ANALYSIS OF THE STATE BUDGET 2020 AMENDMENT

July 2020

Conselho das Finanças Públicas
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Report

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The Portuguese Public Finance Council is an independent body, created by Article 3 of Law No. 22/2011, of 20 May, which made the 5th amendment to the Budgetary Framework Law (Law No. 91/2001, of 20 August, republished by Law No. 37/2013, of 14 June). The final version of the CFP Bylaws was approved by Law No. 54/2011, of 19 October.

The CFP began its work in February 2012, with the mission of carrying out an independent assessment of the consistency, compliance and sustainability of fiscal policy, promoting its transparency in order to contribute to the quality of democracy and economic policy decisions and to strengthen the financial credibility of the state.

This Report has been prepared based on information available up to 26 June 2020.

A spreadsheet file containing the values underlying all graphs and tables in this report is available at www.cfp.pt in the publications area.

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EXECUTIVE SUMMARY

In accordance with Article 7 of the Bylaws of the Portuguese Public Finance Council (CFP) and Article 19 of the Budgetary Framework Law (BFL), this report analyses the Proposed State Budget Review Law for 2020.

Fiscal transparency

The Budgetary Framework Law provides that the approval and execution of the budgets of government departments and entities is subject to the principle of fiscal transparency. In the CFP's understanding, this proposed budget review should be accompanied by sufficient information to justify the changes that radically modify the approved State Budget for 2020, presenting a level of detail at least equivalent to those that accompanied the draft law of the State Budget for 2020. This is not the case.

As stated by the CFP in May, the absence of essential information elements "constitutes an important gap in terms of fiscal transparency, with possible consequences on the confidence of economic agents, one of the most relevant dimensions of the current crisis and, more generally, on the capacity for public scrutiny of the measures and policies that have been adopted in this very adverse context".

The accompanying report includes macroeconomic forecasts for 2020 and 2021. These forecasts were not subject to prior assessment by the CFP. In this respect it should be borne in mind that as this is a budgetary review and not the budget proposal, there is no legal obligation to submit the forecasts to such prior assessment (endorsement procedure). However, the option of not using this mechanism undermines the institutional soundness and the very credibility of these forecasts as a point of reference in the formation of expectations of economic operators.

Review of the macroeconomic scenario

The macroeconomic scenario underlying the State Budget Amendment for 2020 (SBA/2020) represents considerable budgetary risks by having an apparently optimistic outlook when compared to the most recent official forecasts for 2020 in important macroeconomic aggregates.

The new scenario of the Ministry of Finance (MF) anticipates a contraction of economic activity of 6.9% in the current year due to the incorporation of information regarding the impact of COVID-19 on the Portuguese economy. This forecast is at the upper limit of the projection range of official institutions (EC, BdP, IMF, OECD). If only the scenarios published in June are considered, the MF scenario is outside the range of values, delimited by the CFP in its base scenario (-7.5%) and Banco de Portugal (BdP) (-9.5%).

Review of the budgetary scenario for 2020

The new MF budgetary forecast for 2020 points to a significant update of the balance compared to that presented in December. A deficit of 12579 M€ is now forecast, while the implicit forecast for the State Budget for 2020 anticipated a surplus of 515 M€. This review mainly reflects the impact of the deterioration of the macroeconomic scenario resulting from the pandemic crisis, but also the budgetary impact of the exceptional measures in response to the economic, social and health effects triggered by that epidemiological phenomenon.

Two thirds of the planned budgetary balance revision of 13 billion is explained by the deterioration of the macroeconomic scenario. The action of automatic stabilisers, which is reflected to a greater extent in the loss of tax revenue and contributions, and to a lesser extent in the increase in expenditure on unemployment benefits, justifies 7792 M€ of the review of general government revenue (8717 M€) and around 8100 M€ of the downward update of the budgetary balance forecast for 2020.

Budgetary response measures to the economic impact of the pandemic are expected to account for 80% of the public expenditure forecast update and approximately a quarter of the balance review foreseen for 2020. This estimate of the CFP, which points to a direct budgetary impact of those measures on the balance of 3408 M€ (1.7% of GDP), is based on the quantification of measures carried out by the MF and additional information requested from it, although incomplete and hampered by the lack of clarification of relevant issues. Conditional to this limitation, the calculations of the CFP point out that the measures are mainly reflected in an increase in subsidies and the loss of social contributions. The financial support to entities external to the general government and the reinforcement of the financial contribution to the European Union explain a further 1700 M€ of public expenditure, accentuating the review of the balance in relation to that foreseen in the State Budget for 2020. The direct impact of these measures on the economy amounts to 2% of GDP.

After the surplus reached in 2019 (0.2% of GDP), the MF anticipates that by 2020 the general government sector will reach a deficit of 6.3% of GDP, the largest deterioration in a single year in the budgetary balance in the comparable statistical series of national accounts, available from 1995 onwards.

The primary balance, which excludes interest charges, should also reach a deficit position after five consecutive years of primary surpluses. This change in the primary balance sign reflects a deterioration (6.4 p.p. of GDP) higher than the accumulated surpluses in the two previous years (2018, 2019).

Revenue

According to the Government, public revenue should reach 43.4% of nominal GDP in 2020 (+0.5 p.p. of GDP compared to 2019), as a result of the increase in other current revenue and capital revenue. In turn, the share of tax revenue and social contributions in GDP is expected to fall, causing the tax burden to fall to 34.2% of GDP in 2020 (34.7% in 2019). In nominal terms, public revenue is expected to stand at 86 598 M€ in 2020, a decrease of 4410 M€ (-4.8%) compared to 2019 and a downward revision of 8717 M€ (-9.1%) compared to that forecast in the State Budget for 2020. The tax and contributory revenue essentially explains this drop, mainly determined by the automatic stabilisers given the economic contraction.

Taking into account the new macroeconomic framework, MF expects tax revenue to be 4123 M€ (-7.8%) less than in 2019, with net VAT and corporate income tax revenues being the determining factor for this evolution. Justifying the fall in these two taxes is the assumption of substantially high implicit elasticities, which contrasts with the expected rigidity of personal income tax revenues, which, in a context of strong contraction in compensation of employees (-7%), is expected to remain practically unchanged. Thus, and even though in the total tax revenue the MF forecast is relatively prudent vis-à-vis the macroeconomic forecast (elasticity of 1.3 vis-à-vis nominal GDP in a recessive context), there is a risk that its composition will be different from the one anticipated in the SBA/2020, due to the apparent imbalance of the elasticities assumed for the most relevant components of tax revenue. According to the MF, social contributions are also expected to contract considerably in 2020 (-1283 M€; -5.1%) Even so, and discounting the impact of the measures adopted, it is noted that, as for IRS, the MF assumes an elasticity of effective social contributions in relation to abnormally low salaries (0.5), which carries a risk for the pursuit of the overall goal of public revenue registered in the SBA/2020.

Non-tax and non-contributory revenue is expected to increase as a result of the growth in current and capital transfers from the European Union that partly fall within the scope of the response to the COVID-19 pandemic. The increase foreseen for the other current revenue (702 M€; 15.6%), and for capital revenue (711 M€; 95%) partially induced by those transfers fully explain the expected increase for the non-tax and non-contributory revenue (996 M€; 7.9%). Contrary to part of this growth are the sales of goods and services which should decrease by 418 M€ (-5.7%) in 2020.

Expenditure

After having decreased in the last two years, the share of public expenditure in GDP is expected to increase from 43.5% in 2019 to 49.7% in 2020, the highest figure since 2014, when the Novo Banco's capitalisation operation took place. Compared to the initial budget for 2020, there is an upward revision by 6.2 p.p. of GDP, largely due to the economic consequences of the COVID-19 pandemic and the discretionary measures adopted.

In nominal terms, the new MF forecast points to total expenditure of 99,177 M€ - 8573 M€ (or 9.5%) more than in 2019 - representing an upward revision of 4377 M€ from the initial budget. More than three-quarters of the increase this year is expected to be driven by current primary expenditure, with an increase in capital expenditure also foreseen. Interest expenditure is the only item of expenditure that is expected to decrease in comparison with 2019 and also the only one that was revised downwards in comparison with the State Budget for 2020.

In the area of current primary expenditure, the upward revision of subsidies and social benefits - on which most of the impact of the measures on the expenditure side adopted since the pandemic crisis will be focused - is particularly noteworthy, with each of these items projected to increase by 2 thousand M€ when compared to 2019. Intermediate consumption is expected to grow in 2020, after having fallen in the previous year, with most of the reinforcement of the Health Programme and the provisional allocation being incorporated in this heading. Personnel expenditure and "other current expenditure" are also expected to increase, even if the upward revision under these headings seems insufficient.

Capital expenditure is expected to increase by more than 2 thousand M€ in relation to that executed in 2019, to which will contribute Gross Fixed Capital Formation (GFCF) and "other capital expenditure". Under the latter item, a significant upward revision is noted because the loan that the State will grant to TAP (946 M€) is now incorporated, as well as a greater impact resulting from the capital injection into the Novo Banco, under the Contingent Capitalisation Agreement (435 M€ more than foreseen in the State Budget for 2020).

Public debt

According to the SBA/2020, the Maastricht debt is expected to increase by 16.7 p.p. in 2020 to 134.4% of GDP. The dynamic effect is crucial to this evolution (10.6 p.p.), mainly reflecting the unfavourable contribution of the GDP effect and, to a lesser extent, the interest effect. The primary balance effect and the deficit-debt adjustment also contribute to the worsening of the debt ratio respectively by 3.2 and 2.9 p.p. of GDP.

The Ministry of Finance foresees an increase in the gross financing needs of the State of 9.6 thousand M€ compared to the State Budget for 2020, mainly due to the larger budget deficit. The increase in financing will be based on the use of long-term debt issues, namely through Treasury Bonds. Despite the nominal increase in debt, a significant deterioration in the cost of financing is not anticipated, given the current monetary policy and the rating and risk perception of the Portuguese debt, thus preserving the implicit interest rate foreseen in the State Budget for 2020 (2.5%).

Multiannual Budgetary Programming Framework

The SBA/2020 recommends updating for the current year the limit of central government expenditure financed by general revenue. This proposed amendment to the MBPF entails raising the expenditure ceiling from 54 525 M€ to 58 247 ;€ (+3722 M€). Four social and economic area programmes are reinforced, revising downwards the Public Debt Management programme limit, reflecting the expectation of lower interest expenditure compared to that foreseen in the State Budget for 2020. It is not possible to assess the compatibility of the new expenditure ceiling with the budgetary balance in national accounts given the insufficient information provided.

Risks in the budgetary scenario

The risks of the fiscal scenario are historically high and mostly of a downward nature due to the current pandemic context, which fiscal impact in 2020 will depend on the spatial and temporal extension of this epidemiological phenomenon, and the risk of a new wave of contagion and further restrictions on economic activity to contain it cannot be excluded.

Since the beginning of the pandemic, measures have been adopted that do not have a direct impact from the fiscal point of view, but that in many cases constitute contingent liabilities of the general government (such as the financing lines with State guarantee and the public moratorium scheme) and may in certain circumstances aggravate the fiscal balance. This is mainly a risk that may burden fiscal balances and public debt in the coming years.

The projection for the contraction of private consumption seems optimistic in the scenario underlying the SBA/2020, which may imply a greater reduction in tax revenue than that foreseen in the Report accompanying the proposed law. On the expenditure side, it will be important to monitor the evolution of subsidies, since a large part of the impact of the new measures foreseen in the SBA/2020 (especially the simplified lay-off) will occur under this heading. On the capital expenditure side, the downward risk related to the possibility that the loan that the Portuguese State will make to TAP may reach 1200 M€ instead of the 946 M€ considered in the SBA/2020, in national accounts.

1. INTRODUCTION

In accordance with Article 7 of the Bylaws of the Portuguese Public Finance Council (CFP) and Article 19 of the Budgetary Framework Law (BFL), this report analyses the State Budget Amendment for 2020 (SBA/2020). This Report was not preceded by an opinion of the CFP on the underlying macroeconomic forecasts as they were not made available to us under the terms of the protocol established between the Ministry of Finance and the Portuguese Public Finance Council for the assessment of budgetary programming documents.

The analysis made in this report is based on the information contained in Proposed Law No. 33/XIV on the so-called Supplementary Budget for 2020 and presented at Parliament on 9 June, and also takes into account the additional information provided by the MF in response to questions posed by the CFP and received on 20, 24 and 25 of June. The information received did not answer all the questions raised, which is why relevant doubts remain regarding the budgetary forecasts presented and which are detailed in the text.

The following chapters are structured as follows. Chapter 2 presents a note on fiscal transparency issues which have been particularly hampered in the process of SP/2020 and SBA/2020. In the third chapter, a brief assessment is made of the macroeconomic scenario that integrates the proposed budgetary amendment, which is followed by the assessment of the consistency of the budgetary projections with the macroeconomic scenario and the information available on the measures envisaged, and in the fifth chapter, the analysis of the indebtedness envisaged in the SBA/2020 and the evolution of public debt. The sixth chapter systematises the risks to the budgetary scenario that the CFP considers most relevant.

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 budgetary developments.

