.

As regards the measurement of the government debt rule, the path of evolution of the debt ratio for the years 2019 and 2020 presented in State Budget Proposal /2020 points to progress in compliance with the transitional debt rule in the last year of its application (2017-2019) and compliance with the general rule of debt reduction in 2020, to which Portugal will be subject from this year onwards.

Revenue

The share of general government (PA) revenue in GDP underlying the State Budget Proposal /2020 is expected to maintain its upward trend in 2020, reaching 43.8% of GDP (43.3% of GDP in 2019), as a result of the increase in the share of social contributions and non-tax and non-contributory revenue.

In nominal terms, tax and contributory revenue should explain more than 70% of the growth in total PA revenue (4102 M euros), sustained mainly by the evolution of taxes (1800 M euros) and the increase in effective social contributions (1166 M euros).

The expected behaviour for effective social contributions exclusively explains the forecast increase in the tax burden indicator from 34.9% of GDP in 2019 to 35.1% of GDP in 2020, since, according to the State Budget Proposal /2020, the weight of direct and indirect taxes on nominal output will remain unchanged. This stabilization of the tax revenue share on nominal GDP results from an expectation of tax growth (3.4%) at a pace close to the Ministry of Finance's forecast for the evolution of nominal economic activity (3.3%). The same is not true of the effective social contributions whose forecast growth of 5.7% is above the pace considered by the Ministry of Finance for the evolution of workers' wages in 2020 (3.8%). This forecast has implicit an elasticity higher than its macroeconomic basis, which may configure a downward risk in relation to the fulfilment of the budgetary objectives established in State Budget Proposal /2020, given the gains in collection efficiency already achieved.

As regards non-tax and non-contributory revenue, MF forecasts an acceleration of its growth above economic activity. This will be mainly driven by the robust increase in sales and transfers from the European Union, the latter being responsible for the largest expected contribution to growth in "Other current revenue" and capital revenue in 2020.

Expenditure

The share of public expenditure in GDP is expected to increase in 2020, after having declined in the last two years. MF forecasts point to an increase of 0.2 p.p. of GDP this year, with public expenditure now accounting for 43.5% of GDP.

In nominal terms, State Budget Proposal /2020 projects general government expenditure to reach EUR 94 782 million in 2020, increasing by EUR 3395 million compared to last year. Around 80% of this increase should be justified by current primary expenditure, while an increase in capital expenditure is also foreseen. Interest charges should decrease for the sixth consecutive year, although the reduction foreseen for 2020 is less significant.

Almost half of the nominal growth in current primary expenditure projected for 2020 stems from social benefits, although MF forecasts point to a decline in the pace of growth of these benefits due to a lower impact of discretionary measures. Compensation of employees is also projected to increase, largely due to the effect of the end of the phasing out of wage settlements due to the unfreezing of careers in general government. This will be the fifth consecutive year of increase in compensation of employees, although at a lower pace than estimated for 2019. Intermediate consumption is the only item of current primary expenditure whose growth is expected to accelerate in 2020, namely in the sub-sector of regional and local government.

Capital expenditure is expected to increase in 2020, after a reduction last year. According to this Budget Proposal, the growth rate of Gross Fixed Capital Formation will almost double, while "other capital expenditure" is expected to increase, after having fallen in 2019. The impact of temporary measures in the latter item is expected to be 1050 M euros, a lower figure than in 2019, due to the expectation that the capital injection in the Novo Banco will be lower than in 2019.

Government Debt

For 2020, the Ministry of Finance forecasts that the government debt ratio will reach 116.2% of GDP, continuing the path of reduction initiated in 2017. This result represents a reduction of 2.7 p.p. of GDP in relation to that estimated for 2019. This evolution is explained by the favourable contribution of the primary balance (-3.2 p.p.) and to a lesser extent by the dynamic effect (-0.9 p.p.), which reflects nominal GDP growth above the interest effect. The deficit-debt adjustments according to the MF forecast should maintain a negative contribution to debt reduction similarly to that estimated for 2019. Following the path of reduction of the debt ratio, the MF continues to forecast a decrease in the weight of interest as a percentage of GDP, which in 2020 is expected to stand at 2.9% of GDP, compared to the 4.9% observed in 2014 at the end of the Economic and Financial Adjustment Programme (FSAP). This reflects the recent favourable financing conditions, which even allowed for the early amortisation of part of the loans obtained under the EAFP.

Gross government borrowing requirements are expected to decrease as a result of lower debt amortisation and cancellations, contrary to the estimate for 2019.

General government sub-sectors

The expected fiscal surplus of the MF for the general government as a whole is based on the expected budget surpluses for the Social Security Funds and the Regional and Local Government. These surpluses equivalent to 1.6% of GDP are large enough to cancel out the deficit of 1.3% of GDP forecast for Central Government, which is affected by expenditure on transfers under the respective financing laws for the remaining sub-sectors. However, the largest contribution to the improvement of the general government balance (0.3 p.p. of GDP) comes from the Central Government sub-sector. The remaining sub-sectors as a whole present a nil contribution to the evolution of the general government balance, given that the increase in the projected surplus (0.1 p.p. of GDP) for Social Security Funds is offset by the deterioration of the ARL balance.

Multiannual Budgetary Programming Framework

The proposed Multi-Year Budgetary Programming Framework (MFFP) calls for an upward revision of the limits on central government expenditure financed by general revenues for the next four years, compared with the project presented in the Stability Program, submitted in April 2019. For 2020, the expenditure limit for central government financed by taxes increases by EUR 2769 M compared to the estimated for 2019, with the largest reinforcements being concentrated in the groupings of budget programs in the Social (Health, in particular) and Economic area.

The experience with the implementation of the MFFP continues to show the ineffectiveness of this instrument in ensuring medium and long-term fiscal accountability. The usefulness of the PDF in supporting the formulation and implementation of public policies in a multi-annual perspective largely depends on the respect of the established expenditure ceilings. However, and similarly to the previous MFFP, Draft Law no. 6/XIV, which includes the new MFFP, states that the limits for the years 2021 to 2023 are indicative, contrary to the provisions of the budgetary framework law currently in force.

1. INTRODUCTION

In accordance with Article 7 of the Statutes of the Public Finance Council (CFP), this report analyses the State Budget Proposal for 2020 (State Budget Proposal /2020). This Report was preceded by the Report of CFP on the macroeconomic forecasts underlying the State Budget prepared under the combined terms of Article 8 of the Budgetary Framework Law (Law no. 151/2015, of 11 September), paragraph a) Article 6 of the Statutes of the Portuguese Public Finance Public (CFP), approved by Law no. 54/2011, of 19 de October, amended by Law no. 82-B/2014, of 31 December, no. 4 of article 4 and paragraph f) of no. 3 article 6 of Regulation (UE) no. 473/2013 of the European Parliament and of the Council of 21 May 2013.

The analysis made in this report is based on the information contained in the Draft Law no. 5/XIV approving the State Budget for 2020 (hereinafter State Budget Proposal /2020) presented to Parliament on 16 December, the Draft Budget Plan for 2020 sent to the European Commission (EC) and the additional information provided by the Ministry of Finance (MF) to Council of Public Finance (CFP) on 18 December, under the protocol established between the Ministry of Finance and the Council of Public Finance for the consideration of budget programming documents. Subsequently, additional clarifications were requested, which were answered in part on 7 January and at the meeting on the same day, the remainder having been received by the 10th.

The policy measures of a permanent nature and their budgetary impact under analysis thus gather the most complete information obtained by CFP following the above-mentioned requests for clarification and therefore differ from that presented in Table 3.3 of the report of State Budget Proposal /2020 and Paragraph 6 of the Draft Budget Plan 2020, updated on 17 December (*Draft Budgetary Plan 2020 - Update*) and sent to the European Commission (EC).

This report is structured in five chapters and one attachment. The first chapter is introductory and presents the structure of the document. The second chapter assesses the consistency of the budgetary projections with the macroeconomic scenario and the measures envisaged, while the third chapter assesses the budgetary adjustment, the stance of fiscal policy and compliance with existing fiscal rules. The fourth chapter analyses the indebtedness foreseen in State Budget Proposal /2020 and the evolution of government debt. Finally, the fifth chapter assesses the forecasts for the sub-sector accounts.

The general government budget aggregates were not adjusted for the effect of temporary measures, one-off measures and other special factors. However, this adjustment is duly noted when relevant for a better assessment of the fiscal consolidation effort.

The preparation of this report benefited from information and clarifications provided by entities in the Ministry of Finance (MF), namely the Office of Planning, Strategy and

International Relations (GPEARI), the Directorate-General for Budget (DGO) and the Treasury and Government Debt Management Agency (IGCP), and the Ministry of Labour, Solidarity and Social Security. Its preparation continues to be hampered by shortcomings in budgetary transparency in the documents accompanying State Budget Proposal /2020 and by difficulties in obtaining relevant information.

The formulation and quantification of policy measures in the State Budget Proposal Report is a problem that the CFP has repeatedly identified, continuing to persist in State Budget Proposal /2020, reducing the transparency of the budgetary process. The justification for the quantification of policy measures continues to show shortcomings, in addition to the recurrent practice of not carrying out an ex post evaluation.

2. ANALYSIS OF THE CONSISTENCY OF BUDGET FORECASTS

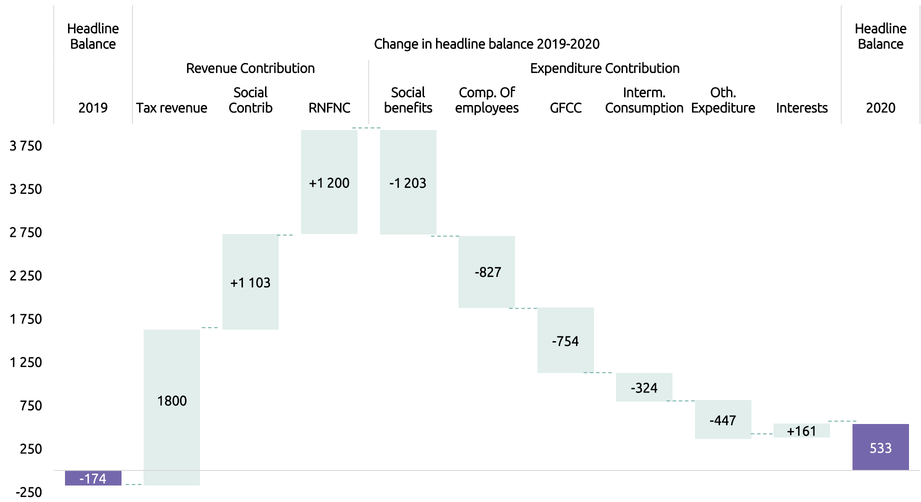
This chapter assesses the consistency of the budget forecast with the macroeconomic scenario and the underlying policy measures, taking as a starting point the MF's invariant policy baseline scenario presented in this budget planning document. The temporary and non-recurring measures considered by the CFP stem from a classification of their own justified in Box 2, which is coincident with that used by the MF for the years 2019 and 2020.

2.1 From the 2019 estimate to the 2020 budget forecast

The State Budget Proposal for 2020 (State Budget Proposal /2020) revises to 0,2% of GDP the forecast budget surplus advanced in April in the Stability Programme, as a result of a higher impact of one-off expenditures. The downward revision of the budget balance by almost 0.1 p.p. of GDP (0.04 p.p.) reflects the greater impact on expenditure of one-off measures relating mainly to deferred tax assets and judicial decisions of the Lisbon Municipal Council not considered in the April forecast PE/2019 (0,4 p.p.). Excluding the negative net Effect on the balance of the temporary measures, the change in the adjusted balance foreseen in the two budgetary planning documents is similar (around de 0,2 p.p. of GDP).

The elimination of the fiscal imbalance, foreseen for 2020, continues the path of improvement of the nominal balance that reflects, in absolute terms, the shift from an estimated deficit of EUR 174 M to a net lending (budget surplus) of EUR 535 M. This improvement is based on an increase of EUR 4102 million in revenue greater than the increase of EUR 3395 million in general government Institutions (PA) expenditure. Thus, the growth of tax and contributory revenue (+2902 MEUR) together with non-tax and non-contributory revenue contributed in particular to the positive evolution of the balance. Also benefiting from the balance are interest charges, which MF expects to decrease for the sixth consecutive year. The remaining components of public expenditure, contribute negatively to the improvement of the budget balance. The increase foreseen by the MF for social benefits, compensation of employees and investment justifies more than three quarters of that unfavourable contribution (EUR 2784 million), the remainder being due to other expenditure and intermediate consumption.

Chart 1 – Contribution of revenue and expenditure to the change of the headline balance between 2019-2020 (M€)



Source: MF and INE. CFP calculations. | Notes: * Excluding the impact of CGD recapitalization; A positive / negative sign corresponds to a positive / negative contribution of a given component of revenue or expenditure to the improvement / deterioration of the budget balance. RNFNC -: Non-tax and non-contributory revenue, including sales, "Other current revenue" and capital revenue; Other expenditure includes "Other current expenditure", subsidies and "Other capital expenditure".

The forecast of revenue and expenditure underlying the 2020 balance target can be broken down into the different effects that determine it. The macroeconomic scenario, the lagged effect of measures adopted in previous years (carry-over) and the effect of new policy measures are the factors that justify the dynamics of behaviour of fiscal variables expected by MF for 2020. Thus, the forecast of general government revenue and expenditure results, on the one hand, from the combination of the expected evolution of these variables - i.e. in the absence of new economic and fiscal policy decisions, usually called the invariant policy scenario - with the direct fiscal effect of the new policy measures and their second-order induced effects. As in previous analyses, based on information provided by the Ministry of Finance (MF), Table 1 decomposes the expected evolution of the PA account in 2020 considering the impacts of:

i. Macroeconomic developments and "other effects" considered in the invariant policy scenario;

ii. Measures approved in previous years whose impacts affect the budget forecast for the following year (carry-over of measures), effects that are taken into account in the scenario of invariant policies;

iii. Permanent discretionary measures (new policy measures), introduced in the scenario with policy measures;

iv. Temporary and one-off measures planned for 2020;

v. A residual component, obtained by difference, called "other effects", which reflects the second order effects induced by new policy measures via interaction with macroeconomic variables and other unidentified effects that do not fall into the above-mentioned categories.

All elements presented in Table 1 are based on information provided by the MF, with the exception of the classification of temporary (or one-off) measures, which is the responsibility of the CFP and is identified in Box 2.

Table 1 – From the 2019 estimate to the 2020 forecast. Policy measures with a budgetary impact (M€)

	No Policy Change Scenário						Policy Change Scenário				
	MF Estimate 2019	One-off	Adjusted Estim. 2019	Macroeconomic scenario and other effects	Carry-over	No Policy Change Scenário	New Policy Measures	Other effects	MF unadjusted Forecast	One-off	MF Forecast 2020
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Total revenue	**91 213**	**51**	**91 162**	**3 778**	**246**	**95 186**	**-10**	**-6**	**95 170**	**145**	**95 315**
Tax and Contribution Revenue	**78 165**	**0**	**78 165**	**2 566**	**258**	**80 989**	**-10**	**88**	**81 067**	**0**	**81 067**
Indirect taxes	31 963		31 963	1 015	1	32 978	37	76	33 063		33 063
Direct taxes	20 946		20 946	644	58	21 649	-69	38	21 645		21 645
Social contributions	25 256		25 256	907	199	26 362	22	-25	26 359		26 359
Other revenue	13 048	**51**	**12 997**	**1 212**	**-12**	**14 197**	**0**	**-95**	**14 102**	**145**	**14 247**
Total expenditure	**91 387**	**1 149**	**90 238**	**2 707**	**800**	**93 744**	**99**	**-111**	**93 732**	**1 050**	**94 782**
Primary Expenditure	84 861	**1 149**	83 712	**2 867**	**800**	**87 378**	**99**	**-110**	87 367	**1 050**	**88 417**
Intermediate Consumption	11 271		11 271	425	0	11 696	-100	-1	11 595		11 595
Compensation of employees	22 701		22 701	185	645	23 531	70	-73	23 528		23 528
Social Benefits	38 749		38 749	1 053	155	39 956	68	-71	39 952		39 952
Subsidies	872		872	46		917	15	-15	918		918
GFCF	4 168		4 168	755		4 923	136	-137	4 922		4 922
Other expenditure	7 099	1 149	5 950	404		6 354	-90	186	6 451	1 050	7 501
Interest paid	6 526	0	6 526	-161	0	6 366	0	0	6 365	0	6 365
Budget Balance	**-174**	**-1 098**	**924**	**1 072**	**-553**	**1 442**	**-109**	**105**	**1 438**	**-905**	**533**

Source: Ministry of Finance. CFP calculations. | Note: * For a better understanding of the effects, the temporary measures included in capital revenue and “other expenditure” were removed from the 2020 forecast base (column 6), adding the effect of the nature of these measures on the MF forecast (column 11), in order to reflect in the budget forecast baseline, only those measures of a permanent nature, approved in previous years, resulting from the discretionary action of the policy maker. The macroeconomic scenario incorporates the impacts of macroeconomic developments on tax and contributory revenue and expenditure, as well as the remaining effects. In these effects. For details of the various effects see Table 20 attached. The temporary (or one-off) measures considered follow CFP's own classification, identified in Box 2. The totals may not necessarily correspond to the sum of the instalments due to rounding.

The direct impact of the new policy measures introduced by State Budget Proposal /2020 differs from that foreseen in PE/2019. The measures concerning the review of tax benefits and the reassessment of the means condition in the framework of the review of expenditure on social benefits considered in PE/2019, but not included in this budget proposal, are identified in this area. The impact foreseen by the MF for each of these measures amounted to EUR 90 million, representing in total a positive net contribution in the balance of EUR 180 million.

The net contribution of the new policy measures has a negative impact on the reduced balance (-EUR 109 million), justified by the greater expression of measures on the expenditure side. 289 million in expenditure expansion measures, reflecting the reinforcement of measures in the field of social policies[1], and justifying about three quarters of the expenditure increase measures planned for 2020. The remainder is attributed to the wage update of civil servants. The negative impact on the balance of these measures is also mitigated by expenditure reduction measures amounting to EUR 190 M relating to savings in intermediate consumption and in “other current

[1] In this context, the Statute of the informal caregiver, the Parenting benefits and the 1st right programme, the latter of a social nature, despite being accounted for in investment, are worthy of note.

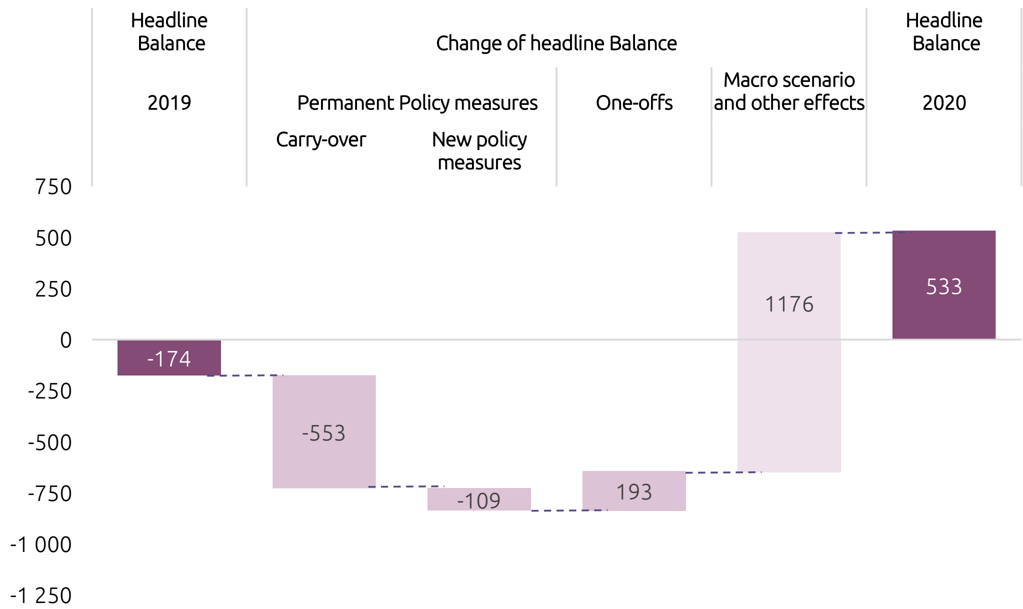
expenditure", whose implementation depends on the success of the "spending review" measure (Table 20). On the revenue side, the net impact of the new measures is also negative (by EUR 10 million), mainly reflecting the loss of revenue from direct taxes: Personal Income Tax – Young people (IRS- Jovem), the increase in Personal Income Tax deductions for children under 3 years of age and the extension of the reduced IRC (Corporate Income Tax) rate limit to Small and Medium Sized Enterprises and Inland Small and Medium Sized Enterprises the deduction scheme.[2]

The negative contribution of measures resulting from the discretionary action of the policy maker is underlined by the effect of measures approved in previous years. The negative impact on the balance of carry-over effects results from expenditure expansion measures approved in 2018 and 2019 (of EUR 553 million) (see Tables 1 and 20). The biggest impact on expenditure in 2020 is focused on personnel expenditure as a result of the effects of the unfreezing of careers and promotions of civil servants. With a smaller but equally relevant impact are the measures related to social benefits, namely: (i) the reform of long contributory careers, (ii) early retirement through flexibility, (iii) the creation of the social benefit for inclusion and (iv) the support programme for the tariff reduction (adding EUR 115 M). The overall carry-over effect of these measures represents around 85% of the negative net contribution of permanent policy measures.

As a result, the forecast for the 2020 budget balance in nominal terms depends more on the economic environment and unidentified "other effects" than on the net effect of permanent policy measures with a budgetary impact adopted. These factors reflecting the impact of the evolution of macroeconomic aggregates on the budgetary variables and "other unidentified effects" benefit the budget balance by EUR 1176 million. This favourable impact, which more than ensures the expected improvement of EUR 707 million in the budget balance in 2020 compared to 2019, is thus based on developments in the economic environment, subject to the downside risks to economic growth identified in the Opinion of the MPC on the macroeconomic forecasts underlying the State Budget Proposal /2020. In any case, the impact of these factors on the balance is (for the time being) sufficient to offset the net negative impact of permanent policy measures adopted in previous years of EUR 553 million (carry-over effects) and measures to be adopted in 2020 (EUR 109 million), totalling EUR 662 million. With an equally favourable impact on the evolution of the balance for 2020 there is the positive variation of EUR 193 million in the use of one-offs (temporary and non-recurring measures) which results mainly from the forecast reduction in support to the financial sector. However, the forecast by MF of a recapitalisation amount for the Novo Banco lower than that achieved in 2019 constitutes a risk, given the obligations arising from the Contingent Capitalisation Agreement of that bank.

[2] The impact of these measures more than offsets the expected revenue increase for indirect taxes (EUR 37 M), which results mainly from the decarbonisation incentive measure.

Chart 2 – From the estimated headline balance for 2019 to the headline balance forecast for 2020 (M€)



Source: MF. CFP calculations. Note: Positive / negative values contribute to the increase / decrease of the deficit. The effect of one-off corresponds to the variation between the measures considered by the CFP for the years 2020 and 2019; the impact of the "macro scenario and other effects" reflects the algebraic sum of columns 4 and 8 of Table 1. Further details of the permanent policy measures and one-offs (see table 20 attached).

While the economic growth forecast will accommodate the negative impact of policy measures, part of the measures proposed to be adopted in 2020 will also have significant effects in 2021 and beyond. As already pointed out in the analyses of S State Budget Proposal /2018 and State Budget Proposal /2019, it should be noted once again that there are measures whose application extends beyond the horizon of this State Budget, implying a permanent increase in the level of expenditure. In this regard, it should be noted that there are measures whose application extends beyond the horizon of this State Budget, implying a permanent increase in the level of expenditure. However, given the unavailability of information for this purpose, it is not possible to assess the full impact in subsequent years arising from these changes.

2.2 Analysis of the public revenue forecast in State Budget Proposal /2020

The MF foresees for 2020 the maintenance of the upward path of the general government revenue share in GDP. This ratio is expected to reach 43,8% of nominal GDP in 2020, continuing the growth of the last two years, which the MF estimates at 0.5 p.p. of GDP in 2020 and 0.3 p.p. of GDP in 2019 (Table 2). The materialisation of this forecast increases the wight of public revenue in GDP, which translates into a growth of PA revenue (4,5%) above that of nominal product (3,3%).

