Conselho das Finanças Públicas

ANALYSIS OF THE NATIONAL MEDIUM-TERM FISCAL-STRUCTURAL PLAN (2025-2028)

October 2024

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

CFP began its activity in February 2012, with the mission of undertaking an independent assessment of the consistency, compliance and sustainability of fiscal policy, while fostering its transparency so as to contribute to the quality of democracy and economic policy decision-making, as well as reinforcing the Republic's financial credibility.

This report was prepared based on the information available as at 22 October 2024.

A spreadsheet containing the numerical data inherent to the charts and tables in this report is available at www.cfp.pt, in the publications area. The main public finance concepts used in this Report are explained in the CFP Glossary available online.

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OVERALL ASSESSMENT

The National Medium-Term Fiscal-Structural Plan (MTP) marks the beginning of a new phase in the European economic governance. As far as the budgetary aspect of this new architecture is concerned, the trajectory of net expenditure is considered crucial to ensure public debt sustainability, significantly conditioning the fiscal policy at national level, particularly in member states with a public debt level above 60% of GDP, which is the case of Portugal. The new MTP contains the annual ceilings for the net expenditure growth that Portugal undertakes to respect until 2028, this indicator being the only operational reference for assessing the implementation of the plan and triggering possible sanctions under the corrective arm of the Stability and Growth Pact.

The MTP presented by the Portuguese government has a time horizon of four years (2025 - 2028), coinciding with the remainder of the current legislative term and the time horizon of the Major Options Law. The commitment made by the Portuguese government translates into a 3.6% average annual growth rate in net expenditure for the next four years. This is in line with the reference trajectory conveyed by the European Commission to the Portuguese authorities in June 2024, although with a different inter-annual profile, essentially reflecting the expectation of full implementation of the Recovery and Resilience Plan.

Complying with this budgetary trajectory does, however, present some risks. CFP's budgetary projections, for the same time horizon and under a no-policy change assumption, point to a 4.3% average net expenditure growth rate, 0.7 p.p. higher than the 3.6% commitment undertaken in the MTP. If this development were confirmed, it would imply an accumulated deviation in the control account of 0.4% of GDP by the end of the Plan's horizon, a figure close to the maximum allowed threshold of 0.6% of GDP. Maintaining budget balances close to balance or in surplus is therefore a vital element in guaranteeing an execution compatible with the plan and avoiding the risk of triggering the mechanisms laid down by law, which could lead to the opening of an Excessive Deficit Procedure, with adverse consequences for the country's creditworthiness.

It is important to realise that the commitment made by Portugal does not leave much room for adopting new measures to increase expenditure or reduce revenue, without compensatory measures or appropriate expenditure review instruments aimed at identifying superfluous, unnecessary or even less effective expenditures. Otherwise, according to CFP's projection, the measures already legislated reach the assumed expenditure limit (as shown in this projection by the accumulated deviation of the 'control account' at the end of the horizon).

The new European economic governance framework also imposes important changes on public financial management systems of the Member States, underlining the importance of having appropriate instruments to develop and monitor a medium-term fiscal strategy. Thus implies the need to revise the Budget Framework Law, transposing the provisions of the new Council Directive (EU), In the spirit of national ownership underlying the new economic governance framework, making this is the right moment to review national fiscal rules and implement a genuine medium-term fiscal framework

that specifies, in an objective, clear and measurable way, the resources, targets and timetables of the policies they are intended to finance.

But the contribution of the budgetary strategy to economic and social development, in the medium and long term, depends on more than just the level of resources allocated to this strategy. Above all, it depends on the vision for the country that this strategy supports. Building a prosperous and sustainable economy involves outlining a clear guidance for the country's development in economic, environmental and social terms, and promoting the effective integration of structural policies capable of responding to the challenges faced by the Portuguese economy and leveraging its growth potential.

Although the MTP includes some public policy measures, it still shows weaknesses in outlining strategic and structural targets. When the BFL is revised, we will also need to reflect on the content and scope of this new plan in the context of a duly valued medium-term programming system. Furthermore, the Budgetary Framework Law is of a structural nature, and therefore the Portuguese Public Finance Council, as the country's independent fiscal institution, should be involved in this process.

INTRODUCTION

The supranational budget framework applicable to EU countries was substantially revised with the reform of the European economic governance framework approved on 29 April 2024. This reform modifies the previously prevailing budgetary rules framework, substantively changing the Stability and Growth Pact, particularly the so-called preventive arm and corrective arm based on the debt criterion.[1]

Pursuant to its mission and attributions, in this document the Portuguese Public Finance Council analyses the National Medium-Term Fiscal-Structural Plan drawn up by the Portuguese government and sent to the European institutions in October 2024. This analysis follows and supplements the Opinion on the Macroeconomic Forecasts underlying the National Medium-Term Fiscal-Structural Plan published on October 11th.

The document is structured as follows: Chapter 1 presents the reform of the European budget framework; Chapter 2 analyses the net expenditure trajectory between 2025 and 2028, comparing an update of CFP's fiscal scenario with the one presented in the National Medium-Term Fiscal-Structural Plan; Chapter 3 concludes. There are also boxes on: the impact of RRP loans on the net expenditure trajectory; the evolution of public investment according to the POEN-MP; relevant budgetary risks over the Plan's horizon; and the budgetary effort underlying the reference trajectory in other euro area countries.

[1] For a detailed description of the previous framework based on budgetary rules, see the European Commission's 'Vade Mecum on the Stability and Growth Pact - 2019 Edition'.

1. THE REFORM OF THE EUROPEAN BUDGET FRAMEWORK

1.1 Explanation of the main changes

This analysis focuses on the changes made to the preventive arm. According to the EU Council, the new framework aims to ensure sound and sustainable public finances and to create incentives that promote growth through reforms and investments, in order to allow countercyclical policies to be pursued. The central target is to reduce debt ratios and deficits in a gradual, realistic, sustained and growth-friendly way, while protecting reforms and public investment in strategic areas such as digital, ecological, social, or defence.

The drawing up of a National Medium-Term Fiscal-Structural Plan (MTP) by each Member State is the centrepiece of the new framework. It has a time horizon of 4 or 5 years, depending on the regular length of the national legislative term. The Plan's duration corresponds to the so-called 'adjustment period'.[2]

The Plan contains budgetary reform and investment commitments, which respond to the main challenges identified in the context of the European Semester. In budgetary terms, the Member State commits to follow its multi-annual 'net expenditure' trajectory. As far as reforms and investment are concerned, they must be more general in scope, taking into account the Union's common priorities, namely: the green transition, including the European Green Deal and the transition to climate neutrality by 2050; the digital transition, including the 2030 Digital Decade Programme; social and economic resilience and the implementation of the European Pillar of Social Rights; energy security; and the strengthening of defence capabilities, where appropriate. The commitments undertaken within the framework of the National Recovery and Resilience Plans should be taken into account when drawing up the first MTP.

'Net expenditure' is the main indicator of the new framework.[3] This is defined as government expenditure net of interest expenditure, discretionary revenue measures (e.g., discretionary tax increases and reductions), expenditure related to Union programmes fully covered by revenue from EU funds, national expenditure related to co-financing of Union-funded programmes, cyclical elements of expenditure related to unemployment benefits, and one-off and other temporary measures.[4]

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[2] The adjustment period may be extended by a maximum of 3 years if the Member State commits to implement a relevant set of reforms and investments in accordance with the criteria set out in Article 14 of Regulation (EU) 2024/1263 of the European Parliament and of the Council of 29 April 2024. This option was not requested in the MTP submitted by Portugal.

[3] In the Portuguese version of the Regulation the expression used is 'net expenditures', the use of the plural in the Portuguese version refers to total adjusted government expenditure, which is generally not written in the plural. Therefore, in this document we will use this designation in the singular, following the usual practice in Portugal.