The preparation of this report benefited from information and clarifications provided by entities in the Ministry of Finance (MF), namely the Office for Economic Policy and International Affairs (GPEARI), the Budget General Directorate (DGO) and the Portuguese Treasury and Debt Management Agency (IGCP), and the Ministry of Labour, Solidarity and Social Security. Its preparation continues to be hampered by shortcomings in fiscal transparency in the documents accompanying the SBA/2020 and by difficulties in obtaining relevant information.

The formulation and quantification of policy measures in the Report is a problem that the CFP has repeatedly identified and continues to persist in SBA/2020, reducing the transparency of the budgetary process. The justification for the quantification of policy measures remains weak, in addition to the recurrent practice of no *ex-post* evaluation.

2. FISCAL TRANSPARENCY

According to Article 19 of the Budgetary Framework Law (BFL), the approval and execution of the budgets of government departments and entities are subject to the principle of fiscal transparency. The law states that "fiscal transparency implies the provision of information on the implementation and execution of programmes, budgetary policy objectives, budgets and accounts of the general government sector, by sub-sector". The information to be made available "shall be reliable, complete, up-to-date, understandable and internationally comparable so as to enable the financial position of the general government sector and the costs and benefits of its activities, including their present and future economic and social consequences, to be accurately assessed".[1]

The BFL exhaustively lists the elements that must accompany the proposed State Budget Law (article 37), but does not specify the information elements that must accompany proposals for revision of the budget law (article 59 of the BFL) that are the responsibility of Parliament. In the CFP's understanding, by analogy with the draft budget law, the elements accompanying the proposed budget revision should be sufficient to justify the extension of the proposed revision. A revision proposal that only gives rise to the transfer of funds between programmes corresponding to different organic-based missions of the Assembly (paragraph d) of Article 59(1)) without changing the total expenditure limit of the central government sub-sector and that does not imply an increase in the State's commitments will certainly need to be accompanied by fewer informative elements than one that leads to changes in all the revisions that fall to the Assembly that increase the authorised expenditure, the State's commitments and the limits of indebtedness. It is therefore important to characterise the proposed budget revision of Law no. 33/XIV.

This proposal for revision is far-reaching, completely changing the configuration of SB/2020, the premises on which it was based and the coverage of the authorisation granted by the Assembly of the Republic at the time of its approval:

i. The overall authorised direct net debt limit is doubled from 10 billion euros to 20 billion euros (the equivalent of 10% of GDP forecast for 2020) under Article 166(1);
ii. The various total expenditure limits are all substantially strengthened [non-consolidated figures]:
    a. the spending limit for integrated services is raised by 5787 M€ (from 176 227 219 715€ to 182 014 446 594 €) (Map IV);
    b. the SFA spending limit is raised by 1266 M€ from 58 711 703 933€ to 59 977 596 543€ (Map IX);

[1] For a more general characterisation of the problem of fiscal transparency see Chapter 6 of the MCP Report No 7/2013 and the bibliographical references listed therein.

c. the Social Security expenditure ceiling is raised by 3882 M€, from 49 231 263 898€ to 53 112 874 574.92€ (Map XII);

iii. The maximum limit for the granting of guarantees, credit insurance, financial credits, guarantee insurance and investment insurance and in favour of the Mutual Counter Guarantee Fund under Article 2 (amending Article 161 of Law No. 2/2020 of 31 March) is increased by 18 150 M€ from 2700 M€ in the approved State Budget to a total of 20 850 M€;

iv. The limits to regional indebtedness established in the Autonomous Regions' Finance Law are suspended;

v. New fiscal policy measures with a high financial profile are adopted;

vi. The State Budget for 2020 was drawn up on the assumption of 1.9% real GDP growth, which is now revised to a recession of 6.9%;

vii. The authorisation granted by Parliament should lead, according to the report accompanying the draft law of the State Budget for 2020, to a budget surplus in national accounts of 0.2% of GDP and 116.2% of public debt as defined in Maastricht. The proposed revision deteriorates the balance by 6.5 p.p. of GDP (revised to a deficit of 6.3% of GDP) and increases the debt by 18.2 p.p. of GDP (to 134.4% of GDP).

In view of this characterisation, the proposed review should be accompanied by sufficient information to justify these changes which radically modify the approved SB/2020, presenting a level of detail at least equivalent to those which accompanied the draft law of SB/2020. This is not the case. In fact, there are several shortcomings in the information accompanying the proposed law:

— The budgetary impact of discretionary measures is not sufficiently detailed, either for those resulting from the measures adopted to combat COVID-19 or for those resulting from the approval of the ESSP (Council of Ministers Resolution No. 41/2020 of 6 June).
— The use of funding under European mechanisms such as SURE does not seem to be reflected in chapter 3 (debt dynamics) of the report accompanying the PPL;
— There is no information to reconcile public accounting with national accounting;
— The nominal GDP value remains missing when the report calculates ratios as a percentage of that value; although it was subsequently made available to the CFP, for the sake of transparency it should appear in the report so that the general public can calculate other magnitudes on the basis of that value. The mere availability of rounded figures for GDP growth and its deflator does not replace its absence as it leads to rounding errors which can be considerable and require knowledge not always present in the general population.

As stated by the CFP in May, the absence of essential information elements "constitutes an important gap in terms of fiscal transparency, with possible consequences on the confidence of economic agents, one of the most relevant dimensions of the current crisis and, more generally, on the capacity for public scrutiny of the measures and policies that have been adopted in this very adverse context".

The document entitled "Stability Programme 2020" (SP/2020) presented on 7 May 2020 did not include any macroeconomic scenario. In its analysis of that document, the Portuguese Public Finance Council called on the Government to provide "adequate forward-looking information in the shortest possible time, so that economic agents can form their expectations and adjust their strategies in order to achieve a recovery of the economy and social cohesion as quickly as possible".

The report accompanying this PPL includes macroeconomic forecasts for 2020 and 2021. These forecasts were not subject to prior assessment by the CFP. In this respect it should be borne in mind that as this is a budget review and not the budget proposal there is no legal obligation to submit the forecasts to such prior assessment (endorsement process) by the CFP, which is the independent national body. However, the option of not using this endorsement mechanism undermines the institutional soundness and the very credibility of these forecasts as a point of reference in the formation of expectations of economic actors.

The legal obligation to subject budgetary forecasts to a process of endorsement or independent production stems exclusively from European legislation and applies compulsorily to the budget programming documents that must be submitted as part of the European Semester: the Stability Programme and the Draft Budget. Indeed, Article 2(1) of Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 provides that "national medium-term budget plans and draft budgets (...) shall be based on independent macro-economic forecasts", i.e. macro-economic forecasts produced or endorsed by independent bodies. National legislation, on the other hand, contains a non-impositive wording: Article 8(3) of the BFL only requires that "budget programming documents shall indicate whether the underlying scenario has been considered by the Portuguese Public Finance Council". This is a much weaker provision, but not fulfilled in this draft law.

As for the characteristics of the forecasts, it follows from both national and European legislation that budgetary projections should be based on the most likely macroeconomic scenario or a more cautious one.

3. REVIEW OF THE MACROECONOMIC SCENARIO FOR 2020

The macroeconomic scenario underlying the State Budget Amendment for 2020 (SBA/2020) represents considerable budgetary risks by having an apparently optimistic outlook when compared to the other most recent known official forecasts for 2020 in important macroeconomic aggregates.

Table 1 – Macroeconomic forecasts for 2020 underlying the SBA/2020

	2019	2020
Real GDP and components (change, %)		
GDP	2.2	-6.9
Private consumption	2.2	-4.3
Public consumption	1.1	3.1
Investment (GFCF)	6.6	-12.2
Exports	3.7	-15.4
Imports	5.3	-11.4
Contributions to real GDP change (p.p.)		
Domestic demand	2.8	-5.2
Net exports	-0.6	-1.8
Prices (change, %)		
GDP deflator	1.7	1.0
Private consumption deflator	1.0	-0.4
Public consumption deflator	2.7	1.6
GFCF deflator	1.9	-0.4
Exports deflator	0.5	-1.3
Imports deflator	-0.1	-3.8
HICP	0.3	-0.2
Nominal GDP		
Change (%)	3.9	-6.0
Labour market (change, %)		
Unemployment rate (% labour force)	6.5	9.6
Employment	0.8	-3.9
Compensation per employees	2.8	-3.3
Apparent labour productivity	1.4	-3.2
External sector (% GDP)		
Net lending / net borrowing, total economy	0.8	0.3
Balance of goods and services	0.1	-0.7
Balance of primary income and transfers	-0.1	0.1
Capital account	0.9	1.0
Net lending / net borrowing, private sector	0.6	6.6
General government balance	0.2	-6.3
Cyclical developments		
Potential GDP (change, %)	1.7	0.6
Output gap (% potential GDP)	2.6	-5.0
Assumptions		
Foreign demand (change, %)	1.8	-13.8
Short-term interest rate (annual average, %)	-0.4	-0.4
EUR-USD exchange rate (annual average)	1.12	1.10
Oil price (Brent, USD/barrel)	63.8	39.2

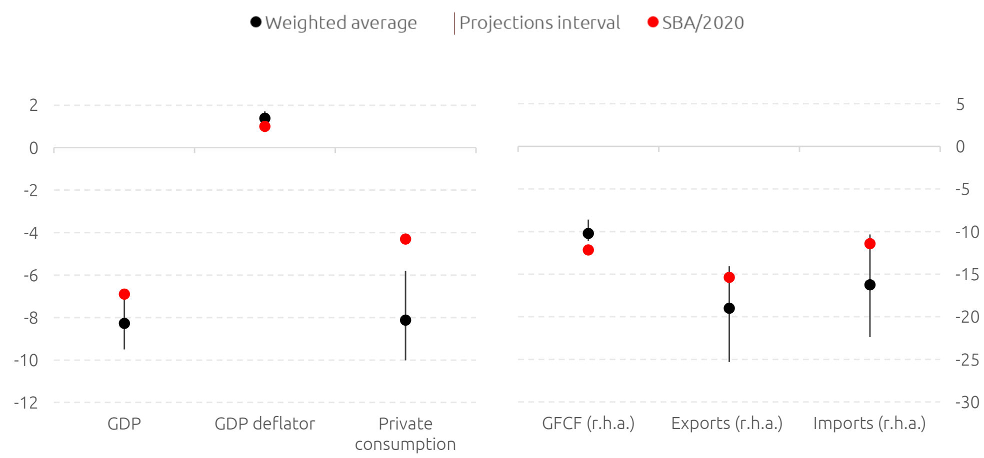
Source: Ministry of Finance - information received on June 20th 2020.

The new scenario of the Ministry of Finance (MF) anticipates a contraction in economic activity of 6.9% this year (Table 1). This is a substantial revision to what was projected in the State Budget for 2020 (SB/2020) (growth of 1.9%) due to the incorporation of information regarding the impact of COVID-19 on the Portuguese economy. The fact that the scenario underlying the SB/2020 is outdated and that no macroeconomic scenario was presented in the Stability Programme 2020-2024 makes it difficult to reconcile the MF scenarios.

The MF forecast for the real Gross Domestic Product (GDP) is at the upper bound of the projection range of the institutions considered in Table 2 and in Chart 1, and is only bounded by the European Commission (EC) scenario with -6.8%. If only the most recent scenarios, published during the month of June 2020, are considered, the MF scenario is outside the range of values, delimited by the CFP in its base scenario (-7.5%) and by the Banco de Portugal (BdP) (-9.5%). At a time when uncertainty is very high, the most recent scenarios incorporate more information on the impact that the COVID-19 pandemic and the support measures have on the internal and external dynamics of the Portuguese economy.

Moreover, it should be noted that the most recent forecasts for the euro area have pointed to a sharper decrease in GDP in 2020 than that forecast in May, by the EC (drop of 7.7%): the forecast by ECB staff points to a drop of 8.7%; the Organisation for Economic Cooperation and Development (OECD) to a reduction of 9.1% (in the single-hit scenario) and the International Monetary Fund (IMF) to a contraction of 10.2%. In the IMF forecast it is also worth mentioning the forecast of contractions greater than 10.0% for Spain, France, Italy and the United Kingdom and a reduction of 7.8% for Germany, all important destinations for Portuguese exports.

Chart 1 – SBA/2020 forecasts framework (change, %)



Source: SBA/2020 and CFP calculations - the weighted average of the growth rates published by other institutions (IMF, EC, CFP, OECD and BdP) is calculated by weighting the respective indicator of each institution (Table 2) according to the percentage of information available at the date of each projection exercise. The percentage represents the time elapsed between the publication of the projections by the institutions considered and the information cut-off date of this report (06/24/2020). For institution *j*'s indicator *i*, the weight ($P_{j,i}$) is obtained as follows: $P_{j,i} = \frac{1-D_{j,i}/360}{P_j}$, where $D_{j,i}$ is the number of days (in a year 360 days) between the POE delivery date and the publication of institution *i*'s projections, and $P_j = \sum_{i=1}^{n}(1 - D_i/360)$. The range of projections is defined by the entire sample of the forecasts of the institutions considered in Table 2, excluding those of the MF.

The optimistic outlook by the MF for private consumption contributes to the expectation of a more moderate contraction of GDP when compared to other institutions. The SBA/2020 anticipates a drop in this aggregate of 4.3%, which compares to -5.8% by the EC and -10.0% by the OECD, in its *single-hit* scenario.