Table 2 – General government revenue and measures' budgetary impact

	General government revenue										Measures	YoY
	% GDP					M€					M€	%
	2018	2019	2020	2018/19	2019/20	2018	2019	2020	2018/19	2019/20	2020	2019/20
Total Revenue	**43,0**	**43,3**	**43,8**	**0,3**	**0,5**	**87 695**	**91 213**	**95 315**	**3 518**	**4 102**	**381**	**4,5**
Tax and social contribution revenue	**37,0**	**37,1**	**37,2**	**0,1**	**0,1**	**75 472**	**78 165**	**81 067**	**2 693**	**2 902**	**248**	**3,7**
Tax revenue	25,3	25,1	25,1	-0,2	0,0	51 637	52 909	54 709	1 273	1 800	27	3,4
Indirect taxes	15,2	15,2	15,2	0,0	0,0	30 956	31 963	33 063	1 007	1 101	38	3,4
Direct taxes	10,1	9,9	9,9	-0,2	0,0	20 681	20 946	21 645	266	699	-11	3,3
Social contributions	11,7	12,0	12,1	0,3	0,1	23 835	25 256	26 359	1 420	1 103	221	4,4
of which: actual soc. contr. received	9,4	9,8	10,0	0,4	0,2	19 128	20 570	21 736	1 443	1 166	125	5,7
Non Tax and non contribution revenue	**6,0**	**6,2**	**6,5**	**0,2**	**0,4**	**12 223**	**13 048**	**14 247**	**824**	**1 200**	**133**	**9,2**
Sales & other current rev.	5,6	5,8	6,1	0,3	0,2	11 395	12 308	13 219	914	911	-12	7,4
Sales	3,5	3,6	3,7	0,1	0,1	7 129	7 550	8 035	421	485	-12	6,4
Other current revenue	2,1	2,3	2,4	0,2	0,1	4 265	4 758	5 184	493	426	0	9,0
Capital transfers received	0,4	0,4	0,5	-0,1	0,1	829	739	1 028	-89	288	145	39,0

Sources: INE (2018) and Ministry of Finance (2019 and 2020). CFP calculations. | Note: The "Measures" column reflects the budgetary impact from measures in 2020 as well as carry over effects. For more information about the measures taken into account see Table 20.

MF expects tax and contributory revenue to continue to increase, justifying the higher contribution to nominal growth in PA revenue. In nominal terms, the government revenue forecast by the MF for 2020 is expected to reach EUR 95 315 million, a result that is EUR 4102 million higher than that estimated for 2019. More than two thirds (71%) of the expected dynamics of tax and contributory revenue (EUR 2902 million) contributed to this evolution, mainly underpinned by the evolution of taxes (EUR 1800 million) and the expected increase in effective social contributions (EUR 1166 million). Regarding non-tax and non-contributory revenue, an increase of EUR 1200 M is expected next year, based on the growth in sales of goods and services (EUR 485 M), the evolution of other current revenue (EUR 426 M) and, finally, the expected increase in capital revenue (EUR 288 M).

The projected growth rate of general government tax revenue closely follows the expected behaviour of nominal GDP. According to the State Budget Proposal /2020, the tax revenue of general government should grow by 3.4% next year, with this growth close to the forecast for nominal GDP (3.3%). Excluding the impact of the planned policy measures, the annual rate of change in tax revenue would stand at 3.5%, and its elasticity to nominal GDP is estimated at 1.06, which shows an expectation of the evolution of tax revenue overall in accordance with the macroeconomic developments forecast by MF in State Budget Proposal /2020.

Table 3 – General government tax revenue and measures' budgetary impact, in national accounts

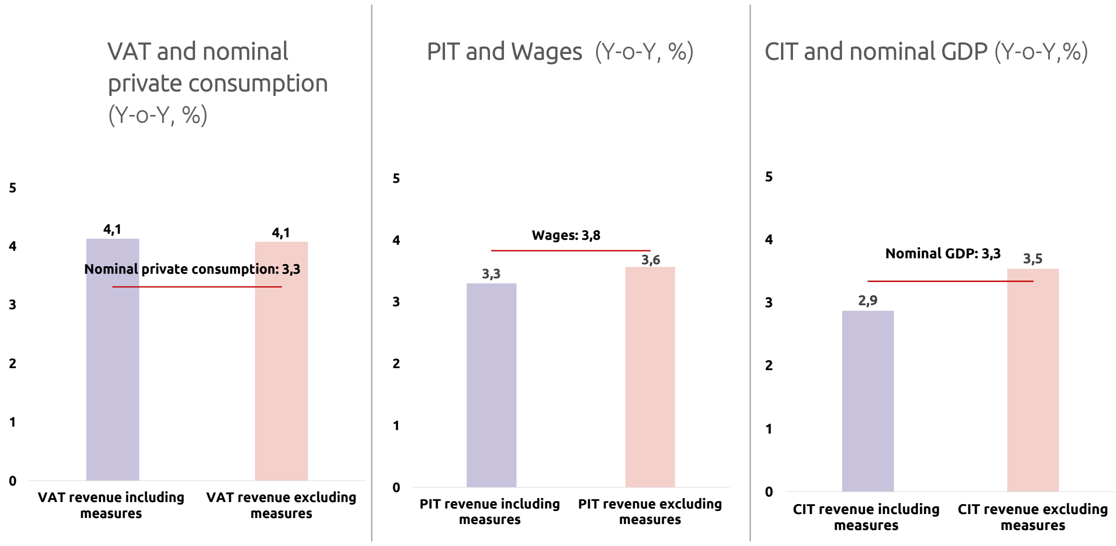
	General government tax revenue						Measures	YoY
	% GDP			M€			M€	%
	2019	2020	2019/20	2019	2020	2019/20	2020	2019/20
General Government tax revenue	25,1	25,1	0,0	52 909	54 709	1 800	27	3,4
Indirect Taxes	**15,2**	**15,2**	**0,0**	**31 963**	**33 063**	**1 101**	**38**	**3,4**
VAT	8,8	8,9	0,1	18 580	19 346	766	-17	4,1
Excise Duties	2,6	2,6	0,0	5 460	5 625	164	37	3,0
Petroleum Tax	1,7	1,8	0,0	3 668	3 855	187	29	5,1
Tobacco Tax	0,7	0,7	0,0	1 493	1 489	-4	9	-0,3
Tax on Alcohol and Alcoholic beverages	0,1	0,1	0,0	299	281	-18	0	-6,1
Vehicle tax	0,4	0,3	0,0	753	710	-42	0	-5,6
Tax on real estate transactions	0,5	0,5	0,0	1 011	1 028	17	0	1,7
Municipal Property Tax	0,7	0,7	0,0	1 536	1 577	41	0	2,6
Others	2,2	2,2	0,0	4 622	4 777	155	18	3,4
Direct Taxes	**9,9**	**9,9**	**0,0**	**20 946**	**21 645**	**699**	**-11**	**3,3**
PIT	6,4	6,4	0,0	13 559	14 006	447	47	3,3
CIT	3,2	3,2	0,0	6 763	6 957	194	-59	2,9
Others	0,3	0,3	0,0	624	682	58	0	9,3

Source: Ministry of Finance (2019 and 2020). CFP calculations. | Notes: The values observed in the "other indirect taxes" and "other direct taxes" lines are obtained by the difference between the total indirect tax revenue and the total direct tax revenue present in the DSB/2020 and the information provided by the MF for the sum of the detailed taxes shown in the table. The "Measures" column reflects the budgetary impact from measures adopted in 2020 as well as carry over effects. For more information about the measures taken into account see Table 20.

In nominal terms, the growth foreseen for tax revenue is mostly sustained by the expected evolution of indirect taxes. Indirect tax revenue is expected to grow by EUR 1101 M (3.4%), representing more than 60% of the expected increase in total tax revenue. Contributing to this evolution will be, above all, the VAT revenue (EUR 766 M; 4.1%) which will represent about 70% of the increase in indirect taxes (Table 3). In this group of taxes, the growth forecast for ISP, IMT, IMI and Other indirect taxes should also be highlighted, which will more than offset the decreases expected for IT, IABA and ISV.

Excluding the effect of the policy measures introduced in State Budget Proposal /2020, indirect tax revenue is growing in line with its macroeconomic base. In the absence of policy measures (+38 M euros), the revenue from indirect taxation would show a rate of change of 3.4%, roughly in line with the expected evolution of nominal private consumption (3.3%).This ratio reflects an implicit elasticity of indirect tax revenue to nominal private consumption close to the unit. This elasticity results from the combination of a VAT elasticity higher than the unit (1.2), reflecting an increase in the net revenue from this tax above the expected annual change in private consumption, with elasticities lower than the unit in the remaining indirect taxes.

Chart 3 – Developments in the main taxes and macroeconomic aggregates in 2020



Source: Ministry of Finance. CFP calculations. Note: y-o-y stands for year-on-year change rate.

Direct taxes are expected to grow appreciably in line with the expected evolution of economic activity according to the State Budget Proposal /2020 forecast. The growth rate of direct taxation is expected to be 3.3% (EUR 699 million) influenced, marginally, by the impact of some policy measures considered in 2020 (- EUR 11 million). In the absence of the impact of these and other measures that affected revenues in 2019 (+ EUR 68 M), direct tax revenues would show a growth of 3.7%, residually above the MF's forecast for the evolution of the Portuguese economy in 2020 (3.3%). The previous relationship reflects an elasticity of this item against nominal GDP of 1.1. By component, the MF forecast reflects an expectation for IRS and IRC revenue compatible with the developments expected for the respective macroeconomic aggregates in 2020. The expected growth in the net revenue from personal income tax without measures (3.6%) is expected to be below that forecast by the MF for the evolution of compensation of employees (3.8%). The annual rate of change in corporate income tax (IRC), excluding the effect of policy measures, should be slightly above that anticipated by the MF for nominal GDP (3.3%).

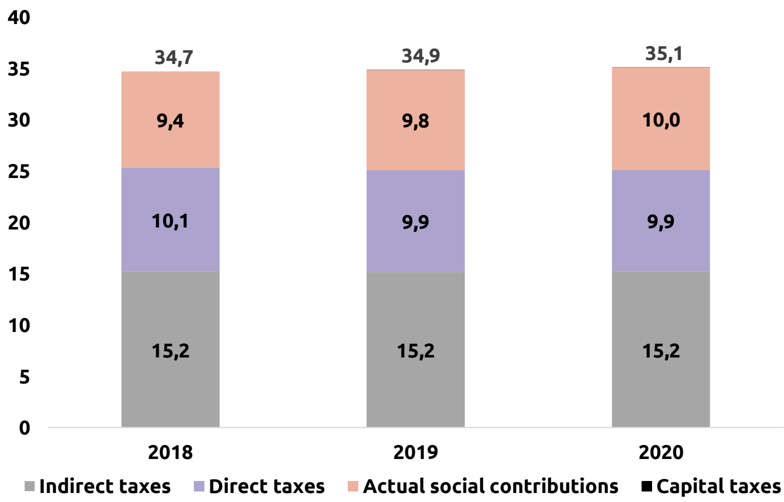
As in previous years, the MF forecasts higher-than-expected growth in actual social contributions for workers' wages in 2020. Social contributions should increase by 4.4% (EUR 1103 million) explained exclusively by the 5.7% (EUR 1166 million) change in actual social contributions, which translates into an increase above that forecast by the MF for workers' remuneration (3.8%). Expanding the Effect of policy measures,[3] it is estimated that the elasticity of effective social contributions to wages stands at 1.5, a figure that reflects an expectation of considerable efficiency gains in the collection of this component (for more details see 5.3 Analysis of the Social Security Funds sub-sector). Considering that increases in collection efficiency have, by definition, a limited budgetary margin and that, in recent years, they seem to have already shown a relevant degree of consolidation, it should be noted that MF’s forecast may somewhat optimistic, and this may constitute a downward risk for general government revenue as

[3] The policy measures envisaged for social contributions and their quantification are detailed in Table 20.

a whole. It should also be noted that although the measures related to the remuneration policy in the civil service, in 2020, will have a positive impact on imputed social contributions (+ EUR 96 M), the MF expects a decrease in this item due to the decrease in the number of subscribers enrolled in CGA and the reduction in contributory revenue associated with this scheme.

The budget forecast for 2020 points to a further increase in the tax burden indicator resulting from the evolution of effective social contributions. The percentage of nominal output collected by PA in the form of effective social contributions and taxes on economic agents should reach 35.1% of GDP next year. This MF forecast represents an increase in the tax burden indicator of 0.2 p.p. compared to 2019, which will occur for the third consecutive year. The increase in the ratio of effective social contributions to GDP (by 0.2 p.p. of GDP) will fully justify this evolution, since the MF anticipates a maintenance of the weight of direct and indirect taxes on GDP. Thus, the share of effective social contributions is expected to reach 10% of nominal output next year, while direct and indirect taxes will remain unchanged at 9.9% of GDP and 15.2% of GDP, respectively.

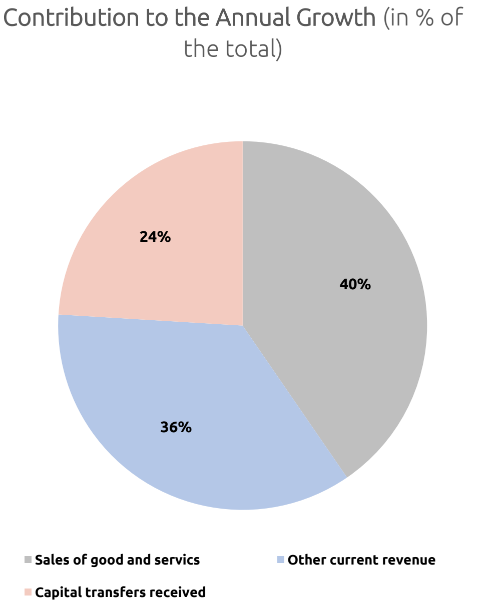
Chart 4 – Evolution of the tax burden (in % of GDP)

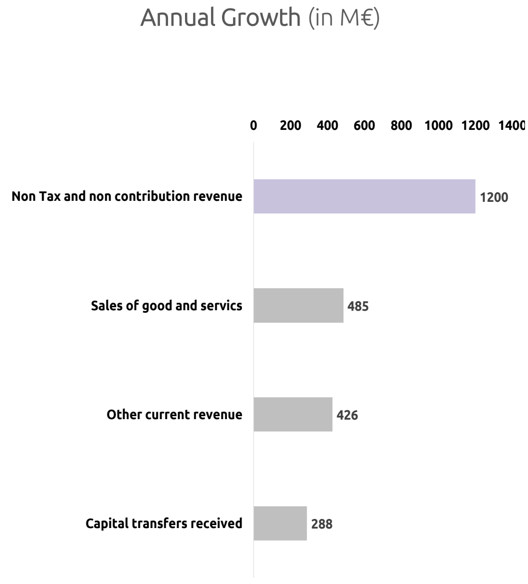


Source: INE (2018) and Ministry of Finance (2019 and 2020). CFP calculations. | Notes: The weight of capital taxes is residual throughout the period, thus is not visible in the graph. The total tax burden in % of GDP may not correspond to the sum of its components because the figures are approximate values.

The growth in non-tax and non-contributory revenue is expected to accelerate in 2020 mainly due to the expected increase in sales and transfers from the European Union. The transfers mainly to the Institute for Employment and Vocational Training (EUR 274 million) and the investment grants received from the EU (EUR 264 million) explain mainly the expected increase in 'other current revenue' and capital revenue respectively. With an equally relevant contribution are identified sales with a robust growth of EUR 485 million (higher than expected for 2019) reflecting, among others, the expected increase in the provision of services in transport companies as well as the growth of justice rates and legal aid. These factors explain a development of non-tax and non-contributory revenue (9.2%) considerably above the developments expected by the MF for economic activity.

Chart 5 – Developments in the non-tax and non-contribution revenue in 2020





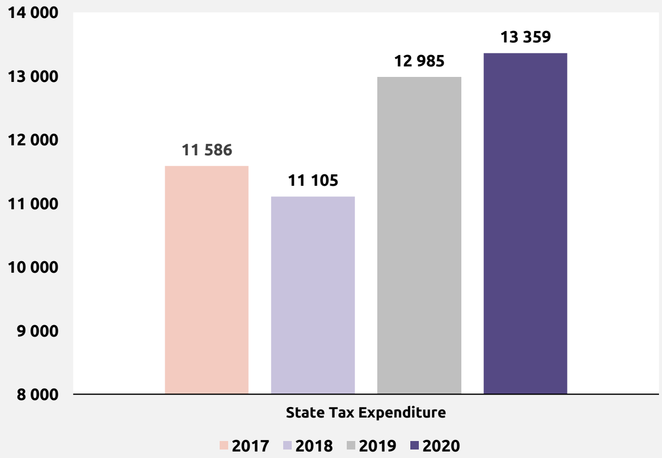
Source: Ministry of Finance.

Box 1 – State Tax Expenditure in State Budget Proposal /2020

Tax expenditure, defined as the amount of tax revenue that a given political entity voluntarily renounces in order to achieve certain socioeconomic objectives, constitutes a fundamental component of tax systems. The analysis of this indicator is therefore relevant for understanding the developments that the MF foresees for 2020.

In this context, and using data from State Budget Proposal /2020 Public Accounting, it can be seen that next year the Portuguese State foresees tax expenditure associated to the various taxes of the National tax system to reach EUR 13 359 M. This amount represents an increase of EUR 374 M (2.9%) compared to the estimated in 2019 and EUR 2254 M (20.3%) compared to 2018, a year in which there was a decrease of EUR 481 M (-4,2%) compared to tax expenditure in 2017 (EUR 11 586 M). As a result of this evolution, MF expects tax expenditure, between 2017 and 2020, to increase by accumulated EUR 1773 M.

Chart 6 – State tax expenditure, 2017-2020 (M€)



Source: Ministry of Finance.

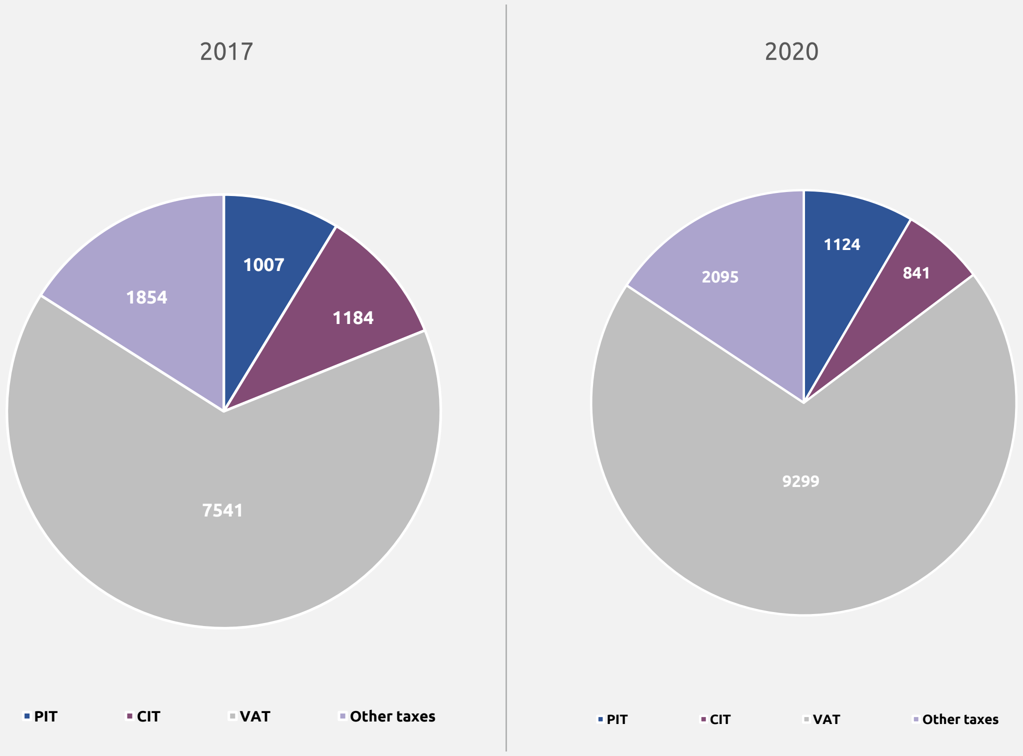
In that period, the evolution of tax expenditure was mainly due to the growth of tax expenditure estimated in terms of VAT (+ EUR 1757 M; 23.3%), which, in a context of expanding domestic demand, reflects more expenditure associated with the preferential rates of this tax (reduced and intermediate rates).

In the same period, the MF also expects to record an increase in tax expenditure on Personal Income Tax of EUR 117 M (11.7&). This change will be related to the increase in the number of people with a degree of disability of 60% or more, to the increase in deductions related to invoice requirements and to the increase in taxpayers benefiting from the taxation regime for non-habitual residents in Portugal. In this context, and based on AT's statistics on personal income tax expenditure and the clarifications obtained from the Ministry of Finance when drawing up this report, indicate that the evolution of the two main categories of tax expenditure for this tax (Non-habitual Residents' Regime and tax expenditure associated to disabled citizens) should register an increase of EUR 121 million (14.4%) between 2017 and 2020. Tax expenditure related to the Non-habitual Residents' Regime will be responsible for more than two thirds of this growth (EUR 82 M; 16.6%), rising from an expenditure of EUR 494 M in 2017, to forecast of EUR 576 M in 2020.

With regard to corporate income tax, the MF forecasts a decrease in tax expenditure between 2017 and 2020 (- EUR 343 million; -28.9%). This decrease, according to State Budget Proposal /2020, is explained by the existence of a base effect in 2017, which results from the abnormally high growth of exempt taxable income by pension and similar funds, which occurred in that year. Excluding from the analysis the tax expenditure registered in corporate income tax in 2017, a relatively moderate growth in corporate tax expenditure is forecast between 2018 and 2020 (EUR 29 million; 3.6%).

With regard to tax expenditure associated to the remaining taxes, it can be seen that the largest contributions to the EUR 241 million growth (13%) recorded between 2017 and 2020 are expected to have been due, by around 70%, to the increases in tax expenditure observed in ISP (+EUR 80 million; + 18.1%) and ISV (87 million; 24.7%).

Chart 7 – State tax expenditure, by tax (M€)



Source: Ministry of Finance.

2.3 Analysis of the public expenditure forecast State Budget Proposal /2020

The share of public expenditure in GDP is expected to increase in 2020, after having declined in the last two years. This ratio decreased 1.9 p.p. in 2018, with MF estimated to have fallen by 0.1 p.p. in 2019, thus reaching 43.4% of GDP. MF forecasts point to an increase of 0.2 p.p. in 2020, bringing public expenditure to 43.5% of GDP. This increase should be justified by capital expenditure (+0.3 p.p.), being mitigated by the forecast reduction in interest expenditure (-0.2 p.p.). Current primary expenditure should stabilise at 37.3% of GDP.

Table 4 – General government expenditure and forecast impact of measures

	General Government expenditure											Measures for 2020
	% of GDP					M€					%	
	2018	2019	2020	2018/19	2019/20	2018	2019	2020	2018/19	2019/20	2019/20	M€
Total expenditure	**43.5**	**43.4**	**43.5**	**-0.1**	**0.2**	**88 606**	**91 387**	**94 782**	**2 781**	**3 395**	**3.7**	**1948**
Primary expenditure	**40.1**	**40.3**	**40.6**	**0.2**	**0.3**	**81 708**	**84 861**	**88 417**	**3 152**	**3 556**	**4.2**	**1948**
Primary current expenditure	37.0	37.3	37.3	0.3	0.0	75 399	78 593	81 282	3 194	2 689	3.4	762
Intermediate consumption	5.4	5.3	5.3	-0.1	0.0	11 067	11 271	11 595	204	324	2.9	-100
Compensation of employees	10.7	10.8	10.8	0.1	0.0	21 835	22 701	23 528	866	827	3.6	715
Social tranfers	18.2	18.4	18.3	0.2	0.0	37 099	38 749	39 952	1 650	1 203	3.1	222
other than in kind	16.4	16.5	16.4	0.1	0.0	33 472	34 730	35 803	1 257	1 074	3.1	222
in kind via market producers	1.8	1.9	1.9	0.1	0.0	3 626	4 020	4 149	393	129	3.2	
Subsidies	0.4	0.4	0.4	0.0	0.0	750	872	918	121	46	5.3	15
Other current expenditure	2.3	2.4	2.4	0.1	0.1	4 648	5 000	5 288	352	289	5.8	-90
Capital expenditure	3.1	3.0	3.3	-0.1	0.3	6 309	6 267	7 134	-41	867	13.8	1186
GFCF	1.9	2.0	2.3	0.1	0.3	3 795	4 168	4 922	373	754	18.1	136
Other capital expenditure	1.2	1.0	1.0	-0.2	0.0	2 514	2 100	2 212	-415	113	5.4	1050
Interest paid	**3.4**	**3.1**	**2.9**	**-0.3**	**-0.2**	**6 898**	**6 526**	**6 365**	**-372**	**-161**	**-2.5**	

Sources: INE and Ministry of Finance. CFP calculations. | Notes: figures related to the year 2018 are the ones published by INE and figures related to the years 2019 and 2020 correspond to the ones considered by the MF in the DSB/2020; column "Measures for 2020" reflects the impact of temporary (1050 M€ in "other capital expenditure") and discretionary (898 M€ in current expenditure) measures in 2020, and the negative values correspond to savings to be obtained under the expenditure review exercise. For detailed information on temporary measures and critical measures in Box 2 and Table 20.