[4] This concept differs from the previous 'expenditure benchmark' by not smoothing government investment based on a moving average and by excluding national co-financing. In the previous

Figure 1 - Net expenditure calculation formula

$$\boldsymbol{net\ expenditure_t} = total\ expenditure_t - interest\ paid_t - oneoff\ expenditure_t$$
$$- cyclical\ unemployment\ exenditure_t - European\ funds\ financing_t$$
$$-national\ cofinancing_t + discretionary\ revenue\ measures_t$$

From a more intuitive point of view, 'net expenditure' is an indicator that seeks to capture the evolution of expenditure and revenue that is not explained by the evolution of the economy and is therefore under the control of the policymaker. According to the legislator, this indicator is not affected by the use of automatic stabilisers (resulting from the economic cycle) or by other fluctuations in expenditure outside the direct control of the government and provides room for countercyclical macroeconomic stabilisation. To this end, in addition to excluding interest expenditure:

- EU funding is not taken into account. It has a neutral impact on the balance (by financing eligible expenditure with revenue from the EU);
- national co-financing is not taken into account. This is an exclusion added to the legislative package at the trilogue stage with the European Parliament, and appears to be intended to protect public investment financed only in part by European funds;
- the impact of the economic cycle on expenditure on unemployment benefits is excluded. The NAWRU, an unobservable variable, continues to be estimated for this purpose. If, for example, in a given year the unemployment rate is higher than the NAWRU estimate, the relevant excess expenditure on unemployment benefits is disregarded from the calculation of the indicator[5]; the reverse would also be true for times when the unemployment rate is lower than the NAWRU estimate;
- discretionary decisions on the revenue side are added. Thus being the case, a discretionary increase in government expenditure accompanied by a discretionary tax increase of the same amount has no impact on net expenditure; in turn, a discretionary increase in expenditure not financed (in whole or in part) by a discretionary tax increase will increase net expenditure, even if the budget balance does not worsen by the same amount due to an increase in cyclical revenue generated in good economic times. If, for example, a tax is reduced by 500 million euros in a given year, this decision would result in an increase in net expenditure of that amount, unless this loss of revenue is

framework, the expenditure benchmark was to grow less than the medium-term potential growth of the economy for countries that had not yet reached their medium-term objective (MTO) for the structural balance, subtracting a recalibrated convergence margin from that growth rate. On the other hand, if the MTO had been achieved, this margin would be zero, and that indicator should grow in line with potential GDP. The growth in potential GDP corresponded to an average of 10 years, with 5 retrospective years, the current year and four prospective years (forecast). These values were calculated for year t based on the European Commission's spring forecast published in year t-1 and kept frozen until their fulfilment was assessed in the spring of year t+1.

[5] According to the European Commission's spring forecasts, the NAWRU for 2023 is estimated at 5.9%. That same year, the unemployment rate stood at 6.5%. Thus, instead of the estimated expenditure on unemployment benefits of 1.8 billion euros, the relevant expenditure on this social benefit, adjusted for the cycle, is 1.6 billion euros, i.e., approximately 9% lower (NAWRU rate - unemployment rate)/unemployment rate.

offset by expenditure reductions or discretionary increases in other taxes of an equivalent amount.

The exclusion of interest and co-financing expenditure, as well as not taking into account the change in revenue resulting from the economic cycle, distances the evolution of this indicator from the budget balance and public debt trajectory. This may be one of the reasons for including two safeguard clauses, described hereinafter.

The presentation of the national plans[6] is preceded by the presentation, by the European Commission, of a net expenditure 'reference trajectory'. In accordance with Regulation (EU) No. 2024/1263, this should ensure consistency with the corrective path in the corrective arm of the Stability and Growth Pact under Council Regulation (EC) No. 1467/97 and that, by the end of the adjustment period:

- the general government debt is on a plausible downward trajectory or stays at prudent levels, even under adverse scenarios;
- the general government deficit is brought and maintained below 3% of GDP, while taking into account the fact that Member States could face additional costs after the end of the adjustment period such as the costs related to demographic ageing.

The reference trajectory, calculated according to the formula described in Figure 2, must also comply with two safeguards[7]:

- The '**debt sustainability safeguard**', i.e., it must ensure that the projected public debt/GDP ratio decreases by a minimum average annual amount of: a) 1 p.p. of GDP, whenever the public debt/GDP ratio exceeds 90%; b) 0.5 p.p. of GDP, whenever the public debt/GDP ratio remains between 60% and 90%.[8]
- The **'deficit resilience safeguard',** i.e., it must ensure that fiscal adjustment continues, if necessary, until the Member State concerned reaches a deficit level that provides a common resilience margin, in structural terms, of 1.5% of GDP in relation to the deficit reference value of 3% of GDP. To achieve the required margin, there must be an annual improvement in the structural primary balance of 0.4 p.p. of GDP, reduced to 0.25 p.p. of GDP if the adjustment period is extended.[9]

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[6] For countries with a debt or deficit above the reference values of 60% and 3% of GDP, respectively.

[7] It is not clear from Regulation (EU) 2024/1263 whether these safeguard clauses also apply to the trajectory contained in the national plans or *ex-post* to the results of that plan's implementation. However, recital 19 of this Regulation seems to indicate that it will apply to the trajectory of the plans when it states that this safeguard will 'act as a minimum requirement for the effort underlying the reference trajectory and the net expenditure path'. The Guidelines for Member States on information requirements for medium-term fiscal-structural plans and annual progress reports published in the Official Journal C/2024/4209 also include the two safeguards in the checklist of elements that the plans should cover.

[8] This average decrease is calculated from the year before the start of the reference trajectory or the year in which the excessive deficit procedure is expected to be revoked, whichever comes last, until the end of the adjustment period.

[9] This common resilience safeguard shall ensure that budgetary reserves are built up to deal with adverse circumstances and shocks, thus facilitating the development of countercyclical policies under the Union's fiscal framework.

Figure 2 - Net expenditure reference trajectory calculation formula

$$\Delta\ net\ expenditure_t = \Delta\ potential\ GDP_t + \Delta\ GDP\ deflator_t - \frac{\Delta\ SPE}{primary\ expenditure\ \%\ GDP}$$

Sources: European Commission (2024). 'The DSA-based methodology in the new EU fiscal framework'. Box II.2.1, Report on Public Finances in EMU 2023, Institutional Paper 295. | Note: SPE corresponds to the structural primary balance. The change in net expenditure and potential GDP correspond to annual growth rates, and the change in SPE is a change measured in p.p. of potential GDP.

The presentation of a National Medium-Term Fiscal-Structural Plan should be preceded by a bilateral technical dialogue between the Member State and the Commission. The net expenditure trajectory presented in the national Plan may differ from the reference trajectory calculated by the Commission. However, in cases where national medium-term fiscal-structural plans are based on different assumptions than those made by the Commission, the differences should be explained and justified transparently and based on sound economic arguments.

In assessing the Plans, the Commission shall examine the plausibility of the macroeconomic and budgetary assumptions, insofar as they differ from those underlying the reference trajectory. For the first national medium-term fiscal-structural plans, the plausibility of the decrease in public debt in the medium-term should be based on the methodology described in the Commission's 2023 Debt Sustainability Report. For this purpose: a) at the end of the adjustment period and in the following 10 years the debt ratio is on a downward trajectory or below 60% of GDP, both in the adjustment scenario and in three deterministic stress tests; b) in the 5 years following the adjustment period the debt ratio is reduced with a probability of at least 70%; i.e., at least 70% of the debt ratio distribution obtained through a stochastic simulation must be lower than the value of the ratio estimated for the last adjustment year (2028 in the case of a 4-year plan).

Each country will prepare an 'Annual Progress Report' every year. It shall address the implementation of the MTP, including the net expenditure trajectory as determined by the EU Council and the reforms and investments implemented.

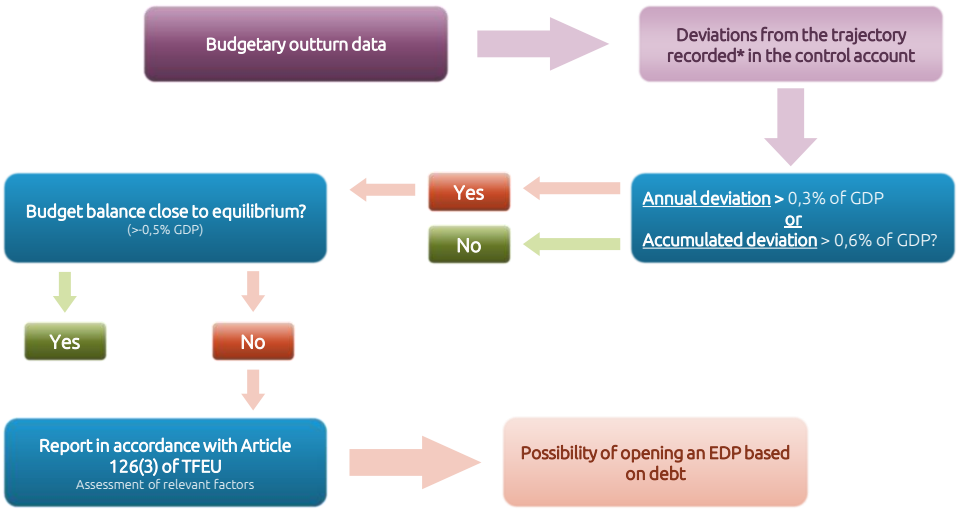
The reform provides for two escape clauses:

- A **general escape clause** in the event of major shocks to the euro area or the Union as a whole, in order to be able to cope with a severe economic downturn in the euro area or the Union as a whole, allowing a deviation from the net expenditure trajectory as determined by the EU Council, provided that such deviation does not endanger fiscal sustainability over the medium term; and
- A **national escape clause** allowing a deviation from the net expenditure trajectory where exceptional circumstances, such as unforeseeable exogenous events outside the control of the Member State, have a significant impact on public finances and require countercyclical fiscal measures, provided that such deviation does not endanger fiscal sustainability over the medium term.