Table 2 – Projections and forecasts for the Portuguese economy for 2020

Year	2019	2020					
Institution and publication		IMF	EC	CFP	MF	OECD	BdP
Publication date	May20	Apr20	May20	Jun20	Jun20	Jun20	Jun20
Real GDP and components (change, %)							
GDP	2.2	-8.0	-6.8	-7.5	-6.9	-9.4	-9.5
Private consumption	2.2	-	-5.8	-7.5	-4.3	-10.0	-8.9
Public consumption	1.1	-	2.4	2.8	3.1	3.1	0.6
Investment (GFCF)	6.6	-	-8.6	-10.4	-12.2	-10.6	-11.1
Exports	3.7	-	-14.1	-20.6	-15.4	-15.5	-25.3
Imports	5.3	-	-10.3	-18.4	-11.4	-13.3	-22.4
Contributions to real GDP growth (p.p.)							
Domestic demand	2.8	-	-5.1	-6.6	-5.1	-8.4	-
Net exports	-0.6	-	-1.6	-1.0	-1.8	-1.0	-
Prices (change, %)							
GDP deflator	1.7	-	1.2	1.2	1.0	1.7	-
HICP	0.3	-0.2	-0.2	-0.2	-0.2	0.2	0.1
Nominal GDP							
Change (%)	3.9	-	-5.6	-6.4	-	-7.8	-
Level ('000 M€)	212.3	-	200.4	198.6	-	195.7	-
Labour market (change, %)							
Unemployment rate (% labour force)	6.5	13.9	9.7	11.0	9.6	11.6	10.1
Employment	0.8	-	-3.4	-5.0	-3.9	-5.7	-3.5
Apparent labour productivity	1.4	-	-3.4	-	-3.1	-	-
External sector (% GDP)							
Net lending	0.8	-	0.5	0.4	0.3	-	0.3
Current account	-0.1	0.3	-0.6	-	-0.6	-0.2	-
Balance of goods and services	0.1	-	-1.0	-0.5	-0.7	-	-0.5
Capital account	0.8	-	1.1	-	1.0	-	-

Sources: 2019: INE. 2020: IMF -World Economic Outlook, April 2020; EC - Spring 2020 Economic Forecast, May 2020; CFP - Economic and Budgetary Outlook 2020-2022 (baseline scenario), June 2020; MF - *Relatório do Orçamento do Estado 2020 Suplementar*, June 2020; OECD - Economic Outlook No 107 (single-hit scenario), June 2020; BdP - Economic Bulletin, June 2020.

It is worth noting, regarding the labour market, that according to the MF the unemployment rate is expected to increase from 6.5% of the labour force in 2019 to 9.6% in 2020. The dynamics expected in the SBA/2020 is once again bounded onlyby the EC scenario (9.7%). The most pessimistic scenario, the one by the IMF, anticipates an increase in this ratio to 13.9% in 2020.

The variables targeted above are important macroeconomic foundations on which budgetary forecasts are, or should be, based. The current context of extreme uncertainty raises the principles of Article 8 of the fiscal framework law (Law No. 151/2015 of 11 September), which stipulates that budgetary projections should be based on the most likely macroeconomic scenario or on a more prudent scenario. Given that, due to the adverse nature of the present conjuncture, it is extremely difficult to prepare a more likely macroeconomic scenario, it becomes even more necessary to have budgetary projections based on a more prudent scenario, which is not the case with the SBA/2020 forecasts. The consideration of optimistic macroeconomic dynamics in fiscal planning biases the perception of the existing fiscal space, which constitutes a very important downside risk.

4. ANALYSIS OF THE COHERENCE OF THE NEW FISCAL SCENARIO

This chapter assesses the new fiscal scenario underlying the proposed amendment to the State Budget 2020, seeking to determine an estimate of the main factors that justify the update of the fiscal forecast for 2020. This estimate, which objective is to improve fiscal transparency in the explanation of the forecast presented in the SBA/2020, uses additional information requested from the MF, even if incomplete, hampered by the lack of clarification of relevant issues. Limited by this constraint, the estimate presented for those explanatory factors must be read with caution, specifically regarding the budgetary impact on the balance of measures in response to the current pandemic crisis. In this particular factor, it should be noted that the CFP estimate allows for the quantification of measures determined by the MF, but the distribution of the fiscal impacts by revenue and expenditure components rely on the CFP initiative, given the absence of identification by the MF of the impact of each measure by revenue and expenditure item. In the absence of a quantification by the MF of the impact of all those measures on the balance, the calculation of the fiscal impact carried out by the CFP for the total of those measures is used, adding it to the impacts of the other factors that justify updating the new forecast. Once the new fiscal forecast has been drafted, the evolution of the fiscal aggregates and their components is analysed in relation to what was achieved in 2019.

4.1 Review of the fiscal forecast for 2020

The new fiscal forecast for 2020 brings the general government balance (GG) back to a budget deficit. This forecast, which contrasts with the anticipated budget surplus in SB/2020, is based on a more favourable starting point than that considered in the forecast presented in December,[2] since the result of the 2019 budget execution turned out to be better than that estimated by MF in the SB/2020 (+578 M€, column 2 of Table 3), mostly due to a lower than expected expenditure. Despite this gain, the new forecast of the SBA/2020 revises the budgetary balance downwards, bringing forward to this year a deficit of 12 579 M€ (6.3% of GDP which contrasts with the surplus of 515 M€ (0.2 of GDP) presented in the SB/2020. This revision, which magnitude in nominal terms and as a ratio of GDP is greater than the budget deficits recorded in the years from 2016 to 2018, mainly reflects the significant impact of the deterioration of the macroeconomic scenario and the fiscal response to the economic and social effects triggered by the current pandemic context.

Table 3 identifies the main explanatory factors that determine the revision of the fiscal forecast for 2020:

[2] This gain resulting from the 2019 implementation is also reflected in the update of the balance forecast for 2020. Thus, considering the surplus of 515 M€ which was predicted for 2020 in the State Budget for 2020, the drag of that gain would imply an update of that surplus to 1093 M€.

i. **Update of the forecast base:** results from the difference between INE's first estimate for 2019, reported in the March 2020 EDP notification, and the estimate for 2019 anticipated by the MF, in the framework of the SB/2020 submission;

ii. **Macroeconomic and other effects**: mainly translates the fiscal impact of the action of automatic stabilizers, the "other effects" being due to second order impacts of macroeconomic variables and to discretionary factors arising, among others, from discretionary fiscal management, incorporation of changes in the final approval of the State Budget for 2020; updating of expectations for the cost of debt financing and others;

iii. **Measures in response to the COVID-19 pandemic**: Estimate of direct impact on the balance of all measures adopted and their effect on revenue and expenditure components (Box 1);

iv. **Support and financial contributions**: covers the impacts on expenditure resulting from financial aid to TAP, the increase in the financial contribution to the European Union and the increase in extraordinary expenditure for capital reinforcement in the Novo Banco.

Table 3 – CFP estimate of the factors underlying the revision of the fiscal forecast (M€)

	SB/2020	EXPLANATORY FACTORS FOR THE FORECAST UPDATE							SBA/2020
	forecast	Forecast base update	one-offs (change)	Financial aid to TAP	Contribution to E.U.	Response measures to the Covid-19 pandemic	Macroeconomics effects and others	Forecast Review	New Forecast
	(1)	(2)	(3)	(4)	(5)	(6)	(7)=(8)-(2)-...-(6)	(8)= (9) - (1)	(9)
Total Revenue	**95 315**	**-205**	**-2**	**0**	**0**	**90**	**-8 600 0**	**-8 717**	**86 598**
Current Revenue	94 287	-214	0	0	0	-285	-8 651 0	-9 149	85 137
Tax Revenue	54 709	104				33	-5 956 0	-5 819	48 890
Indirect Taxes	33 063	186				33	-3 629 0	-3 410	29 653
Direct Taxes	21 645	-81				0	-2 327 0	-2 408	19 237
Social Contributions	26 359	87				-550	-1 836 0	-2 299	24 060
Sales	8 035	-161				0	-903 0	-1 064	6 971
Other Current Revenue	5 184	-243				232	43 0	32	5 216
Capital Revenue	1 028	9	-2			374	51 0	432	1 460
Primary Expenditure	88 434	-636	355	946	406	3 498	35 0	4 604	93 039
Current Primary Expenditure	81 298	-481	0	0	406	3 062	413 0	3 400	84 698
Intermediate Consumption	11 595	-280				410	151 0	281	11 876
Compensation of employees	23 535	98				50	-99 0	50	23 585
Social Benefits	39 961	-65				190	517 0	641	40 603
Subsidies	918	15				2 081	-57 0	2 039	2 957
Other Current Expenditure	5 288	-250			406	332	-99 0	389	5 677
Capital Expenditure	7 137	-154	355	946		436	-378 0	1 204	8 340
GFCF	4 925	-188				436	-214 0	34	4 959
Other Capital Expenditure	2 212	34	355	946		0	-165 0	1 170	3 382
Primary Balance	**6 880**	**431**	**-357**	**-946**	**-406**	**-3 408**	**-8 635 0**	**-13 321**	**-6 441**
Interests	6 365	-147					-80 0	-227	6 138
Total Expenditure	**94 800**	**-782**	**355**	**946**	**406**	**3 498**	**-45 0**	**4 377**	**99 177**
Budget Balance	**515**	**578**	**-357**	**-946**	**-406**	**-3 408**	**-8 555 0**	**-13 095**	**-12 579**

Sources: Ministry of Finance and calculations and distribution of measures under the responsibility of the CFP. | Note: (i) Variation of one-offs detail in Table 13 attached; (ii) response measures to the COVID-19 pandemic, for details see Box 1; (iii) the impact of macroeconomic effects and others is found by difference The totals may not necessarily correspond to the sum of the instalments due to rounding.

Two thirds of the review of the forecast for the budgetary balance are explained by the deterioration of the macroeconomic scenario and other effects. The negative effect on the fiscal balance induced by the action of automatic stabilizers that is reflected in the loss of tax and contributory revenue as well as in the increase in expenditure related to unemployment benefits contributes to the largest share of the revision of the general government revenue and to more than half of the update of the fiscal balance forecast for 2020 (-13 095 M€, column 8 of Table 3). This significant deterioration of the fiscal situation results mainly from the strong revision of nominal private consumption and compensation, which sign of change in these macroeconomic bases is reversed from 2019. To a lesser extent, the loss of revenue from the sale of goods and services is determined by the effects resulting from lower toll collection and lower revenue from the provision of services by transport companies, municipal taxes and regulatory fees. On the expenditure side, the update of this aggregate reflects differentiated effects. In addition to the increase in expenditure on unemployment benefits, which results from the above-mentioned action of the stabilisers, the incorporation of changes resulting from the final approval of the SB/2020, namely the extraordinary update of pensions, as well as, in intermediate consumption, the major allocation of the 300 M€ increase in the provisional appropriation, are also identified within the scope of social benefits. The negative effects identified in column 7, with the exception of lower interest expenditure, which reflects market conditions up to May, may in other cases result in part from the overestimation of some of the impacts attributed to the policy measures quantified in column 6 of Table 3, or from an incorrect distribution of these measures by item, but also from the use of some discretionary fiscal management expedient.

According to calculations by the CFP, the fiscal response measures to the COVID-19 pandemic are responsible for a quarter of the balance review in the new fiscal forecast[3]. This estimate that points to a direct fiscal impact of those measures on the balance of 3408 M€ (1.7% of GDP) is based on the quantification of measures carried out by the MF and additional information requested from the MF, which is still incomplete and does not answer relevant questions. Conditional on this limitation, CFP calculations indicate that around 80% of that impact on the balance is explained by subsidy expenditure (2081 M€) and by the loss of contributory revenue (550 M€) resulting from the exemption from the Single Social Tax on lay-off and family support (Box 1). Expenditure on exceptional combat and mitigation measures adopted in the 1st phase of the pandemic (between March and May) and those recently approved under the Economic and Social Stabilisation Programme (ESSP), mainly affecting public expenditure totalled 3498 M€. This amount justifies around 80% of the update of the public expenditure forecast for 2020, of which more than half is only due to expenditure on subsidies (column 6 of Table 3). To mitigate the impact on expenditure, the new MF fiscal forecast for 2020 has implicit financial support from the European Union, as part of the financial contribution to the COVID-19 pandemic response measures, which, according to CFP calculations, will amount to around 600 M€ (Box 1).[4]

[3] According to the explanation given by the European Commission in the context of the assessment of the 2020 Stability Programme for Portugal, it is clarified that following the activation of the general escape clause, the measures adopted in the fiscal response to the COVID-19 pandemic are not treated as temporary or one-off measures, and as such are not excluded from the estimate of the structural balance.