The State Budget Proposal /2020 points to na acceleration in expenditure growth from 3.1% in 2019 to 3.7% in 2020. Thus, public expenditure is expected to grow above nominal output (which in turn will decelerate from 3.4% in 2019 to 3.3% in 2020). In nominal terms, MF expects PA expenditure to increase by EUR 2781 million in 2019 and EUR 3395 million in 2020, reaching EUR 94 782 million. The expected increase in 2020 is driven by current primary expenditure (+ EUR 2 689 million) and capital expenditure (+ EUR 867 million), being mitigated by a decrease in interest charges of EUR 161 million (Table 4).

Other capital expenditure "is the item that contributes the most to the acceleration in public expenditure growth projected for 2020. According to the State Budget Proposal /2020, this item should total EUR 2212 million, with an increase of EUR 113 million in 2020, after a reduction of EUR 415 million in 2019. This development is influenced by a base Effect resulting from the sale of land from the former Feira Popular, carried out by the municipality of Lisbon for EUR 273.9 million, which in national accounts was deducted from "other capital expenditure" in 2019. The impact of temporary measures in this item is expected to amount to EUR 1050 M in 2020, EUR 99 M less than last year (Box 2). This lower impact stems from the expectation that the capital injection into Novo Banco will be lower than in 2019 (by EUR 549 million),[4] which will allow for more than offsetting the impact of other temporary measures planned for 2020, arising from: i) conversion of deferred tax assets into tax credits (EUR 130 million); ii) payment of an indemnity by the Lisbon City Council, as part of a judicial decision (EUR 160 million); (iii) amortisation of contributions to Banco de Portugal, following the transfer of the deposit guarantee window of the Mutual Agricultural Credit Guarantee Fund to the Deposit Guarantee Fund (EUR 80 million);[5] iv) compensation to Infraestruturas de

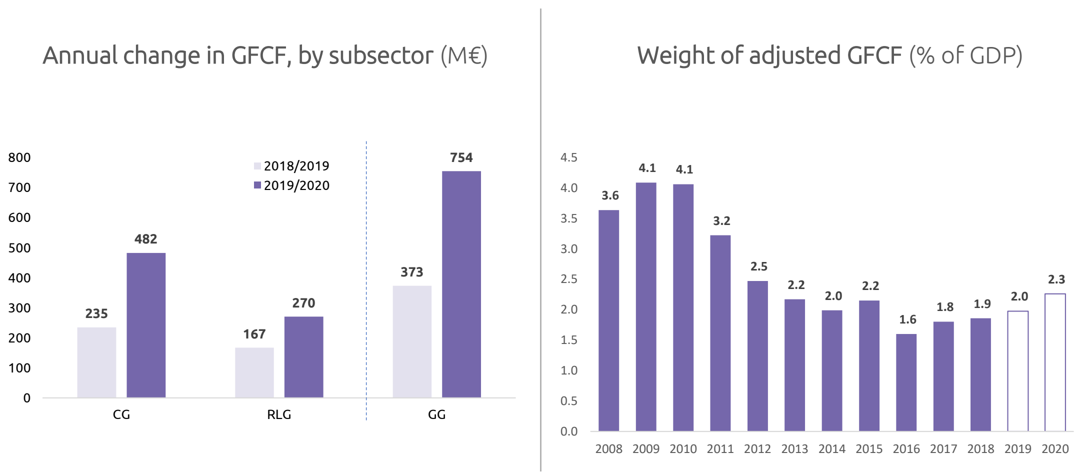
[4] It should be recalled, however, that in the State Budget for 2009 the impact on national accounts resulting from this capital increase was expected to amount to EUR 400 million, eventually totalling EUR 1149 million. For the current year an impact of EUR 600 million is foreseen in POE/2020.

[5] Under the terms of Article 4 of Decree-Law No. 106/2019 of 12 August.

Portugal for the cancellation of the Algarve Litoral road sub-concession (EUR 80 million).

According to State Budget Proposal /2020, the growth of Gross Fixed Capital Formation (GFCF) will practically double from 9.8% in 2019 to 18.1% this year. This acceleration is justified mainly by central government investment, but also by regional and local government (see the left panel of Chart 8). MF forecasts point to GFCF of all general government totalling EUR 4922 million this year, EUR 754 million more than in 2019. This will be the fourth consecutive year of GFCF increase and the most significant in that period (increasing by almost EUR 2 billion between 2017 and 2020). The increase foreseen for the current year is based on the expectation of a set of structuring public investments totalling EUR 1345 M (plus EUR 605 M in relation to the estimated execution for 2019) [6] and on the operationalisation of the "1st Right Programme" measure to support access to housing (EUR 136 M).[7] It should be remembered, however, that in recent years GFCF has fallen well short of the initial forecast and, according to MF's estimate, this situation occurred again last year. As a percentage of GDP, GFCF is expected to increase by 0.3 p.p. in 2020, setting the ratio at 2.3% of GDP and exceeding the value reached in 2015 (2.2% of GDP, as shown in the right panel in Chart 8).

Chart 8 – Developments in GFCF



Source: INE and MF. CFP calculations. | Notes: the left panel chart does not include the social security sub-sector because its expenditure is insignificant. CG - central government; RLG – regional and local government; SS - social security funds; GG - general government. In the right panel chart the figures are adjusted for temporary and non-recurring measures and the unfilled bars correspond to the MF estimate for 2019 and the forecast for 2020, included in DSB/2020.

Interest charges are the only item of expenditure where a reduction is foreseen in 2020, although lower than in recent years. This item is expected to total EUR 6365 million in 2020, EUR 161 million less than last year. If this forecast comes true, it will be

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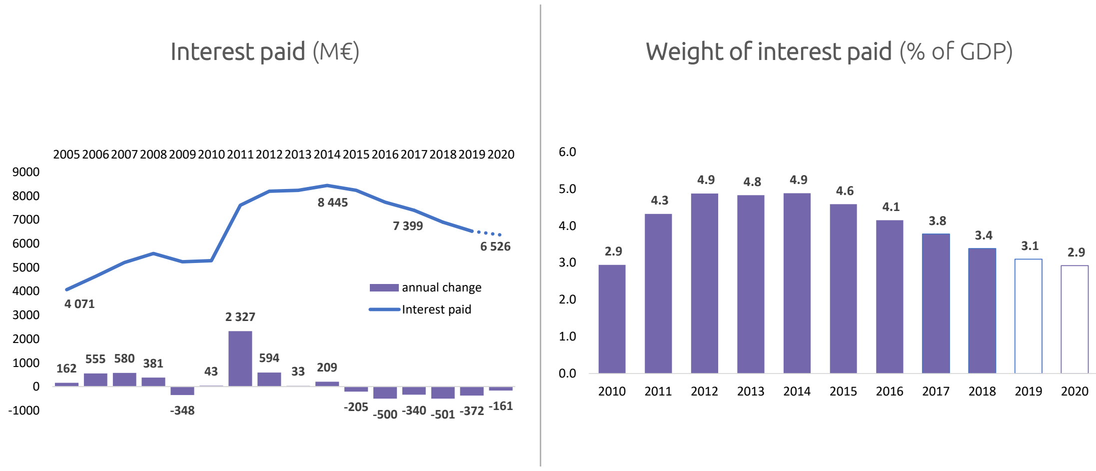
[6] Most of the expected increase will come from projects included in the 2020 Railway investment plan (EUR 148 M), Lisbon and Porto Metro expansion works and the installation of the Mondego Mobility System (EUR 129 M), fleet acquisition (EUR 62 M) and infrastructure investments by Portuguese National Health System (EUR 87 M) and Education (EUR 84 M).

[7] Program established through Decree-Law no. 37/2018, of May 4, aiming at the promotion of housing solutions for the poorer families with no housing alternative. According to MF, to this Program will be allocated financial resources, earmarked for non-reimbursable co-payments, totalling EUR 700 M by 2024.

the sixth consecutive year in which this expenditure will decrease, although less expressive (the cumulative decrease between 2015 and 2020 will amount to EUR 2 billion, as shown in the left panel of Chart 9). The pace of decline in interest expenditure is expected to slow from 5.4% in 2019 to 2.5% in 2020. According to the State Budget Proposal /2020, the reduction foreseen for the current year should result from the decrease in charges borne by public entities reclassified from the central government (mainly resulting from loan amortisations in 2019) and from interest and other charges on the State's direct debt. MF forecasts indicate that this year interest expenditure as a percentage of GDP will continue on the downward path initiated in 2015: this ratio should fall by 0.2 p.p., equal to the 2.9% of GDP recorded in 2010 (right panel of Chart 9).

Chart 9 – Developments in interest paid



Source: INE and Ministry of Finance. CFP calculations. | Note: in the right panel chart the figures for 2019 and 2020 are considered by the Ministry of Finance in DSB/2020.

Growth in current primary expenditure is expected to decelerate from 4.2% in 2019 to 3.4% in 2020. This aggregate expenditure is expected to increase by EUR 8309 million in the three-year period 2018-2020, of which EUR 2689 million in the current year. Around 80% of the increase forecast for 2020 is justified by social benefits, although MF forecasts indicate that the growth rate of these benefits will fall from 4.4% in 2019 to 3.1% in 2020, reaching EUR 39 952 million. The increase in social Benefits forecast for 2020 stems from the regular updating of social security pensions (+ EUR 92 M) and Caixa Geral de Aposentações (Civil Servants Pension Funds),[8] the Effect of the discretionary measures referred to in the following paragraph (+EUR 22 M), the evolution of the numbers of pensioners and the updating of IAS (for more details see 5.3 Analysis of the Social Security Funds sector).[9] In the opposite direction, expenditure on PPPs for Health is expected to decrease by EUR 86 million (partly due to the end of

[8] As last year, pensions will be regularly updated from January 2020 onwards, although at a lower rate. In 2020, pensions of up to 2 times the IAS value will be updated by 0.7%, while pensions of between 2 and 6 times the IAS value will be updated by 0.24% (average inflation rate, without housing, in the year ending November 2019). Official forecasts indicate that the impact of the regular updating of social security pensions will be 143 M euros lower than in 2019. The CFP requested information on the impact of the regular update of CGA pensions but received no response.

[9] According to additional information provided by the MF, the number of old-age pensions is expected to increase by 0.1% in 2020, after a reduction of 0.1% in 2019, and the IAS update will have an impact on benefit expenditure (excluding pensions) of EUR 12 million in 2020.

the private management contract at Braga Hospital) and the effect of the expected improvement in the labour market should allow expenditure on unemployment benefits to decrease by EUR 29 million this year. As a percentage of GDP, expenditure on social benefits is expected to decrease by 0.04 p.p., from 18.4% in 2019 to 18.3% in 2020.

Part of the increase in social benefits in 2020 is due to the EUR 222 million impact of the main measures in State Budget Proposal /2020. However, this is less than what was planned for 2019 in the State Budget for 2009 (EUR 648 million) because it is mainly a question of strengthening and extending measures already implemented. On the one hand, the measures concerning the National Strategy for the Integration of Homeless People (+ EUR 7.5 M) and the Support Programme for Tariff Reduction (+ EUR 26 M) will be reinforced. On the other hand, an overall impact of EUR 132 million is planned to follow the extension of the scope of measures such as the family allowance (which will be fully granted to children between 4 and 6 years old), parenting benefits, the Solidarity Supplement for the Elderly and the Social Inclusion Benefit. The State Budget Proposal /2020 also incorporates an overall impact of EUR 65 M arising from the early retirement scheme for the enhancement of very long contributory careers and the early retirement scheme for flexible old-age pension age, which have been in force since October 2017 and January 2019 respectively. Finally, it should be noted that an increase if the EUR 20 million is planned for 2020 as a result of the creation of a support allowance for informal carer and a saving of EUR 39 million through the reuse of school textbooks.

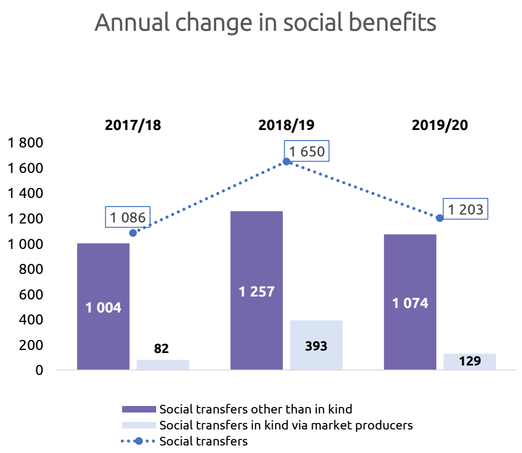
Table 5 – Impact of discretionary measures on social benefits in 2020

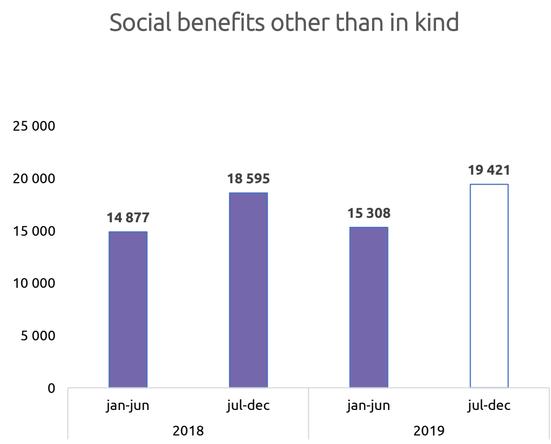
Designation	Change in M€
Very long contributory careers + Early retirement scheme for flexibilization	65
Social transfer for Inclusion	64
Parenting benefits	30
Status of informal caregiver	30
Tariff Reduction Support Program	26
Family allowance	19
Supplementary Supplement for the Elderly	19
National Strategy for Integration of People in Homeless Situations	8
School manuals - reuse	-39
Total	**222**

Source: MF. CFP calculations. | Note: the negative value for the measure "School Manuals" corresponds to a savings forecast resulting from its reuse.

For the third year in a row, the increase in expenditure on social Benefits that will not exceed EUR 1 billion. MF forecasts point to this expenditure increasing by EUR 1074 million in 2020, after the EUR 1004 million increase recorded in 2018 and the estimated EUR 1257 million increase in 2019 (left panel of Chart 10). The fulfilment of this new estimate for 2019 implies that, in the 2nd half of last year, this expenditure amounted to EUR 19 421 million, 826 million more than in the same period of 2018 (right panel of Chart 10). Given that the model for the payment of the Christmas bonus remained unchanged in 2019,[10] the materialisation of this forecast will depend on a strong volume effect in the second half of last year.

Chart 10 – Developments in social benefits (M€)





Source: INE and Ministry of Finance. CFP calculations. | Note: in the right panel chart the value for the 2nd semester of 2019 corresponds to the amount necessary for the materialization of the new MF estimate for social transfers in 2019.

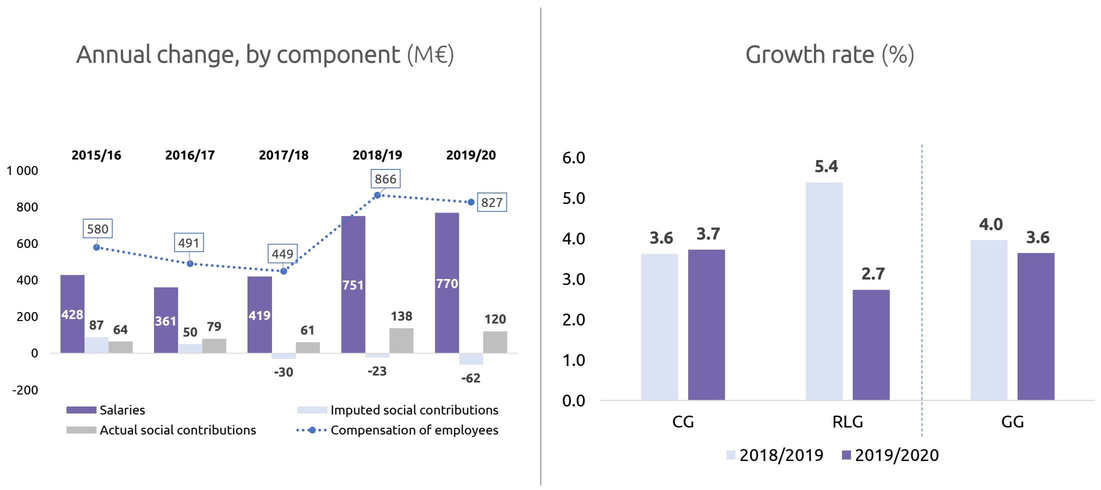
Personnel expenditure is expected to grow for the fifth consecutive year, although a deceleration from 4.0% in 2019 to 3.6% in 2020 is expected. Between 2016 and 2018, personnel expenditure increased at an annual average of EUR 507 million and MF forecasts point to an average of EUR 847 million over the period 2019-2020. According to the MF, personnel expenditure will have increased by EUR 866 million in 2019 and in 2020 it should grow for the fifth consecutive year (left panel of Chart 11), reaching EUR 23 528 million and approaching the peak recorded in 2010 (EUR 24 576 million). The increase foreseen for the current year (of EUR 827 million) is slightly lower than estimated for 2019 because a deceleration of this expenditure is foreseen in the regional and local government sub-sector (right panel of Chart 11). The increase in 2020 should be justified mainly by central government (+ EUR 684 M), due to an increase in expenditure in the NHS entities[11] and in the budget programme "Labour, Solidarity and Social Security".[12] As a percentage of GDP, personnel expenditure should stabilise at 10.8% in 2020.

[10] In 2018 and 2019 the Christmas subsidy was paid in full in the last quarter. It should be recalled that due to the fact that in 2017 this allowance was paid in twelfths, there was a year-on-year increase in social benefits other than in kind of EUR 968 million in the second half of 2018.

[11] In the biennium 2020-2021 more than 8400 health professionals are scheduled to be recruited.

[12] According to additional information provided by the MF, the increase in this Programme is mainly justified by IEFP and SCML. In the former case, new jobs (PREVPAP, returns and mobility) and salary rescheduling are at stake, while in the case of the SCML it is essentially a result of promotions and progressions.

Chart 11 – Developments in compensation of employees (M€)



Source: INE and Ministry of Finance. CFP calculations. | Notes: the right panel chart does not include the social security sub-sector because its expenditure is insignificant. CG - central government; RLG – regional and local government; GG - general government.

Most of the increase in compensation of employees foreseen for 2020 stems from wage appreciation measures. The following factors should contribute to the EUR 827 million increase in personnel expenditure - of which EUR 770 million in wages and salaries, an item that should grow (4.6%) above nominal GDP (3.3%):

i) End of the phase of remuneration rescheduling of careers in general government (+ EUR 527 M);[13]

ii) Career review carried out in 2019 (+ EUR 94 M) and other rights (+ EUR 24 M);[14]

iii) Wage update of 0.3% in the Civil Service (+ EUR 70 M);

iv) Increase in the number of staff (EUR 112 M);[15]

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[13] In December 2019, the fourth and final phase of the career thawing process was completed. Of the total impact of EUR 527 million expected for 2020, EUR 45 million relate to promotions and EUR 482 million to progression. The latter figure includes around EUR 153 million relating to the progressions of primary and secondary school teachers and EUR 99 million resulting from the gradual mitigation of the time frozen between 2011 and 2017 in the special careers of Teachers, Armed Forces, GNR, Magistrates and Justice Officers. It should be recalled that under the terms of Decree-Law no. 65/2019, of 20 May, the accounting of the time of service in multi-sector careers was phased as follows: 1/3 of the time on 1 June, 2019; 1/3 of the time on 1 June, 2020 and 1/3 of the time on 1 June, 2021.

[14] Among other rights, they include those arising from: i) increase in the value of the minimum monthly salary guaranteed, from 600 euros in 2019 to 635 euros in 2020 (Decree-Law No. 167/2019 of 21 November); ii) full payment of performance bonuses in general government (in 2019 it is now permitted to award them, but only in 50% and covering employees who have not had progression since 1 January 2018).

[15] The POE/2020 report states that the Government will complete the centralised recruitment procedure for 1000 skilled workers with higher training. The POE/2020 Health sector website mentions the intention to strengthen the system with the hiring of 4200 new employees in 2020.

v) The programme for the extraordinary regularisation of precarious links in general government (PREVPAP) was completed.[16]

Table 6 – Main appropriations centralized in the Ministry of Finance (breakdown in national accounts perspective, M€)

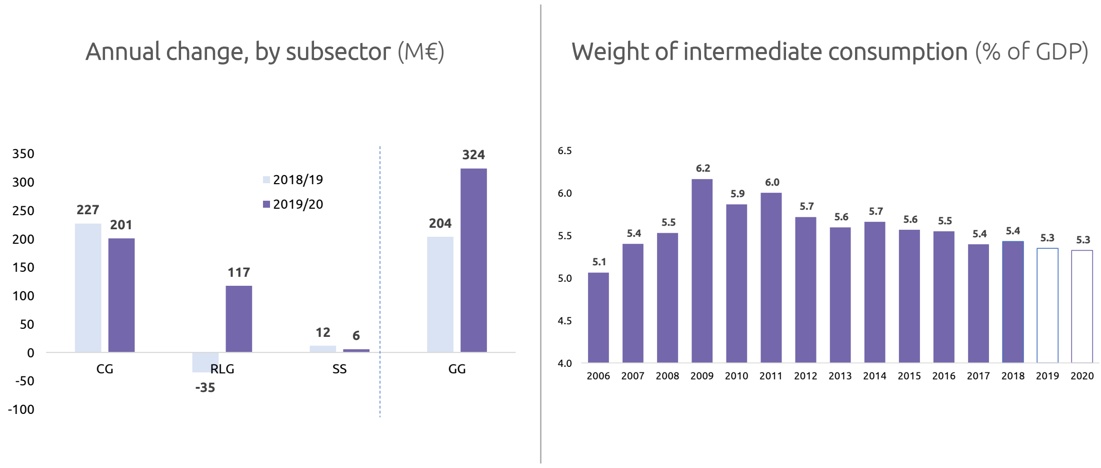
Designation	SB/2019	DSB/2020	Change
Intermediate consumption:			
- Budgetary reserve	470.3	515.4	45.1
- Provisional appropriation	130.0	50.0	-80.0
- Sustainability of the Health Sector	84.9	84.9	0.0
Compensation of employees:			
- Provisional allocation	200.0	220.0	20.0
Other current expenditure:			
- Financing of the Tariff Reduction Support Program	104.0	129.7	25.7
- Provisional appropriation	-	60.0	60.0
GFCF:			
- National public contribution	50.0	50.0	0.0
- Participatory budgeting	5.0	5.0	0.0
Total of effective expenditure	1 044.2	1 115.0	70.8

Sources: MF. CFP calculations. | Note: the appropriation for the settlement of liabilities (20 M€ in SB/2019 and 170 M€ in DSB/2020) is not included because it has no impact on the accrual accounting perspective; It does not include the appropriation for the investment of assets (380 M€ in SB/2019 and 520 M€ in DSB/2020) as this is not effective expenditure and therefore has with no impact on the budget balance.

Intermediate consumption is the only item of current primary expenditure whose growth is expected to accelerate from 1.8% in 2019 to 2.9% in 2020. MF expects intermediate consumption to reach EUR 11,595 million in 2020, which implies an increase of EUR 324 million (or 2.9%) compared to the new estimate for 2019, an increase which should be mainly justified by central government (+EUR 201 million). This is lower than nominal GDP (3.3%), but higher than the estimate for 2019 (+EUR 204 M) because an increase in expenditure in regional and local government is foreseen, after a reduction in 2019 (left panel of Chart 12). It is assumed that these developments may be related to the implementation of the PREVPAP. Attenuating the increase in intermediate consumption in the current year is the forecast reduction in expenditure on road PPPs (-EUR 28 M) and the savings in the public expenditure review exercise (around EUR 100 M, mostly in the Health sector). According to information provided by the MF, a portion (EUR 50 million) of the provisional allocation for 2020 is budgeted for intermediate consumption (Table 6). As a percentage of GDP, the MF expects intermediate consumption to remain at 5.3% (right panel of Chart 12).

[16] The MF estimates that the integration of precarious in the State will have a zero effect on the PA balance, implying only a reclassification from intermediate consumption to personnel expenditure.

Chart 12 – Developments in intermediate consumption



Source: INE and Ministry of Finance. CFP calculations. | Note: CG - central government; RLG – regional and local government; SS - social security funds; GG - general government. In the right panel chart the figures for 2019 and 2020 are the ones considered by the MF in the DSB/2020.