The Commission shall set up a control account for each Member State to keep track of cumulative upward and downward deviations in the net expenditure observed from the path as set by the EU Council. Under certain conditions these deviations can trigger an

Excessive Deficit Procedure (EDP). The Commission shall draw up a report[10] pursuant to Article 126(3) of the Treaty on the Functioning of the European Union (TFEU) when the ratio of public debt to GDP exceeds the reference value, the budgetary position is not close to balance or in surplus and the deviations recorded in the Member State's control account exceed 0.3 percentage points (p.p.). of GDP per year or 0.6 p.p. of GDP cumulatively.

Figure 3 - Stages for the possible opening of a debt EDP



Sources: CFP. | * Not applicable if general or national safeguard clauses are active.

This enhances the importance of avoiding the accumulation of deviations in the control account and maintaining a budgetary position close to balance[11] or in surplus. For countries like Portugal, which have a debt ratio well above 60% of GDP, this commitment is essential to avoid triggering a mechanism that could give rise to an EDP, with the negative consequences that this could entail in terms of the country's creditworthiness.

The possibility of revising the Plan is foreseen, but conditioned. Should there be objective circumstances that prevent the implementation of the MTP, the Member State may ask to submit a revised Plan to the Commission, no later than 12 months before the expiry date of the current Plan. In this case, the revised Plan covers the period up to the end of the initial Plan period. A newly formed government may present a Plan covering a new period of four or five years, depending on the regular length of its legislative term. There are, however, some safeguards. The revised Plan should not, as a rule, result in a less demanding trajectory than the one previously agreed upon; commitments regarding reforms and investment shall remain in force, unless there are relevant objective circumstances that preclude it.

[10] According to the current version of Article 2(2) of Council Regulation (EC) No. 1467/97.

[11] According to Regulation 2024/1264, the budgetary position shall be considered close to balance if the general government deficit does not exceed 0.5% of GDP.

1.2 Transposition into national law

The legislative package approved in April 2024 also amended the Directive[12] which lays down the requirements applicable to Member States' budget frameworks. This amendment shall be transposed into national law by 31 December 2025 and requires Member States to establish 'an effective and credible national medium-term fiscal framework that provides for the adoption of a budgetary planning horizon of at least three years in order to ensure that national budgetary planning is part of a multi-annual budgetary planning outlook'. (Article 9(1)).

Those budget frameworks shall be compatible with any specific national numerical budgetary rules and with the provisions relating to the MTP mentioned above. They must also present a 'description of the medium-term policies envisaged, including reforms and investments, with an impact on general government finances and on sustainable and inclusive growth, broken down by the most relevant items in terms of expenditure and revenue, revealing how the adjustment to the national medium-term budgetary targets is fulfilled'.

Together with the new provisions of the economic governance reform, this will necessarily lead to an amendment of the Budget Framework Law. This amendment shall fulfil the requirement for a medium-term fiscal framework, which cannot be subsumed to the presentation of the MTP or in the current 'multi-annual framework for public expenditure', which has proved ineffective in terms of multi-annual budgetary planning. The effective implementation of programme budgeting could help to fulfil this requirement. The approval of coherent numerical budgetary rules specifically designed for the Portuguese case, for Portugal's general government as a whole and for the various subsectors, instead of a mere transposition of EU rules, can also contribute to meeting national targets. Its adoption therefore merits broad and in-depth reflection and debate.

1.3 CFP's role in POEN-MP monitoring

The Regulation gives the Member State the option of requesting the competent independent fiscal institution to issue an opinion on the macroeconomic forecasts and the macroeconomic assumptions underlying the MTP. To this end, sufficient time must be granted to the independent fiscal institution to draw up its opinion. The Ministry of Finance (MF) framed the request for an opinion in the Protocol between the Ministry of Finance and the Portuguese Public Finance Council, signed on 6 February 2015. The existence of an opinion is also in line with the principles of Article 8 of the Budgetary Framework Law (Law 151/2015, of 11 September 2015): '*The budget projections underlying budget programming documents shall be based on the most likely macroeconomic scenario or a more prudent scenario*".[13]

[12] Directive 2011/85/EU.

[13] This same guiding principle of using realistic forecasts to conduct fiscal policies is also enshrined in European legislation, in particular the Stability and Growth Pact and Council Directive 2011/85/EU, of 8 November 2011, which lays down the requirements applicable to Member States' budget frameworks.

The Opinion[14] on the macroeconomic forecasts underlying the MTP fulfils, albeit partially, the first stage of CFP's monitoring. As mentioned at the time of publication, its preparation was restricted to the macroeconomic scenario elements received by CFP, and did not cover the assumptions needed to calculate the net expenditure trajectory, since CFP was not provided with the methodological assumptions used to calculate the net expenditure trajectory commitment.

Once approved by the Council, the Plan enters the monitoring phase. In this regard, Article 23(1) of Regulation (EU) 2024/1263 provides that Member States may request the independent fiscal institution to analyse the compliance of the budgetary outturns data reported in the Annual Progress Report with the net expenditure trajectory. Member States can also request an analysis of the factors underlying a trajectory deviation. In the State Budget Report for 2025, and with regard to the transposition of Directive 2024/1265 and adaptation to the new Regulations, the government states that one of the amendments to be made to the LEO corresponds to 'providing for the intervention of the Portuguese Public Finance Council' in assessing both the MTP and the Annual Progress Reports.

CFP shall regularly monitor the development of net expenditure. This will take place in the context of its mission[15] and statutory duties, namely assessing compliance with the established budgetary rules and monitoring budget execution, which implies adapting its analysis, monitoring and projection tools, something that has already been reflected in the publication in September of the Economic and Fiscal Outlook 2024-2028 (update). In addition to the medium-term public balance and debt trajectory outlook, the net expenditure growth rate underlying the projection was highlighted and quantified, and its main determinants were identified. The comparison between this net expenditure trajectory (under no-policy change) and the one approved by the EU Council, as well as the balance of the control account to be established as of spring 2026, will provide an indication of the type of action, expansionary or restrictive, that is respectively possible or necessary.

The limited role that governments and the European Parliament were willing to assign to independent fiscal institutions constitutes a weakness of the new framework. Requesting their opinion on the Plans will be optional until at least 2032. According to the *European Fiscal Board*, governments have underestimated the importance of obtaining an independent opinion to make policies more transparent and improve their quality. Also according to the same European Commission advisory body, that option will also hamper the role to be played by the Commission itself, weakening the supervision of national expenditure plans due to the unavailability of a second qualified opinion drawn up by the respective independent fiscal institution.[16] According to the IMF, the existence of independent evaluations is vital to the credibility of the commitments presented in fiscal plans, increasing the provision of budgetary information with greater regularity and quality, thus improving the capacity for public

[14] Opinion no. 03/2024. 'Macroeconomic forecasts underlying the National Medium-Term Fiscal-Structural Plan'.

[15] The current Budget Framework Law provides for CFP in Article 7.

[16] European Fiscal Board (2024). 'Annual Report'.

scrutiny.[17] These limitations of the framework at European level can, however, be mitigated at national level when defining the national budget framework, and within the framework of the transposition of the aforementioned Directive and the revision of the fiscal framework law.

[17] IMF (2024). 'Fiscal Monitor: Putting a lid on public debt'. October.