[4] This calculation of around 600 M€ is supported by the additional information provided by the MF on the amount of current transfers and capital from the European Union (EU) foreseen in the SB/2020 and

The financial support to entities outside the general government sector and the reinforcement of the financial contribution to the European Union justify 1700 M€ of public expenditure, accentuating the review of the balance in relation to that foreseen in the SB/2020. The financial support includes in a first case, the capital reinforcement in the Novo Banco (one-off measure), which implementation in May this year raised its impact on the general government balance to 1035 M€, with its impact on the GG balance implying an increase in extraordinary expenditure of 435 M€, compared to the 600 M€ impact that MF anticipated in the SB/2020. However, this increase in extraordinary expenditure was mitigated in 80 M€ by the cancellation of the compensation for infrastructures in Portugal resulting from the cancellation of the Algarve Litoral road sub-concession, which had been considered in the SB/2020 (column 3 of Table 3). The State loan to TAP, as part of the financial aid to this entity, is the second case, which results from part of the increase in the budget allocation provided for in the SBA/2020 for expenditure on financial assets in the State sub-sector. The nature of this financial aid was considered by MF as a capital transfer with an impact of 946 M€ on the financing needs of the GG sector. As regards the financial contribution to the European Union, the new fiscal forecast includes a reinforcement of this contribution by 406 M€. Taken together, this support and the increased financial contribution explain about 13% of the downward revision of the balance for 2020.

Box 1 - Exceptional and temporary measures to contain and mitigate the effects of the COVID-19 pandemic included in SBA/2020

The SBA/2020 incorporates the impacts of the immediate response measures to the effects of the SARS-CoV-2 pandemic (COVID-19) adopted during the calamity and emergency period between March and May, and the main measures of the Economic and Social Stabilization Program (ESSP). The first phase was aimed at preserving the National Health System' response capacity and, at the same time, mitigating the fall in income of families and companies. With a time horizon until the end of 2020, the ESSP aims at economic and income stabilisation and ensuring that the NHS (National Health System) remains endowed with resources to tackle the pandemic. According to the SBA/2020, the ESSP is based on four fundamental axes: (i) the maintenance of employment and the gradual recovery of economic activity; (ii) support to people's income, especially those who were most affected by the economic consequences of the pandemic; (iii) support to companies; and finally (iv) a framework that allows for conditions to accelerate investment and economic recovery.

Within the framework of this support, this box seeks to systematise and quantify the joint impact of these measures on the balance, given the absence of this information in the report accompanying the SBA/2020. Clarifications were requested from the MF, and no response was obtained that would allow the CFP to make a distribution of the fiscal impacts between the expenditure and revenue components by economic classification. Therefore, in the absence of better information and clarifications, the calculation of the fiscal impact

what the MF now considers in the SBA/2020. The increase of around 600 M€, which is calculated between the two forecasts and will be implicit in the new fiscal forecast, is lower than the value of the general government measures financed by European Funds (1059 M€) presented in Table 1 of the MF report accompanying the SBA/2020. This results in a difference of more than 400 M€ not explained in the report and which the FE justifies, in response to the question raised by the CFP, as "the increase in the FE is not fully visible in the increase in the OCR [Other Current Revenue], because there are factors leading to its decrease". It should be noted that the forecast increase in the Portuguese contribution to the EU is 406 M€.

of the CFP was used for the measures identified in the table below.

Table 4 – Main policy measures included in the SBA/2020

Impact on budget aggregates and components	M€
Revenue	**90**
Contributions losses	**-550**
Banks solidarity contribution	**33**
EU funding increase vis-à-vis OE / 2020	**607**
Current transfers from the EU	232
Capital transfers from the EU	374
Expenditure	**3 498**
Intermediate Consumption	**410**
Health measures	410
Compensation of employees	**50**
Increase in employees compensation	50
Subsidies	**2 081**
Simplified layoff and extension	1 110
Extraordinary incentive to standardization	297
Support for the reduction of the economic activity of self-employed workers	185
Protection of self-employed and informal workers	38
Simplification and digitization	327
Culture measures	64
Professional training	34
Professional requalification in higher education	25
Social benefits	**190**
Prophylactic isolation	60
Social integration income	14
Social insertion income extension	16
Social unemployment subsidie extension	40
Unemployment subsidie extension	17
Family benefit	32
Illness benefit	9
Child and grandchild care allowances	3
Other current expenditure	**332**
Exceptional family support	100
Stabilization complement	70
Social assistance	37
Other current and capital expenditures	48
Other measures	78
GFCF	**436**
Health investment	76
Requalification and maintenance of infrastructures	298
Housing	62
Direct impact in the economy (excl. EU co-payment)	**4 015**
% of GDP	**2.0**
Impact on budget balance	**3 408**
% of GDP	**1.7**

Source: Ministry of Finance, SBA/2020, ESSP. CFP calculations. The total reflects the negative impact on the balance of general government, which corresponds to the difference between the amount of lost revenue and the increase in public expenditure.

On the revenue side with a positive signal are (i) the increased support from the European Union through European funds in the framework of the EU response to the COVID-19 pandemic (607 M€), based on MF information on current and capital transfers from the EU respectively of 232 M€ and 374 M€ and (ii) the measure on the additional solidarity contribution on the banking sector (33 M€). In the opposite direction, the loss of contributory revenue of 550 M€, reflecting a fall in actual social contributions through the exemption from the single social tax resulting from the application of the simplified lay-off and family support.

The CFP disaggregated the impact of the measures on the expenditure side by adopting its interpretation of their classification according to the nature of expenditure defined in national accounts. This classification has not been confirmed by the MF, nor the measures included in the calculation of this impact. The total value estimated by the CFP for measures responding to the pandemic crisis with an impact on expenditure is expected to amount to 3498 M€ (Table 4). Expenditure on subsidies is expected to be the most affected item, amounting to a total of 2081 ;€, where more than half of this figure is explained by the simplified lay-off and its extension (1110 M€). Also noteworthy is the measure on "simplification and digitisation", which cuts across general government, the extraordinary incentive for standardisation and support for the reduction of economic activity of self-employed workers, totalling 809 M€. Following the fourth fundamental axis mentioned above, the evolution of GFCF will reflect a set of measures with a value of 436 M€ divided into upgrading and maintenance of infrastructures, additional investment under the Health Programme and the impact of new measures adopted in the housing area. Intermediate consumption, which ensures a fundamental part of the health system's response in the fight against the pandemic, namely personal protection equipment, medicines and diagnostic tests, incorporates 410 M€ in measures. Other current expenditure and social benefits total 522 M€, essentially reflecting social and family support measures. Finally, reference is made to the impact of the increase in salaries (50 M€), part of which concerns health professionals, and which, according to the clarification provided by the MF, is intended to remedy some shortcomings and imbalances in terms of human resources.

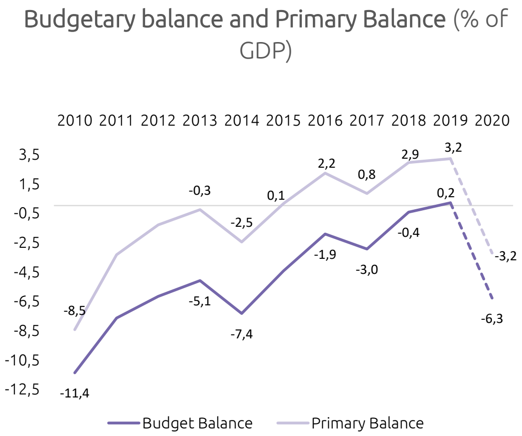
The figures on the fiscal impact of the above measures do not, however, include the possible effects on the general government balance that may arise from the liquidity measures planned to support enterprises, households and other entities. Contrary to the SP/2020, where measures were estimated by the MF to be worth around 25 thousand M€, the current SBA/2020 and the ESSP do not present in a clear and systematic way an estimate for the materialization of these measures or a respective overall value. Among these, we highlight the easing of the payment of tax and contribution obligations, moratoria on housing loans and corporate loans, export credit insurance with State guarantees and credit lines also guaranteed by the State, including lines for cash financing and long-term investments. In this context, it should be noted that this support may constitute a fiscal risk, particularly in cases where the beneficiaries (companies and households) fail to meet their obligations, which would imply the assumption of such liabilities by the State, with a consequent negative impact on the general government balance and debt in the coming years.

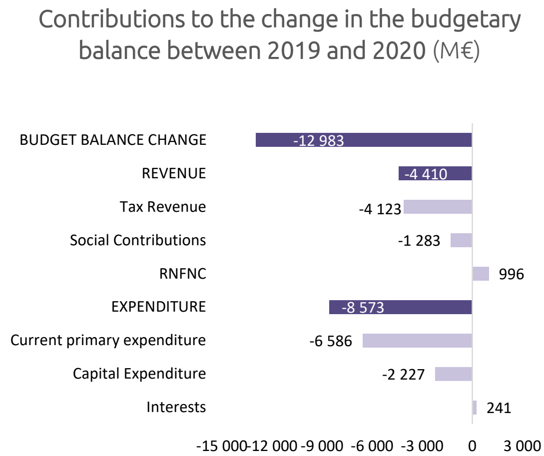
4.2 From the 2019 account to the new fiscal forecast for 2020 (SBA/2020)

4.2.1 Budgetary balance and primary balance

The new MF fiscal forecast for 2020 points to a significant deterioration of the general government balance, which is expected to reach a deficit of 6.3% of GDP this year. If this forecast is realised, it will be the largest deterioration of the budgetary balance in the comparable statistical series of national accounts, available from 1995 onwards. This return to an imbalance after the surplus reached in 2019 (0.2% of GDP) is determined by the strong contribution of expenditure (See section 4.2.3). In nominal terms, the MF expects this budgetary aggregate to account for two thirds of the deterioration in the budgetary balance for which current primary expenditure (6586 M€) is the key determinant by concentrating, among other effects, almost the entire impact of the fiscal response to the COVID-19 pandemic (right panel of Chart 2). With a smaller impact, the MF foresees that the fall in general government revenue will also contribute to the deterioration of the balance, mainly as a result of the action of automatic stabilisers, which effects penalise tax and social contributions revenue.

Chart 2 – Fiscal position developments for 2020





Source: INE, MF. CFP calculations. A positive / negative sign corresponds to a positive / negative contribution of a given component of revenue or expenditure to the improvement / deterioration of the budgetary balance. RNFNC -: Non-tax and non-contributory revenue, including sales, "Other current revenue" and capital revenue.

The primary balance, which excludes interest charges, is expected to fall back to a deficit position in 2020, interrupting the path of primary surpluses seen since 2015. This MF forecast of a primary deficit of 3.2% of GDP reflects a negative change in the primary balance of 6.4 p.p. of GDP, higher than the accumulated surpluses in the last two years (2018, 2019).

4.2.2 Analysis of public revenue forecast in SBA/2020

Forecasts in the SBA/2020 continue to point to an increase in the share of public revenue in output, despite anticipating its contraction in nominal terms. According to the MF, the share of public revenue in GDP is expected to grow by 0.5 p.p. in 2020, reaching 43.4% of GDP, which reflects an expectation of a year-on-year contraction in public revenue (4.8%) lower than that expected for nominal output (6%). This increase is due to the larger relative weight of capital revenue (+0.3 p.p. of GDP) and other current revenue (+0.5 p.p. of GDP), since the weight of tax and contributory revenue is expected to decrease by 0.4 p.p. of GDP, causing the tax burden to fall to 34.2% of GDP in 2020 (34.7% of GDP in 2019). In nominal terms, public revenue is expected to stand at 86,598 M€, a decrease of 4410 M€ compared to 2019, essentially due to the reduction in tax and contributory revenue (5,406 M€ vs. 2019). The contraction expected for tax and contributory revenue results, fundamentally, from the operation of the automatic stabilisers in a context of contraction in economic activity, since the impact of the policy measures envisaged for its components is not substantive (see Table 3).

Table 5 – General government revenue

	2019	2020		2019/2020 (Change)				2019	2020	
				M€		%			% of GDP	
		SB/2020	SBA/2020	SB/2020	SBA/2020	SB/2020	SBA/2020		SB/2020	SBA/2020
Total Revenue	**91 008**	**95 315**	**86 598**	**4 307**	**-4 410**	**4.7**	**-4.8**	**42.9**	**43.8**	**43.4**
Current Revenue	**90 259**	**94 287**	**85 137**	**4 028**	**-5 122**	**4.5**	**-5.7**	**42.5**	**43.3**	**42.6**
Tax Revenue	53 013	54 709	48 890	1 695	-4 123	3.2	-7.8	25.0	25.1	24.5
Indirect taxes	32 148	33 063	29 653	915	-2 495	2.8	-7.8	15.1	15.2	14.9
Direct taxes	20 865	21 645	19 237	780	-1 628	3.7	-7.8	9.8	9.9	9.6
Social contributions	25 342	26 359	24 060	1 016	-1 283	4.0	-5.1	11.9	12.1	12.1
of which: actual soc. contr. Received	20 598	21 736	19 397	1 138	-1 201	5.5	-5.8	9.7	10.0	9.7
Sales of goods and services	7 389	8 035	6 971	646	-418	8.7	-5.7	3.5	3.7	3.5
Other current revenue	4 514	5 184	5 216	670	702	14.8	15.6	21.0	2.4	2.6
Capital transfers received	**749**	**1 028**	**1 460**	**279**	**711**	**37.3**	**95.0**	**0.4**	**0.5**	**0.7**
Memo items:										
Tax and social contribution revenue	*78 356*	*81 067*	*72 950*	*2 712*	*-5 406*	*3.5*	*-6.9*	*36.9*	*37.2*	*36.5*
Non Tax and non contribution revenu	*12 652*	*14 247*	*13 648*	*1 595*	*996*	*12.6*	*7.9*	*6.0*	*6.5*	*6.8*

Sources: INE (2019) and Ministry of Finance (2020). CFP calculations.