The PA account for 2020 in national accounts incorporates a reduction of EUR 590 million, mostly in intermediate consumption.[17] The PA account for 2020 from a national accounts perspective incorporates a reduction in central government sub-sector expenditure of EUR 590 million, an amount equal to that considered in the last two years. This abatement is referred to in the report of State Budget Proposal /2020[18] and corresponds to a procedure usually used by the MF, arising from the possibility conferred by Article 3 of the Draft Law of State Budget Proposal /2020 and the mechanisms for budgeting and implementing expenditure appropriations. That rule conditions the use of some budget appropriations of central government entities, subjecting them to prior authorisation by the member of the Government responsible for the area of finance.[19] According to additional information provided by the MF, this abatement in national accounts reflects the expectation of not using the totality of the expenditure budget appropriations resulting from "legal and standardised procedures related to the procurement of goods and services, investment or staffing contracts".[20] It should be noted that the PA account in national accounts is part of the report accompanying the draft law of the State Budget for 2020, but it is not subject to approval by Assembly of the Republic.[21] The expenditure appropriations that appear in

[17] According to the MF, most of the budgetary reserve for 2020 (which amounts to EUR 515.4 million and has been included in intermediate consumption) has not been considered in the national accounts estimate.

[18] In the note to "Table 3.4. - Transition of balances from Public to National Accounting".

[19] The CFP requested information on the total initial captives resulting from POE/2020, and the MF replied that this information is not available. According to the Draft Law of the State Budget 2020, the initial captives resulting from the State Budget Law and the budget execution decree will have to be less, on the whole, than 90% of the global value of the initial captives approved in 2017 (that year reached EUR 1.9 billion, of which EUR 0.4 billion related to the budget reserve).

[20] For example, according to no. 36 of Budget General Directorate (DGO) Circular no. 1394 of 5 November 2019, entities must budget 14 months of salary, regardless of the date on which they plan to hire workers.

[21] According to the Budget Framework Law, the only State Budget document subject to approval by Parliament is the draft State Budget Law, which contains the articles and the so-called "maps of the law" in public accounting (provided for in Article 32 of Law No. 41/2014 of 10 July).

the State Budget Law are presented from the public accounts perspective and correspond to maximum ceilings, being approved by the Assembly of the Republic always in gross terms, that is, without being affected by abatements. However, the report of State Budget Proposal /2020 does not present a breakdown by item of the abatement of EUR 590 M, which would be advisable in terms of increasing the transparency of the budget process.

"Other current expenditure" is expected to increase by 5.8% in 2020. This corresponds to an increase of EUR 289 million, of which EUR 85 million as part of the financial contribution to the budget of the European Union and EUR 60 million corresponding to part of the provisional allocation for 2020 (Table 6). A saving of approximately EUR 90 million in the context of the expenditure review exercise underlies the increase in this heading. It should be noted that the most recent State Budgets have been incorporating significant savings arising from the expenditure review exercise (which includes initiatives to improve efficiency and control expenditure), without subsequently providing elements to assess the degree of implementation of the measures adopted under that exercise.

3. FISCAL ADJUSTMENT, FISCAL POLICY STANCE AND COMPLIANCE WITH THE RULES

For the analysis presented in this chapter, the following considerations should be taken into account: 1) the assessment of compliance with the budget balance rule is based, as denominator, on nominal GDP, as defined in the fiscal framework law; 2) the structural balance calculated in this chapter is based on the classification of temporary measures and one-off measures according to the criteria for the analysis of the CFP (see Box 2) and the cyclical components calculated in line with the common methodology agreed in the European Union. The differences obtained from the figures presented in State Budget Proposal/2020 result from the difference in assumptions on the use of the common methodology and the difference in classification of temporary measures in the years 2017 and 2018. As regards the comparison of the figures published by the EC (autumn forecast), the differences are justified not only by the different macroeconomic scenario, but also by the CFP's own classification of the temporary measures. The divergences, following the previous assumptions, affect the assessment of the structural balance and the consequent adjustment to which Portugal is bound under the preventive arm of the Stability and Growth Programme (SGP).

3.1 Budget balances

State Budget Proposal /2020 brings forward to 2019 a better balance estimate than foreseen in the two previous budget programming documents (State Budget Proposal /2019 and EP/2019). Although the comparison of the most recent MF estimate is influenced by the above-mentioned change in the statistical basis of national accounts, this estimate incorporates an impact of temporary measures on the more unfavourable balance (0.2 p.p. of GDP) than that considered in the State Budget for 2019. This difference is fundamentally explained by the higher amount of the capital injection made in Novo Banco. Expanding the impact mentioned above, a budget surplus of 0.4% of GDP would be obtained, higher than the 0.2% of GDP that would be implicit in the State Budget for 2009. This higher budget surplus reflects a more favourable outlook of the MF for budgetary variables, in particular social contributions, together with control over the level of expenditure, whose growth estimated by the MF is expected to be below nominal GDP.

For 2020, the budget proposal pursues a consolidation strategy that continues to benefit from the contribution made by interest. The MF foresees the elimination of the fiscal imbalance in 2020 with a budget surplus of 0.2% of GDP. This improvement will be explained by the reduction in interest expenditure (0.17 p.p. of GDP), the reduction of the unfavourable impact of temporary effects (0.11 p.p. of GDP), as well as a slight improvement in the structural primary balance (0.05 p.p. of GDP).

Table 7 – Budget indicators

	% of GDP				Change (in p.p. of GDP)			
	2017	2018	SB/2020		2017	2018	SB/2020	
			2019	2020			2019	2020
Primary balance	**0,8**	**2,9**	**3,0**	**3,2**	**-1,4**	**2,1**	**0,1**	**0,2**
Global balance	**-3,0**	**-0,4**	**-0,1**	**0,2**	**-1,1**	**2,5**	**0,4**	**0,3**
Adjusted from temporary and one-off measures	-0,8	0,0	0,4	0,7	1,5	0,8	0,4	0,2
Cyclically-adjusted	-3,4	-1,2	-0,9	-0,5	-2,1	2,2	0,4	0,3
Structural balance	**-1,2**	**-0,8**	**-0,3**	**-0,1**	**0,5**	**0,5**	**0,4**	**0,2**
Primary Structural	2,5	2,6	2,8	2,8	0,1	0,1	0,1	0,1
Memo item:								
temporary and one-off measures	-2,2	-0,5	-0,5	-0,4	-2,6	1,7	-0,1	0,1
output gap*	0,8	1,6	1,5	1,5	2,0	0,7	0,0	0,0
cyclical component	0,4	0,8	0,8	0,8	1,0	0,4	0,0	0,0
interest	3,8	3,4	3,1	2,9	-0,4	-0,4	-0,3	-0,2

Source: INE, MF. CFP calculations. Note: *as a percentage of potential output. The semi-elasticities employed are those used by the EC and the output gap has been recalculated by the CFP according to the community methodology (using the CONV program from the European Commission's Autumn Forecast 2019). Temporary and one-off measures reflect the CFP classification, which does not coincide with the MF's. The changes do not necessarily match the differences in the figures as a percentage of GDP due to rounding.

In 2020, and as in previous budgets, the budget deficit forecast in national accounts will be lower than from a cash point of view. In 2020, and as in previous budgets, the budget deficit forecast in national accounts will be lower than from a cash point of view. This circumstance results from the different recording approach underlying each of the accounting systems. As in 2019, this is a situation that keeps away from the monthly monitoring of the public accounts obtained from the cash point of view, from that resulting from the calculation in national accounts. As in 2019, the positive sign of the total adjustments in 2020 leads to a better clearance of the balance in national accounts than foreseen from the cash point of view. Thus, for 2020, the value of the adjustments in national accounts amounts to EUR 1954 M (0.9 p.p. of GDP) reflecting a substantial adjustment between the two accounting perspectives, explained mainly by the adjustments relating to accrual accounting, which corrects the cash data (receipts and payments) for the year to which the transaction originating them relates. This significant adjustment is based on (i) the temporal adjustments that the MF foresees for the Reclassified Public Entities (EUR 1107 million); (ii) the accrual of interest (EUR 737 million); (iii) the implicit payment of pensions to the transfers of pension funds collected in past years not to be considered as expenditure in national accounts (EUR 490 million); (iv) guarantees (EUR 222 million); and (v) the temporal adjustments related to taxes and social contributions (EUR 199 million). On the other hand, the adjustments relating to the neutrality of European funds (-EUR 740 million) and the other adjustments (-EUR 67 million) are basically the same.

Box 2 – Temporary measures considered by the CFP in 2019 and 2020

The identification of temporary and non-recurring measures is one of the essential elements for the calculation of the structural balance, together with the determination of the cyclical component. The code of conduct in the implementation of the Stability and Growth Pact defines temporary and non-recurring measures as those whose budgetary effect is transitory, not leading to a sustained change in the intertemporal budgetary position. As a rule, this type of measures does not present permanent effects that affect the fiscal balance. Therefore, in order to be able to identify the fiscal consolidation effort in structural terms, the budgetary aggregates are adjusted for the respective effects.

The following table identifies the temporary measures or one-off measures considered by the CFP in the analysis of the public accounts for 2019 and 2020, underlying State Budget Proposal /2020.

Table 8 – Impact of temporary measures on the budgetary balance

	Millions of euros			% of GDP		
	2018	2019	2020	2018	2019	2020
One-off measures (impact in budget balance)	-951	-1 098	-905	-0,5	-0,5	-0,4
Revenue	166	51	145	0,1	0,0	0,1
BPP guarantee recovery	166	51	145	0,1	0,0	0,1
Expenditure	1 117	1 149	1 050	0,5	0,5	0,5
Capital Injection to Novo Banco	891	1 149	600	0,4	0,5	0,3
DTA			130			0,1
Forest fires	130			0,1		
Judicial Court Decision- Lisbon Municipality	96		160	0,0		0,1
Transfer of FGCAM to FDG			80			0,0
IP indemeniztion			80			0,0

Source: INE and MF. CFP calculations. | Note: Calculations and classification of CFP responsibility. Due to rounding the totals do not necessarily correspond to the sum of the percentage GDP figures.

The measures considered by the CFP as temporary or non-recurring for the year 2019 and 2020 are, overall, measures whose analysis has already been classified in previous reports. Thus, on the revenue side, the measure relating to the recovery of the remaining guarantee provided by the State to Banco Privado Português (BPP), whose full recovery in State Budget Proposal /2019 foresaw in 2018, is identified. Its classification as a temporary measure is based on the fact that the extraordinary revenue to be obtained results from the reversal of an operation to support the financial system that in 2010 negatively affected the balance of the PA.

On the expenditure side, measures already previously classified by the CFP as temporary are largely identified. In this area, a group of measures with an impact in 2019 and 2020 are referred to, the nature of which is part of the exceptional support to the financial system, specifically: the capital increase in Novo Banco (recapitalisation) by activation of the contingent capital mechanism agreed within the scope of the process of disposal of that financial institution and the conversion into deferred tax asset tax credits. In addition to these, the measure relating to extraordinary payments for judicial decisions concerning the Municipality of Lisbon is also considered, which, although planned for 2019 (State Budget Proposal /2019), will now occur in 2020, according to the MF. The classification as a temporary measure stems from the fact that the expenditure associated with several lawsuits is highly likely to occur as a result of those lawsuits. In this circumstance, the expenditure, if it occurs, will be of an extraordinary nature, since it will result from a judicial decision.

The novelty introduced by State Budget Proposal /2020 is based on the classification as temporary measures of two operations with an impact on expenditure: (i) return of contributions to Banco de Portugal, following the transfer of the deposit guarantee arm of the Mutual Agricultural Credit Guarantee Fund to the Deposit Guarantee Fund and (ii) compensation of Infraestruturas de Portugal (IP) to the Algarve sub-concession, due to the refusal of approval by the Court of Auditors. In the first case we are dealing with a measure transferring the deposit guarantee arm of FGCAM to FGD with the aim of concentrating the guarantee function in Portugal in a single deposit guarantee fund, as provided for in Decree-Law No 106/2019 of 12 August. With this change, the deposit guarantee function is separated from the assistance component that FGCAM also provides. Once this transformation is completed, FGCAM shall transfer to Banco de Portugal the amount resulting from its contributions to FGCAM. After the return of these contributions, FGCAM becomes an autonomous asset operating with the Central Mutual Agricultural Credit Bank. As this transformation aims to comply with the creation of a European deposit guarantee scheme, as envisaged in the third pillar of the Banking Union, this expenditure resulting from the return of contributions to Banco de Portugal by FGCAM is an operation within the scope of exceptional support to the financial system.

With regard to the planned expenditure resulting from the compensation of Infraestruturas de Portugal (IP) to the Algarve sub-concession, the CFP requested clarification from MF. The explanation provided by MF indicated that a court assessment is currently under way to determine the legal validity of the contract regarding the duration of its term, so that the value of a possible compensation to be paid by IP can be ascertained. In this respect, the MF adds that, as a matter of prudence, IP has already recorded this liability as an expense for 2020, recognising that it is contingent. This charge to be confirmed, the resolution of which depends on a court decision, constitutes the nature of an extraordinary expense.

In this understanding, the CFP classifies expenditure resulting from the return of FGCAM contributions to Banco de Portugal and the payment of compensation by IP as temporary or non-recurring measures. This classification may be subject to revision in the light of additional information that calls into question this assessment.

3.2 Fiscal adjustment and fiscal policy stance

According to MF forecasts, by 2020 the recalculated structural balance [22] underlying the State Budget Proposal /2020 should continue to converge towards the Medium-Term Objective (MTO). CFP calculations put the structural balance at -0.1% of potential GDP, approaching the MTO (0% of potential GDP for the three-year period 2020-2022). This result underlies an estimate of the structural balance for the years 2019 and 2020 that reinforces the necessary safety margin in relation to the 3% of GDP nominal budget deficit ratio.[23] This margin enables fiscal policy to respond to normal cyclical fluctuations through the operation of automatic stabilisers without incurring in the excessive deficit situation.

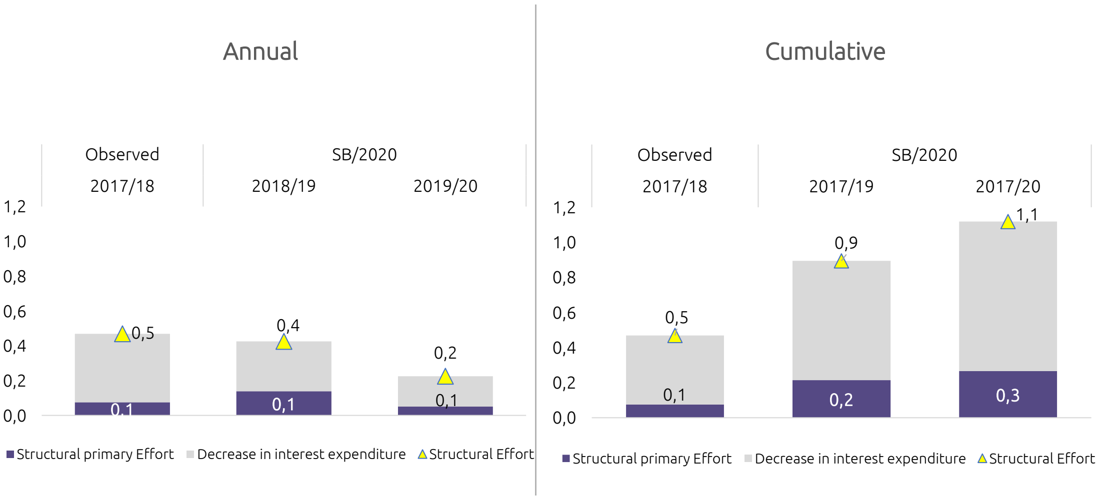
The fiscal effort [24] should continue to depend essentially on the contribution of the reduction in interest burden, according to State Budget Proposal 2020 (Chart 13). According to the figures underlying State Budget Proposal /2020, in cumulative terms in the period from 2017 to 2020, there will be a structural improvement of 1.1 p.p. of GDP, of which a further three quarters will be due to the contribution of the reduction of the interest burden (0.9 p.p. of GDP) and the remainder to the budgetary effort arising from government action (0.3 p.p. improvement in the structural primary balance).

[22] The structural balance corresponds to the budget balance expurgated from the effects of the business cycle by the CFP and one-off and temporary measures according to the CFP's own classification. The estimation of the cycle effects was carried out according to the common methodology agreed in the EU, with the CFP recalculating the value of the output gap on the basis of this methodology and the macroeconomic forecast of POE/2020.

[23] In technical terms, the estimated structural deficit is below the "minimum benchmark" which is currently -1% of GDP for 2019 and -1.3% for 2020 (Vade Mecum on the Stability and Growth Pact, 2019 Edition).

[24] Measured by the change in the structural balance.

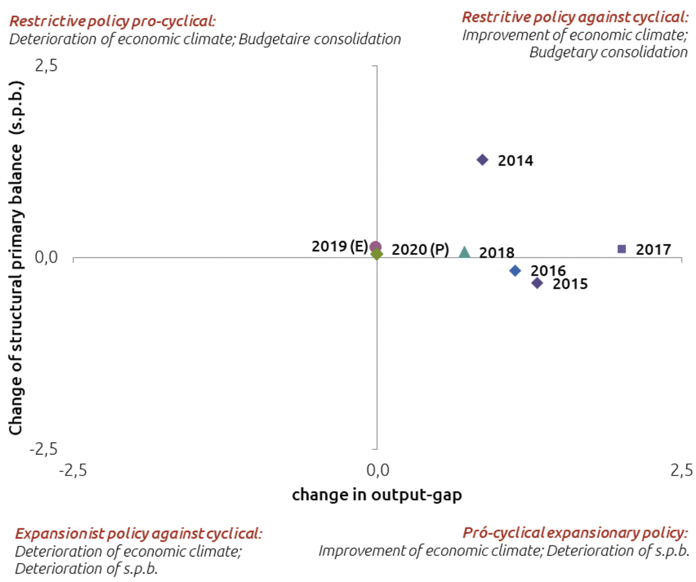
Chart 13 – Fiscal Effort (p.p. of GDP)



Source: INE, MF. CFP calculations. Notes: the figures are net of the cyclical effect and one-offs (see Box 2). The changes may not necessarily match the sum of the figures as p.p. of GDP due to rounding

In 2020, the fiscal policy stance is expected to remain neutral, in line with the estimated position for 2019. Its determination is measured by the change in the structural primary balance, which makes it possible to assess the restrictive or expansionary discretionary nature of fiscal policy, combined with the change in the output gap. For 2020, the recalculation made by the CFP for the structural primary balance points to a practically nil change (0.05 p.p. of GDP), in a conjunctural context where, according to the macroeconomic forecast underlying the State Budget Proposal /2020, the economic environment will stabilise (Chart 14).

Chart 14 – Fiscal policy and cyclical position [2014 – 2020]



Source: INE and MF. CFP calculations. | Note: (i) The fiscal policy stance is assessed by the change in the structural primary balance; (ii) The cyclical position of the economy is evaluated by the change in the output gap, given by the difference between GDP growth rates and potential GDP. iii) The CFP deems fiscal policy to be restrictive if the ratio of the structural primary balance records an annual improvement of at least 0.25%

of potential GDP and to be expansionist if that ratio is less than 0.25%. if the change is between -0.25% and +0.25% fiscal policy is deemed to be neutral. E- Estimate, P – Forecast.

3.3 Compliance with budgetary rules

Within the framework of the rules on budgetary surveillance agreed at European level, Portugal has been subject to the rules defined under the preventive arm of the Stability and Growth Pact (SGP) since 2017. The set of rules applicable in this context establishes that the public finances of each Member State should make progress to ensure, in a first step, the structural adjustment needed to achieve the medium-term objective (MTO) and, in a second step, the preservation of a sound budgetary position that ensures its permanence at the MTO. The assessment of the appropriate adjustment path towards that objective requires its assessment to be made on the basis of the structural balance indicator and the expenditure benchmark ('Benchmark'). Once the MTO has been achieved (based on the assessment of the implementation results for year t-1) and the permanence in that target is ensured, Member States may deviate from the requirements to meet the expenditure benchmark, unless exceeding the MTO is explained by the significant impact of windfall gains on revenue. Under no circumstances may a Significant Deviation Procedure be triggered in this second phase. In parallel with this progress, compliance with the transitory provisions of the debt rule, which for Portugal are in force for the three-year period 2017-2019, should also be ensured. After this transitional period (from 2020 onwards) Portugal will be obliged to comply with the general rule of debt reduction. This rule establishes that the excess of the government debt ratio over the 60% limit will decrease over three years, at an annual average rate of 1/20, and its non-compliance may lead to the opening of an excessive deficit procedure.

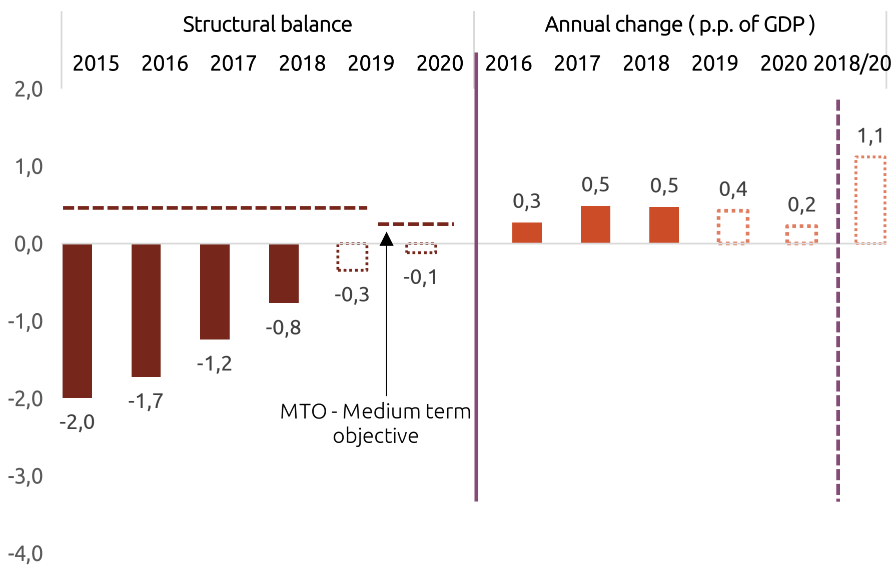
In line with the provisions of the Stability and Growth Pact, the most recent recommendations addressed to Portugal stipulate that the medium-term budgetary objective (MTO) be achieved by 2020, in parallel with the use of revenue windfalls to accelerate the reduction in the government debt ratio.[25] This recommendation of the Council of the European Union of 9 July 2019 was refocused in the autumn 2019 forecasts of the European Commission (EC). In these forecasts, the European authorities anticipate that Portugal in 2019 will be at 0.4 p.p. of GDP at the MTO, and therefore, to ensure that objective in 2020, "the nominal growth rate of net primary expenditure should not exceed 1.7%, which corresponds to an improvement in the structural balance of 0.4% of GDP".

Based on the available information and on the own classification of temporary and non-recurring measures, the CFP estimates that the planned improvement in the structural balance underlying the State Budget for 2020 amounts to 0.2 p.p. of GDP in 2020 and 0.4 p.p. in 2019. These figures compare with the change of 0.3 p.p. in 2020 and 0.2 p.p. of GDP in 2019 presented by MF in the State Budget Proposal /2020 Report. The calculation of the CFP is based on the fiscal balances presented in the State Budget Proposal /2020, the output gap underlying the Government's macroeconomic forecast recalculated according to the common methodology and the classification of temporary

[25] The recommended structural adjustment should take into account the margin of tolerance associated with exceptional circumstances for which a temporary deviation from the adjustment path towards the medium-term budgetary objective was authorised in 2018, the amount of which carried forward to 2020 amounts to 0.04% of GDP, "corresponding to the additional expenditure arising from the exceptional forest fire prevention measures following the unprecedented forest fires of 2017".

and non-recurring measures of the CFP[26]. This estimate points to a planned improvement in the structural balance in 2019 (0.4 p.p. of GDP) below that required to ensure the 0.5 p.p. of GDP improvement established in the budgetary framework law (LEO)[27] and the 0.6 p.p. of GDP improvement resulting from the recommendation of the Council of the European Union for 2019.[28] Despite this deviation, the (recalculated) structural balance for 2019 is estimated to be negative at 0.3% of GDP. Convergence towards that objective implies that in 2020 the structural balance would improve by 0.3 p.p. of GDP. According to the MF forecast for 2020, the planned improvement in the recalculated structural balance is 0.2 p.p. of GDP, which puts that indicator at 0.1 p.p. of GDP away from the MTO corresponding to a balanced structural balance, which is close to the target.

Chart 15 – Structural Balance developments (% and p.p. of GDP)



Sources: INE and Ministry of Finance. The structural figures shown are net of the impact of the economic cycle and the impact of temporary and one-off measures (see Box 2). The CFP criterion for classification of temporary measures and non-recurrent measures does not coincide with that considered by MF for the years prior to 2019. This difference assumes particular relevance in the calculation of the CFP for the variation of the structural balance.

The planned improvement in the structural balance foreseen for 2020 points to the risk of deviation from the structural adjustment needed to achieve the MTO. This deviation of 0.1 p.p. of GDP, although within the limit that an ex post evaluation by the European

[26] The estimated change in the structural balance in 2019 is sensitive to the classification of one-off measures. If the quantification of temporary and one-off measures of the Ministry of Finance were used, an improvement of 0.2 p.p. of GDP would be achieved in 2019.