2. NET EXPENDITURE BETWEEN 2025 AND 2028

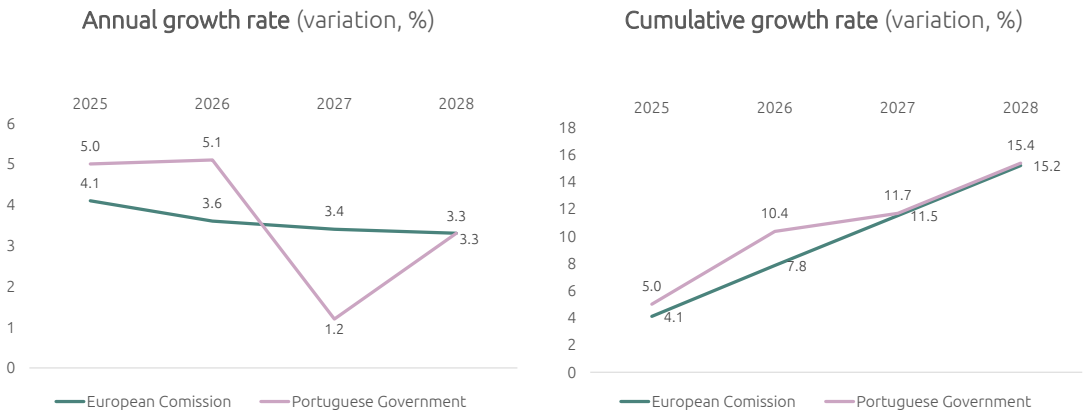
Within the framework of the new European economic governance reform, the Plans must present a net expenditure trajectory. To ensure this target, Member States commit to keep net expenditure growth, in nominal terms, below committed growth rates, both in annual and cumulative terms. This means that the MTP proposes annual ceilings for the growth of net expenditure that the Member State undertakes to respect. Once the EU Council has approved the net expenditure trajectory, this indicator will be the only operational reference for assessing the plan's implementation and triggering a possible excessive deficit procedure (EDP).

2.1 Description of the commitment undertaken

In the MTP, the Portuguese government committed to a 3.6% average annual growth rate in net expenditure for the next four years.[18] Although this coincides with the reference trajectory conveyed by the European Commission to the Portuguese authorities in June 2024, the inter-annual profile undertaken by the Portuguese government is different from the Commission's proposal (Chart 1). Thus, while in the first two years of the plan (2025 and 2026) the annual growth rate of net expenditure is higher than that conveyed by the EC, this is not the case in the following two years. For 2025, the MF justifies this different profile with the evolution of nationally financed primary expenditure underlying the SB/2025 and the impact of revenue reduction measures (which aggravate the growth of net expenditure). In 2026 and 2027, the MF's profile is marked by the implementation of RRP projects financed by loans from the Recovery and Resilience Facility. Excluding the implementation of RRP projects financed by loans, the MF adds that 'the annual growth in net expenditure will decelerate consistently over the Plan's horizon (by a similar magnitude to that forecast in the Reference Trajectory)'. The nominal growth in expenditure between 2025 and 2028 proposed in the MTP (15.4%) is, in any case, cumulatively close to the reference trajectory proposed by the European Commission (15.2%).

[18] The POEN-MP can be found on the GPEARI website, and is also available in English together with the reference trajectory on the European Commission's website.

Chart 1 - Net expenditure trajectory 2025-2028



Sources: MF and EC.

2.2 CFP's medium-term scenario and net expenditure

As part of its assessment of the net expenditure trajectory under a no-policy change scenario, CFP has updated its fiscal projection for the 2025-2028 period. Compared to CFP's projection published in September, this update includes the revision of the new National Accounts statistical base and the new policy measures contained in the proposed 2025 State Budget, with an upward review of the pay rises relating to career reviews of specific civil service professional groups.[19]

CFP's projection under a no-policy change scenario points to a downward trend in the budget surplus. This is compatible with a position slightly above structural balance and a reduction in public debt to a ratio lower than 80% of GDP (Table 1). This projection is subject to the considerable fiscal risks presented in Box 3.

The starting point in 2024 for the budget balance is more favourable than that anticipated by the MF in the DBP/2025. Compared to the MF's projection, CFP's projection points to a lower public expenditure nominal figure (especially current primary and investment expenditure), and a more favourable performance for tax on production and imports revenue and contributions. Their combined effect leads to a positive balance of 0.6% of GDP in 2024, which is 0.2 p.p. higher than estimated by the MF.

In subsequent years, CFP's budget projection points to continued budget surpluses, albeit decreasing, reaching 0.2% of GDP in 2028. This trajectory is underpinned by positive primary balances, averaging over 2.3% of GDP, although penalised by the growing budgetary impact of the use of RRP loans until 2026 (0.3% in 2025 and 0.8% of GDP in 2026). After removing the effects of the cycle and of one-off measures, the

[19] Of particular note is the inclusion of the budget cost for the revision of the nurses' career agreed upon at the end of September and the revision of the budget cost of the remuneration supplements for the armed forces and security forces. It also assumes that military support for Ukraine will gradually dissipate from 2025 onwards.

structural balance is expected to be positive overall, between 0% and 0.4% of potential GDP, ensuring compliance with the common resilience margin provided for in the European governance reform.

In 2028 the public debt ratio is projected to fall by 19 p.p. of GDP, to 78.9% of GDP. This would be its lowest level since 2009. This is supported by the size of the primary balance effect, which accounts for two thirds of the projected reduction.

Table 1 - Main budgetary indicators recalculated under a no-policy change scenario (% of GDP)

	2023 (INE)	CFP Projection				
		2024	2025	2026	2027	2028
Total Revenue	**43.6**	**43.4**	**44.0**	**43.8**	**42.7**	**42.0**
Tax and contributory revenue	37.4	37.3	37.3	37.2	37.2	37.1
Non Tax and non contributory revenue	6.2	6.1	6.7	6.6	5.4	5.0
Total Expenditure	**42.4**	**42.7**	**43.7**	**43.8**	**42.3**	**41.8**
Primary expenditure	40.3	40.7	41.5	41.6	40.1	39.5
Current primary expenditure	36.4	37.0	36.8	36.5	36.4	36.1
Capital expenditure	3.9	3.7	4.7	5.1	3.7	3.4
Primary balance	**3.3**	**2.7**	**2.5**	**2.1**	**2.6**	**2.5**
Interests	2.1	2.1	2.1	2.2	2.2	2.3
Headline Budget balance	**1.2**	**0.6**	**0.4**	**0.0**	**0.3**	**0.2**
Structural Balance	1.1	0.2	0.2	0.0	0.4	0.2
Primary Structural Balance	3.1	2.3	2.3	2.2	2.7	2.5
Public Debt	**97.9**	**92.3**	**88.3**	**85.0**	**82.2**	**78.9**
Net expenditure Growth (%)	-	10.0	6.3	4.8	2.7	3.5

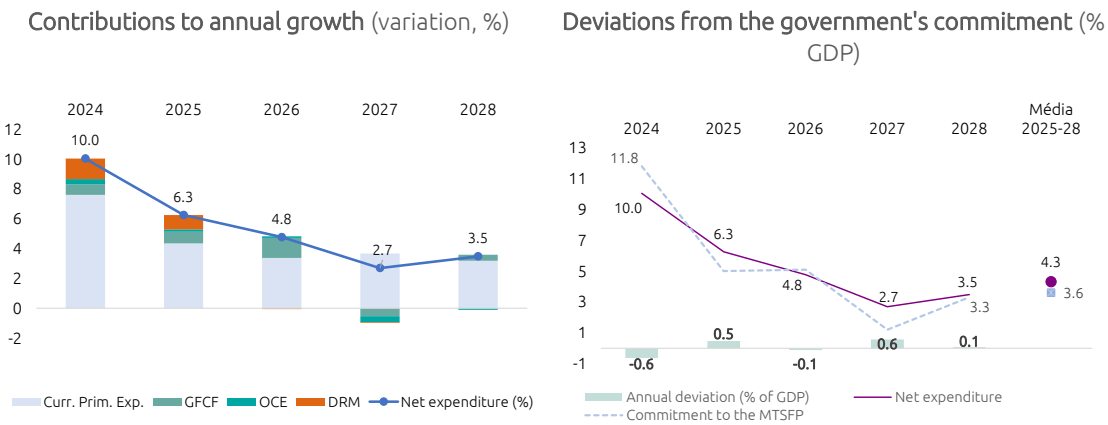
Sources: Statistics Portugal (2023). CFP Projection 2024-2028.

CFP's projection does not support the budget trajectory presented by the Government for 2027 and 2028. The information contained in the Plan is not plausible in terms of the expected trajectory for public revenue and government expenditure in its last two years and, consequently, for the budget balance. The balance presented in the Plan for 2027 and 2028 is 1.1% and 1.3% of GDP respectively, figures that compare, for those same years, with the 0.4% and 0.2% of GDP surpluses that had been projected in the 2024-28 Stability Programme presented last April, in a scenario that does not consider any new policy measures. CFP's projection for these years points to a budget balance of 0.3% and 0.2%, respectively.