General government tax revenue is expected to fall substantially as a result of the expected decline in economic activity in 2020. According to the MF, general government tax revenue is expected to decrease by 7.8%, a change that will be higher than the estimated drop in nominal GDP (-6%). In nominal terms, tax revenue is expected to fall to 48890 M€ this year, less 4123 M€ than in 2019. The deterioration of the outlook for the main macroeconomic bases of the different taxes justifies the negative behaviour of tax revenue.

The sharp contraction in net VAT and corporate income tax revenues will largely determine the negative evolution of tax revenues in 2020. The decrease in tax revenue forecast for this year is explained both by the shrinkage in indirect taxes (-2495 M€; -7.8%) and direct taxes (-1628 M€; -7.8%), with the first reflecting, in about three quarters, the expected decrease in VAT revenue (-1901 M€; -10.1%; euros), and the second reflecting, almost entirely, the drop in net corporate income tax revenue (-1551 M€; -23.3%). The comparison with the macroeconomic scenario from the SBA/2020 shows that the elasticities of VAT and corporate income tax to private consumption and nominal GDP, respectively, are considerably higher than the unit value, which contrasts with the rigidity envisaged for net personal income tax revenue in relation to compensation of employees (Table 7). Therefore, and despite the relative prudence of the estimate of total tax revenue in the SBA/2020, there is a risk that its composition will be different from that projected by MF. This risk arises to the extent that the more than proportional contraction of tax revenue vis-à-vis nominal output results from the assumption of substantially high implicit elasticities for VAT and corporate income tax, which contrasts with the optimism shown for the evolution of net personal income tax revenue, which, according to MF, is not likely to show any decline in a scenario of severe contraction of remunerations paid in the economy (-7%).

Table 6 – General government tax revenue, in national accounts

	2019	2020		2019/2020 (Change)				2019	2020	
				M€		%			% of GDP	
		SB/2020	SBA/2020	SB/2020	SBA/2020	SB/2020	SBA/2020		SB/2020	SBA/2020
General Government tax revenue	53 013	54 709	48 890	1 695	-4 123	3.2	-7.8	25.0	25.1	24.5
Indirect Taxes	**32 148**	**33 063**	**29 653**	**915**	**-2 495**	**2.8**	**-7.8**	**15.1**	**15.2**	**14.9**
IVA	18 828	19 346	16 927	519	-1 901	2.8	-10.1	8.9	8.9	8.5
IECS	5 422	5 625	5 060	203	-361	3.7	-6.7	2.6	26.0	2.5
Petroleum Tax	3 639	3 855	3 351	216	-288	5.9	-7.9	1.7	1.8	1.7
Tobacco Tax	1 484	1 489	1 450	5	-34	0.3	-2.3	0.7	0.7	0.7
Tax on Alcohol and Alcoholic bev.	299	281	259	-18	-40	-6.1	-13.4	0.1	0.1	0.1
Vehicle tax	743	710	511	-33	-232	-4.4	-31.2	0.4	0.3	0.3
Tax on real estate transactions	1 005	1 028	975	23	-30	2.3	-3.0	0.5	0.5	0.5
Municipal Property Tax	1 554	1 577	1 567	23	13	1.5	0.8	0.7	0.7	0.8
Others	4 597	4 777	4 614	180	17	3.9	0.4	2.2	2.2	2.3
Direct Taxes	**20 865**	**21 645**	**19 237**	**780**	**-1 628**	**3.7**	**-7.8**	**9.8**	**9.9**	**9.6**
PIT	13 579	14 006	13 599	427	20	3.1	0.1	6.4	6.4	6.8
CIT	6 662	6 957	5 111	296	-1 551	4.4	-23.3	3.1	3.2	2.6
Others	624	682	527	58	-97	9.3	-15.5	0.3	0.3	0.3

Sources: INE (2019) and Ministry of Finance (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 SBA/2020 and the information provided by the MoF for the sum of the detailed taxes shown in the table.

Social contributions are expected to record the first annual decrease since 2012, reflecting the expected deterioration in the labour market. According to the MF, social contributions are expected to fall by 5.1% annually in 2020, with actual social contributions falling by 5.8%, still below the prospect of a contraction in wages paid to workers (-7%). Thus, and purging the effect of the policy measures considered for 2020,[5]the elasticity of effective social contributions in relation to the remuneration of workers will be 0.5, revealing an abnormally high rigidity for this item, which in itself constitutes a risk for achieving the objective of the total revenue of the SBA/2020. In nominal terms, social contributions should fall to 24 060 M€ in 2020, 1283 M€ less than in 2019, implying a downward revision of 2299 M€ relatively to the amount registered in the SBA/2020. This negative behaviour is explained by the deterioration of the labour market and the impact of the policy measures taken to mitigate the effects of the economic paralysis.

[5] The measures considered contemplate the loss of income through the TSU exemptions on lay-off and family support considered in the SBA/2020 (-550 M€), as well as the measures already legislated in the SB/2020.

Table 7 – Tax revenue, main taxes and actual social contribution elasticities in the SBA/2020

	2020 (SBA)
Tax revenue elasticity with respect to nominal GDP	1.3
CIT elasticity with respect to nominal GDP	-0.1
PIT elasticity with respect to wages	3.8
VAT elasticity with respect to private consumption	2.2
Actual social contributions elasticity with respect to wages	0.5

Sources: Ministry of Finance. CFP calculations.

According to the SBA/2020, non-tax and non-contributory revenue is expected to increase as a result of the growth in current and capital transfers from the EU. Contributing to the growth of non-tax and non-contributory revenue in 2020 compared to 2019 (996 M€; 7.9%) will be the expected increase in the other current revenue (702 M€; 15.6%), resulting from the increase in transfers from the European Social Fund (ESF), the EU Solidarity Fund and REACT-EU, as well as the expected increase in capital revenue (711 M€; 95%), partly justified by the support from European Funds in the framework of the EU response to the COVID-19 pandemic. It should be noted that these headings are the only ones, in the GG revenue as a whole, to show increases compared to the figures budgeted in the State Budget for 2020, and in which variations were expected, compared to 2019, of 670 M€ (14.8%) for current revenue and 279 M€ (37.3%) for capital revenue. On the other hand, the year-on-year contraction expected for sales of goods and services[6] (-418 M€; -5.7%) in SBA/2020 should be highlighted, which essentially reflects the recessive dynamics of the new MF macroeconomic scenario.

4.2.3 Analysis of public expenditure forecast in SBA/2020

According to the SBA/2020, the share of public expenditure in GDP will reach 49.7% in 2020, 6.2 p.p. more than foreseen in the initial budget. This upward revision - which puts this ratio at its highest value since 2014 (the year in which the Novo Banco's capitalisation operation took place) - stems above all from the economic consequences of the COVID-19 pandemic and the discretionary measures that have since been adopted. Thus, after having decreased in the last two years, the weight of public expenditure is expected to increase by 7 p.p. in 2020. This projected increase is justified by current primary expenditure (+5.6 p.p.) and, to a lesser extent, by capital expenditure (+1.3 p.p.) and interest charges (+0.1 p.p.).

[6] According to the MF, the loss of revenue under this heading is related to the duration of the state of emergency and the gradual resumption of economic activity, from which the impacts on the revenue from tolls, regulatory fees, municipal taxes and the sale of goods and services of public transport companies stand out.

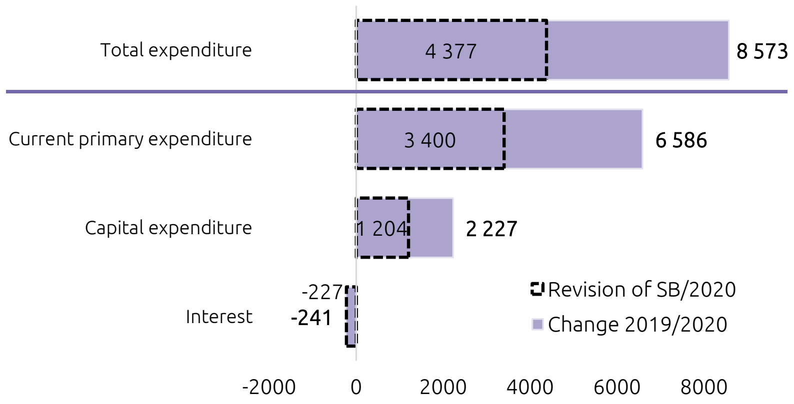
Table 8 – General government expenditure

	2019	2020		2019/2020 (Change)				2019	2020	
				M€		%			% of GDP	
		SB/2020	SBA/2020	SB/2020	SBA/2020	SB/2020	SBA/2020		SB/2020	SBA/2020
Total expenditure	**90 604**	**94 800**	**99 177**	**4 195**	**8 573**	**4.6**	**9.5**	**42.7**	**43.5**	**49.7**
Primary Expenditure	**84 225**	**88 434**	**93 039**	**4 209**	**8 814**	**5.0**	**10.5**	**39.7**	**40.6**	**46.6**
Current primary expenditure	78 112	81 298	84 698	3 186	6 586	4.1	8.4	36.8	37.3	42.4
Intermediate consumption	10 991	11 595	11 876	604	885	5.5	8.0	5.2	5.3	5.9
Compensation of employees	22 799	23 535	23 585	736	785	3.2	3.4	10.7	10.8	11.8
Social transfers	38 684	39 961	40 603	1 278	1 919	3.3	5.0	18.2	18.3	20.3
other than in kind	34 731	35 803	36 562	1 073	1 832	3.1	5.3	16.4	16.4	18.3
in kind via market producers	3 953	4 158	4 041	205	88	5.2	2.2	1.9	1.9	2.0
Subsidies	887	918	2 957	31	2 070	3.5	233.3	0.4	0.4	1.5
Other current expenditure	4 750	5 288	5 677	538	927	11.3	19.5	2.2	2.4	2.8
Capital expenditure	6 113	7 137	8 340	1 024	2 227	16.7	36.4	2.9	3.3	4.2
GFCF	3 980	4 925	4 959	945	979	23.7	24.6	1.9	2.3	2.5
Other capital expenditure	2 133	2 212	3 382	79	1 249	3.7	58.5	1.0	1.0	1.7
Interest paid	**6 379**	**6 365**	**6 138**	**-14**	**-241**	**-0.2**	**-3.8**	**3.0**	**2.9**	**3.1**

Sources: INE and Ministry of Finance. CFP calculations. | Notes: the values for 2019 are those published by INE and those for 2020 correspond to those considered by the MF in SB/2020 and in SBA/2020; values are not adjusted from the temporary measures presented in Table 12, attached.

MF expects public expenditure to reach 99 177 M€ this year, up 8573 M€ (or 9.5%) from 2019. This increase reflects a strong acceleration compared to the 2.3% growth registered in 2019 and is influenced by an upward revision of the expenditure forecast presented in the SB/2020 (+4377 M€), largely justified by the pandemic[7]. The increase in expenditure this year will be induced by current primary expenditure (+6586 M€) and capital expenditure (+2227 M€), to be mitigated by a 241 M€ decrease in interest charges (Table 8).

Chart 3 – Expenditure in SBA/2020: revision of SB/2020 and expected annual change (in M€)



Source: INE and MF. CFP calculations. | Note: values are not adjusted from the temporary measures and non-recurring measures.

Current primary expenditure justifies more than three-quarters of the increase foreseen for public expenditure in 2020. This expenditure aggregate is expected to record an increase of 6586 M€ in the current year, almost 2.5 times higher than in 2019 and corresponding to 76.8% of the increase forecast for general government expenditure in 2020 (Chart 3). Contrary to what was foreseen in the initial budget, the growth of current primary expenditure should accelerate in 2020 (from 3.6% in 2019 to

[7] About 58% of this upward revision is the result of the reinforcement of the Social Security expenditure budget.

8.4%), due to the impact of the pandemic crisis and the measures adopted in the meantime.

The acceleration in current primary expenditure will be mainly driven by expenditure on subsidies, which has been significantly revised upwards. Following this significant revision, subsidy expenditure is expected to reach 2957 M€ in the current year and to increase (+2070 M€) much more than in 2019 (+137 M€). The review carried out and the subsequent increase foreseen in comparison to 2019 result from the effect of the measures to mitigate the impacts of the pandemic and to re-launch the economy, of which the following should be highlighted: i) the simplified lay-off scheme and the support mechanism for the gradual recovery (which together should amount to 1,100 M€);[8] ii) the extraordinary incentive to normalise business activity (297 M€) and iii) the extraordinary support following the reduction in the economic activity of self-employed workers (185 M€).

The forecast for social benefit expenditure for 2020 has been revised upwards by 641 M€, now implying an increase of 1919 M€ over the previous year. The growth in social benefits is expected to accelerate from 4.3% in 2019 to 5.0% in 2020, reaching 40,603 M€. The realisation of this forecast implies an accumulated increase in this expenditure of around 4.6 billion euros between 2018 and 2020. The forecast for this expenditure for 2020 was revised upwards by 641 M€,[9] of which 311 M€ to meet higher unemployment benefits than initially forecast (through the effect of the automatic stabilisers[10] and the automatic extension of unemployment benefits until the end of 2020) and 154 M€ related to the extraordinary update of pensions of an amount equal to or less than 1.5 times the IAS value, with effect from May[11]. Also noteworthy are the impacts resulting from the increases in the prophylactic isolation and COVID-19 sickness benefit (69 M€) and family allowance (32 M€) and the change in the reference period in the RSI (14 M€). As a percentage of GDP, expenditure on social benefits is expected to increase by 2.1 p.p. from 18.2% in 2019 to 20.3% of GDP in 2020.