[27] No. 6 of article 12 C of the Budgetary Framework Law (as amended by Law 41/2014 of 10 July) states that "until the medium-term objective is reached, the annual adjustment of the structural balance cannot be lower than 0.5 [p.p. of GDP]".

[28] The Council of the European Union recommended on 13 July 2018 that "in 2018 and 2019, Portugal should take measures to ensure that the nominal growth rate of net public primary expenditure in 2019 does not exceed 0.7 %, corresponding to an annual structural adjustment of 0.6 % of GDP". - Recommendation of the Council of the European Union COM (2018) 421 final of 23 May 2018 on the National Reform Programme 2018 Portugal and providing a Council Opinion on the Portuguese stability programme 2018.

Commission (EC) may consider that a Member State is at its MTO,[29] signals in this ex ante evaluation (which is not yet based on the outcome of implementation) the existence of a risk of deviation. The nature of the risk of deviation in 2020 remains when taking the average of the deviations calculated for the years 2019 and 2020. For those years as a whole the average deviation is below 0.25% of GDP.[30] In any of the circumstances (annual or two-year average), considering the short distance to the MTO, the ex-ante evaluation carried out points to a risk of deviation.

The projected evolution of the structural balance in 2020 does not reflect progress consistent with meeting the expenditure benchmark.[31] The reading of the budgetary effort based on the expenditure indicator, which excludes interest and does not capture the revenue windfall gains (elements that have benefited the reading of the budgetary effort when the structural balance is used) points to the nominal growth rate of net public primary expenditure being higher than the applicable reference rate in 2020. Based on information provided by the MF, CFP calculations point to the planned nominal growth of primary expenditure net of discretionary measures and one-off temporary measures of 4.2% (see Box 3). This exceeds the maximum recommended increase of 1.7% (the applicable expenditure benchmark), leading to a deviation from the programmed growth of that primary expenditure of -0.9% of GDP in 2020. This result, which already excludes the effect of temporary and non-recurring measures, reflects a deviation above the maximum limit of 0.5%, which points to a risk of significant deviation in 2020. The nature of this deviation remains, even considering the average of the deviations in the years 2019 and 2020 (-1.1% of GDP).

Considering the overall reading provided by the two pillars for assessing the adjustment path, namely the closeness of convergence of the structural balance to the MTO, the pace of adjustment envisaged points to a risk of deviation in 2020. For the purpose of assessing compliance with the fiscal rules of the structural arm of the Stability and Growth Pact, the expectation of compliance with the MTO will have to be confirmed in the "ex post" assessment to be carried out in the spring of 2021, together with a projection of developments in the structural balance for the following years that ensures the permanence of a budgetary position at the MTO. Should these developments not be confirmed, an "overall assessment" carried out by the EC will be required to determine a possible deviation from the recommended adjustment path.

The evolution path of the debt ratio for the years 2019 and 2020 presented in the State Budget Proposal /2020 points to compliance with the requirements of the debt reduction rule established in the preventive arm of the Stability and Growth Pact. In the last year of the transitional debt rule period (2017-2019), CFP calculations based on

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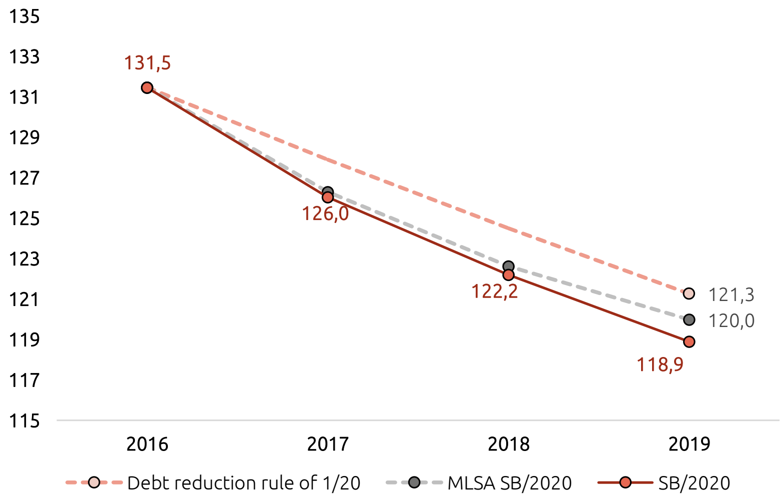
[29] By convention, the Commission considers that a Member State is at its MTO if the calculation points to a value of up to ¼ percentage points of GDP of its MTO. This convention has been applied over time and aims to note the inevitable uncertainty in determining the precise position of the structural balance. For 2020, the margin of tolerance associated with exceptional circumstances of 0.04% of GDP for which a temporary deviation has been allowed must also be taken into account.

[30] According to Articles 6(3) and 10(3) of Commission Regulation 1466/97, in the case of a Member State that has not achieved the medium-term objective (MTO), a deviation from the required adjustment is considered significant if it is at least 0.5 p.p. of GDP in a given year or if it is at least 0.25 p.p. of GDP in two consecutive years.

[31] The aggregate under analysis does not correspond to total government expenditure, but to an adjusted primary expenditure aggregate (see explanation in Box 3).

the estimation of the MF government debt ratio for 2019 (118.9% of GDP) indicate sufficient progress to ensure compliance with the debt reduction rule in 2019. This progress is measured by a change in the (recalculated) structural balance for 2019 (0.4 p.p. of GDP) above that required by the MLSA minimum linear structural adjustment (-0.7 p.p.) signals its compliance with the requirements of the transitional debt rule. For 2020, since the debt ratio estimated for 2019 is above 60% of GDP, Portugal is now subject to compliance with the general rule of debt reduction. According to the forecast of the government debt ratio for 2020 in State Budget Proposal /2020 (116.2% of GDP), the information available to assess compliance with the debt criterion points to compliance with the general rule of debt reduction in that year (see Box 4).

Chart 16 – Government debt reduction rule in the last year of the transitional period - 2019 (% of GDP)



Source: MF. CFP calculations.

Box 3 – Measuring compliance with the Expenditure Benchmark

The measurement of compliance with the rule results from the calculation algorithm adopted by the European Commission (EC). The information used by the CFP to calculate the deviation is based on the estimate and forecast provided by the Ministry of Finance, respectively for the years 2019 and 2020, and on the EC data contained in the 2017, 2018 and 2019 spring forecasts.

This exercise is part of an ex ante evaluation that aims to indicate whether or not there is a risk of significant deviation. The following tables present the steps for the calculation that determine the verification of compliance with the rule as described in the Box provided on the CFP website – Expenditure Benchmark.

Calculation of corrected aggregate expenditure: It uses information from some of the components of government expenditure and revenue underlying the estimate for 2019 and forecast for 2020 presented in the State Budget Proposal /2020, as well as specific information from the tables attached to the Draft Budget Plan 2020 sent to the European authorities, except for the amount of temporary and non-recurring measures which follows the classification of the CFP (Box 2).

Table 9 – The Modified Expenditure Aggregate calculation (B€)

MODIFIED EXPENDITURE AGGREGATE CALCULATION	2019	2020	Fórmulas
General government expenditure	**91,4**	**94,8**	(1)
Interest expenditure	6,5	6,4	(2)
Government expenditure on EU programmes fully matched by EU funds revenue	0,7	0,9	(3)
Nationally financed gross fixed capital formation t	3,5	4,0	(4)
Annual average nationally financed gross fixed capital formation t-3 to t	2,9	3,4	(5)
Cyclical unemployment expenditure	-0,1	0,0	(6)
Total discretionary revenue measures (DRM)	0,0	0,0	(7)
One-offs on the revenue side	0,1	0,1	(8)
One-offs on the expenditure side	-1,1	-1,1	(9)
One-offs	-1,1	-0,9	(10)=(8)+(9)
Total discretionary revenue measures net of one-offs	0,1	-0,1	(11)=(7)-(8)+(8)ano $_{(n-1)}$
Corrected expenditure aggregate* (nominal)	**83,7**	**87,0**	(12)=(1)-(2)-(3)-(4)+(5)-(6)
Corrected expenditure aggregate net one-offs * (nominal)	82,6	85,9	(13)=(12)+(9)
Corrected expenditure aggregate net of DRM and RML* (nominal)	83,7	86,9	(14)=(12)-(7)
Corrected expenditure aggregate net of DRM, RML and one-offs * (nominal)	82,5	86,0	(15)=(13)-(11)
Net public expenditure annual growth in % (nominal)	**4,2**	**3,9**	$(16)=100*[(14)-(12)_{t-1}]/(12)_{t-1}$
Net public expenditure annual growth corrected for one-offs in % (nominal)	**4,1**	**4,2**	$(17)=100*[(15)-(13)_{t-1}]/(13)_{t-1}$

Sources: MF and CE. CFP calculations. Note: Cyclical unemployment benefit expenditure uses the CFP recalculation of NAWRU according to the EC commonly agreed methodology.

Calculation of the reference rate: Uses EC information from the spring forecasts for 2018 and 2019: (i) the 10-year average growth rate of potential output; (ii) the GDP deflator; (iii) primary expenditure as a ratio to GDP.

Table 10 – Applicable Expenditure Benchmark rate (%)

Applicable Expenditure Benchmark rate calculation	2019	2020	Fórmulas
Applicable expenditure Benchmark rate (real)	**-0,7**	**0,0**	(18)=(19) - (20)
Geometric average of the 10-year Potential Product growth rate (real)	0,8	1,0	(19)
SF 2018 |Year 2019 based on horizon [2013 - 2022]	0,8		
SF 2019 |Year 2020 based on horizon [2014 - 2023]		1,0	
Convergence margin recalibrated	1,5	1,0	(20)=(21) x (22)
Convergence margin	1,2	1,2	(21)= 50 / (22)
Primary Expenditure of (Year n-1) as % GDP based on SF Ano (n-1)	40,5	41,0	(22)
Required Adjustment > = 0,6	0,6	0,4	(23)
GDP deflator (% change) | Assessment of Year n based on SF Ano (n-1)	1,4	1,6	(24)
Applicable expenditure Benchmark rate (nominal)	**0,7**	**1,7**	(25)=[(1+(18)/100)*(1+(24)/100)-1]x100

Sources: CE. CFP calculations. Note: SF Year (n-1) means EC Spring Forecast for the year prior to the reporting date, i.e. the 2020 year analysis uses the 2019 spring forecast (SF 2019).

Measuring compliance with the rule: Exercise comparing the result obtained by each of the indicators identified above in order to ascertain the deviation and distance between it and the established ceiling of 0.5% of GDP in one year, or cumulatively in two consecutive years.

Table 11 – Expenditure Benchmark (B€)

EB deviation adjusted for one-offs	2019	2020	Fórmulas | Formulas
Deviation in year t (B€)	-2,7	-2,0	(26)=[(8)-(17)]/100*(13) t-1
GDP nominal	210,8	217,8	(27)
Deviation in year t, if negative it is an excess over the benchmark (in % GDP)	-1,3	-0,9	(28)=(26)/(27)*100
Average deviation in t-1 and t (in % GDP)		-1,1	(29)=Média[(28) t-1 ;(28)]

Sources: CE. CFP calculations. Note: A negative sign deviation means an excess over the benchmark (Table 10). This implies excessive expenditure for each of those years a risk of significant deviation from the recommended structural adjustment as it is above the permitted ceiling of 0.5%. Considering the analysis for all those years, the risk of significant deviation remains. The average deviation of -1.1% from GDP is greater than the admitted cumulative ceiling of 0.5% of GDP (i.e. 0.25% of GDP each year).

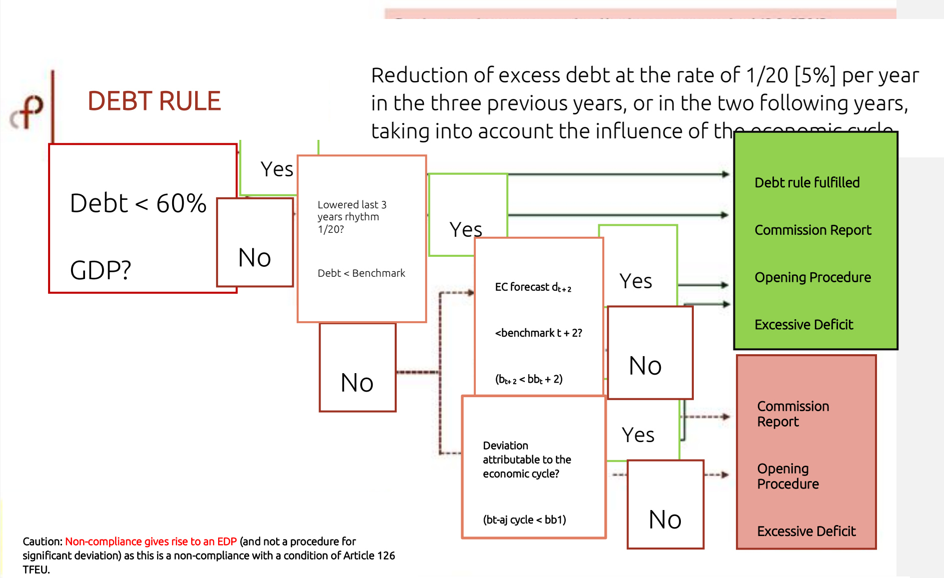
Box 4 – Assessment of compliance with the debt criterion

Compliance with the debt criterion has to be measured when the debt ratio of a given Member State exceeds 60% of GDP. The progress made by Portugal during the period of application of the transitional debt rule (2017-2019) has allowed the debt ratio to be placed on a declining path, even if above the limit set in the Stability and Growth Pact. In this situation, each member state must guarantee a sufficient reduction of the debt ratio, at a satisfactory pace, to enable it to approach the reference value for this indicator (60% of GDP).

The path of reduction of the debt ratio is complied with, as is the pace at which this reduction takes place, if the excess of the debt ratio over the reference value decreases in the three years preceding an annual average rate of 1/20. In this assessment, the influence of the economic cycle on the pace of debt reduction, as laid down in Regulation (EC) 1467/97, should also be considered. The debt criterion requirement shall also be fulfilled if the Commission's budgetary projections indicate that the necessary reduction in the excess will take place within three years of the last two years for which data are available.

In this understanding, the assessment of compliance with the debt criterion is measured according to three approaches: (i) backward looking rule; (ii) forward looking rule; and (iii) consideration of the impact of the business cycle on debt (Cyclical adjusted debt). The backward and forward-looking approaches are calculated over a three-year horizon, so that the calculation is not affected by debt peaks. This eliminates the volatility that would result from applying an annual rule. Cyclical correction is another step in the assessment aimed at ensuring that the breach of the reference value for meeting the debt criterion cannot be attributed to the influence of the business cycle. In this case, the debt ratio will have to be adjusted and then compared with the debt reference value in order to assess whether the breach of the debt criterion is confirmed. Should the default on the debt reduction rule occur in all three approaches mentioned above, the condition of Article 126 of the Treaty on the Functioning of the European Union (TFEU) would be breached. This triggers the opening of an Excessive Deficit Procedure (EDP). The following scheme systematises the steps to be observed in the process of assessing compliance with the debt criterion.

Table 12 – Steps in the process of evaluating the government debt reduction rule



Notes: $bb_t = 60\% + 0.95/3\ (b_{t-1} - 60\%) + 0.95^2 / 3\ (b_{t-2} - 60\%) + 0.95^3 / 3\ (b_{t-3} - 60\%)$. where bb, is the benchmark and b_t the debt ratio in year t. The effect of the cycle in step 3 is operationalised by recalculating the numerator and denominator of the debt ratio assuming that GDP grew at the pace of potential output.

In assessing compliance with the 2020 debt criterion, the information available, while not providing sufficient elements to measure the forward-looking approach, leads to the conclusion that the hindsight approach points to compliance with the debt criterion in 2020. The difference between the debt ratio as a percentage of GDP forecast for 2020 by the MF (116.15%) and the debt reference value calculated by the hindsight approach (116.23%) allows for the calculation of a gap of -0.1% of GDP. This negative value indicates that the gross debt ratio as a percentage of GDP projected by the MF for 2020 ensures compliance with the general rule of debt reduction.

3.4 Multiannual budgetary programming framework (MPPF)

Article 12 - D of the Budgetary Framework Law (LEO) states that with the first draft State Budget Law (OE) presented after the Government takes office, a draft law with the multi-annual budgetary programming framework (QPPO) must be presented and discussed simultaneously. The updating of this programming framework, for the following four years, should be annual, in line with the objectives established in the Stability Programme (SP). On 26 October, 2019, the inauguration of the XXII Constitutional Government, justified the presentation of the Draft Law (PPL) no. 6/XIV, simultaneously with the State Budget Proposal /2020, with the purpose of approving the QPPO for the period 2020 to 2023. The previous QPPO corresponds to the one approved by Law no. 7-C/2016, of 31 March 2016, as amended by the laws of the State Budget from 2017 to 2019. In this regard, it is important to note that, unlike the State Budgets, the projects of the QPPO that accompany the Stability Programs do not have the force of law and are not voted in Parliament.

The expenditure ceiling for 2020 in the QPPO is compatible with the national accounts balance objective (0.2% of GDP). The consistency between those two benchmarks can be gauged through a Top-Down exercise as presented in Table 13. The calculation of this expenditure ceiling is based on the forecast of the adjustments which, from the national accounts balance target (EUR 533 million), lead to the determination of that target from the public accounts perspective (deficit of EUR 1421 million). Once this restriction is known, as well as the forecast balance for sub-national governments (regional and local government) and social security, the balance target for central government is calculated. The actual expenditure value for this sub-sector for 2020 (considering the expectation of not fully using the budget appropriations) is determined by the sum of the actual revenue and the budget balance forecast for CA. The maximum value of expenditure of SC in public accounting is calculated by adding to the previous result the so-called "expectation that the budget appropriations will not be fully utilised" (590 M EUR). The difference between the overall value of SC expenditure and the expenditure financed by own revenue determines the maximum value of central government expenditure covered by general revenue only[32] (54 509 M€), i.e. the expenditure ceiling foreseen in the QPPO for 2020.

Table 13 –From the general gov. balance in national accounts to the expenditure limit in the MBPF for 2020 (M€)

1. General Government budget balance (EDP)	533
2. Adjustments to the cash basis accounts balance	-1 954
Accrual (Commitments adjustments - Cash)	-1 307
Taxes and Social contributions	-199
Difference between interested paid and accrued	-737
Other accounts receivable (-)	740
Other accounts payable (+)	-1 111
Differences due to General Government perimeter	0
Other adjustments	-647
3. General Government Balance (cash basis) [(1)+(2)]	-1 421
a) Regional and Local Government Balance	611
b) Social Security Balance	2 730
4. Central Government Balance [(3)-(a)-(b)]	-4 762
c) Revenue	66 777
Tax revenue	48 044
Other current revenue	16 104
Capital transfers received	2 630
d) CG effective expenditure [(c)-(4)	71 539
e) Expectation not to make full use of budget appropriations	590
f) CG maximum Expenditure Limit [(d)+(e)]	72 129
g) Financed by own revenues	17 621
5. CG limit for expenditure financed by general revenue (MBFP) [f)-(g)]	54 509

Source: Ministry of Finance. CFP calculations. | Note: CG - Central Government.

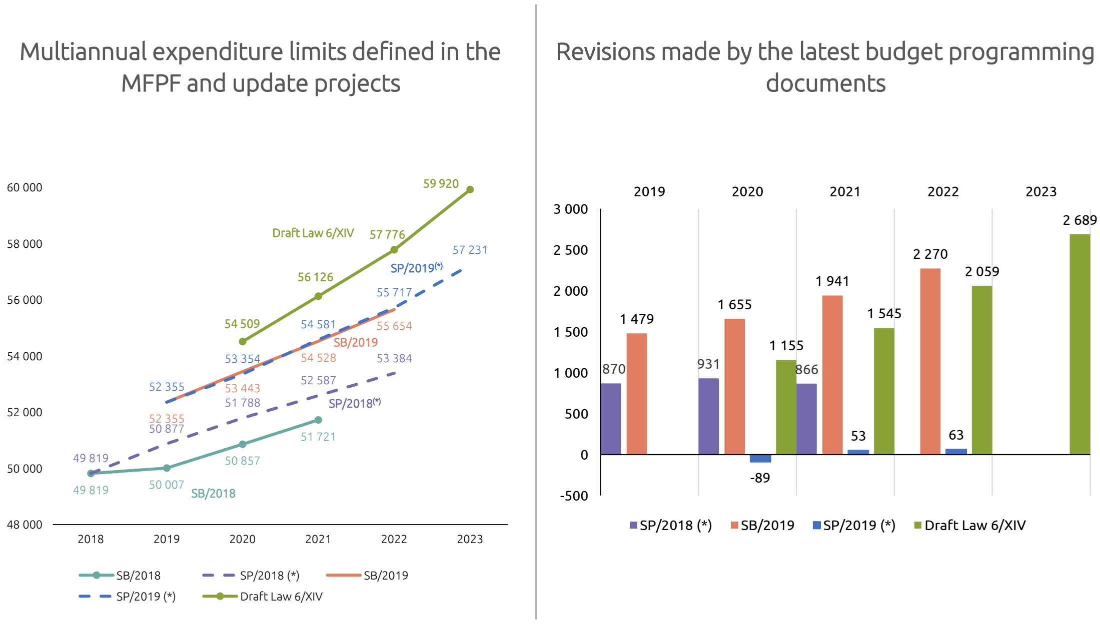
For the period 2021-2023, no information is available to assess the compatibility of the expenditure ceilings in the PDB with the budgetary objectives defined in national accounts. In fact, as in previous years, the requirements of Article 12d(6) of the LEO are still not complied with, which stipulates that, together with the PPFO, the general

[32] It essentially corresponds to expenditure financed by taxes. The QPPO does not cover expenditure financed by services' own revenue (e.g. fees). See in this respect the CFP Public Finance Glossary.

revenue and own revenue projections of the central government bodies and the social security sub-sector must be published for the following four years.

PPL no. 6/XIV advocates an upward revision of the limits on central government expenditure financed by taxes, namely for the year to which the budgetary proposal refers, compared with the limits advanced by the Stability Programme of April 2019. As can be seen, in the last two years, with the exception of this last fiscal programming document, the multi-annual expenditure ceilings for the four years of the QPPO moving horizon have always been revised upwards (left panel of Chart 17).

Chart 17 – Recent multiannual expenditure limits defined in the MFPF (M€)

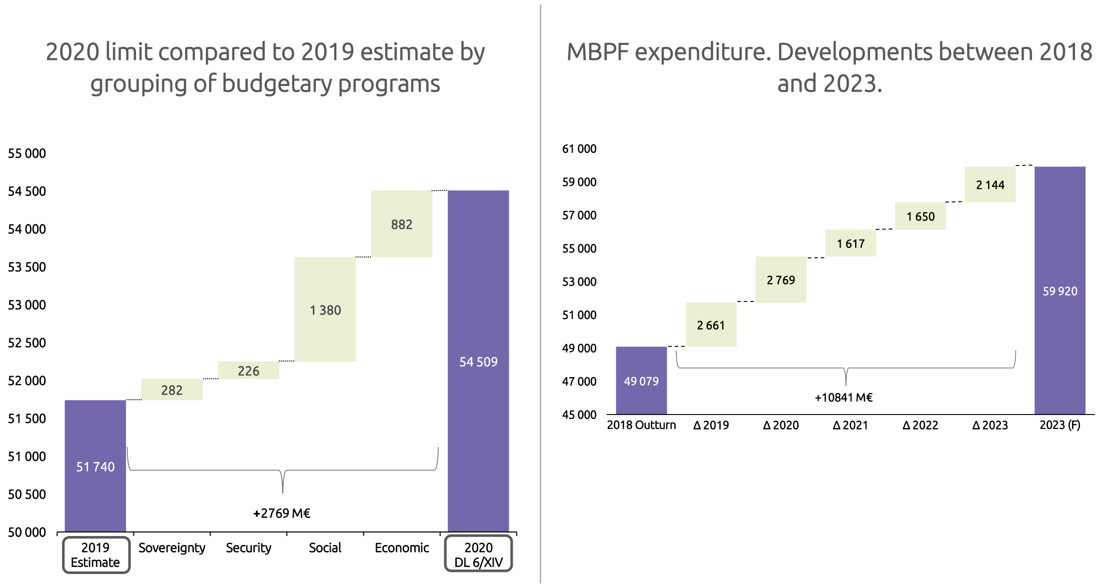


Source: Ministry of Finance. CFP calculations. | Notes: (*) Draft update of the QPPO, without force of law or vote in the Assembly of the Republic. The magnitude of the revisions is calculated from the immediately preceding budget programming document for each of the common years in the period considered (e.g. those of SP/2018 are calculated relative to the limits of SB/2018). For SB/2019, the starting value was considered and not the corrected value in November 2019. According to the MF, expenditure financed by tax revenues increased by 7 M € as a result of «a budgetary change in the centralized allocation to settlement of liabilities and investment of assets, which resulted in an increase in effective expenditure against financial assets.».