The Plan does not identify any economic policy measures to back up the commitment presented. When comparing CFP's projection under a no-policy change scenario and the commitment made in the Plan, one can infer that, according to the information available, additional policy measures will be needed to reduce the growth of net expenditure within the committed limit. According to the MTP guidelines, the presentation of the policy measures needed to fulfil them is optional and should be outlined afterwards in the annual budgets. However, the European Commission also points out that presenting it in the plan would strengthen its credibility and reduce future implementation risks.

In CFP's projection, the average growth rate of net expenditure between 2025 and 2028 is 4.3%, higher than the 3.6% commitment undertaken in the MTP. The average growth rate of this indicator is therefore projected to be 0.7 p.p. higher. According to CFP's projection, net expenditure has a less steep downward profile over the horizon than the Plan's commitment. Net expenditure is only projected to grow less than assumed in the MTP in 2026, when there is a significant impact from expenditure financed by RRP loans (Box 1), which nevertheless constitutes government expenditure, and its financing is public debt.

Chart 2 - Projected development of net expenditure under no-policy change 2024-28

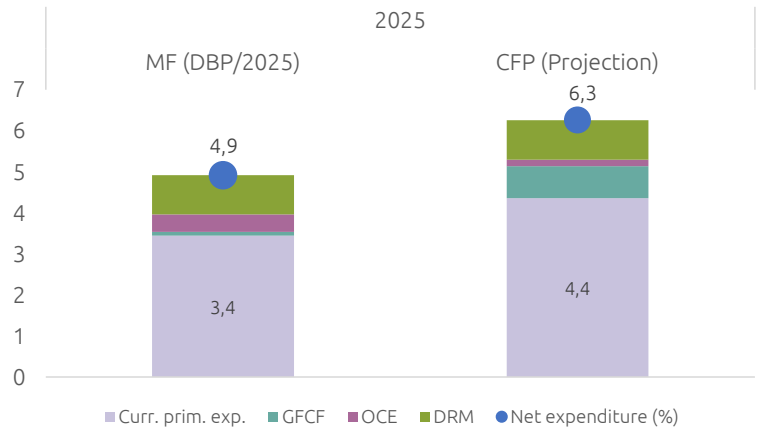


Source: MF. CFP calculations and projections. | Note: (i) Curr. Prim. Exp. - Current primary expenditure;(ii) OCE - other capital expenditure; and (iii) DRM, means discretionary revenue measures. A positive contribution from the latter reflects revenue reduction measures, which are primarily fiscal in nature, increasing net expenditure and consequently its growth rate.

CFP's budget projection for 2025 points to a 6.3% net expenditure growth rate. 2025 will be the first year in which the assessment of the budgetary commitments made in the Plan will be subject to the new fiscal rules framework. In an *ex-ante* assessment, the net expenditure growth implicit in CFP's projection exceeds MF's projection by 1.4 p.p. (4,9% - see Chart 3). More than two-thirds (68%) of this difference is explained by the expected higher growth in current primary expenditure. If this result is confirmed in an *ex-post* assessment, the deviation would be equivalent to 0.5% of GDP[20] compared to the maximum value proposed for the growth rate of this indicator in 2025, which is 5%. This deviation is mainly determined by the impact of revenue reduction measures (discretionary revenue measures) which represent 0.4% of GDP.

[20] This deviation can only be confirmed based on execution data, within the framework of the annual progress report on the Plan's implementation in spring 2026.

Chart 3 - Contributions to the rate of change in net expenditure in 2025 (in % and p.p.)



Source: MF. CFP calculations and projections. | Note: (i) Curr. Prim. Exp. - current primary expenditure; (ii) OCE - other capital expenditure; and (iii) DRM, means discretionary revenue measures. A positive contribution from the latter reflects revenue reduction measures, which are primarily fiscal in nature, increasing net expenditure and consequently its growth rate.

CFP's 0.5% of GDP deviation projected for 2025 exceeds by 0.2 p.p. of GDP the maximum threshold that an annual deviation can assume in the 'control account'. This deviation could lead to a report being drawn up by the European Commission, pursuant to Article 126(3) of the TFEU, in order to assess the need to open an excessive deficit procedure (EDP), if at the same time the budget balance was not in a position close to balance or in surplus. However, CFP's projection shows that it is plausible to maintain a budget surplus position in 2025, which would prevent such a report (see Figure 3). Furthermore, when assessing the relevant factors, the European Commission would have to consider the fact that the accumulated deviation of the control account is lower than 0.6% of GDP (Table 2). A net expenditure growth of 10% is projected for 2024, which is lower than the baseline rate used for the commitment (11.8%).[21]

CFP's projection for 2027 also points to a deviation between net expenditure and the commitment that is twice the maximum annual threshold. An annual deviation of 0.6 p.p. of GDP is, in fact, projected for 2027. However, as in 2025, the projection of a budget surplus makes it possible to rule out drawing up the aforementioned report, which could trigger an EDP.

The only year in which the annual deviation contrasts with previous years is 2026. The estimated deviation of -0.1 p.p. of GDP results from a projected net expenditure growth rate of 4.8%, lower than the 5.1% rate presented in the Plan. The nature of this deviation generates a credit on the control account.

In cumulative terms, considering the commitment made between 2025 and 2028, the net expenditure trajectory projected by CFP points to a cumulative deviation in the control account of 0.4% of GDP at the end of the Plan's horizon. However, such a

[21] This results in a control account credit equivalent to 0.6% of GDP.

cumulative deviation in the control account does not trigger any sanctioning procedure, as it is lower than the maximum 0.6% of GDP threshold allowed.[22]

Table 2 - Control account deviations under no-policy change

		2024	2025	2026	2027	2028
Annual Growth						
Projected Net Expenditure Growth	% change	10.0	6.3	4.8	2.7	3.5
Medium-term Fiscal-Structural Plan Commitment	% change	11.8	5.0	5.1	1.2	3.3
Cummulative Growth						
Projected Net Expenditure Growth	% change	10.0	16.9	22.5	25.8	30.2
Medium-term Fiscal-Structural Plan Commitment	% change	11.8	17.4	23.4	24.9	29.0
Control Account						
Annual Balance	% GDP	-0.6	**0.5**	-0.1	**0.6**	0.1
Cumulative Balance	% GDP	-0.6	-0.1	-0.3	0.3	0.4

Source: CFP calculations. | Notes: The 2024 growth rate is not a commitment, but rather a forecast included in the Plan, which must be taken into account when determining the cumulative deviation from the baseline year of 2023, the last year with execution data. The control account only applies from 2025 onwards. The figures marked in bold in the 'Control Account' correspond to the years in which a positive deviation is projected over the annual maximum threshold of 0.3% of GDP or 0.6% of cumulative GDP. The deviations presented in the 'control account' were calculated in accordance with CFP's interpretation of the legislation and technical clarifications. Therefore, this technical exercise may not take into account possible details concerning the control account that have not yet been encoded.

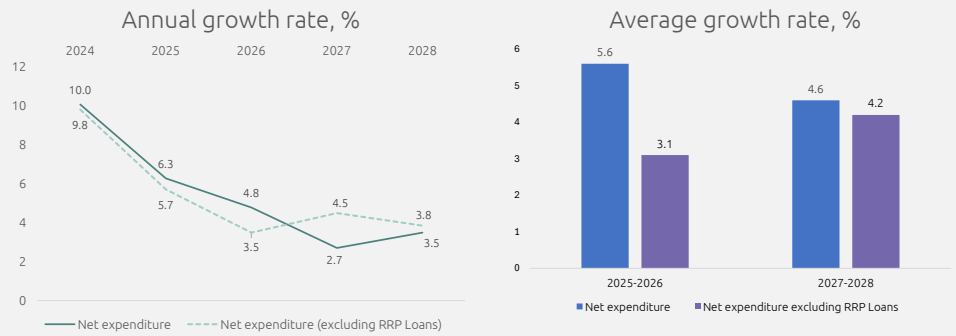
Box 1 - The impact of RRP loans on the projected net expenditure trajectory

The purpose of this Box is to describe the evolution of the net expenditure trajectory projected by CFP, under a no-policy change assumption, after excluding RRP loans. This allows gauging the growth rate commitment of the net expenditure indicator corrected for a volatile and temporary factor, even if its impact on the expenditure level is effective. RRP loans-financed expenditure represents, in cumulative terms, around 1.3% of GDP, with a particularly significant impact in 2026 (0.8% of GDP), creating a base effect that affects the calculation of the rate of change in expenditure in 2027.

