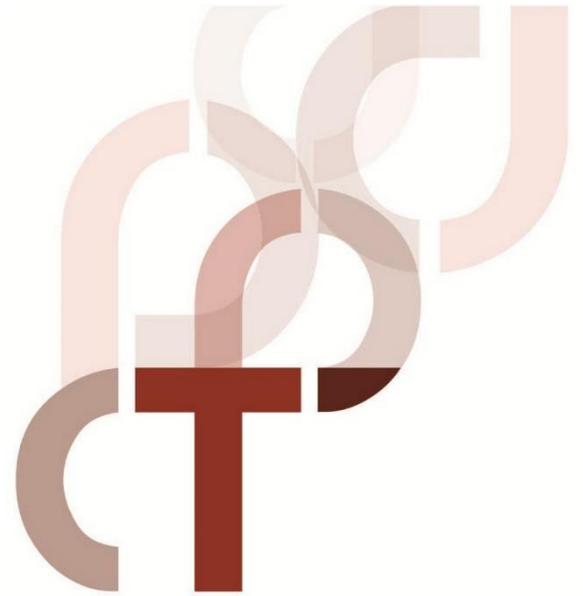


Executive Summary



Fiscal developments until the end of the 3rd
quarter 2016

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EXECUTIVE SUMMARY

Fiscal developments until the end of the 3rd quarter 2016

The data for the budget outturn up to September 2016 in national accounts (analysed in this report), as well as the figures in public accounts published up to November 2016, suggest that the 2016 deficit forecast in the Draft State Budget for 2017 may be met. However, the developments and the breakdown of the revenue and expenditure underlying that deficit, as well as the related macroeconomic scenario, have changed significantly over the year in comparison to the Ministry of Finance's initial projections.

In addition to the developments observed in revenue and expenditure over the year, the Draft State Budget for 2017 latest macroeconomic scenario, revises downwards the scenario included in the General Outline of the State Budget published in January and the one underlying the Draft State Budget presented in February. These facts confirmed the risks highlighted by the Portuguese Public Finance Council (CFP) and other entities which led to the adoption of additional measures in order to meet the goal set for the overall balance. This matter will be subject to a more detailed analysis when the final 2016 budget outturn is known.

Up to the end of September 2016 the general government budget deficit, in adjusted terms, stood at 2.5% of GDP - a 0.9 p.p. of GDP decrease in year-on-year terms. The balance for the 3rd quarter was -1.9% of the period's GDP -0.7 p.p. lower than the value recorded in the previous quarter - and continued the downward trend in the budget deficit observed since the beginning of the year.

Excluding expenditure on interest, the adjusted primary balance up to the end of the 3rd quarter of 2016 is a surplus of approximately 1.7% of GDP. Primary surpluses have been recorded since the 3rd quarter of 2015. This trend was strengthened by the accumulated primary balance up to the end of September 2016. Under the 2016 State Budget the goal for the year is an adjusted primary surplus of 2.1% of GDP (3,896 M€). This goal was revised downwards to 1.7% of GDP (3,196 M€) in the estimate for 2016 set out in the Draft State Budget for 2017 Report.

Up to September general government revenue recorded a year-on-year growth of 0.8% (losing momentum in the 3rd quarter in comparison to the first half of the year) which corresponds approximately to one quarter of the 2016 annual growth forecast in the 2016 State Budget (3%). Tax revenue was the decisive factor in this performance.

The rate of decline in direct taxes (PIT -6.2% and CIT -2.7%) was greater than the Ministry of Finance target for the year. This decline combined with the reduced contribution from indirect taxes (5.6% compared to the annual forecast of 6.3%), led to a level of tax revenue in the 3rd quarter lower than in the same quarter of 2015. Of particular note is the accumulated year-on-year increase in the VAT revenue collection. In net terms, its increase in the first three quarters was less than half the amount forecast by the Ministry of Finance for the year as a whole (2.4% versus 5.1%). This performance corroborates the risk highlighted by the CFP, which is confirmed by the latest Ministry of Finance estimate. Not including the impact of the new measures that had not been foreseen in the 2016 State Budget, this new estimate revises the annual growth in tax revenue downwards from 3.1% to 1.7% (-641 M€).

On the expenditure side, up to September there was a year-on-year decrease of 1.0%, contrasting with the 1.9% increase forecast by the Ministry of Finance for 2016. However, the accumulated year-on-year growth rate of general government adjusted expenditure rose from -3.1% in the 1st quarter to -2.3% in the 2nd quarter and to -1.0% by the end of the 3rd quarter. From July to September quarterly expenditure increased for the first time in 2016 (+1.4% in year-on-year terms).

Expenditure on intermediate consumption is expected to record significant savings compared to the goal forecast in the 2016 State Budget. This item has risen by 326 M€ up to September compared to an annual forecast increase of 1,196 M€. Expenditure on interest is also expected to be lower than originally forecast. Up to September, investment (gross fixed capital formation) recorded a sharper decrease (21.8%) than forecast in the budget (3.3%), with a level of implementation of 51.9% at the end of the 3rd quarter, the lowest figure recorded in the national accounts database.

Contrary to total expenditure, compensation of employees should be higher than forecast in the budget. Its year-on-year rate of change increased (in cumulative terms) from 1.2% in the 1st quarter to 2.1% in the 2nd quarter and to 2.7% in the 3rd quarter of 2016. This contrasts with the +0.2% forecast for 2016 in the budget. The main reason for this difference is that social contributions associated with the increase in wages were initially underestimated. In fact, spending on wages, despite the growth resulting from the gradual civil servants' wage reinstatement, had increased by 2.6% up to September, approximately in line with the budget forecast (2.7%).

Expenditure on social transfers, which grew 0.9% up to September, is also expected to be greater than forecast in the budget (34,645 M€). The cumulative year-on-year rate of change in social transfers other than in kind (the item that accounts for 91% of total spending on social transfers) rose from 0.6% in the 1st quarter to 1.0% in the 2nd quarter and to 1.2% in the 3rd quarter of 2016. This growth is above the 0.1% increase forecast for 2016.

Public debt (Maastricht definition) stood at 133.4% of GDP in the 3rd quarter of 2016, compared to 131.7% in the 2nd quarter, while the 2016 Budget Report estimated the ratio would drop to 127.7% of GDP (versus 129% at the end of 2015). Compared to the previous quarter, the 1.6 p.p. of GDP increase in debt in the 3rd quarter is explained by the increase in Central Government deposits (+1.7 p.p.), since the debt net of deposits recorded a slight drop (-0.1 p.p.).

As in the previous quarter, in the 3rd quarter of 2016 the budget deficit (non-adjusted) explained 18% of the increase in debt (Maastricht definition) and this change was mainly due to the stock-flow adjustments which rose to 3,756 M€ because of the aforementioned increase in deposits.

Note: M€ stands for million EUR.