The limit for central government expenditure for 2020 set by PPL No. 6/XIV is higher than that advanced in PE/2019. The draft update of the QPPO included in PE/2019 also considered upper limits of expenditure for the years 2021 and 2022, although it revised the limit for 2020 downwards, in relation to those approved by the Law of the State Budget for 2009. However, the magnitude of the update to be carried out by PPL 6/XIV is much higher than the project presented in PE/2019 (right panel of Graph 17). In fact, for 2020, PPL no. 6/XIV revises upwards the expenditure limit by EUR 1066 million, when the QPPO project underlying PE/2019 even indicated a downward revision of the SC expenditure limit by EUR 89 million.

The new QPPO in PPL no. 6/XIV incorporates successive increases in expenditure, with the largest increases concentrated in 2019 and 2020. Taking into account data from the MF's estimate in public accounting by Budget Program, the effective central government expenditure financed by general revenue in 2019 will have been below the ceiling foreseen in the State Budget for 2009. From the data available for MF's 2019 estimate in public accounting, it is possible to obtain activity expenditure financed by general revenues (EUR 51 098 million), to which must be added around EUR 642 million of project expenditure[33] for a total of EUR 51 740 million (24.5% of MF's estimated 2019 GDP). Assuming these assumptions, the execution of the QPPO in 2019 will have been EUR 615 million below the ceiling set by the State Budget for 2019. This estimate would imply a total expenditure increase of EUR 10 841 million from 2019 to 2023 (right panel of Chart 18).

Chart 18 – Expenditure limits in the scope of the MBPF (M€)



Source: Ministry of Finance. Calculations CFP . | Notes : " Δ " refers to expected change over the previous year; the change in 2019 results from the estimated outturn calculated for that year according to information from the MF. (F) - Forecast. DL = Draft Law.

The expected growth in tax-financed SC expenditure for 2020 is mainly due to the strengthening in the Social and Economic areas. Based on the estimate for 2019, the increase in the limit for that expenditure should amount to 2769 M In the Social area, the growth is largely the result of the reinforcement of the Health Budget Programme by EUR 968 million, while in the Economic area it is mainly the increase in the Finance Programme (EUR 925 million) that contributes to the respective increase, as a result of the consideration in this programme of the provisional appropriation and centralised appropriations in the MF.[34] The increase in the Sovereignty grouping limit (EUR 282 million) reflects the growth of transfers from the State Budget to local and regional governments under the sub-sector's financing laws (Box 5). On the contrary, the decreases in the limits of the Government Debt Management Programme (- EUR 105

[33] From the report accompanying POE/2020, it is possible to obtain from the MF's estimate for 2019, by adding the figures in the detailed tables of the 18 budgetary programmes. a total of EUR 695 million for national funding of which EUR 642.2 million relate to general revenues, according to additional information provided by the MF.

[34] This basic effect results from the inclusion in the initial budget, within the limit set for the Finance Programme, of the provisional appropriation and centralised appropriations in the SF whose appropriations are eventually applied in return for strengthening other expenditure items in all budgetary programmes. In 2019, this figure was EUR 593.9 million, while for 2020 a total of EUR 769.6 million is foreseen. The increase foreseen for this Programme in 2020 was also due to the increase in transfers from the EU relating to Portugal's contribution and other specific appropriations of the MF.

M), reflecting the expectation of lower interest expenditure to be paid by the State, as well as of the Education Programme[35] (- EUR 205 M). With regard to the latter, it should be noted that the report of State Budget Proposal /2020 refers from the outset to the prospect of strengthening this expenditure during 2020 (p. 155), despite not including this expectation in the initial budget.

The experience with the implementation of the PDBF continues to show the ineffectiveness of this instrument for fiscal accountability in the medium and long term. The usefulness of the PDF in supporting the formulation and implementation of public policies in a multi-annual perspective largely depends on the respect of the established expenditure ceilings. However, and similarly to the previous QPPO, the PPL No. 6/XIV in which the new QPPO states that the limits for the years 2021 to 2023 are indicative, contrary to the LEO, in the articles currently in force. [36] Furthermore, experience has shown that the limits of the QPPO are only indicative and do not condition the preparation of annual budget proposals, since the ceilings contained in the QPPO projects included in the Stability Programmes are subsequently subject to legal amendment through the State Budget.

[35] Elementary and Secondary School Program and School Administration.

[36] Under the terms of paragraph 5 of Article 12-D of the LEO (article of Law No. 91/2001, of 20 August, applicable by virtue of paragraph 2 of Article 7 of Law No. 151/2015, of 11 September, in its current wording), the expenditure limits for each budget programme, for each grouping of programmes and for all programmes as a whole are binding, respectively, for the first, second and third and fourth economic years thereafter. It should be noted that Article 35 of Law No 151/2015 of 11 September, applicable only from April 2020 under the extension introduced by Law No 37/2018 of 7 August, considers the replacement of the QPPO by a "Multiannual Framework for Public Expenditure" (QPDP). In addition to a total expenditure ceiling and per organic-based mission, this new QPDP should also include revenue projections, by source of financing, in a manner compatible with the objectives of the stability programme. The expenditure limits become binding for the budget of the following economic year and indicative for the programming period coinciding with the rest of the legislature.

4. GOVERNMENT DEBT

4.1 State debt and financing requirements

The limit of direct indebtedness of the State foreseen for 2020 points to being compatible with the coverage of net borrowing. According to the calculations made by CFP, the overall direct indebtedness in 2020 is expected to be 0.7 billion below the 10 billion limit established in the draft law of the State Budget for 2020 (article 128.1). The sum of i) the central government budget deficit in public accounts (EUR 5.4 billion); ii) the consolidated net acquisition of financial assets (EUR 4.5 billion); and iii) the expectation that the central government budget appropriations will not be fully used (EUR 0.6 billion) contributes to this calculation.

The MF foresees a reduction in the government's gross borrowing requirements in 2020, mainly driven by lower medium and long-term debt amortisations. According to State Budget Proposal /2020 debt amortisations and cancellations are expected to be EUR 3.9 billion less than in 2019 (Table 18). This is justified by the decrease in medium- and long-term amortisations, amounting to EUR 6.7 billion , which more than offset the increase in short-term depreciation (EUR 2.7 billion). With regard to net borrowing, the MF expects these to decrease slightly, as the larger budget deficit of the State sub-sector is offset by a decrease in net acquisition of financial assets. Thus, the lower volume of amortisations and cancellations explains 95% of the decrease in gross borrowing requirements (-EUR 4.1 billion).

Table 14 – State borrowing requirements 2019-2020 (M€)

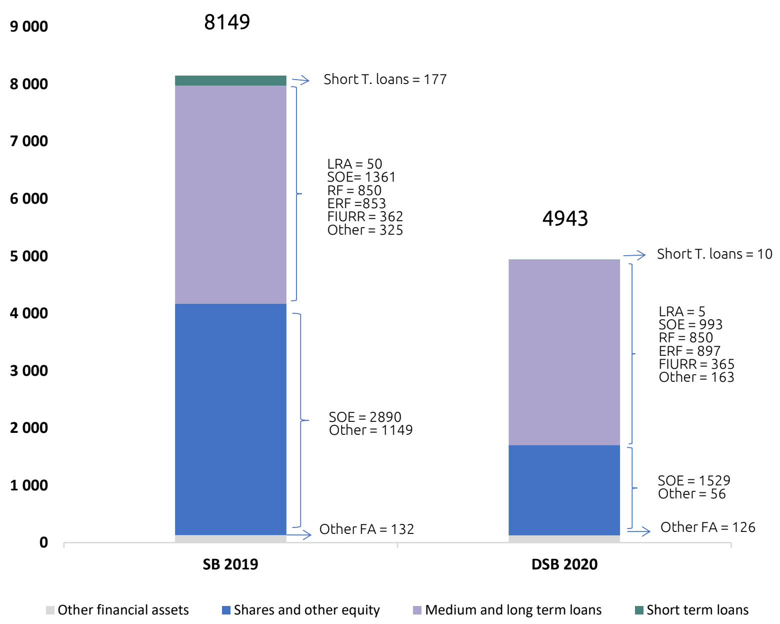
Borrowing requirements	2019		2020		Change 2020/19	
	Amount	Weight (%)	Amount	Weight (%)	Amount	%
1. Net borrowing requirements (a) + (b) - (c)	**9 803**	**19**	**9 577**	**21**	**-226**	**-2**
a) Budget deficit	4 194	8	5 874	13	1 680	40
b) Net Acquisition of Financial Assets (except privatizations)	5 609	11	3 703	8	-1 906	-34
c) Privatization revenues	0	0	0	0	0	0
2. Amortizations and cancellations [settled debt] (d) + (e) + (f) + (g) + (h)	**40 484**	**81**	**36 589**	**79**	**-3 895**	**-10**
d) SC + TC	3 914	8	4 103	9	189	5
e) Short-term debt in euros	21 697	43	24 398	53	2 701	12
f) Medium long term debt in euros	14 812	29	8 108	18	-6 704	-45
g) Non-euro currency debt	87	0	0	0	-87	-100
h) Swaps capital flows (Net)	-26	0	-20	0	6	-23
3. Gross borrowing requirements (1) + (2)	**50 287**	**100**	**46 166**	**100**	**-4 121**	**-8**

Source: MF. CFP calculations.

The advance payments made in 2019 justify the lower amount of amortisations of well-founded debt scheduled for 2020. The advance payment to the European Financial Stabilisation Fund (EFSF) in the amount of EUR 2 billion, as well as the repurchase of Treasury Bond (OT) securities existing in the market (over EUR 4 billion), reflect a strategy of smoothing the amortisation profile. This strategy avoids the concentration of higher volume payments in a given year, and implied, in 2019, an increase in medium and long-term debt amortisations. For 2020, the MF expects this amount to decrease as no loan payments are foreseen under the European Funds and the forecast presented in State Budget Proposal /2020 does not include possible OT repurchases.

In 2020, the forecast of lower net borrowing is mainly explained by the expected decrease in the acquisition of financial assets. MF expects lower expenditure on financial assets, totalling EUR 4.9 billion in 2020, compared to an estimated EUR 8.2 billion in 2019. Of particular note is the reduction in expenditure on shares and other equity, from EUR 4 billion to EUR 1.6 billion (Chart 19), namely through lower capital endowments to Metropolitano de Lisboa, Infraestruturas de Portugal, Comboios de Portugal and Non-Financial Public Companies. A decrease in expenditure on loans, both medium and long-term and short-term, is also expected. According to the information received by the CFP, it is expected that expenditure on the Resolution Funds (National and European), totalling EUR 1.7 billion (0.8 p.p. of GDP) will not be fully realised in 2020 (although it has been budgeted since the State Budget for 2006).

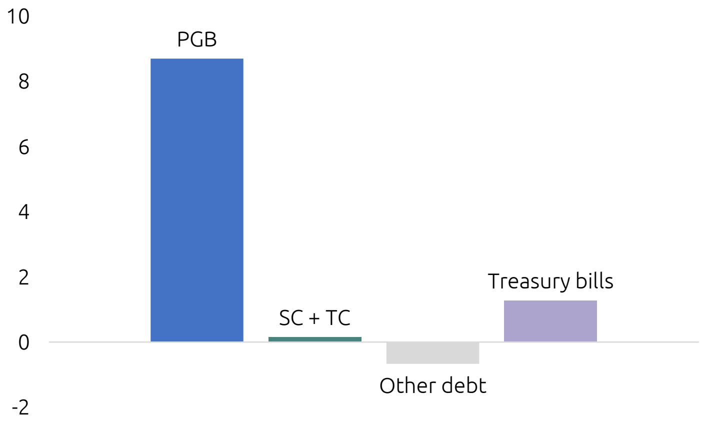
Chart 19 – Financial assets expenditure forecasts (M€)



Source: DGO and MF. CFP calculations.

To ensure the gross government borrowing requirements for 2020, the MF foresees that the debt issuance to be carried out will be almost entirely by Treasury Bonds (OT). State Budget Proposal /2020 forecast points to OT emissions (EUR 16.7 billion) being higher than amortisations (EUR 8 billion), resulting in net annual financing of EUR 8.7 billion (Chart 17). The balance of Treasury Bills (TB) is expected to increase, contributing EUR 1.3 billion to the State's financing. In the opposite direction, the financing to be obtained through CEDIC and CEDIM should decrease (- EUR 0.6 billion on the whole), thus contributing to the decrease of the Other debt. With a marginal impact on financing, the most noteworthy are the Certificates of Credit (CA) and Treasury Certificates (CT) for which a slightly positive balance (EUR 0.2 billion) and zero respectively is expected. In total, the net financing of the State is anticipated to be EUR 9.5 billion, cash basis.[37]

Chart 20 – Financing composition in 2020 (B€, cash basis)



Source: MF. CFP calculations. | Notes: Other debt includes CEDIC, CEDIM, other short-term debt, other medium and long term debt, other non-euro debt and swaps.

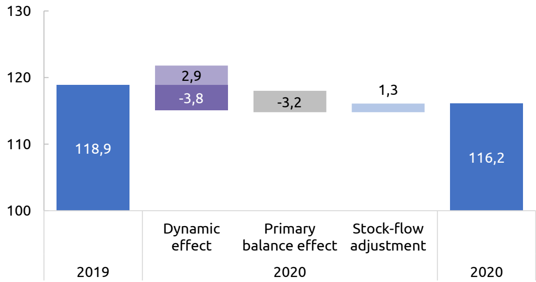
4.2 Debt dynamics

For 2020, the MF forecasts that the government debt ratio will reach 116.2% of GDP, continuing the path of reduction initiated in 2017. This result represents a reduction of 2.7 p.p. of GDP in relation to that estimated for 2019. This evolution is explained by the favourable contribution of the primary balance and, to a lesser extent, the dynamic effect, which reflects nominal GDP growth greater than the interest effect. Of the 2.7 p.p. reduction forecast for 2020, the MF expects the primary balance to explain 3.2 p.p. of GDP. The unfavourable impact of interest (2.9 p.p.) is expected to be more than offset by the effect of nominal GDP (-3.8 p.p.), resulting in a favourable dynamic effect that contributes 0.9 p.p. to the reduction of the ratio. The unfavourable deficit-debt adjustment should contribute with 1.3 p.p. to an increase in the debt ratio. This debt dynamics is similar to that seen in 2019, with only the most unfavourable deficit-debt adjustment standing out (0.6 p.p. in 2019 compared to 1.3 p.p. in 2020) (Chart 22).

[37] Equivalent to nominal value, excluding interest.

Chart 21 – Government debt developments (% of GDP and p.p.)

Contributes to 2020 change



Decomposition of 2019-2020 change

	2019	2020
Maastricht Debt (% of GDP)	118,9	116,2
Change (p.p. of GDP)	-3,3	-2,7
Primary balance effect	-3,0	-3,2
Dynamic effect	-0,9	-0,9
Interest effect	3,1	2,9
GDP effect	-4,0	-3,8
Other	0,6	1,3

Source: MF and CFP calculations.

According to the State Budget Proposal /2020, the weight of interest on GDP should continue to show a downward trajectory. Since 2016, interest as a percentage of GDP has declined from 4.9% in 2014 to 2.9% in 2020 in the MF forecast. Between 2016 and 2018 the annual change was around 0.4 p.p., while for 2019 a decrease of 0.3 p.p. and 0.2 p.p. is expected for 2020 (Table 23). This decrease is mainly explained by the price effect, although it is expected to be close to the stock effect in 2020. The favourable financing conditions, based on the maintenance of the ECB's asset purchase policy and the improved rating and risk perception of the Republic's debt, allowed nominal interest payable to decrease from EUR 8.5 billion in 2014 to EUR 6.9 billion in 2018, with a forecast decrease to EUR 6.5 and EUR 6.4 billion in 2019 and 2020 respectively.

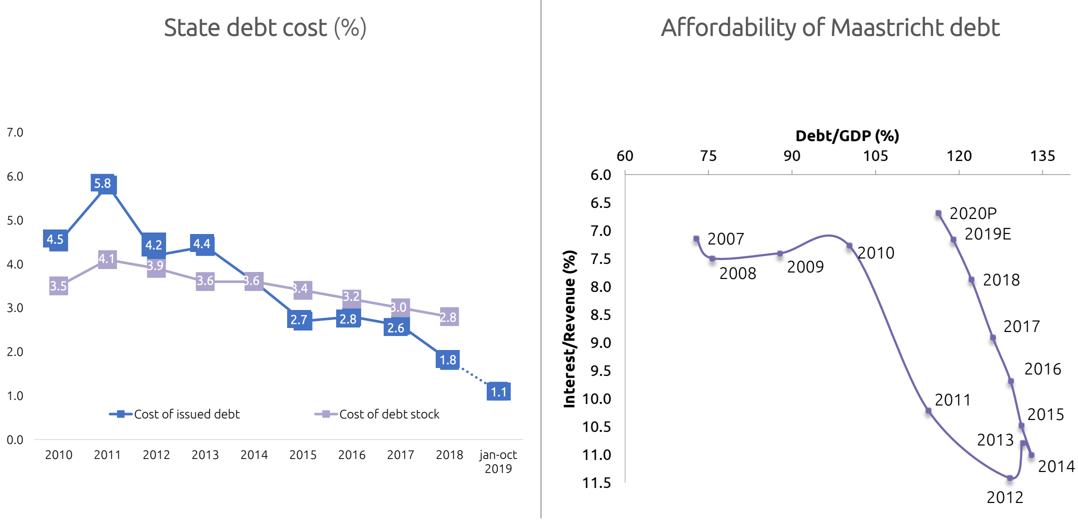
Table 15 –Contributions to changes in interest

	Public debt stock (% of GDP)	Public Debt average stock (% do GDP)	Interest (% of GDP)	Implicit interest rate (%)*	Interest weight change (p.p.)	Contributions to interest Δ		
						Stock effect	Price effect	Cross effect
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2015	131.2	132.1	4.6	3.5	-0.30	0.00	-0.29	0.00
2016	129.2	130.2	4.1	3.2	-0.43	-0.06	-0.38	0.01
2017	126.0	127.6	3.8	3.0	-0.37	-0.08	-0.30	0.01
2018	122.2	124.1	3.4	2.7	-0.39	-0.10	-0.30	0.01
2019	118.9	120.5	3.1	2.6	-0.29	-0.10	-0.20	0.01
2020	116.2	117.6	2.9	2.5	-0.17	-0.08	-0.10	0.00

Source: Ministry of Finance. CFP calculations. Formulas: Current year=t and previous year=t-1; PD = public debt; (1)=DP/PIB; (2)=[(1)t-(1)t-1)/2]; (3)=Interest/ GDP; (4)=(3) t /(2) t); (5)=[(4)t-1*((2)t-(2)t-1)]+[(2)t-1*((4)t-(4)t-1)]+[((2)t-(2)t-1)*((4)t-(4)t-1)]; (6)= (4)t-1*((2)t-(2)t-1); (7)=(2)t-1*((4)t-(4)t-1); (8)= ((2)t-(2)t-1)*((4)t-(4)t-1).
* Note: the implicit interest rate shown here differs from that in DSB/2020 to the extent it has been calculated through the average debt stock in the current year and the preceding year (column (2)), whereas the latter is based exclusively on the preceding year's debt stock. Nonetheless, despite these methodological differences, the figures shown are similar to those in DSB/2020 for 2019-20.

The cost of direct state debt for 2020, as in previous years, may continue to benefit from the path of reduction in the share of interest in GDP. The cost of direct state debt for 2020, as in previous years, may continue to benefit from the path of reduction in the share of interest in GDP. Through November, the average cost of debt issued by the state stood at 1.1%, compared to 1.8% in 2018. Since 2014, the average cost of BT, OT and MTN issued has been on a downward trajectory, contributing to a reduction in the total cost of the state's direct debt. Since the latter accounts for approximately 98% of the consolidated general government debt, this improvement in the State's financing costs translates into a favourable evolution of the government debt 's affordability (Chart 24, right panel). Thus, the decrease in nominal interest payable, together with the increase in general government revenue and the favourable dynamics of GDP growth relative to nominal debt, imply an improvement in Portugal's capacity to bear the full burden of debt in its budget.

Chart 22 – Debt cost and affordability



Source: IGCP and MF. CFP calculations.

The MF forecasts for 2020 fall within the forecast range of the international institutions. The MF anticipates a 2.7 p.p. of GDP decline in the debt ratio, while the institutions expect it to decline by between 2.2 and 2.8 p.p. of GDP. For both years, the EC and OECD forecasts anticipate higher debt ratios, while the IMF is the international institution that forecasts the most favourable evolution of debt as a percentage of GDP (Table 21, left panel). It should be noted, however, that the IMF forecasts are based on the debt series prior to the revision, which now includes the amounts associated with capitalised interest on postal savings certificates.

Table 16 –International forecasts and sustainability

Government debt evolution (% GDP)

Institution	2019	2020
MF	118.9	116.2
IMF	117.6	114.8
EC	119.5	117.1
OECD	119.3	117.1

Sustainability indicators for Portugal (p.p. of GDP)

	MF	EC
S1	1.2	4.3
S2	-0.8	0.7

Sources: Left panel - OECD – Economic Outlook No 106, November 2019; IMF - World Economic Outlook, October 2019; MF – DSB/2019, December 2019; EC – Autumn 2019 Economic Forecast, November 2019. Right panel - MF and EC – Country Report Portugal, February 2019.

The MF's assessment of medium-term sustainability risks differs substantially from that of the EC. According to the MF, indicator S1[38] stands at 1.2 p.p., representing a medium risk. This implies that, in order to reach a debt ratio of 60% of GDP in 2033, Portugal will have to make an accumulated additional effort of 1.2 p.p. of GDP in the structural primary balance during the first 5 years of adjustment against the invariant policy scenario (i.e. 0.24 p.p. per year). From the EC perspective, this cumulative adjustment would be higher, namely 4.3 p.p. of GDP (0.86 p.p. per year), representing a high risk (Table 20, right panel). The calculations differ mainly in the forecast for the structural primary balance (2.9% for MF in 2020 compared to 2.3% of GDP for the EC in the same year) and the effect of nominal GDP considered. The latter, with a significant impact on the medium-term projection of government debt, shows a drop until 2023 (from 3.8% in 2020 to 1.8% in 2023), with values subsequently estimated to be higher than 4% between 2024 and 2029, and decreasing between 2030 and 2033 to 3.1% in the MF forecast. This trajectory is more favourable than that forecast by the EC, in which GDP growth is between 2.6% and 2.8% in 2021 and 2023, and then falling to values around 3% by 2029.

The long-term risk indicator calculated by the MF points to a less unfavourable assessment than that advanced by the EC. The MF assesses the S2[39] indicator at -0.8 p.p., compared to 0.7 p.p. by the EC. This indicator reflects the adjustment of the structural primary balance needed to stabilise the debt ratio over an infinite horizon, and this adjustment is kept constant indefinitely. However, stabilising debt at that level does not comply with the Treaty on the Functioning of the European Union (TFEU). Although both figures point to low risks to long-term sustainability (below 2 p.p.), the EC considers that the risks to sustainability are medium, due to the high risk in the DSA (Debt Sustainability Analysis).

[38] S1: the country presents a low medium-term risk if the indicator is below 0 p.p.; medium risk if it is between 0 p.p. and 2.5 p.p. and high risk if it is above 2.5 p.p..

[39] S2: the country presents a low long-term risk if the indicator is below 2 p.p.; medium risk if it is between 2 p.p. and 6 p.p. and high risk of more than 6 p.p..

Box 5 – Comparison of the 2019 estimate in the State Budget Proposal /2020 with the forecast in the State Budget for 2019

State funding in 2019 was EUR 1.4 billion higher than forecast in the State Budget for 2019. This document anticipated an increase in net indebtedness of EUR 7.9 billion, while the State Budget Proposal /2020 presents an estimate of EUR 9.3 billion for the year under review. These data reveal, from the outset, a composition of financing different from that initially forecast (Table 15). Despite the EUR 2 billion amortisation of the EFSF and the lower funding through BT, there was an increase of EUR 4.2 billion in the balance of CEDIC, a higher funding through savings products and a more positive than expected evolution of the balance of OT.

Gross borrowing requirements for 2019 were higher than forecast in the State Budget for 2019, largely due to a higher volume of amortisations. These amounted to EUR 40.5 billion, according to the State Budget Proposal /2020, being EUR 4.3 billion higher than forecast in the State Budget for 2019 (Table 16). This is mainly justified by the carrying out of more medium- and long-term amortisations, highlighting the early payment to the EFSF and the early amortisations of OT with maturity in 2020 and 2021. Net borrowing also contributed to the increase in gross borrowing requirements, through a larger budget deficit and greater net acquisition of financial assets.