Although both trajectories at the end of the horizon are close, the annual profile of the net expenditure growth rate developments differ. In fact, cumulatively, the net expenditure growth projected up to 2028 (30.2%) is close to that resulting from excluding expenditure financed by RRP loans (30.3%). On an annual basis, when excluding the impact of implementing loan-financed RRP projects, the profile of net expenditure growth shows a less significant deceleration. This is particularly visible in 2027, when there is a dissipation of the expenditure financed by these loans.

[22] Preparation of a report under Article 126(3) TFEU to assess whether to open an excessive deficit procedure (EDP).

Chart 4 - Projected net expenditure trajectory and the RRP loans effect



Source: CFP calculations.

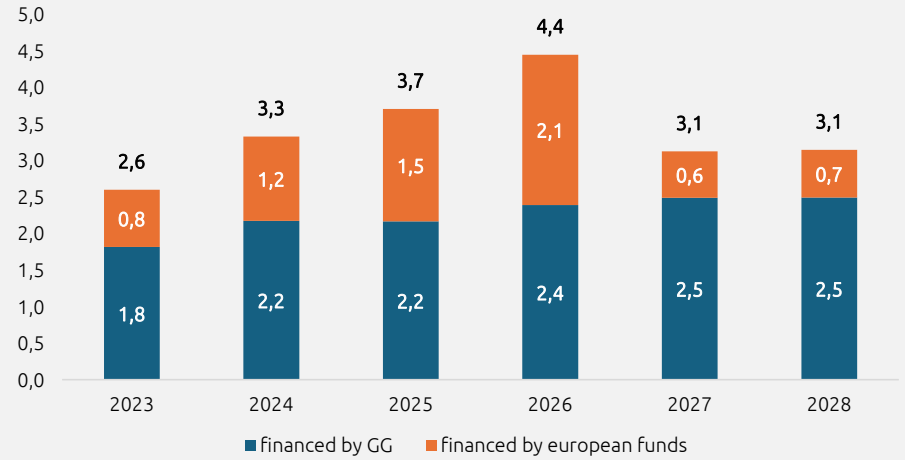
Box 2 – Public investment developments according to the MTP

The macroeconomic and fiscal scenario of the MTP presents a forecast for the evolution of public investment between 2024 and 2028. According to the data available in the document, and information subsequently provided by the MF, public investment, as a percentage of GDP, should increase from 2.6% in 2023 to 4.4% in 2026, with an average annual growth of approximately 25%. The 34.4% increase forecast for 2024 contrasts, however, with the outturn in the first half of this year (less than a third of what is expected for the year as a whole), as well as with CFP's projection for 2024 (8.2%), pointing to a downside risk in the forecast. This risk had already been identified in Opinion no. 02/2024, which pointed out that the expected growth in real investment in the Portuguese economy, in the second half of the year (approximately 7%, after 1.2% in the first half), seemed to be based on an expected execution of public investment that would be difficult to achieve.

There is a significant drop in public investment for the 2027-2028 biennium. After reaching 4.4% of GDP in 2026, the public investment rate drops significantly to 3.1% of GDP in 2027 (equivalent to a reduction of 1.3% of GDP or 3.7 billion euros). MTP anticipates investment to stabilise at 3.1% of GDP in 2028, as well.

This is based on a limited increase in investment with national financing compared to the evolution of investment financed by European funds. In fact, according to the MTP, public investment financed by the general government should increase from 2.2% of GDP in 2024 to 2.4% in 2026. In 2027 and 2028 it stabilises at 2.5% (+0.1 p.p. of GDP). By contrast, investment financed by European funds, in particular through the implementation of the Recovery and Resilience Plan (RRP), shows an upward trend between 2024 and 2026 (from 1.2% of GDP to 2.1%, respectively), decreasing significantly in 2027 (to 0.6% of GDP).

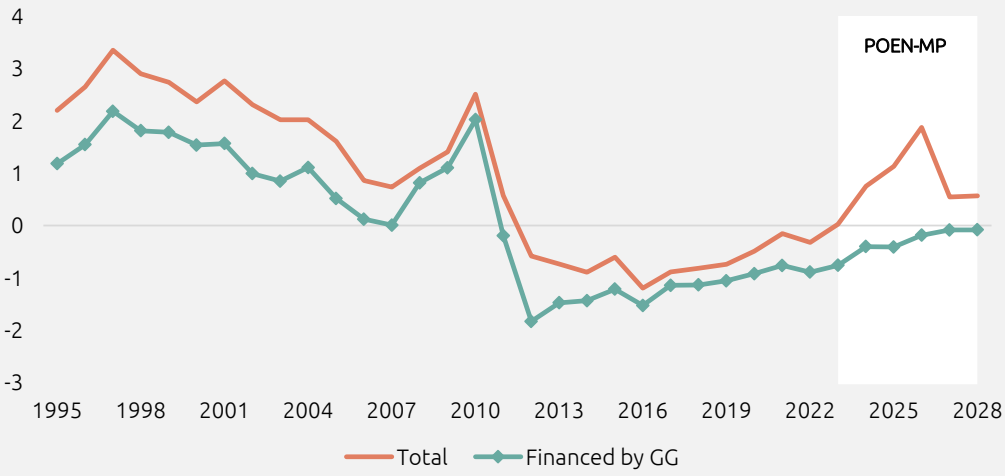
Chart 5 - Public investment, % of GDP



Source: MF and CFP calculations.

This drop brings the rate of public investment, net of depreciation, close to 0.5% of GDP in 2028, translating into a modest increase in public sector capital stock. The positive net forecast for investment between 2024 and 2028 is based on investment with European funding. Considering only the nationally financed component, in net terms, it is expected to remain negative until 2028 (albeit marginally in 2027-2028), which has been the case since 2010. The appropriateness of these developments should be assessed considering the Portuguese economy's medium-term challenges, including, among others, the energy transition, digital infrastructure and skills, defence, and other structural challenges, particularly demographic ones. Given the outlook for the growth rate of 'other expenditure', as well as the proposed reference path for overall net expenditure, meeting these needs would require financing by revenue discretionary measures or a reduction in expenditure other than public investment.

Chart 6 – Investment net of depreciation, % of GDP



Source: MF and CFP calculations. | Note: for depreciation, general government consumption of fixed capital is assumed to stabilise at 2.6% of GDP as reported in 2023.

Box 3 - Relevant budgetary risks in the MTP horizon

CFP's updated fiscal projection presented in this report includes the expected revenue and expenditure developments, under a no-policy change assumption, from 2026 onwards. This does not take into account new policy measures, or measures already announced that are not legislated. In this understanding, the implementation of unanticipated or unplanned economic policy measures, as well as their extension, modification, or discretionary elimination, has implications for the evolution of budgetary variables and, potentially, for the macroeconomic scenario itself. In addition to this element, as in any exercise with a medium-term horizon, it is possible to catalogue a set of risks or pressures surrounding the central scenario.

There are pressures with a significant fiscal impact for which quantification remains in doubt, that can materialise within the Plan's timeframe. These risks include: (i) the budgetary impact of the Porto-Lisbon high-speed train line (LAV) and the New Lisbon Airport; (ii) defence and security expenditure, considering Portugal's international commitments; and (iii) social expenditure, specifically with health.

The Porto-Lisbon high-speed train line project will comprise three phases under a Public-Private Partnership (PPP). The budgetary impact of these projects will depend on the allocation of risks between the public and private sectors, as well as the percentage of funding from European funds, where applicable. Publicly available information suggests that the net burden of PPPs, particularly with construction, signalling and telecommunications, will gain relevance in 2027 and 2028, and could reach 0.1% and 0.2% of GDP, respectively. This coincides precisely with the biennium in which Portugal's commitment to net expenditure growth is most restrictive.

National defence expenditure will have to increase to meet the 'Defence Investment Commitment' undertaken by NATO Allies in 2014. [23] Regarding national defence, in 2023 Portugal recorded an expenditure of approximately 1.5% of GDP, [24] which is also the average figure reported since 2014. This is lower than the figure outlined in the 'Defence Investment Commitment' made by the North Atlantic Treaty Organisation (NATO) Allies in 2014, a situation similar to that of most EU countries. Bearing in mind the commitment made in the MTP, this should put pressure on government expenditure, since the sustained allocation of 2% of GDP to National Defence will require an increase in this expenditure of around 0.5 p.p. of GDP (approximately 1,650 M€ at 2028 prices), a burden that is not included in this projection under a no-policy change scenario presented by CFP.