Intermediate consumption is expected to grow by 8.0% in 2020, after having fallen by 0.7% in the previous year, with most of the reinforcement of the Health Programme and the provisional allocation being incorporated under this heading. MF expects intermediate consumption to reach 11 876 M€ this year, 885 M€ more than in 2019. Although in 2019, intermediate consumption was 280 M€ lower than the MF estimate that served as the basis for the initial forecast for the current year, this forecast has now been revised upwards by 281 M€. This circumstance results mainly from the

[8] This expenditure will be financed through SURE (the new European loan mechanism to alleviate the risks of unemployment, which is on the State and not the Social Security), as well as through the State Budget and the frontloading of Community funds. Payments under the simplified lay-off scheme amounted to 580 M€ by June 16, according to the Ministry of Labour, Solidarity and Social Security.

[9] Following an upward revision of the forecast expenditure on benefits other than in kind for 2020 (+759 M€) and a downward revision of social benefits in kind (-117 M€).

[10] Expenditure on unemployment benefit and employment support is expected to increase by 27% compared to 2019, following an increase in the unemployment rate from 6.5% in 2019 to 9.6% in 2020, according to the MF. Data recently published by the IEFP indicate that, by the end of May 2020, the number of registered unemployed increased by 34% compared to the same month in 2019.

[11] In 2019, the extraordinary update of the pensions of the General Social Security Scheme and the Convergent Social Protection Scheme took effect in January.

reinforcement of the intermediate consumption of the NHS (410 M€),[12] aiming at the acquisition of personal protection equipment and the performance of diagnostic tests to COVID-19, among other purposes. In addition, according to the MF, the reinforcement of the provisional appropriation (+300 M€) was mostly considered under the item of intermediate consumption in national accounts[13]. As a percentage of GDP, the MF forecasts that intermediate consumption will increase from 5.2% in 2019 to 5.9% in 2020, the highest figure since 2011.

The forecast of personnel expenditure for 2020 was slightly revised upwards. Under this heading there has been a minor revision (+50 M€) - which, according to the MF, reflects part of the increase in salaries for health professionals - bearing in mind that the starting figure for the previous year is higher: personnel expenditure was 98 M€ above the estimate for 2019. Personnel expenditure is expected to grow for the fifth consecutive year, although a deceleration from 4.4% in 2019 to 3.4% in 2020 is expected. An increase of 785 M€ is expected this year which will raise this expenditure to 23 585 M€, bringing it closer to the maximum recorded in 2010 (24 576 M€). This increase will be mainly due to the fact that the end of the unfreeze of career progression process only occurred in December 2019 and to the increase in the number of staff. It should be recalled that the intention to hire 4200 new Healthcare Professionals in 2020 was already mentioned in the SB/2020.[14] As a percentage of GDP, personnel expenses should increase from 10.7% in 2019 to 11.8% in 2020.

The upward review of "other current expenses" may not be sufficient to accommodate the additional expenses foreseen in SBA/2020. The new MF forecast points out that this item will total 5677 M€, 927 M€ more than the previous year. The forecast for this expenditure for 2020 has been revised upwards by 389 M€, although in 2019 it was 250 M€ below the estimate made by MF when preparing the SBA/2020. However, this gap of 639 M€ seems insufficient to accommodate additional expenditure resulting from the upward review of the financial contribution to the EU budget (+406 M€)[15] and some support measures such as the exceptional family support (100 M€), the extraordinary stabilisation supplement (70 M€ to be paid in July directly to the workers covered by this measure) and other measures totalling 163 M€, as detailed in Table 4.

The forecast for capital expenditure for 2020 was revised upwards by 1204 M€, pointing to an increase of 36.4% over the previous year. The revision occurred mainly in

[12] The expenditure budget for the Health Programme has been increased by EUR 504 million, of which EUR 340 million will be financed from general revenues and the remainder from unused funds from previous years.

[13] According to the MF, part of this reinforcement is intended to support the cultural sector following the fall in income of professionals in the performing arts. Thus, the provisional allocation for 2020 practically doubles to 629.7 M€, amount that is initially centralised in the Ministry of Finance.

[14] Through Order no. 3301-E/2020, of 15 March, the Minister of Health delegated the power to authorize the hiring of workers for the constitution of fixed-term employment contracts, for a period of four months, with a view to strengthening the human resources needed in the context of the COVID-19 pandemic. Recently, the Government stated its intention to move the approximately 3000 professionals recruited in the meantime to permanent contracts, according to needs. According to point 3.1.2 of the ESSP, the burden of hiring health professionals for support activities and for direct provision of care in the context of the pandemic is expected to amount to 29 M€ between April and December 2020.

[15] Reflecting the additional effort involved in the measures forming the framework of the European Union's response to the effects of the COVID-19 disease outbreak.

the item "other capital expenditure" (+1170 M€) because the loan the State will grant to TAP Air Portugal (946 M€) is now incorporated, [16]as well as a greater impact resulting from the capital injection in the Novo Banco, under the Contingent Capitalisation Agreement (435 M€ more than foreseen in the State Budget for 2020).[17] In the opposite direction, the compensation of Infraestruturas de Portugal for the cancellation of the Algarve Litoral road sub-concession, which had been considered in the initial budget for the amount of 80 M€, was no longer foreseen. Thus, the item "other capital expenditure" should total 3382 M€ in 2020 and increase by 1249 M€, after having decreased by 374 M€ in 2019.

Gross Fixed Capital Formation (GFCF) is expected to grow for the fourth consecutive year, with an acceleration from 4.9% in 2019 to 24.6% this year. The GFCF forecast for the current year has been revised upwards by only 34 M€, but it must be taken into account that the starting value for the previous year is lower, since GFCF was 188 M€ below the estimate for 2019 that had been made by MF under the SB/2020. According to the SBA/2020, GFCF should total 4959 M€ this year, 979 M€ more than in 2019. In addition to the structural investments considered in the initial budget, this item incorporates an additional investment of 76 M€ under the Health programme and the impact of new measures adopted in the housing area[18]. Although it is worth pointing out the aforementioned expected acceleration of GFCF growth, it should again be recalled that in recent years this expenditure has been well below forecast. As a percentage of GDP, GFCF is expected to increase by 0.6 p.p. in 2020, bringing the ratio to 2.5% of GDP, the highest since 2012.

Interest charges are the only item of expenditure that has been revised downwards in comparison with the State Budget for 2020 and also the only item that is expected to decrease in comparison with 2019. According to the SBA/2020, this item should amount to 6138 M€, 241 M€ less than in 2019. If this forecast comes true, it will be the sixth consecutive year in which this expenditure will decrease (the accumulated decrease between 2015 and 2020 will amount to 2.3 billion euros). However, the rate of decrease in interest expenditure is expected to slow from 7.5% in 2019 to 3.8% in 2020. This expenditure was revised downwards by 227 M€ compared to the initial forecast, mainly due to the fact that interest expenditure in 2019 was 147 M€ below MF's estimate. According to the MF, market conditions up to May 2020 justify the remaining part of the revision (-80 M€). As a percentage of GDP, the new MF forecast points out that this year interest expenditure will stop the downward trend that began in 2015: this ratio should increase by 0.1 p.p. in 2020, reaching 3.1% of GDP.

[16] Although the decision of the Directorate General for Competition of the European Commission on this request for State aid is still awaited, in SBA/2020 this operation was accounted for in national accounts as capital expenditure and, consequently, with a negative impact on the budget balance.

[17] According to the Resolution Fund's statement, last May a payment of 1035 M€ was made to the Novo Banco. In the SB/2020 an allocation of 600 M€ was foreseen.

[18] In the general discussion of the SBA/2020, the Minister of Finance also highlighted the anticipation of small local public investments, which will be launched this year, but whose implementation will run until 2021.

4.3 Multiannual budgetary programming framework (MBPF)

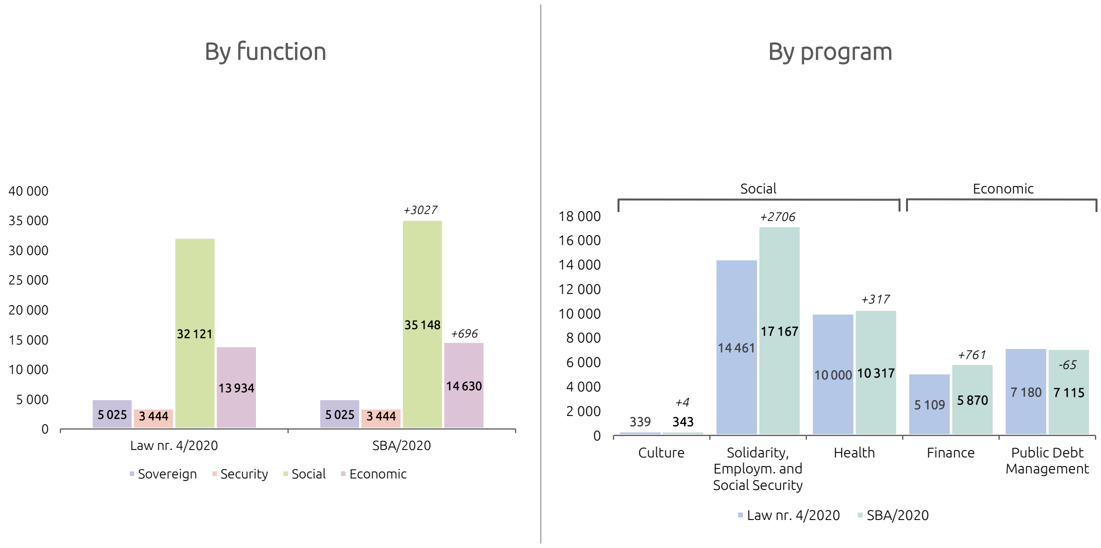
Article 12d of the Budgetary Framework Law (BFL)[19] states that with the first draft State Budget Law (SB) presented after the Government takes office, a draft law with the multi-annual budgetary programming framework (MBPF) must be presented and discussed simultaneously. On 26 October 2019 the XXII Constitutional Government took office, which justified the presentation, simultaneously with the PSB/2020, of the Proposed Law (PPL) No. 6/XIV. This proposal gave rise to Law no. 4, of 31 March, which approved the MBPF for the period from 2020 to 2023. Accordingly, the limits on Central Government (CG) expenditure financed by general revenues are indicative for 2021 to 2023 and mandatory for 2020, although it is possible to modify the limits by programme and area for this year due to budgetary changes. In this follow-up, Article 6 of the articles of the SBA/2020 proposes to modify the limits for Central Government expenditure financed by general revenue for 2020 contained in the current MBPF.

The SBA/2020 recommends raising the limit for the current year of central government expenditure financed by general revenue. This proposal to amend the MBPF 2020-2023, approved by Law no. 4/2020 of 31 March, implies updating the ceiling from 54,525 M€[20] to 58,247 M€, maintaining the limits for the following four-year period unchanged. The increase, totalling 3722 M€ occurs in the Social and Economic areas (Chart 4). In the Social area the ceilings for the Labour, Solidarity and Social Security, Health and Culture programmes are high, including expenditure arising from measures adopted in those areas in response to the COVID-19 pandemic. In the Economic area, the Finance Programme is reinforced by 761 M€, while the Public Debt Management Programme proposes a reduction of the respective ceiling by 65 M€, incorporating the expectation of lower interest expenditure in 2020 than that forecast in the State Budget for 2020.

[19] Approved by Law 91/2001, of 20 August, applicable by virtue of the provisions of Article 7(2) of Law 151/2015, of 11 September, as currently worded.

[20] Law no. 4/2020, of 31 March, which approved the MBPF for the four-year period 2020-2023 established for the first year a value 16 M€ higher than that contained in the PPL no. 6/XIV, discussed at the same time as the SB/2020, the analysis of which is contained in the CFP Report no. 1/2020.

Chart 4 – Expenditure limits in the scope of the MBPF for 2020 and amendment proposal (M€)



Source: Ministry of Finance. CFP calculations. | Note: Change by function and program resulting from the State Budget Amendment (SBA)/2020 are indicated in italics.

It is not possible to assess the compatibility of the new expenditure ceiling of the PDB for 2020 with the balance in national accounts, given the insufficient information available. The MBPF is drawn up from the public accounts point of view and it is necessary to assess the compatibility of the expenditure ceiling entered in the MBPF with the MF's estimate from the national accounts point of view. However, the table showing this changeover, which includes in particular the details of the accrual adjustments inherent in the national accounts, is not included in the Report accompanying the SBA/2020, contrary to what occurred with the PSB/2020. Although the MF sent additional information following questions from the CFP, the lack of some information inherent to this framework, as well as the value of expenditure financed by own revenues, prevents the validation of such compatibility.