Table 17 –Financing needs forecasts for 2019 (M€)

Borrowing requirements	2019 (SB 2019)		2019 (DSB 2020)		Difference DSB/2020 vs. SB/2019	
	Amount	Weight (%)	Amount	Weight (%)	Amount	p.p.
1. Net borrowing requirements (a) + (b) - (c)	**8 638**	**19.3**	**9 803**	**19.5**	**1 165**	**0.2**
a) Budget deficit	3 638	8.1	4 194	8.3	556	0.2
b) Net Acquisition of Financial Assets (except privatizations)	5 000	11.2	5 609	11.2	609	0.0
c) Privatization revenues	0	0.0	0	0.0	0	0.0
2. Amortizations and cancellations [settled debt] (d) + (e) + (f) + (g) + (h)	**36 202**	**80.7**	**40 484**	**80.5**	**4 282**	**-0.2**
d) SC + TC	4 037	9.0	3 914	7.8	-123	-1.2
e) Short-term debt in euros	21 587	48.1	21 697	43.1	110	-5.0
f) Medium long term debt in euros	10 647	23.7	14 812	29.5	4 165	5.7
g) Non-euro currency debt	90	0.2	87	0.2	-3	0.0
h) Swaps capital flows (Net)	-159	-0.4	-26	-0.1	133	0.3
3. Gross borrowing requirements (1) + (2)	**44 840**	**100.0**	**50 287**	**100.0**	**5 447**	

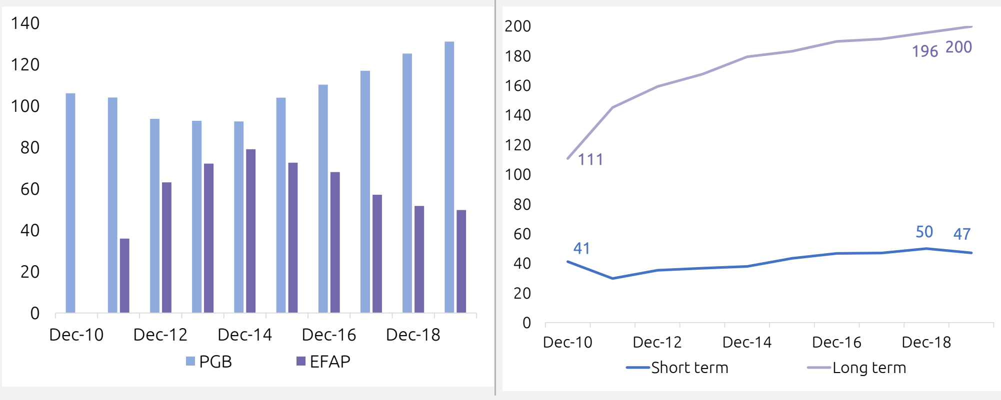
Source: MF. CFP calculations. | Notes: SC = Saving certificates and TC = Treasury Certificates.

The return to debt market financing made it possible to repay the EFAP loan in advance, while long-term debt increased. After losing access to the debt markets in 2011, Portugal returned to funding from investors in January 2013. Since then, the stock of medium and long-term debt has gradually increased, particularly the balance of OT, which rose from EUR 92.7 billion in December 2013 to EUR 130.9 billion in November 2019 (Chart 20). On the contrary, since February 2014 the EFAP loan, contracted in May 2011, has been decreasing, from a maximum of EUR 80.4 billion to EUR 49.6 billion in November 2019. Short-term debt, on the other hand, after registering a slight decrease at the beginning of the EFAP, increased again to values close to EUR 50 billion.

Chart 23 – Evolution of OT outstanding and short- and long-term debt (% of GDP and GDP p.p.)

PGB and EFAP loans stock

Short- and long-term debt



Source: IGCP and CFP calculations.

5. SUBSECTORS

The forecast of the General Government Accounts for the year to which the budget proposal refers and the estimate for the immediately preceding year consider the breakdown by institutional sub-sector: Central Government (AC), Regional and Local Government (ARL) and Social Security Funds (FSS). The flows between sub-sectors (e.g. transfers received and paid) are purged when accounting for the consolidated revenue and expenditure of PA, which explains that the sum of revenue and expenditure of the sub-sectors may be higher than the totals of all PA.

5.1 Compared view

The forecast of the general government MF surplus is based on the expected budget surpluses for the Social Security and Regional and Local Government Funds. The MF foresees that the budget surplus of these two sub-sectors will be EUR 654 million and EUR 2799 million respectively, whose size is sufficient to cancel the deficit of EUR 2920 million foreseen for Central Government, which is affected by the expenditure with transfers under the respective financing laws of the other sub-sectors (Table 18).[40] As a ratio to GDP, the ARL surplus will translate into 0.3% of GDP and that of Social Security Funds into 1.3% of GDP, with Central Administration showing a deficit of 1.3% of GDP[41] (Chart 24).

Table 18 –Balance by subsector 2017 – 2020 (M€)

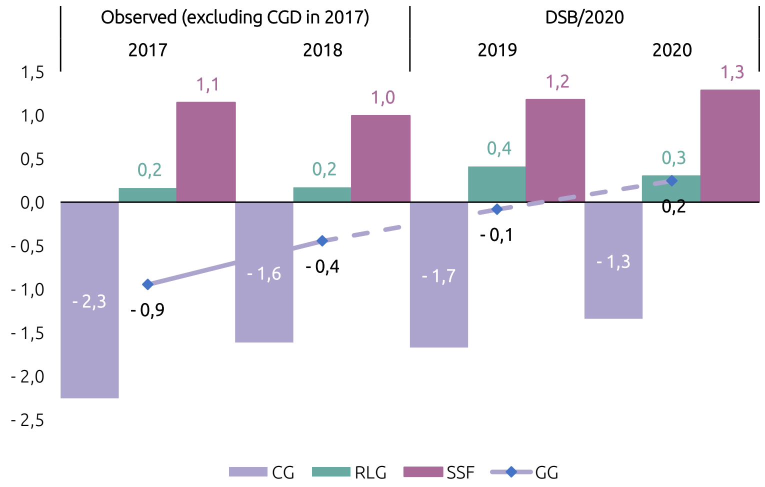
	Turnout		DSB/2020		
Subsector	2017*	2018	2019	2020	Change 2019/2020
CG	-4 414	-3 286	-3 519	-2 920	599
RG	10	-38	-17	-26	-9
LG	307	386	881	680	-201
RLG	317	347	864	654	-210
SSF	2 243	2 028	2 481	2 799	318
GG	-1 855	-911	-174	533	707

Sources: INE and Ministry of Finance. CFP calculations. | RLG corresponds to the "Local Government" ESA 2010 definition. * Excluding CGD recapitalization impact in 2017.

[40] This will represent, in the case of FSS, if it materialises, a new maximum for this sub-sector, considering the comparable data available since 2008.

[41] Basic Law of Social Security (LBSS; Law no. 4/2007, of 16 January), Regional Finance Law (LFR; Organic Law 2/2013, of 2 September) and Local Finance Law (LFL; Law no. 73/2013, of 3 September). By way of illustration, it should be noted that the transfers under the LFR and LFL foreseen by POE/2020 total about 1.6% of GDP foreseen for the year to which the budget proposal refers, while the transfers to comply with the LBSS amount to 3.2% of GDP.

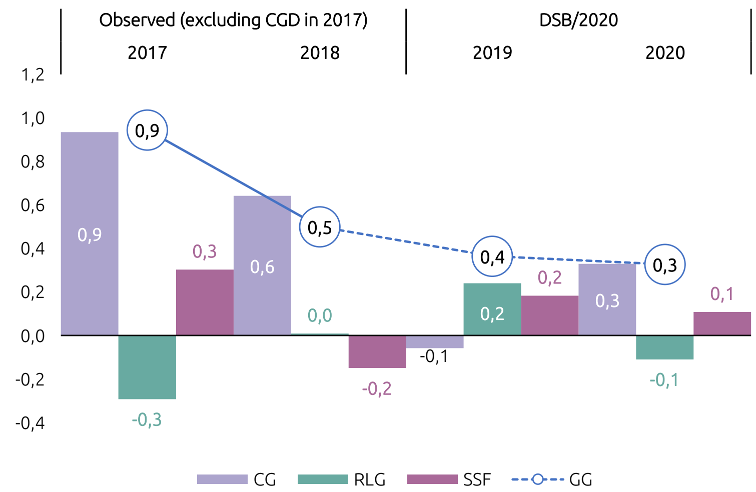
Chart 24 – Contributions from subsectors to the accumulated balance (% of GDP)



Sources: INE and Ministry of Finance. CFP calculations. | Note: The total presented for GG may not correspond to the exact sum of the values presented for each subsector due to rounding. *The 2017 balance excludes the effect of CGD's recapitalization.

Central Government is the sub-sector that justifies the largest contribution to improvement in the balance (0.3 p.p. of GDP). For the remaining sub-sectors, a positive contribution is forecast in the case of FSS, due to the increase in the respective surplus (0.1 p.p. of GDP), and a negative contribution from ARL, which reflects the decrease in the balance forecast for subnational governments (by 0.1 p.p. of GDP) - Chart 25.

Chart 25 – Contribution from subsectors to improve the balance (GDP p.p.)



Sources: INE and Ministry of Finance. CFP calculations. | Note: The total presented for GG may not correspond to the exact sum of the values presented for each subsector due to rounding. *The 2017 balance excludes the effect of CGD's recapitalization.

The forecast for 2020 keeps the revenue and expenditure structures specific to each of the PA subsectors practically unchanged. In SC the tax revenue represents about three quarters of the total revenue forecast by the MF for 2020 while in FSS the majority of the revenue (65%) comes from social contributions, which derives from the very nature of the sub-sector, the rest being due to "other current revenue" (31% of the total), of which about three quarters (74%) relate to the transfer of the State Budget to comply with the LBSS. As for the Autonomous Regions (RA), the proportion of own revenue (namely from taxes collected in the Regions) is prevalent (59% of total revenue)[42], while in LA tax revenue for 2020 will be only 36% and a significant part of the revenue will come from transfers from the State under the LFL (28% of total revenue). In the area of expenditure, social benefits account for the vast majority (86%) of the expected FSS burdens in 2020. In turn, in ARL capital expenditure has a higher weight than in the other sub-sectors (21% of total expenditure versus 7% in AC).[43] This pattern is identical to previous years,[44] with the exception of the increase in the importance of capital expenditure in ARL (+3.8 p.p., concomitant with the expected increase in capital revenue and the effect of a temporary measure on expenditure[45]), while expenditure of employees and intermediate consumption in this sub-sector lose weight (-1.9 p.p. and -1.3 p.p., respectively).

5.2 Regional and Local Government Subsector

The budgets of the Autonomous Regions, as well as those of the Municipalities and Parishes, being autonomous, are approved by the respective deliberative bodies. The estimate for 2019 and the forecast for 2020 analysed in this section correspond to the accounts foreseen by the MF under State Budget Proposal /2020.

For 2020, the MF foresees a deterioration of the general government budget balance of sub-national governments, as a result of a widening of the regional government deficit and a reduction of the local government surplus. For 2019, ARL is estimated to have achieved a positive balance of EUR 864 million, while for 2020 this surplus is projected to be reduced to EUR 654 million, with the largest contribution coming from LA (Table 18). This development is supported by a prospect of growth in ARL's total expenditure of 8.9% for 2020, above that expected for revenue (6.2%).

The largest contribution to the increase in regional and local expenditure in 2020 stems from the increase foreseen for "other capital expenditure", which incorporates the budgetary impact of the payment of compensation for legal proceedings underway by the Municipality of Lisbon. MF forecasts that this item will grow by EUR 413 million (250%) in 2020. This development is partly due to that measure, classified as temporary

[42] The transfers of the State Budget under the LFR correspond to 17%.

[43] For AR and AL capital expenditure represents 14% and 23%, respectively, of total planned expenditure.

[44] Changes above 1.0 p.p. occur only in other CA current revenue (+1.0 p.p., as a result, namely, of the increase relative to sales) and in ARL.

[45] Payment of judicial decisions by the Municipality of Lisbon. Although foreseen in the State Budget for 2009 (in EUR 170 M), this measure did not materialise and was carried over to 2020 in the amount of EUR 160 M.

and non-recurring, whose impact of EUR 160 million represents more than a quarter of the "other capital expenditure" forecast for 2020. Although this is a residual item, where the estimate may prove more difficult, the remaining 'other capital expenditure' is not, however, specified. Also contributing to the growth of expenditure is the increase of EUR 270 million foreseen for investment in the sub-sector in 2020 (13.9%; this rate being higher in the HR), followed by intermediate consumption (+ EUR 117 million).

More than half of ARL's expected revenue growth for 2020 comes from capital revenue, which follows the contribution of tax revenue. The expected increase in capital revenue (EUR 458 million) is anchored on the one hand, to the expectation of increasing European funds for co-financing ARL projects, in line with the MF's forecast for the sub-sector investment. On the other hand, there is an increase in other capital revenue, namely from capital transfers from the State Budget to ARL under the subnational financing laws (Box 6). To a lesser extent, there is an increase in tax revenue (EUR 234 million) whose evolution depends on the favourable outlook for regional (+5.6%) and local (+3.8%) tax revenue. The dynamics of the latter will be helped by the new participation in VAT by municipalities in 2020 (EUR 62 M), as well as the forecast growth prospects for the two main local taxes, IMI (2.6%) and IMT (1.7%), stronger than now estimated by MF for 2019.[46]

The forecast decrease in ARL's surplus carries risks, even if with a different sign. Around three quarters of the said reduction stems from the temporary measure concerning payments for unfavourable judicial decisions to the Municipality of Lisbon. The non-implementation of this measure constitutes an upward (positive) risk in relation to the budget balance of the local sub-sector, widening the margin against other deviations that may occur in the opposite direction. Downside risks include those that may arise from charges with entities of the regional and local corporate sector that have not been reclassified in the PA perimeter.[47] Other situations inherent to State Budget Proposal /2020 with possible budgetary impact are, in the case of AR: (i) the possibility of changing transfers for each AR, following the update of regional GDP by the end of 2020[48]; (ii) as in previous years, being excluded from the rule imposing the non-increase of net indebtedness of each AR the loans that may be contracted to finance projects co-financed by European funds, as well as for the purposes of the total debt rule. As for LA, incentives to implement projects co-financed by European funds are maintained, namely through more flexible rules on the application of the Law on Commitments and Delayed Payments (LCPA) to the sub-sector, it being assumed that the lack of available funds does not prevent applications for co-financed projects. [49] The LCPA also

[46] MF's estimate for 2019 is for a 0.3% growth in IMI, below the expected in POE/2019 (2.0%). In the case of IMT the same estimate considers a variation of 0.7%, less than one tenth of that forecast in POE/2019 (8.0%).

[47] For example, those resulting from the dissolution of these entities or from capital injections and/or provision of guarantees. In the case of the Azores, the report accompanying the budget proposal for 2020 mentions the process of restructuring the regional public enterprise sector starting in 2018. It should be recalled that, in that year, the granting of a guarantee and capital increase by SATA Air Açores increased the region's expenditure by EUR 76 million.

[48] See Article 60(4) of the operative part of POE/2020.

[49] See Article 78(4) of the operative part of POE/2020. The same article also allows, as it has been the case since 2018, that in determining the funds available, account can be taken of the amounts corresponding to the expected revenue from approved applications, relating to the respective

continues to exclude municipalities that, as of 31 December, 2019, comply with the legally established debt limits.[50] This relaxation of rules integrates the renewal of derogations to the total debt limit foreseen in the LFL: possibility of extending the use of the available debt margin for each municipality, up to 30%, for the purpose of borrowing for urban rehabilitation operations; exception of debts arising from the process of decentralisation of powers[51]; the possibility of the indebtedness limit being exceptionally exceeded due to the contracting of loans exclusively intended to finance investment in urban lease programmes and in housing solutions promoted under the "1st Right" Housing Access Support Programme.[52]

Box 6 – Transfers from State Budget 2020 under the subnational finance laws

According to public accounting data in the State Budget Proposal /2020 report, transfers under the Local Finance Act (LFL) increase by EUR 265 million (9.5%) to EUR 3039 million, while transfers under the Regional Finance Act (LFR) are expected to decrease from EUR 10 million (-2.0%) to EUR 522 million.

In the case of the Autonomous Regions, of the total of EUR 522 million planned for next year, EUR 294 million concerns the Azores and EUR 228 million Madeira. The sums to be transferred to the AR are part of the solidarity breakdown (cf. art. 48 of the LFR), totalling EUR 372 million, and the Cohesion Fund - EUR 150 million (cf. art. 49 of the LFR). The decrease in transfers to the AR is explained by the lower allocation of funds to the RA, specifically those resulting from the Cohesion Fund (- EUR 25 million). The ratios determining the Cohesion Fund allocation amounts as provided for in Article 49(3) of the LFR reflected in the case of the Autonomous Region an increase in the value of the ratio between regional GDP per capita and national GDP per capita in the reference year (t-4, i.e. 2016) and therefore led to a decrease in the allocation coefficient from 40% (State Budget for 2009) to 25% in the State Budget for 2020.

commitments to be made during the year. It should be noted that the LFL, as amended by LOE/2016, now excludes from the total debt limit the loans intended for national financing of projects co-financed by European funds.

[50] See Article 78(5) and (6) of the operative part of POE/2020. The assessment of exclusion is the responsibility of each local authority, taking effect after the approval of the reporting documents and from the date of communication to the Directorate-General for Local Authorities (DGAL) of the respective demonstration. Local authorities that benefited from this exclusion in 2019 shall retain it, except in situations of non-compliance with those limits.

[51] According to the POE/2020 report, around EUR 300 M are foreseen in the scope of the decentralization process in progress (Law no. 50/2018, of 16 August, Framework Law), concerning the transfer of competences from CA to be ensured by LA in the areas of education, health and culture. These transfers should be made through the Decentralisation Fund (FFD), provided for in the LFL and managed by DGAL. According to the DGAL balance sheet of 19 December 2019, 234 of the 278 municipalities in mainland Portugal took over responsibilities in at least one of the 15 areas planned (of which 50 in all, including the situations in which they mentioned not being applicable), while 44 municipalities did not intend to take over any of them. The articulation also includes a map with the transfer of competencies from the municipalities to the parishes (provided for in the Framework Law and implemented by Decree-Law no. 57/2019, of 30 April) in a total of EUR 20.5 M, financed by deduction from the FEF and participation in the IRS of the respective municipalities.

[52] See Article 92(4) of the operative part of POE/2019.

						(M€)
	2019 Estimate			DSB/2020		
	Azores AR	Madeira AR	RG TOTAL	Azores AR	Madeira AR	RG TOTAL
Solidarity Distribution	184	177	361	190	183	372
Cohesion Fund	101	71	172	104	46	150
... in % of Solidarity Distribution	*55%*	*40%*	*n.a.*	*55%*	*25%*	*n.a.*
SB transfers to RG under RFA	286	248	533	294	229	522

Notes:

n. a.: not applicable.

Source: DSB/2020 report and draft law proposal. Own calculations.

In calculating the participation of local authorities in State taxes (PIE) in State Budget Proposal /2020, account was taken of the wording given to LFL by Law 51/2018 of 16 August. The revenue taken into account for the purposes of calculating the participation of local authorities in State taxes corresponds to the simple arithmetic average of the State's revenue from personal income tax, corporate income tax and VAT, for the penultimate year to which the State Budget Law refers (in the case of 2018), to which certain percentages are applied for the calculation of the various funds, to which the participation of the municipalities in the personal income tax and, in 2020, the participation of the municipalities in VAT are added. According to the data made available by the MF, the rate of change in revenue considered for the calculation of the participation of local authorities in State taxes in 2020 is 5.5%, corresponding to the change calculated in 2018.

In 2020, as in 2019, the calculation of transfers to municipalities and parishes includes an additional amount with a view to convergence, by 2021, between the amounts to be transferred and those resulting from the application of the distribution criteria of the law. This amount corresponds to 25% of the difference between what would result from the direct application of the LFL and that transferred in 2018. According to the LFL, the surplus resulting from the necessary compensations after the application of the distribution criteria to ensure the maximum annual variations foreseen in the LFL for each local authority, (-2.5% to +5%, municipalities; -5% to 5%, parishes) is redistributed and does not affect these same variations. In this way, the 5% ceiling can be exceeded, which occurs in 2020, as in the previous year. In this follow-up, transfers to municipalities and parishes under the LFL (as shown in the table below) increase, respectively, to EUR 2815 M (9,7%) or EUR 224 M (7,5%). The greatest growth is registered in the component of capital transfers (FEF, 45%).

				(M€)
	SB/2019	DSB/2020	Change 2019/2020	
			Absolute	%
Financial Equilibrium Fund (a)	1 990	2 152	162	8,1%
of which FEF current transfer	*1 683*	*1 707*	*24*	*1,4%*
of which FEF capital transfer	*306*	*444*	*138*	*45,0%*
Social Municipal Fund	163	163	0	0,0%
Municipal share of PIT (b)	413	438	25	6,1%
Municipal share of VAT		62	62	n.a.
Subtotal Transfers to Municipalities	2 566	2 815	249	9,7%
Parishes Financing Fund (PFF) (c)	208	224	16	7,5%
Transfers under the Local Finance Act	2 774	3 039	265	9,6%

Notes:

n. a.: not applicable.

(a) Includes the additional amount provided for in paragraph 3 of article 35 of the LFA. According to paragraph 4 of the same article, this transfer takes on the nature of a capital transfer in the years in which it occurs.

(b) The value presented includes only the municipalities of the Mainland.

(c) *Fundo de Financiamento das Freguesias (FFF)* in Portuguese. Includes the additional amount provided for in paragraph 8 of article 38 of the LFA.

Source: Maps XIX (municipalities) and XX (parishes) attached to SB/2019 and DSB/2020. Own calculations.

It should be noted that, according to the new wording given to the LFL, the variables and indicators for calculating transfers to local authorities are now part of the report accompanying the State Budget Proposal. However, this is again not the case in State Budget Proposal /2020, as it was for 2019.

5.3 Social Security Funds Subsector

The State Budget Proposal /2020 foresees the maintenance of a budget surplus trajectory for the Social Security Subsector, anticipating a surplus of 2799 M for 2020, EUR 318 M more than the estimate for 2019. This forecast reflects a Welfare System budget surplus of EUR 1567 million for the sixth consecutive year. The higher contribution given by the increase in revenue (EUR 1 499 million), compared to the expected increase in expenditure (EUR 1181 million), justifies the positive change in the budget balance.

Table 19 – Social Security Funds Subsector Account

	2019^E	2020^P	ΔM€	%
Total Revenue	**28 654**	**30 153**	**1 499**	**5,2%**
Current Revenue	**28 618**	**30 112**	**1 494**	**5,2%**
Indirect taxes	1 096	1 128	32	2,9%
Social Contributions	18 487	19 652	1 165	6,3%
Actual social contributions	18 451	19 613	1 161	6,3%
Sales and other current revenue	9 035	9 332	297	3,3%
of which:				
State Budget transfers to comply with SSFL	6 987	6 927	-61	-0,9%
State Budget transfers related to social VAT	854	883	29	3,4%
State Budget transfers related to Aditional Property Tax	50	283	233	465,4%
State Budget transfers related to CIT	199	377	178	89,7%
Capital transfers received	**36**	**41**	**5**	**15,2%**
Total Expenditure	**26 173**	**27 354**	**1 181**	**4,5%**
Current Expenditure	**26 105**	**27 250**	**1 145**	**4,4%**
Compensation of employees	275	307	32	11,5%
Intermediate Consumption	82	88	6	7,0%
Social Benefits	22 530	23 524	993	4,4%
Other than in kind	22 407	23 394	987	4,4%
Pensions	17 423	18 187	765	4,4%
Unemployment benefits and employment support	1 227	1 198	-30	-2,4%
Illness benefits	611	642	31	5,0%
Parenthood benefits	596	664	69	11,5%
Social Integration Income	349	356	7	2,0%
Elderly pension Supplement	216	235	19	8,8%
Family benefit	793	830	37	4,6%
Social benefits for inclusion	338	402	64	18,9%
Other social benefits	854	881	26	3,1%
in kind	123	129	6	4,9%
Subsidies and other current expenditures	3 217	3 331	114	3,5%
Other capital expenditure	3 075	3 208	133	4,3%
Capital Expenditure	**68**	**104**	**37**	**54,1%**
Social Security Balance	**2 481**	**2 799**	**318**	**-**

Source: Ministry of Finance. CFP calculations. | Notes: E – estimate; P – Forecast and SSFL – Social Security Framework Law.

The behaviour foreseen for Social Security revenue continues to be based on expectations of favourable developments in the macroeconomic environment, with particular emphasis on the labour market. In this area, State Budget Proposal /2020 highlights the expected growth in wages (which includes the increase in the minimum monthly wage), the positive evolution of the labour market resulting from the continued decrease in the unemployment rate[53] and the slight growth in employment. It also refers to the contribution made by unspecified measures of effectiveness in the declaration and collection of contributions and debts, as well as the modernisation of the social security system. By November 2019, coercive collection amounted to 41.9% of the expected growth in contribution revenues for 2019.[54] The CFP does not yet have information on coercive collection for December, but with the inclusion of this data it is likely that coercive collection will approach 50% of the growth expected for 2019. For 2020, and although revenue growth in previous years may have reflected the implementation of this type of measures, their continued sustained materialisation over time raises some doubts as to their impact, as there is less and less room for efficiency gains in this area and may thus constitute a risk to budget execution.