The provision of health care puts increased pressure on public expenditure. One approach to its sizing is the use of the risk scenario from the *Ageing Report*, which incorporates a more dynamic growth in expenditure in line with the most recent trends and captures the impact of non-demographic (technological innovation, new treatments and diagnostic equipment) and institutional factors (extension of the care provided). In this context, in 2028 health and long-term care expenditure could increase by around 0.4% of GDP compared to the central scenario of the exercise.

[23] This political commitment undertaken by the Allies set a target of at least 2% of GDP in overall defence expenditure over a decade (i.e. by 2024), in order to meet NATO's capability priorities. Likewise, NATO (in 2014) and the European Council (in 2017) set the goal of 'increasing defence investment expenditure to 20% of total defence expenditure in the medium-term', which includes differentiating equipment and related research and development.

[24] Stockholm International Peace Research Institute (Sipri).

This non-exhaustive set of pressures corresponds to approximately 1% of GDP. Should they materialise as described above, in 2028 there would be an increase of around 2.5% in net expenditure, thus posing challenges in meeting the assumed trajectory in the absence of compensatory measures of an equivalent size.

2.3 The fiscal policy stance

As net expenditure is the only operational indicator in the new economic governance framework, its evolution is important in assessing the fiscal policy stance. Usually, the fiscal policy stance in relation to the economic cycle is assessed by the relationship between the primary structural balance (or its annual change) and the output gap (or its annual change). With fiscal rules shifting their focus from the structural budget balance (and its medium-term objective) to rate of growth of net expenditure, the European Commission has been presenting a complementary reading of the fiscal policy impulse consistent with this perspective.[25]

For this purpose, the net expenditure nominal growth rate is compared with medium-term nominal potential growth.[26] If net expenditure grows at a faster rate than medium-term growth, the fiscal impulse on aggregate demand is considered expansionary. Otherwise, the fiscal stance is characterised as restrictive. It should be noted that, by design, the indicator contains mostly acyclical expenditure components (e.g. by correcting, for example, the impact of the economic cycle on unemployment expenditure) and excludes, among others, interest expenditure. Thus, changes in the share of net expenditure in nominal potential output derive mainly from the discretionary action of governments.

According to CFP's projection, fiscal policy will be expansionary in 2025, neutral in 2026 and restrictive in 2027–2028.[27] The composition of this impulse - between what originates from the national budget and what originates from expenditure financed by European funds[28] - differs over time, although it is generally in accordance. In particular in 2025, expenditure financed by European funds, mostly the RRP, is projected to offer a significant growth impulse, as is net expenditure with national financing, although the contribution of the latter is proportionally lower. In 2027, the end of the RRP (see Box 2) will result in a significant negative impulse for aggregate demand, which will be reinforced by a growth in expenditure financed by the national budget that is lower than medium-term potential growth. This scenario is expected to continue in 2028.

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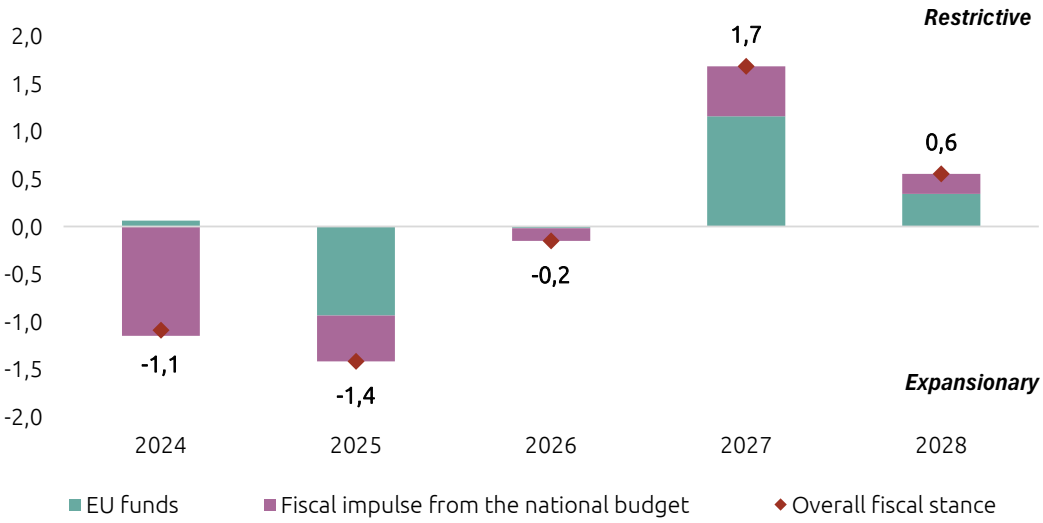
[25] See European Fiscal Board (2024). 'Assessment of the fiscal stance appropriate for the euro area in 2025' and European Commission (2023). 'Fiscal surveillance indicators used in the assessment of the 2024 Draft Budgetary Plans', Box 1, Staff Working Document 951.

[26] Like the European Commission, this analysis assumes that medium-term nominal potential GDP corresponds to the geometric average of estimated real potential growth over a 10-year time horizon (between t-6 and t+3), applying the deflator observed (or projected) in each year. The estimate of potential GDP growth underlying the macroeconomic scenario presented in Report 04/2024 was used.

[27] Orientation is usually read in intervals, as it cannot be precisely estimated because it is influenced by the composition of any measurements and their multiplier effect. It is therefore agreed that a neutral contribution corresponds to a budget impulse between -0.25% and 0.25% of GDP.

[28] Expenditure financed by transfers from abroad reflected in GG revenue.

Chart 7 - Fiscal policy stance regarding the economic cycle, % GDP



Source: CFP calculations.

Box 4 - The budgetary effort underlying the reference trajectory of the Plans in other euro area countries

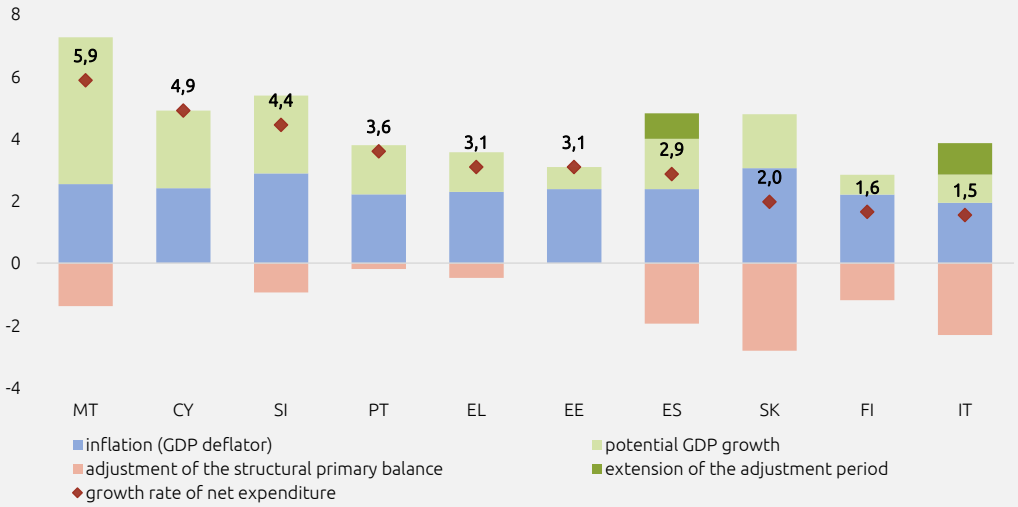
At the time this Report was drafted, 18 Member States, of which 14 belong to the euro area, had submitted their plans. For countries whose general government deficit does not exceed 3% of GDP and whose public debt does not exceed 60% of GDP, the Commission provides, at the request of the Member State, technical information on the structural primary balance needed to ensure that the nominal deficit remains below 3% of GDP in the absence of additional measures in the medium and long term, indicating whether this implies budgetary adjustment needs. This is the case of Denmark, the Netherlands, Czechia and Sweden. In the case of Ireland and Luxembourg, only the macroeconomic forecasts and assumptions for the medium-term public debt projection were shared. For the remaining 12 Member States, including Portugal, the European Commission conveyed the reference trajectory of net expenditure for the Plan's horizon, both in the case of a 4-year adjustment period and in the case of a request for an extension to a 7-year horizon.

