Executive Summary

Analysis of the General Government Account 2016

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General government balance in 2016

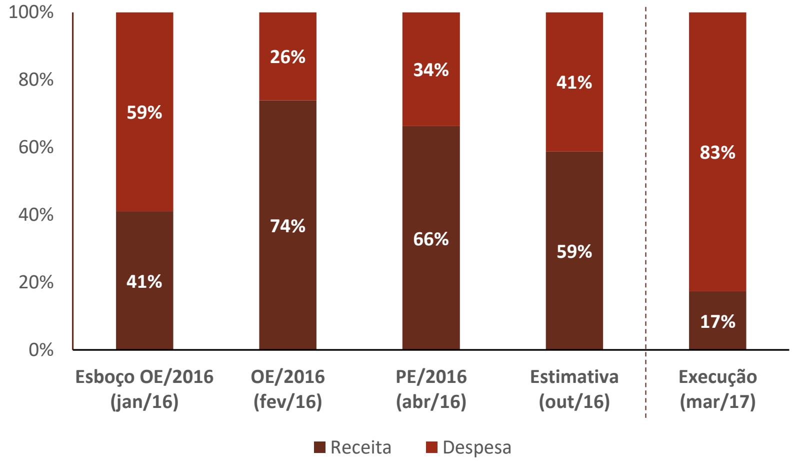
In 2016, General Government (GG) recorded a deficit of 3807 M€ (2.1% of GDP), down 376 M€ (0.1 p.p. of GDP) on the forecast in the 2016 State Budget (4183 M€; 2.2% of GDP). This outcome turned out lower than forecast in all Ministry of Finance documents prepared in 2016.

Compared to 2015 there was an improvement of 2.3 p.p. of GDP (4019 M€). Part of this was due to the base effect related to the resolution of the Banif bank in December 2015 (that increased the 2015 deficit by 2463 M€, leading to a decline of 1.4 p.p. of GDP in the following year), and to temporary and one-off measures that exceptionally benefitted the budget outturn by 780 M€ (0.4% of GDP). The one-off measures consisted of the reimbursement of the prepaid margins on one of the two loans granted by the European Financial Stability Facility (EFSF), part of the revenue from the Special Programme to Reduce Indebtedness to the State (PERES, according to the Portuguese acronym) and the sale of military equipment. Therefore the deficit net of one-offs totalled 2.5% of GDP, which accounts for an improvement of 0.6 p.p. of GDP compared to 2015. Half of that improvement was due to the 0.3 p.p. of GDP decrease in public debt interest payments, implying an improvement of 0.3 p.p. of GDP in the adjusted primary balance.

The headline GG deficit fell for the second year running, leading in 2016 to a deficit lower by 0.9 p.p. of GDP than the 3.0% of GDP limit and by 0.4 p.p. of GDP relative to the recommendation of the EU Council in August 2016 (2.5%). The 2016 outturn thus prolonged the downward trend started in 2010.

In 2016 the largest contribution to the decrease in the deficit relative to 2015 came from the expenditure side, contrary to the Ministry of Finance (MF) forecasts in most budgetary planning documents.

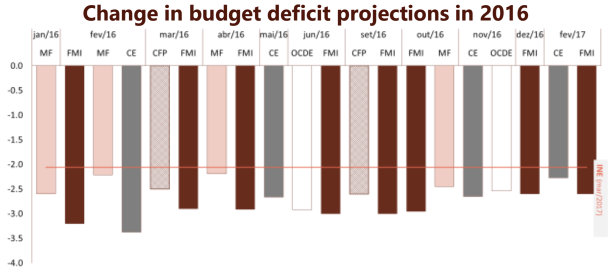
Contributions to improvement in the GG budget balance compared to 2015



Source: Statistics Portugal (INE) and Ministry of Finance. CFP calculations. | Notes: unadjusted figures; the contribution calculations are based on changes in million euros; the budget outcome is that calculated by INE.

The projections for the 2016 budget balance published by the various official institutions showed significant differences between successive projections. Only after the 2016 State Budget was published did all the forecasters make deficit projections in line with or below the 3% of GDP limit. The budget balance projections were impacted by the quarterly changes in GDP in 2016. As was shown in the CFP's Report no. 2/2017, the year-on-year growth in GDP below 1% throughout the 1st and 2nd quarters of the year led to downward revisions of expected growth over the year in the projections made between June and November 2016 (pointing to an annual growth rate of around 1.1%). This deterioration in the macroeconomic outlook was reflected in the projection for General Government revenue. In addition, none of the projections included the measures that had not been announced. These turned out to include the use of an expenditure management tool, by way of greater frozen appropriations than reflected in the official MF forecasts, and the PERES programme enacted in November, both ensuring compliance with the Portuguese Government's commitment to abide by fiscal rules.