As a result, total revenue is expected to grow by 5.2% (EUR 1499 M), mainly reflecting the evolution of social contribution revenues (6.3%; EUR 1165 M). Not expecting a significant additional contribution from the fight against fraud and evasion, this forecast constitutes a potential risk factor for budget execution, since the revenue from social contributions is expected to grow above its economic bases, i.e. above the nominal growth of wages forecast for 2020 is 3.8%, which already incorporates the expected increase in employment of 0.6%.

The State Budget Proposal /2020 foresees a decrease of -0.9% (EUR -64 M) in the transfers from the State Budget to comply with the Basic Law on Social Security (LBSS), reserved for the financing of the Social Protection and Citizenship System.[55] Finally, revenues of EUR 660 million are also expected for the Social Security Financial Stabilisation Fund (FEFSS), broken down into EUR 283 million and EUR 377 million, relating to the IMI Additional and the consigned revenue from IRC, respectively. It should be noted that of the EUR 233 million mentioned above, around EUR 165 million [56] relate to 2017 and 2018. Thus, discounting this effect, the value of the additional to the IMI foreseen for 2020 is around EUR 118 million, a significant increase compared to the values foreseen (EUR 50 million) in previous State Budgets. This forecast is in line with the values collected in previous years, thus mitigating the difference between the value transferred to the FEFSS based on the forecast and the value calculated from the AIMI.

[53] The MF expects the unemployment rate to fall from 6.4% in 2019 to 6.1% in 2020.

[54] Growth of EUR 1439 million based on the provisional figures published by INE for 2018 and the value estimated by the MF for 2019 for "Social Contributions".

[55] According to the CFP Glossary: The Social Protection System of Citizenship is part of the Social Security System which aims to guarantee the right to vital minimums for citizens in situations of economic deprivation, to prevent and eradicate situations of poverty and social exclusion and to compensate citizens for increased family burdens, as well as in the field of disability and dependency. It includes three subsystems, the Social Action Subsystem, the Solidarity Subsystem and the Family Protection Subsystem, and is financed by transfers from the State Budget and by tax revenues.

[56] It includes the charges of collection by the Tax and Customs Authority, to be discounted when transferred to the FEFSS.

According to the State Budget Proposal /2020, expenditure in the Social Security sub-sector is expected to increase by 4.5% (EUR 1181 M), mostly justified by the evolution of social benefits. The performance of social benefits is mainly explained by the 4.4% increase in pension expenditure (EUR 765 million). This worsening reflects the positive change in the price effect underlying the update of social benefits, as well as the impact of measures, of which the most noteworthy:

i. the updating[57] the updating of pensions of the general social security and convergent social protection regime - updates of 0.7% for pensions up to 2 IAS, 0.24% for pensions between 2 and 6 times the value of IAS, not foreseeing an update for pensions above 6 times the value of IAS. The impact of the Social Security System pension update should be EUR 91.1 million;

ii. the 0.7% update of the Social Support Index (IAS) in accordance with Law 53-B/2006 of 29 September, whose expected impact is EUR 12.3 M;

iii. the materialization of the support directed to the main informal caregiver,[58] aiming at the prevention of situations of risk of poverty and social exclusion informal caregiver status, with an expected impact of EUR 30 M; and

iv. in the context of parenthood provision[59], the strengthening of protection by increasing the daily amount of specific risk allowances and for childcare from 65% to 100% of reference pay, as well as by extending the period of compulsory enjoyment of exclusive parental leave for the father from 15 days to 20 working days, paid at 100%; At the same time, the optional licence will be reduced from 10 to 5 working days. The extension of leave to care for children with disabilities or chronic illness to cases of cancer (paid at 65%). The measures to strengthen the protection of parenthood have an expected impact of EUR 30 million.

In addition to the factors mentioned above, the impacts of other measures adopted in previous years will continue to have an impact on the evolution of social benefit expenditure. In the field of pensions, the system of very long contributory careers[60] and early retirement through flexibility is identified (EUR 65 M).[61] As regards the remaining

[57] Update carried out in accordance with Articles 4 to 7 of Law 53-B/2006, of 29 December, as well as the amendments introduced by Law 42/2016, of 28 December. And by the updating of the pensions of the convergent social protection regime established in article 6 of Law no. 52/2007, of 31 August and amended by Law no. 11/2008, of 20 February. These updates are based on the evolution of the GDP growth rate and the CPI without housing.

[58] Law no. 100/2019, of 6 September, approved the Statute of Informal Care, amending the Code of Social Security Contribution Schemes and Law no. 13/2003. This approval provides for the regulation of a set of pilot projects, including the granting of a support allowance to the main informal caregiver, subject to the condition of resources, increased in the case of access to Voluntary Social Security.

[59] Law No. 90/2019 of 4 September has reinforced the protection in parenthood.

[60] It came into force in October 2017, and its scope was extended in October 2018 to cover beneficiaries aged 60 or over and with at least 46 years of discount and who began their contribution career at the age of 16 or less.

[61] The Early Retirement Flexibility Scheme for beneficiaries with at least 40 years of contributory career at 60 years of age. Created by Decree-Law no. 119/2018, of 27 December, came into force in January 2019, and the first phase began, covering beneficiaries aged 63 or over whose pensions started from that date; the second phase came into force in October 2019 and covered beneficiaries aged 60 or over whose pensions started from that date.

social benefits, the objective of reducing levels of income poverty and deprivation of the most vulnerable households remains, through the social benefit for inclusion (EUR 64 M),[62]the child benefit (increase of EUR 37 million, of which EUR 19 million refers to the maintenance of measures from previous years[63]) and the solidarity supplement for the elderly (EUR 19 million).[64]

Finally, the expected increase in expenditure on subsidies and other current expenditure (EUR 114 million) should be highlighted. The expected evolution of these two expenditure components contrasts with the anticipated reduction of 2.4% (EUR 30 million) in unemployment benefits and employment support, which reflects the continued improvement in the level of employment and the decrease in the unemployment rate.

[62] Decree-Law 136/2019, of 6 September, proceeded to the third phase of implementation of the social benefit for inclusion, defining the access to the measure for children and young people with disabilities.

[63] In 2019, the Family Benefits was reinforced for: (i) children up to the age of 6 years in the first three steps; (ii) extension of the fourth step up to the age of 6 years; and (iii) extension of the increment for second or more children up to the age of 36 months.

[64] Article 58(2) of the Draft Legislation of the State Budget 2020 states that "during the year 2020, the Government shall assess the rules for allocation of the Solidarity Supplement for the Elderly, namely by extending the elimination of the impact of the income of the children considered in the assessment of the applicant's resources to the second step".

6. ATTACHMENTS

Table 20 – From the 2019 estimate to the 2020 budget forecast - details of policy measures with budgetary impact in 2020 (EUR M)

	2019			2020				
	Estimate	*One-off*	Adjusted Estimate	*Carry-over (measures from previous years)*	One-off	New Policy Measures	Macroeconomic scenario and other effects	MF Forecast
	(1)	(2)	(3)	(4)	(6)	(7)	(8)	(9)
Revenue	91 213	51	91 162	246	145	-10	3 772	95 315
Tax and Contribution Revenue	78 165	0	78 165	258	0	-10	2 654	81 067
Indirect taxes	31 963	0	31 963	1	0	37	1 091	33 063
Stamp duty				18				
VAT reduction				-17				
Tobacco tax refresh and structure change						9		
measures to incentivise decarbonisation						29		
Direct taxes	20 946	0	20 946	58	0	-69	682	21 645
Extension of the limit for the tax benefit for								
the reinvestment of retained earnings				-20				
Extension reduced CIT tax limit to SME ´s in inland						-24		
Review of the coefficient of local accomodation in						10		
Autonomous Taxes						-15		
Public administration carreers gradual unfreeze				64				
additional revisions to careers				14				
wage updates						8		
Young PIT						-25		
Children PIT deduction increase for families with						-24		
Social contributions	25 256	0	25 256	199	0	22	882	26 359
Public administration carreers gradual unfreeze				163				
additional revisions to careers				36				
wage updates						22		
Non Tax and non contributory Revenue	13 048	51	12 997	-12	145	0	1 118	14 247
School fees				-12				
BPP Guarantee Recovery		51			145			
Expenditure	91 387	1 149	90 238	800	1 050	99	2 596	94 782
Primary Expenditure	84 861	1 149	83 712	800	1 050	99	2 757	88 417
Intermediate Consumption	11 271	0	11 271	0	0	-100	424	11 595
Spending Review						-100		
Compensation of employees	22 701	0	22 701	645	0	70	112	23 528
Public administration carreers gradual unfreeze				527				
additional revisions to careers				118				
wage updates						70		
Social Benefits	38 749	0	38 749	155	0	68	981	39 952
Programme to support the tariff reduction				26				
School Books Reutilization				-39				
New flexible early pensions regime and access to the				65				
Social benefits for inclusion				64				
Family allowance				19				
Social supplement for Elderly				19				
Extension of the changes in Family benefit; Social						30		
Parenthood benefits						30		
Unformal caregiver status						8		
Subsidies	872	0	872	0	0	15	31	918
PROTransP Programme						15		
GFCF	4 168	0	4 168	0	0	136	618	4 922
1º Direito Programme						136		
Other expenditure	7 099	1 149	5 950	0	1 050	-90	590	7 501
Spending Review						-90		
Recapitalization of Novo Banco		1 149			600			
Deferred Tax Assets					130			
IP indemenization					80			
Return FGCAM contributions to BdP					80			
Judicial Court Decision- Lisbon Municipality					160			
Interests	6 526	0	6 526	0	0	0	-161	6 365
Budget Balance	-174	-1 098	924	-553	-905	-109	1 176	533

Source: Ministry of Finance. CFP calculations. | Note: Macroeconomic scenario incorporates the impacts of macroeconomic developments on tax and contributory revenue and expenditure, as well as the remaining effects. The values in column 8 correspond to the sum of columns 4 and 8 in Table 1. For the individualization of one-off measures see Box 2. The totals may not necessarily correspond to the sum of the instalments due to rounding.

Table 21 – General Government Account (EUR M)

	2015	2016	2017	2018	POE/2020 2019	POE/2020 2020
Total revenue	78 712	80 007	83 105	87 695	91 213	95 315
Current revenue	**77 327**	**78 970**	**82 387**	**86 867**	**90 473**	**94 287**
Tax revenue	45 448	46 269	48 568	51 637	52 909	54 709
Indirect taxes	26 173	27 472	29 155	30 956	31 963	33 063
Direct taxes	19 274	18 797	19 414	20 681	20 946	21 645
Social contributions	20 784	21 610	22 693	23 835	25 256	26 359
Of which: effective	16 182	16 914	17 955	19 128	20 570	21 736
Sales and other current income	11 095	11 091	11 126	11 395	12 308	13 219
Capital revenues	**1 386**	**1 037**	**718**	**829**	**739**	**1 028**
Total Expenditure	86 707	83 535	88 904	88 606	91 387	94 782
Primary expenditure	**78 468**	**75 796**	**81 505**	**81 708**	**84 861**	**88 417**
Primary current expenditure	70 757	72 119	72 973	75 399	78 593	81 282
Intermediate consumption	10 005	10 348	10 572	11 067	11 271	11 595
Personnel costs	20 316	20 895	21 386	21 835	22 701	23 528
Social benefits	35 033	35 483	36 013	37 099	38 749	39 952
Social benefits other than in kind	31 638	32 058	32 468	33 472	34 730	35 803
Social benefits in kind	3 396	3 424	3 544	3 626	4 020	4 149
Subsidies	1 037	926	823	750	872	918
Other current expenses	4 366	4 467	4 179	4 648	5 000	5 288
Capital expenditure	**7 711**	**3 676**	**8 533**	**6 309**	**6 267**	**7 134**
GFCF	4 045	2 875	3 496	3 795	4 168	4 922
Other capital expenditure	3 665	801	5 036	2 514	2 100	2 212
Interest	**8 239**	**7 739**	**7 399**	**6 898**	**6 526**	**6 365**
Overall balance	-7 995	-3 527	-5 799	-911	-174	533
Primary balance	**244**	**4 211**	**1 600**	**5 987**	**6 352**	**6 898**
Tax burden	61 630	63 184	66 524	70 764	73 480	76 445
Current Expenditure	**78 997**	**79 858**	**80 372**	**82 297**	**85 119**	**87 647**
Government Debt	**235 746**	**245 158**	**246 966**	**249 143**	**250 589**	**252 980**
Nominal GDP	**179 713**	**186 490**	**195 947**	**203 896**	**210 774**	**217 803**

Source: INE and Ministry of Finance.

Table 22 – Adjusted General Government Account (EUR M)

	2015	2016	2017	2018	DSB/2020	
					2019	2020
Total revenue	78 582	79 262	83 033	87 529	91 162	95 170
Current revenue	**77 197**	**78 527**	**82 387**	**86 867**	**90 473**	**94 287**
Tax revenue	45 318	45 873	48 568	51 637	52 909	54 709
Indirect taxes	26 043	27 369	29 155	30 956	31 963	33 063
Direct taxes	19 274	18 505	19 414	20 681	20 946	21 645
Social contributions	20 784	21 563	22 693	23 835	25 256	26 359
of which: actual soc. contr. rec	16 182	16 867	17 955	19 128	20 570	21 736
Sales & other current rev.	11 095	11 091	11 126	11 395	12 308	13 219
Capital transfers received	**1 386**	**735**	**645**	**662**	**688**	**883**
Total expenditure	84 244	83 569	84 618	87 489	90 238	93 732
Primary expenditure	**76 005**	**75 830**	**77 219**	**80 591**	**83 712**	**87 367**
Current primary expend.	70 757	72 042	72 973	75 369	78 593	81 282
Intermediate consumption	10 005	10 348	10 572	11 067	11 271	11 595
Compensation of employees	20 316	20 895	21 386	21 835	22 701	23 528
Social transfers	35 033	35 483	36 013	37 099	38 749	39 952
other than in kind	31 638	32 058	32 468	33 472	34 730	35 803
in kind via market producers	3 396	3 424	3 544	3 626	4 020	4 149
Subsidies	1 037	926	823	750	872	918
Other current expenditure	4 366	4 390	4 179	4 617	5 000	5 288
Capital expenditure	**5 248**	**3 788**	**4 246**	**5 222**	**5 118**	**6 084**
GFCF	3 866	2 987	3 537	3 795	4 168	4 922
Other	1 381	801	709	1 428	951	1 162
Interest paid	**8 239**	**7 739**	**7 399**	**6 898**	**6 526**	**6 365**
General government balance	-5 662	-4 307	-1 586	40	924	1 438
Primary balance	**2 577**	**3 432**	**5 813**	**6 937**	**7 450**	**7 803**
Tax burden	61 500	62 740	66 524	70 764	73 480	76 445
Current expenditure	**78 997**	**79 781**	**80 372**	**82 267**	**85 119**	**87 647**
Public debt	**235 746**	**245 158**	**246 966**	**249 143**	**250 589**	**252 980**
Nominal GDP	**179 713**	**186 490**	**195 947**	**203 896**	**210 774**	**217 803**

Source: INE and MF. | Note: the detail of the adjustments made can be found in Tables 8 and 20.

Table 23 – General Government Account (% of GDP)

	2015	2016	2017	2018	POE/2020 2019	POE/2020 2020
Total revenue	43,8	42,9	42,4	43,0	43,3	43,8
Current revenue	**43,0**	**42,3**	**42,0**	**42,6**	**42,9**	**43,3**
Tax revenue	25,3	24,8	24,8	25,3	25,1	25,1
Indirect taxes	14,6	14,7	14,9	15,2	15,2	15,2
Direct taxes	10,7	10,1	9,9	10,1	9,9	9,9
Social contributions	11,6	11,6	11,6	11,7	12,0	12,1
Of which: effective	9,0	9,1	9,2	9,4	9,8	10,0
Sales and other current income	6,2	5,9	5,7	5,6	5,8	6,1
Capital revenues	**0,8**	**0,6**	**0,4**	**0,4**	**0,4**	**0,5**
Total Expenditure	48,2	44,8	45,4	43,5	43,4	43,5
Primary expenditure	**43,7**	**40,6**	**41,6**	**40,1**	**40,3**	**40,6**
Primary current expenditure	39,4	38,7	37,2	37,0	37,3	37,3
Intermediate consumption	5,6	5,5	5,4	5,4	5,3	5,3
Personnel costs	11,3	11,2	10,9	10,7	10,8	10,8
Social benefits	19,5	19,0	18,4	18,2	18,4	18,3
Social benefits other than in kind	17,6	17,2	16,6	16,4	16,5	16,4
Social benefits in kind	1,9	1,8	1,8	1,8	1,9	1,9
Subsidies	0,6	0,5	0,4	0,4	0,4	0,4
Other current expenses	2,4	2,4	2,1	2,3	2,4	2,4
Capital expenditure	**4,3**	**2,0**	**4,4**	**3,1**	**3,0**	**3,3**
GFCF	2,3	1,5	1,8	1,9	2,0	2,3
Other capital expenditure	2,0	0,4	2,6	1,2	1,0	1,0
Interest	**4,6**	**4,1**	**3,8**	**3,4**	**3,1**	**2,9**
Overall balance	-4,4	-1,9	-3,0	-0,4	-0,1	0,2
Primary balance	**0,1**	**2,3**	**0,8**	**2,9**	**3,0**	**3,2**
Tax burden	34,3	33,9	33,9	34,7	34,9	35,1
Current Expenditure	**44,0**	**42,8**	**41,0**	**40,4**	**40,4**	**40,2**
Government Debt	**131,2**	**131,5**	**126,0**	**122,2**	**118,9**	**116,2**

Source: INE and Ministry of Finance.

Table 24 – General government account adjusted (% of GDP)

	2015	2016	2017	2018	DSB/2020 2019	DSB/2020 2020
Total revenue	43.7	42.5	42.4	42.9	43.3	43.7
Current revenue	**43.0**	**42.1**	**42.0**	**42.6**	**42.9**	**43.3**
Tax revenue	25.2	24.6	24.8	25.3	25.1	25.1
Indirect taxes	14.5	14.7	14.9	15.2	15.2	15.2
Direct taxes	10.7	9.9	9.9	10.1	9.9	9.9
Social contributions	11.6	11.6	11.6	11.7	12.0	12.1
of which: actual soc. contr. recei	9.0	9.0	9.2	9.4	9.8	10.0
Sales & other current rev.	6.2	5.9	5.7	5.6	5.8	6.1
Capital transfers received	**0.8**	**0.4**	**0.3**	**0.3**	**0.3**	**0.4**
Total expenditure	46.9	44.8	43.2	42.9	42.8	43.0
Primary expenditure	**42.3**	**40.7**	**39.4**	**39.5**	**39.7**	**40.1**
Current primary expend.	39.4	38.6	37.2	37.0	37.3	37.3
Intermediate consumption	5.6	5.5	5.4	5.4	5.3	5.3
Compensation of employees	11.3	11.2	10.9	10.7	10.8	10.8
Social transfers	19.5	19.0	18.4	18.2	18.4	18.3
other than in kind	17.6	17.2	16.6	16.4	16.5	16.4
in kind via market producers	1.9	1.8	1.8	1.8	1.9	1.9
Subsidies	0.6	0.5	0.4	0.4	0.4	0.4
Other current expenditure	2.4	2.4	2.1	2.3	2.4	2.4
Capital expenditure	**2.9**	**2.0**	**2.2**	**2.6**	**2.4**	**2.8**
GFCF	2.2	1.6	1.8	1.9	2.0	2.3
Other	0.8	0.4	0.4	0.7	0.5	0.5
Interest paid	**4.6**	**4.1**	**3.8**	**3.4**	**3.1**	**2.9**
General government balance	-3.2	-2.3	-0.8	0.0	0.4	0.7
Saldo primário	**1.4**	**1.8**	**3.0**	**3.4**	**3.5**	**3.6**
Carga fiscal	34.2	33.6	33.9	34.7	34.9	35.1
Despesa corrente	**44.0**	**42.8**	**41.0**	**40.3**	**40.4**	**40.2**
Dívida Pública	**131.2**	**131.5**	**126.0**	**122.2**	**118.9**	**116.2**

Source: INE and MF. | Note: the detail of the adjustments made can be found in Tables 8 and 20.

6.1 List of Abbreviations

Abbreviations	Meaning
CA	Central Administration
AIMI	Additional to the Municipal Property Tax (Adicional ao Imposto
AP	General Government
ARL	Regional and Local Administration (Administração Regional e
ECB	European Central Bank
BPP	Banco Privado Português
TB	Treasury Bills
SC	Savings Certificates
EC	European Commission
CEDIC	Special Short-term Debt Certificates (Certificados Especiais de Dívida de Curto Prazo)
CEDIM	Special Certificates of Medium- and Long-Term Debt
CFP	Public Finance Council
CGA	Civil Servants Pension Funds (Caixa Geral de Aposentações)
CGD	Caixa Geral de Depósitos
CT	Treasury Certificates
DGAL	Directorate-General for Local Authorities (Direção Geral das Autarquias Locais)
DGO	Directorate-General for Budget (Direção-Geral do Orçamento)
DP	Government Debt
DSA	Debt Sustainability Analysis
GFCF	Gross Fixed Capital Formation
FEF	Financial Equilibrium Fund
EFSF	European Financial Stabilisation Fund
FEFSS	Social Security Financial Stabilisation Fund
FFD	Decentralisation Fund
FGCAM	Mutual Agricultural Credit Guarantee Fund
FGD	Deposit Guarantee Fund (Fundo de Garantia de Depósitos)
IMF	International Monetary Fund
FSS	Social Security Funds (Fundos de Segurança Social)
GNR	Republican National Guard (Guarda Nacional Republicana)
IABA	Tax on Alcohol and Alcoholic Beverages (Imposto sobre o Álcool
IAS	Social Support Index (Indexante de Apoios Sociais)
IEFP	Professional Job and Training Institute (Instituto do Emprego e Formação Profissional)
IGCP	Government Debt Management Agency (Agência de Gestão da Tesouraria e da Dívida Pública)
IMI	Municipal Real Estate Tax (Imposto Municipal Sobre Imóveis)
IMT	Municipal Property Transfer Tax (Imposto Municipal Sobre as
INE	National Statistical Institute of Portugal (Instituto Nacional de
IP	Infraestruturas de Portugal
CPI	Consumer Price Index
IRC	Corporate Income Tax (Imposto sobre o Rendimento das Pessoas
IRS	Personal Income Tax
IS	Stamp Duty
ISP	Tax on oil and energy products
ISV	Vehicle Tax
IT	Tobacco Tax
VAT	Value Added Tax
LBSS	Basic Law on Social Security
LCPA	Law on Commitments and Delayed Payments
LEO	Budgetary Framework Law
LFL	Local Finance Act
LFR	Regional Finance Act
M€	Millions of Euros
MDR	Discretionary measures on the revenue side
MF	Ministry of Finance
MLSA	Minimum Linear Structural Adjustment
MROL	Measures in the revenue due to the obligation of the law
MTN	Medium Term Note
NAWRU	Non-accelerating inflation rate of unemployment

Abbreviations	Meaning
OECD	Organisation for Economic Co-operation and Development
OE	State Budget
MTO	Medium Term Objective
OT	Treasury Bonds (Obrigações do Tesouro)
OTRV	Variable Income Treasury Bonds
EAFP	Economic and Financial Assistance Programme
EDP	Excessive Deficit Procedure
SP	Stability Programme
SGP	Stability and Growth Pact
GDP	Gross Domestic Product
PIE	Participation of local authorities in State taxes
POE	State Budget Proposal
p.p.	Percentage points
PPL	Draft Law
PPP	Public-Private Partnerships
PREVPAP	Programme for the extraordinary regularisation of precarious
QPDP	Multiannual Framework for Public Expenditure
QPPO	Multiannual Budgetary Programming Framework
AR	Autonomous Regions
ARM	Autonomous Region of Madeira
RNFNC	Non-tax and non-contributory revenue
SCML	Santa Casa da Misericórdia de Lisboa
SF	Spring Forecast
NHS	National Health Service
TFUE	Treaty on the Functioning of the European Union
TVH	Year-on-year rate of change
EU	European Union

6.2 Main Sources of Statistical Information

CFP (2019a), Public Finances: Situation and Conditioning 2019-2023 (Update).

CFP (2019b), Macroeconomic forecasts underlying the Proposed State Budget for 2020.

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EUROPEAN COMMISSION (2019b), Assessment of the 2019 Stability Programme for Portugal.

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INE (2019), National Accounts by Institutional Sector - 2nd quarter 2019.

MINISTRY OF FINANCE (2019a), State Budget Report for 2020.

MINISTRY OF FINANCE (2019b), Draft Budgetary Plan 2020 – Update.

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