Executive Summary

Economic and fiscal developments until the end of the 3rd quarter and outlook for 2015

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EXECUTIVE SUMMARY

Forecasts for the global economy were repeatedly revised downwards in 2015 which reinforced expectations of a global slowdown. On the other hand the recovery in the advanced economies has proved to be slower than expected. On top of that, risks arose in regard to the emerging economies. Despite the slowdown in the world economy, up to the third quarter Portuguese exports of goods and services grew 4.7% in nominal terms, compared to 3.7% in 2014. Spain was responsible for 40% of that performance while Angola proved to be the most troublesome destination as exports to that country fell by 23%.

In the third quarter the Portuguese economy grew 1.4% on year-on-year terms, below the 1.6% recorded in the Euro area. Cumulatively GDP rose 1.5%, and this rise was once again based on increased domestic demand (which accounted for 2.4 p.p.). Despite the export growth the change in imports led to a negative contribution from net external demand (-0.9 p.p.). The rate of household savings fell to the lowest figure since 1999 (4.0% of available income), which reflects the continued growth in private consumption in excess of available income. The labour market continued to perform favourably over the whole period, despite the recent stabilisation in employment and unemployment. At the same time prices continued to rise with the GDP deflator growing 1.7% in accumulated terms.

For 2015 CFP estimates growth in real GDP of 1.5%, slightly under the annual forecast made by the Ministry of Finance in the 2015-2019 Stability Programme (1.6%). Domestic demand will have made the largest contribution (2.3 p.p.), while net external demand should make a negative contribution (-0.8 p.p.), which is very different from the Ministry of Finance's forecast (1.6 and 0.1 p.p., respectively). CFP estimates point to an annual GDP deflator of around 2.0% (higher than the Ministry of Finance's forecast of 1.3%). This may lead to nominal GDP growth of about 3.5%, which is higher than the forecast in the 2015-19 Stability Programme (2.9%).

The general government budget deficit stood at 3.6% of GDP at the end of the third quarter of 2015. This outcome is also above the forecast made in the 2015 State Budget for the entire year, but it represents a year-on-year improvement of 0.5 p.p. in adjusted terms (due to positive contributions from all subsectors), resulting from a larger increase in revenue than in spending. The third quarter recorded a primary surplus of 1.0% of GDP. This balance compares favourably with the deficits recorded in the previous two quarters, but it still falls short of the State Budget forecast for the year in adjusted terms, (2.1% of GDP).

In order to meet the 2015 State Budget target, net of temporary and one-off measures (-2.8% of GDP) the deficit should not exceed 0.5% of GDP in the last quarter of 2015 (if the nominal GDP forecast by the Ministry of Finance were to be achieved). That is not likely, but nonetheless the CFP projections point to a deficit in adjusted terms between 2.9% and 3% of GDP. The unadjusted budget deficit will exceed the 3% of GDP limit, as a result of the measures taken last December to resolve the Banif bank difficulties that involved a significant State support.

In the first nine months of the year revenue recorded year-on-year growth of 2.2%, which is below the annual goal of 4.3% set by the MF for 2015. That outcome reflects a decline in growth compared to the first six months of the year (2.5%), and a deviation of several revenue components from the annual target. Tax revenue recorded a year-on-year change of 5.4%, which was above the figure in the 2015 State Budget for the whole year (5%). However, revenue development was constrained by the rate of growth in social contributions (+1.7%) which fell short of the projection for the end of the year (+3.5%), reversing the favourable position recorded in the first half of the year.

As for (adjusted) expenditure year-on-year growth up to the 3rd quarter was around half of that forecast for the entire year. The performance of current primary expenditure and interest payments was decisive. Growth in current primary expenditure slowed in the 3rd quarter, buoyed by compensation of employees and "other current expenditure", as well as the change in social transfers which by September was increasing by one tenth of the change forecast by the Ministry of Finance for 2015. Up to September the year-on-year outturn does not reflect the outcomes of the intermediate consumption consolidation measures set out in the 2015 State Budget. Capital expenditure maintained year-on-year growth above the annual forecast explaining the increase in public expenditure recorded up to the third quarter. Increases in the share capital of some entities and debt assumptions largely explain the sharp growth in "other capital expenditures" (+114.8%).

The public debt ratio under the Maastricht definition rose to 130.5% of GDP at the end of the 3rd quarter (up 1.9 p.p. of GDP compared to the figure for the 2nd quarter of 2015). The 4874 M€ increase, of which 4022 M€ was employed to strengthen deposits, in the central government subsector had a decisive impact. Therefore central government's public debt, net of deposits, increased by 900 M€, to stand at 119.6% of GDP at the end of the 3rd quarter of 2015. At that time deposits accounted for around 10.8% of gross public debt.

The public debt ratio is expected to end at a higher level than the Ministry of Finance estimated, although below the 2014 figure (130.2% of GDP). Achieving the debt ratio set by the Ministry of Finance in the Stability Programme for 2015 (124.2% of GDP) would require a decrease of around 6.3 p.p. of GDP in the final quarter. To reach that goal debt stock should have fallen 2,700 M€ in 2015. Such a decrease had not occurred by the end of November. Therefore, CFP estimates that the public debt ratio ended 2015 above 129% of GDP.