The reference trajectory for Portugal is at the upper limit of the distribution among others published. This is particularly evident when the proposal (3.6%) is compared with that made for countries with a debt of over 90% of GDP, such as Spain (2.9%), Italy (1.5%)[29] and Greece (3.1%). This is essentially due to a more favourable starting budgetary position, including under a no-policy change scenario, thus determining the existence of a lower additional adjustment. Indeed, apart from Cyprus and Estonia, which are countries with no need to improve the structural primary balance or a tighter fiscal policy, Portugal has the lowest adjustment requirement among the published Plans (approximately 0.3 p.p. of GDP). This still implies maintaining a significant structural primary balance surplus, equivalent to 2.5% of GDP in 2028.

[29] In the case of Spain and Italy, the average growth rate of net expenditure is increased by 0.8 p.p. and 1 p.p., respectively, with the possibility of extending the adjustment period to 7 years.

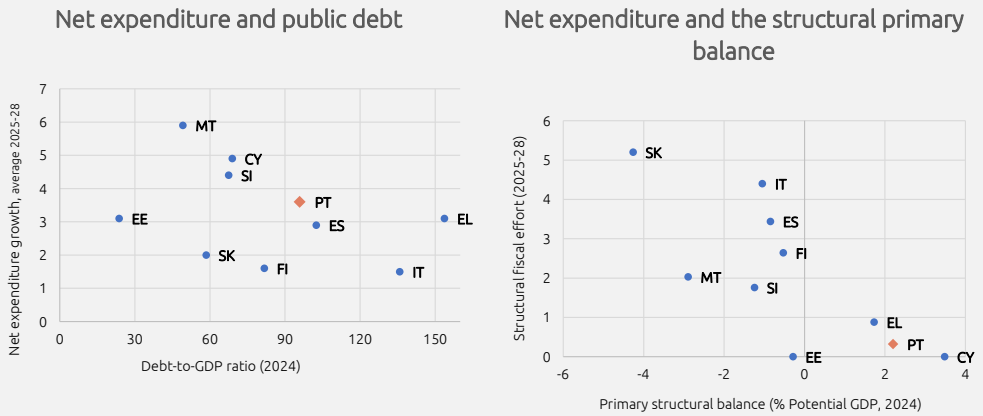
The potential GDP estimate is also decisive for the reference trajectory. This derives directly from the formula described in Figure 2, which translates the adjustment requirements, measured by the change in the structural primary balance, into a rate of change for net expenditure. This can be seen in Chart 8, which compares the average rate proposed by the Commission with those for the other euro area countries. In the case of Portugal, the average potential growth estimated by the Commission for 2025-2028 is 1.6%, identical to that of Spain and close to that of Greece (1.3%) and Slovakia (1.7%). For Italy, Estonia and Finland growth is expected to be lower than 1%; Cyprus and Slovenia by 2.5% and Malta by 4.7%.

Chart 8 - Breakdown of the net primary expenditure growth rate in the European Commission's reference trajectory 2025-28



Source: European Commission, CFP calculations. | Note: Only Member States belonging to the euro area for which the European Commission shared a reference trajectory and whose information was public at the time this report was prepared were considered.

Chart 9 - Net expenditure and the budgetary and debt position of the Member States



Source: European Commission, CFP calculations. | Note: Only Member States belonging to the euro area for which the European Commission shared a reference trajectory and whose information was public at the time this report was prepared were considered. Government debt corresponds to the estimate presented in each of the Plans submitted.

3. CONCLUSION

This Report analyses the budgetary commitments undertaken by Portugal in the MTP. Its analysis focused on the substantive changes to the preventive aspect of the SGP introduced by the recent European economic governance reform. In this new paradigm, the drawing up of a Plan by each Member State with a 4- or 5-year time horizon, depending on the regular duration of the national legislative term, is a central element. The committed net expenditure growth rate is the only operational indicator in this new framework. Its trajectory, which reflects the commitment needed to ensure the sustainability of public debt, is the only budgetary constraint that frames national fiscal policy over the Plan's horizon. A control account will be set up by the Commission in order to record the cumulative upward and downward deviations of net expenditure from the trajectory approved by the EU Council. Under certain conditions, these deviations can trigger an EDP.

The Portuguese MTP committed to a 3.6% average annual growth rate in net expenditure for the following four years. Despite coinciding with the Commission's reference trajectory, the inter-annual profile to which the Portuguese government has committed to differs from the Commission's reference trajectory, showing higher growth until 2026 (inclusive). The Plan attributes part of this difference to the impact of expenditure associated with RRP loans. The nominal growth in expenditure between 2025 and 2028 proposed in the MTP (15.4%) is, in any case, cumulatively close to the reference trajectory (15.2%).

CFP's updated projection under a no-policy change assumption points to a net expenditure growth above the MTP trajectory. Net expenditure has a projected 4.3% average growth rate, 0.7 p.p. higher than the Plan. If confirmed, in 2028 this would result in an accumulated deviation of 0.4% of GDP in the control account. The deviation would be higher were it not for the accumulation of a credit in 2024. This deviation alone would not trigger an EDP because it is lower than the maximum 0.6% of GDP threshold allowed.

Annual deviations above the maximum reference thresholds are expected in both 2025 and 2027. In 2025, under a no-policy change assumption, net expenditure is projected to grow by 6.3%, higher than the government's 5% commitment. In 2027, the projected rate is 2.7%, comparable to the Plan's 1.2%. In annual terms, this leads to deviations of 0.5% and 0.6% of GDP, respectively. These figures are higher than the 0.3% of GDP maximum annual threshold laid down in Regulation 2024/1264. However, as a surplus budget position is projected for both years, failure to meet the annual threshold will not trigger an excessive deficit procedure (EDP). For 2025, this deviation is mainly determined by the impact of revenue reduction measures representing 0.4% of GDP. This is the only year for which information is available on possible policy measures with an impact on revenue.

The ability to maintain a budgetary position close to balance or in surplus appears to be vital for the Plan's implementation to be compatible with the new framework. The projection of an annual deviation above the maximum threshold allowed in both 2025 and 2027 would alone lead to a Report under Article 126(3) of the TFEU, a scenario which is ruled out by the projection of a surplus in the budget balance. This surplus, however, is not immune to unfavourable developments in the economic cycle. An

accumulated control account balance close to the upper limit allowed (and sensitive to the 2024 estimate), will also limit the possibility of approving additional measures to increase expenditure without an equivalent compensation (in other expenditure or in revenue). For countries like Portugal, which have a debt ratio well above 60% of GDP, this commitment to a balanced budget position is essential to avoid triggering a mechanism that could give rise to an excessive deficit procedure, with the adverse consequences that this could create in the country's creditworthiness.

There are also likely and materially relevant risks for expenditure developments. CFP's scenario presented in this report includes the expected revenue and expenditure developments, under a no-policy change assumption from 2026 onwards. In addition to this element, as in any exercise with a medium-term horizon, it is possible to catalogue a set of risks or pressures surrounding the central scenario. These risks include the budgetary impact of the Porto-Lisbon high-speed train line (LAV), defence and security expenditure in view of Portugal's international commitments, and social expenditure, specifically in the health sector. This non-exhaustive set of pressures corresponds to approximately 1% of GDP. This would add around 2.5% to the net expenditure level in 2028, creating difficulties in meeting the trajectory without compensatory measures.

A MTP is not necessarily a medium-term fiscal framework. The central element of any MTP is the commitment regarding net expenditure, which can be seen as the identification of a target to be achieved in a top-down exercise, i.e., the establishment of a maximum limit. The MTP Regulation does not require the presentation of how the Member State plans to achieve those targets, nor does it require the presentation of the policy measures to be adopted, thus differing from the previous stability programmes. For this reason, another piece of legislation, Council Directive (EU) 2024/1265, provides for the creation of a 'true' medium-term fiscal framework, extending the budgeting horizon beyond one year, which, if fulfilled, will allow outlining the future impact of economic policy measures. This will involve, for example, identifying expenditure measures with a multi-annual impact, similar to what is published in the No-Policy Change Framework (QPI) for the following year, or other relevant pressures, making it possible to gauge expenditure's structural evolution more accurately.

CFP will regularly monitor the evolution of net expenditure. Once approved by the EU Council, the Plan enters the monitoring phase. In this regard, the Regulation provides that Member States may request the independent fiscal institution to assess compliance of the budget execution data reported in the annual progress report with the net expenditure trajectory. Member States can also request an analysis of the factors underlying a trajectory deviation. In any case, CFP will monitor the development of net expenditure, in the context of its mission and statutory duties.

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