5. PUBLIC DEBT

5.1 Indebtedness and financing needs of the State

The upward review of the debt limit for 2020 frames the increased funding foreseen for 2020 in the SBA/2020. The SBA/2020 bill (PPL no. 33/XIV/1.ª) aims at the upward revision of the overall direct indebtedness limit of the Portuguese State, from 10 thousand M€ to 20 thousand M€. This change makes it possible to increase funding in order to cope with the greater funding needs anticipated in the context of the current pandemic, which led to an increase in global direct indebtedness to 19.7 thousand M€ (9.3 thousand M€ in the SBA/2020). In CFP calculations, to the State's direct indebtedness mainly contributed i) the central government budget deficit in public accounts (14.5 thousand M€); followed by ii) the consolidated net acquisition of financial assets (5.8 thousand M€); and iii) the expectation of not fully using the central government budget appropriations (0.6 thousand M€).

The SBA/2020 implies an increase of 9.6 billion euros in the gross financing needs of the State compared to the SBA/2020, justified essentially by the larger budget deficit. The net borrowing of the State now forecast by the MF justifies the total increase in gross borrowing, reflecting the increase in the State deficit (+10 thousand M€) and, to a lesser extent, the net acquisition of financial assets (+1.7 thousand M€) (Table 9). Of the amortizations, slightly lower than in the State Budget for 2020, the lower amortization of short-term debt stands out, motivated by a lower amortization of CEDIC (-2 thousand M€), which is partly compensated by a higher PGB amortization than that foreseen in the SB/2020 (+ thousand M€). As a result of this new MF forecast (SBA/2020), gross borrowing requirements are EUR 5.8 thousand M€ (11.7%) higher than in 2019.

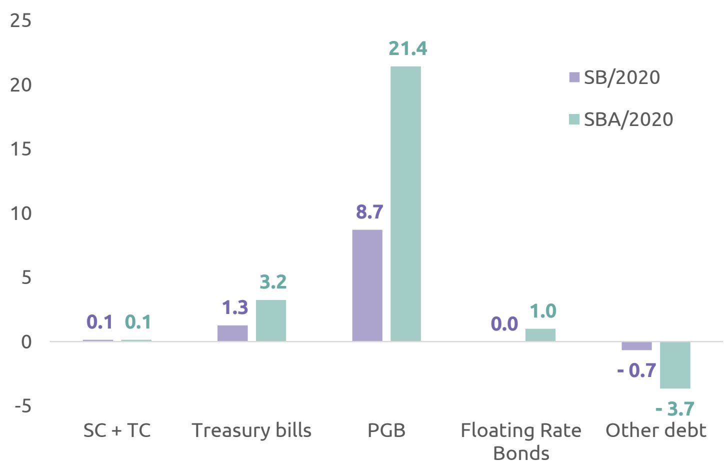
Table 9 – State borrowing requirements (M€)

Financing Needs	2019		SB/2020		SBA/2020	
	Amount	Weight (%)	Amount	Weight (%)	Amount	Weight (%)
1. Net Financing Needs (a) + (b) - (c)	9 499	19	9 577	21	20 262	36
a) Budget deficit	3 940	8	5 874	13	14 846	27
b) Net purchasing of financial assets (except privatisations)	5 559	11	3 703	8	5 416	10
c) Privatisation revenues	0	0	0	0	0	0
2. Redemptions and cancellations [funded debt] (d) + (e) + (f) + (g) + (h)	40 449	81	36 589	79	35 510	64
d) SC + TC	3 876	8	4 103	9	4 103	7
e) Short-term euro-denominated debt	21 697	43	24 398	53	22 327	40
f) Medium and long term euro denominated debt	14 815	30	8 108	18	9 106	16
g) Non-euro denominated debt	86	0	0	0	0	0
h) Swaps capital flows (net)	-25	0	-20	0	-26	0
3. Gross Financing Needs (1) + (2)	49 948	100	46 166	100	55 772	100

Source: MF. CFP calculations.

The increase in financing needs will be ensured mainly by the use of long-term debt issues. According to the SBA/2020, PGBs remain the main source of financing, through a significantly higher amount of net issuances than forecast in the SB/2020 (increase of 12.7 thousand M€) (Chart 5). In short-term financing, the MF foresees a higher net issuance of Treasury Bills and a new issuance of a Floating Rate Bond. In the opposite direction, a decrease in the Other debt is anticipated, essentially justified by the reduction in the balance of the CEDIC. Although reference is made to the use of 1182 M€ of loans via the EU SURE programme in the Report accompanying the proposed budget review, this same financing is not reflected in the tables of the chapter on public debt in this Report, nor in the lines of action for the 3rd quarter released by the IGCP in June.[21]

Chart 5 – Financing composition in 2020 (B€, cash basis)



Source: MF. CFP calculations. | Notes: SC = Saving Certificates and TC = Treasury Certificates; PGB = Portuguese Government Bonds. Other debt includes SSTDC, SMLTDC, other short-term debt, other medium and long-term debt, other non-euro debt and swaps.

5.2 Debt Dynamics

According to the SBA/2020, the debt ratio is expected to increase by 16.7 p.p. in 2020 to 134.4% of GDP. All the components contribute unfavourably to this evolution (Chart 6, left panel), contrasting with the SB/2020, which was expected to show a favourable evolution in comparison to 2019. In the current context of deteriorating economic activity, the GDP effect justifies a significant part of the worsening of the ratio (7.5 p.p.) and, together with the interest effect (3.1 p.p.), results in a dynamic effect of 10.6 p.p.. The primary balance effect amounts to 3.2 p.p., while the debt adjustment explains 2.9 p.p. of the change in the ratio. According to additional information from the Ministry of Finance, the latter is due to a higher accumulation of deposits than foreseen in the

[21] https://www.igcp.pt/fotos/editor2/2020/Programa_de_Financiamento/PF20203TPT.pdf

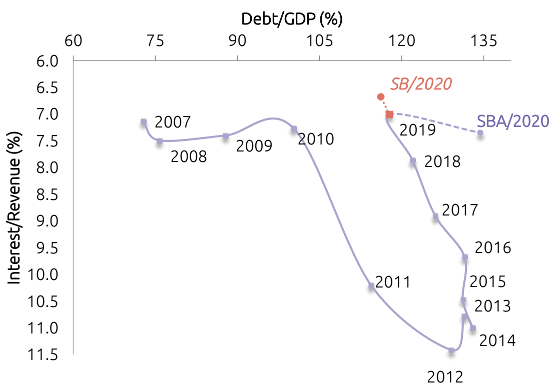
SB/2020[22]. The increase in nominal debt and the decrease in GDP, combined with the decrease in general government revenue, is reflected in a deterioration in the debt's affordability, interrupting the favourable trajectory it had been on since 2015 and reflecting the country's greater fiscal effort to bear the debt burden (Chart 6, right panel).

Chart 6 – Public debt developments (% of GDP and p.p.)

Contributes to change in 2019-2020

	2019	SBA/ 2020	*memo item SB/2020*
Maastricht debt (% of GDP)	**117.7**	**134.4**	***116.2***
Change (p.p. of GDP)	-4.3	16.7	*-2.7*
Primary balance effect	-3.2	3.2	*-3.2*
Dynamic effect	-1.6	10.6	*-0.9*
Interest effect	3.0	3.1	*2.9*
GDP effect	-4.6	7.5	*-3.8*
Others	0.5	2.9	*1.3*

Debt affordability



Sources: MF and CFP calculations.

Despite the nominal increase in debt, no significant deterioration in the cost of financing is anticipated. Since 2017, the average cost of new debt issued[23] has been falling from 2.6% to 0.5% in 2020. The maintenance of the ECB's asset purchase policy and the improvement in the rating and risk perception of the Republic's debt have contributed to this behaviour. The increase in interest charges as a ratio to GDP forecast for 2020 is due to the decrease in nominal GDP since the nominal interest charges remain practically unchanged. For this year, the higher weight of interest on GDP is justified almost exclusively by the stock effect (Table 10), with the price effect being practically zero, which makes it possible to maintain the implicit interest rate forecast in the SB/2020 (2.5%).

[22] The SBA/2020 anticipates a considerably higher debt adjustment (5.7 billion euros) than foreseen in the SB/2020 (2.9 billion euros). According to the MF, this increase is due to the greater accumulation of deposits, in order to cope with possible periods of instability in the funding markets in the context of a pandemic. The Cash and Deposits item now represents almost 60% of the total adjustment (against -13% in the State Budget for 2020).

[23] Treasury Bonds, Treasury Bills and Medium Term Notes.

Table 10 – Contributions to changes in interest

	Public Debt stock (% of GDP)	Average Public Debt stock (% of GDP)	Interest (% of GDP)	Implicit interest rate (%)*	Change of interest weight on GDP (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	131.5	131.3	4.1	3.2	-0.43	-0.02	-0.41	0.00
2017	126.1	128.8	3.8	2.9	-0.37	-0.08	-0.30	0.01
2018	122.0	128.9	3.4	2.7	-0.40	-0.14	-0.27	0.01
2019	117.7	119.9	3.0	2.5	-0.37	-0.11	-0.27	0.01
2020	134.4	126.1	3.1	2.5	0.14	0.16	-0.01	0.00
memo items								
SB/2020	*116.2*	*117.6*	*2.9*	*2.5*	*-0.17*	*-0.08*	*-0.10*	*0.00*

Source: Ministry of Finance. CFP calculations. Formulae: 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 SB/2020 and SBA/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 solely on the preceding year's debt stock.

6. RISKS OF THE FISCAL SCENARIO

The forecasts for the evolution of national public finances in 2020, presented in the SBA/2020, should be analysed with additional caution in light of the historically high risks (mostly of a downward nature) stemming from the current pandemic context.

The SBA/2020 incorporates a forecast of the impacts resulting from the crisis response measures adopted between March and May (emergency phase) and the measures included in the Economic and Social Stabilization Program, which will be in force in the 2nd half of 2020. However, contrary to what would be desirable, there is no identification of the impact of each measure by revenue and expenditure item and no mention is even made of the total expected impact of the set of measures adopted since the beginning of the pandemic on the budgetary balance in national accounts in 2020. The CFP requested this breakdown from the MF, but obtained it in a partial way only, a situation which does not support fiscal transparency and which implied a clearance exercise by the CFP, which may not be entirely correct because complete information is not available. The risk that the total impact may be more negative than expected by the MF should be noted, as it will depend on the spatial and temporal extent of the epidemiological phenomenon and the risk of a new wave of infection and restrictions on economic activity cannot be excluded.

Since the beginning of the pandemic, measures have been adopted that do not have a direct impact from the fiscal point of view, but that in many cases constitute contingent liabilities of general government. This is the case of the financing lines with a State guarantee until the end of the year (which, after the 6.8 thousand M€ reinforcement foreseen in the SBA/2020, will now total 13 thousand M€, the maximum value authorised by the European Union) and the public moratorium regime that allows for the suspension of the payment of bank loan instalments to residents in Portugal (a regime that was generally extended until March 2021). These are contingent liabilities of the State which, in the event of default by the debtor, materialise into capital expenditure, contributing to the worsening of the budgetary balance. This potentially high downside risk on the budgetary balance and on the public debt ratio in the coming years becomes even more relevant given the pre-existing level of contingent liabilities, which were assessed by Eurostat at 42.4% of GDP at the end of 2018.

The achievement of the GDP growth projected by the MF is a critical factor in meeting the fiscal targets. The quality of this forecast is even more important in the current crisis context. Should the contraction of the economy be more intense than foreseen in the SBA/2020, this will have an even more unfavourable effect on the behaviour of budgetary aggregates, and may imply a sharper increase in expenditure on social benefits (unemployment benefit and, in the current context, sickness benefit and the Social Insertion Income itself) and a greater reduction in tax revenue (via private consumption, which fall seems to have been underestimated in the scenario underlying the SBA/2020). Still in the area of revenue, the tax payment deferral measure is important to ensure liquidity to companies, but it also entails downside risks, to the extent that the payment of these tax obligations may be jeopardized if insolvency situations occur.

On the expenditure side, it will be important to monitor the evolution of subsidies, as much of the impact of the new measures foreseen in the SBA/2020 (in particular the simplified lay-off) will occur under this heading. With regard to capital expenditure, stress should be laid on the downward risk related to the loan that the Portuguese State will grant to TAP. In national accounts, the MF considered a negative impact of 946 M€ on this year's budgetary balance (since it is assumed that this State aid carries a high risk of capital loss to GG), but in public accounts this operation was budgeted for the maximum amount authorised by the European Commission (1200 M€) . Thus, the fiscal risk on the balance, from the national accounts point of view, is pointed out, which arises from the possibility that this loan could be 1200 M€ (increase considered in expenditure on financial assets in Map IV, in public accounts), instead of the 946 M€ considered in SBA/2020, in national accounts.

Still in the area of capital expenditure, it should be noted that the SBA/2020 incorporated the amount of 1035 M€ that the Resolution Fund transferred to the Novo Banco last May (in the SB/2020 only 600 M€ were foreseen). It should be noted that so far 2976 M€ have been paid under the Novo Banco's Contingent Capitalisation Agreement, which provides for a maximum charge of 3890 M€. As of next year, the Novo Banco may still request the remaining 914 M€ from the Resolution Fund, depending on the calculation of losses incurred on assets protected by the contingent capitalisation mechanism and regulatory requirements in terms of capital ratios.

With regard to interest expenditure, the risks arise mainly in the coming years, given the strong increase in the public debt ratio forecast in the SBA/2020. The already high debt level in the pre-pandemic period - Portugal has the third highest public debt ratio (in the Maastricht definition) in the European Union - puts Portugal in a particularly vulnerable situation. With little fiscal space, the capacity to respond with the policies that the current health crisis requires in order to guarantee the recovery of economic activity is limited. However, such recovery is essential for the return to a favourable dynamics of the debt ratio, and a slower than expected economic recovery would negatively influence the ratio, as well as investors' perception of the Portuguese debt. The implementation of the ECB's asset purchase programmes, together with a favourable outlook and rating, allowed financing costs to remain at historically low levels. Even so, it is advisable to monitor the volatility that may arise in financial markets, maintaining, as foreseen in the SBA/2020, a liquidity cushion to ensure future funding needs.

The SBA/2020 provides for an authorisation to double the increase in the overall direct net debt that had been approved in the SB/2020 to a maximum amount of 20 000 M€. In the case of the Autonomous Regions, an exceptional increase in net indebtedness (of 948 M€, according to the ESSP) is foreseen, suspending the limits to regional indebtedness established in the Autonomous Regions' Finance Law. Although the authorisation for these increases is intended to cover exceptional financing needs arising from the pandemic, it nevertheless constitutes a risk to the sustainability of national public finances.

7. ATTACHMENTS

Table 11 – General government account (M€)

	2018	2019	2020		2019/2020 change (M€)		2019/2020 change (%)	
			SB/2020	SBA/2020*	SB/2020	SBA/2020	SB/2020	SBA/2020
Total revenue	87 695	91 008	95 315	86 598	4 307	-4 410	4.7%	-4.8%
Current revenue	**86 867**	**90 259**	**94 287**	**85 137**	**4 028**	**-5 122**	**4.5%**	**-5.7%**
Tax revenue	51 637	53 013	54 709	48 890	1 695	-4 123	3.2%	-7.8%
Indirect taxes	30 956	32 148	33 063	29 653	915	-2 495	2.8%	-7.8%
Direct taxes	20 681	20 865	21 645	19 237	780	-1 628	3.7%	-7.8%
Social contributions	23 835	25 342	26 359	24 060	1 016	-1 283	4.0%	-5.1%
of which: actual soc. contr. receiv	19 128	20 598	21 736	19 397	1 138	-1 201	5.5%	-5.8%
Sales & other current rev.	11 395	11 903	13 219	12 188	1 316	284	11.1%	2.4%
Capital transfers received	**829**	**749**	**1 028**	**1 460**	**279**	**711**	**37.3%**	**95.0%**
Total expenditure	88 599	90 604	94 800	99 177	4 195	8 573	4.6%	9.5%
Primary expenditure	**81 701**	**84 225**	**88 434**	**93 039**	**4 209**	**8 814**	**5.0%**	**10.5%**
Current primary expend.	75 399	78 112	81 298	84 698	3 186	6 586	4.1%	8.4%
Intermediate consumption	11 067	10 991	11 595	11 876	604	885	5.5%	8.0%
Compensation of employees	21 835	22 799	23 535	23 585	736	785	3.2%	3.4%
Social transfers	37 099	38 684	39 961	40 603	1 278	1 919	3.3%	5.0%
other than in kind	33 472	34 731	35 803	36 562	1 073	1 832	3.1%	5.3%
in kind via market producers	3 626	3 953	4 158	4 041	205	88	5.2%	2.2%
Subsidies	750	887	918	2 957	31	2 070	3.5%	233.3%
Other current expenditure	4 648	4 750	5 288	5 677	538	927	11.3%	19.5%
Capital expenditure	**6 302**	**6 113**	**7 137**	**8 340**	**1 024**	**2 227**	**16.7%**	**36.4%**
GFCF	3 795	3 980	4 925	4 959	945	979	23.7%	24.6%
Other capital expenditure	2 507	2 133	2 212	3 382	79	1 249	3.7%	58.5%
Interest paid	**6 898**	**6 379**	**6 365**	**6 138**	**-14**	**-241**	**-0.2%**	**-3.8%**
General government balance	-904	404	515	-12 579	111	-12 983	n.a.	n.a.
Primary balance	**5 994**	**6 783**	**6 880**	**-6 441**	**97**	**-13 224**	**1.4%**	**-195%**
Tax burden	70 764	73 612	76 445	68 288	2 833	-5 324	3.8%	-7.2%
Current expenditure	**82 297**	**84 491**	**87 663**	**90 836**	**3 172**	**6 345**	**3.8%**	**7.5%**
Public debt	**249 261**	**249 980**	**252 980**	**268 302**	**3 000**	**18 322**	**n.a.**	**7.3%**
Nominal GDP	**204 305**	**212 303**	**217 803**	**199 630**	**5 500**	**-12 673**	**2.6%**	**-6.0%**
Memo items (adjusted values from one-off measures)								
Adjusted total revenue	*87 529*	*90 953*	*95 170*	*86 455*	*4 217*	*-4 499*	*4.6%*	*-4.9%*
of which: Capital transfers received	*662*	*694*	*883*	*1 317*	*189*	*623*	*27.5%*	*89.8%*
Adjusted total expenditure	*87 482*	*89 236*	*93 750*	*97 772*	*4 513*	*8 536*	*4.7%*	*9.6%*
of which: Other current expenditure	*4 617*	*4 750*	*5 288*	*5 677*	*538*	*927*	*11.3%*	*19.5%*
of which: Other capital expenditure	*1 421*	*765*	*1 162*	*1 977*	*397*	*1 212*	*5.5%*	*158.4%*
Adjusted general government balance	*47*	*1 717*	*1 420*	*-11 317*	*-297*	*-13 034*	*n.a.*	*n.a.*

Source: INE and Ministry of Finance. Notes: The implicit change take into account the 2019 outturn. The details of the temporary and non-recurring measures can be found in Table 13. | n. a. : not applicable. * SBA: State Budget Amendment.

Table 12 – General government account (% GDP)

	2018	2019	2020 SB/2020	2020 SBA/2020	2019/2020 change (GDP p.p.) SB/2020	2019/2020 change (GDP p.p.) SBA/2020
Total revenue	42.9	42.9	43.8	43.4	0.9	0.5
Current revenue	**42.5**	**42.5**	**43.3**	**42.6**	**0.8**	**0.1**
Tax revenue	25.3	25.0	25.1	24.5	0.1	-0.5
Indirect taxes	15.2	15.1	15.2	14.9	0.0	-0.3
Direct taxes	10.1	9.8	9.9	9.6	0.1	-0.2
Social contributions	11.7	11.9	12.1	12.1	0.2	0.1
of which: actual soc. contr. Received	9.4	9.7	10.0	9.7	0.3	0.0
Sales & other current rev.	5.6	5.6	6.1	6.1	0.5	0.5
Capital transfers received	**0.4**	**0.4**	**0.5**	**0.7**	**0.1**	**0.4**
Total expenditure	43.4	42.7	43.5	49.7	0.8	7.0
Primary expenditure	**40.0**	**39.7**	**40.6**	**46.6**	**0.9**	**6.9**
Current primary expend.	36.9	36.8	37.3	42.4	0.5	5.6
Intermediate consumption	5.4	5.2	5.3	5.9	0.1	0.8
Compensation of employees	10.7	10.7	10.8	11.8	0.1	1.1
Social transfers	18.2	18.2	18.3	20.3	0.1	2.1
other than in kind	16.4	16.4	16.4	18.3	0.1	2.0
in kind via market producers	1.8	1.9	1.9	2.0	0.0	0.2
Subsidies	0.4	0.4	0.4	1.5	0.0	1.1
Other current expenditure	2.3	2.2	2.4	2.8	0.2	0.6
Capital expenditure	**3.1**	**2.9**	**3.3**	**4.2**	**0.4**	**1.3**
GFCF	1.9	1.9	2.3	2.5	0.4	0.6
Other capital expenditure	1.2	1.0	1.0	1.7	0.0	0.7
Interest paid	**3.4**	**3.0**	**2.9**	**3.1**	**-0.1**	**0.1**
General government balance	-0.4	0.2	0.2	-6.3	0.0	-6.5
Primary balance	**2.9**	**3.2**	**3.2**	**-3.2**	**0.0**	**-6.4**
Tax burden	34.6	34.7	35.1	34.2	0.4	-0.5
Current expenditure	**40.3**	**39.8**	**40.2**	**45.5**	**0.5**	**5.7**
Public debt	**122.0**	**117.7**	**116.2**	**134.4**	**-1.6**	**16.7**
Nominal GDP	**100.0**	**100.0**	**100.0**	**100.0**	**0.0**	**0.0**
Memo items (adjusted values from one-off measures)						
Adjusted total revenue	*42.8*	*42.8*	*43.7*	*43.3*	*0.9*	*0.5*
of which: Capital transfers received	*0.3*	*0.3*	*0.4*	*0.7*	*0.1*	*0.3*
Adjusted total expenditure	*42.8*	*42.0*	*43.0*	*49.0*	*1.0*	*6.9*
of which: Other current expenditure	*2.3*	*2.2*	*2.4*	*2.8*	*0.2*	*0.6*
of which: Other capital expenditure	*0.7*	*0.4*	*0.5*	*1.0*	*0.2*	*0.6*
Adjusted general government balance	*0.0*	*0.8*	*0.7*	*-5.7*	*-0.2*	*-6.5*

Source: INE and Ministry of Finance. Notes: The implicit change take into account the 2019 outturn. The details of the temporary and non-recurring measures can be found in Table 13. * SBA: State Budget Amendment.

Table 13 – Impact of the temporary measures on the budgetary balance

	Millions of euros				% of GDP			
			2020				2020	
	2018	2019	SB/2020	SBA/2020	2018	2019	SB/2020	SBA/2020
One-off measures (impact in budget balance)	-951	-1 313	-905	-1 262	-0.5	-0.6	-0.4	-0.6
Revenue	166	55	145	143	0.1	0.0	0.1	0.1
BPP guarantee recovery	166	55	145	143	0.1	0.0	0.1	0.1
Expenditure	1 117	1 368	1 050	1 405	0.5	0.6	0.5	0.7
Capital Injection to Novo Banco	792	1 149	600	1 035	0.4	0.5	0.3	0.5
DTA	100		130	130	0.0		0.1	0.1
Wild fires	130				0.1			
Judicial Court Decision- Lisbon Municipality	96		160	160	0.0		0.1	0.1
Compensation to the concessionaire AEDL, S.A.		219				0.1		
Transfer of FGCAM to FDG			80	80			0.0	0.0
IP indemnification			80				0.0	
Memo items (impact by budget aggregate)								
Capital transfers received	*166*	*55*	*145*	*143*	*0.1*	*0.0*	*0.1*	*0.1*
Other current expenditure	*31*				*0.0*			
Other capital expenditure	*1 087*	*1 368*	*1 050*	*1 405*	*0.5*	*0.6*	*0.5*	*0.7*

Sources: INE and Ministry of Finance. | Note: CFP's calculation and classification of temporary measures. Due to rounding the totals do not necessarily correspond to the sum of the percentage GDP figures.

7.1 List of Abbreviations

Abbreviations	Meaning
CG	Central Government
AMPT	Additional to the Municipal Property Tax
GG	General Government
ECB	European Central Bank
BPP	Portuguese Private Bank
TT	Treasury Tickets
SC	Savings Certificates
EC	European Commission
SSTDC	Special Short-term Debt Certificates
SMLTDC	Special Medium and Long Term Debt Certificates
CFP	Portuguese Public Finance Council
TC	Treasury Certificates
DGB	Directorate General for Budget
PD	Public Debt
GFCF	Gross Fixed Capital Formation
IMF	International Monetary Fund
SSI	Social Support Index
IEFP	Institute for Employment and Vocational Training
TPDMA	Treasury and Public Debt Management Agency
IMI	Municipal Real Estate Tax
IMT	Municipal Property Transfer Tax
INE	National Statistical Office
CPI	Consumer Price Index
IRC	Corporate Income Tax
IRS	Personal Income Tax
VAT	Value Added Tax
BFL	Budgetary Framework Law
LFA	Local Finance Act
RFA	Regional Finance Act
M€	Millions of Euros
MRS	Discretionary measures on the revenue side.
MF	Ministry of Finance
OECD	Organisation for Economic Cooperation and Development
SB	State Budget
TB	Treasury Bonds
VITB	Variable Income Treasury Bonds
SP	Stability Program
ESSP	Economic and Social Stabilisation Programme
GDP	Gross Domestic Product
SBP	State Budget Proposal
p.p.	Percentage points
PPL	Proposed Law
MBPF	Multiannual Budgetary Programming Framework
RNFNC	Non-tax and non-contributory revenue
NHS	National Health Service
YRC	Year-on-year rate of change
EU	European Union

7.2 Main Sources of Statistical Information

EUROPEAN COMMISSION (2020b), Assessment of the 2020 Stability Programme for Portugal.

EUROPEAN COMMISSION (2020c), European Economic Forecast - Spring 2020.

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

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

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

MINISTRY OF FINANCE (2020b), Stability Programme 2020.

MINISTRY OF FINANCE (2020c), Supplementary Budget for 2020.

7.3 Chart Index

7.4 Table Index

7.5 Box Index