Change in budget deficit projections in 2016



Sources: INE (2017) and the projections of the following institutions: EC, CFP, IMF, MF and OECD.

Structural balance in 2016

Based on the available information it is estimated that the business cycle had a positive impact of 0.4 p.p. of GDP on the budget balance. Thus the structural balance estimate, which corrects for the impact of the business cycle and one-offs, points to a structural deficit of 2.1% of GDP in 2016. Therefore in the coming years Portugal will have to undertake an additional consolidation effort of 2⅓ p.p. of GDP to achieve the medium-term goal of a structural surplus of 0.25% of GDP.

The estimated figure for 2016 represents an improvement in the structural balance of 0.1 p.p. of GDP compared to 2015. Thus, the improvement trend in this indicator, which began in 2010 and was interrupted in 2015, was resumed, albeit at a lower rate than in the period 2010 to 2014. From 2010 to 2016 the decrease in the structural deficit is estimated to be 6.4 p.p. of GDP, of which 3.0 p.p. of GDP occurred in 2012 and 1 p.p. in 2014.

Revenue and expenditure in 2016

Growth in general government revenue slowed in 2016 to less than half of the previous year, and for the second consecutive year its relative weight in GDP fell by 0.9 p.p. The main reason for this outcome was the less favourable performance of tax revenue, as a result of the negative developments in direct taxes, driven by the legislative changes in personal income tax (PIT) both in 2015 (tax reform) and in 2016 (cut in surcharge). Though slowing down in 2016, the growth of tax revenue was entirely supported by indirect taxes, in particular special taxes on consumption, while the impact of the measures relating to the extraordinary debt settlement scheme (PERES) and to the revaluation of fixed assets, which favoured the collection of corporate tax revenue, partly offset the decline in PIT. In conclusion, the rate of growth of 1.4% in tax revenue is associated, on the one hand, with the 512.4 M€ collected under the PERES programme and, on the other, with the Optional Revaluation of Tangible Fixed Assets and Investment Properties (104 M€). Without these effects tax revenue would have grown by 0.1% in 2016. Social security contributions grew faster than in the previous year, with effective social contributions up 4.5%.

As a result of the behaviour of these aggregates the tax burden fell to 34.2% of GDP accounting for a 0.3 p.p. of GDP decrease over 2015. Non-tax and non-contributions revenue dropped compared to 2015, an outcome that was offset by the positive impact of the reimbursement of the above mentioned prepaid margins. Without the effects of temporary and one-off measures, the general government revenue in nominal terms was roughly the same as in 2015, falling from 43.9% to 42.6% as a percentage of GDP.

In 2016 total general government revenue growth was around one quarter of the MF's forecast in the State Budget. All revenue items contributed to this result except social contributions, which grew faster than forecast in the budget. Tax revenue grew at half the rate projected by the MF, despite benefitting from the PERES programme. Indirect taxes, in particular VAT and special taxes on consumption, were a decisive factor in that deviation, confirming the risks highlighted by CFP in its analysis of the Draft Budget Plan for 2016. As regards non-tax and non-contribution revenue outturns, we draw attention to the divergence from the "other current revenue" and "capital revenue" forecasts, as their combined deviation represents over three-quarters of the total revenue deviation, one third of which reflects the lower volume of European Union investment support. In adjusted terms total general government revenue recorded an unfavourable deviation of 3 p.p. compared to that forecast in the 2016 State Budget.

General government expenditure fell by 3.2 p.p. of GDP compared to 2015, a change that was partly driven by the impact of the Banif bank resolution in 2015 (net of one-offs the decrease amounts to 1.8 p.p. of GDP). The increase in current primary expenditure was more than offset by the decrease in capital expenditure and in interest payments.

The decrease in expenditure (-3319 M€) was sharper than forecast in the State Budget (-950 M€) due to the management of frozen appropriations (which provided a 0.3% of GDP saving on intermediate consumption) and to favourable deviations in interest payments (-653 M€) and in Gross Fixed Capital Formation (-797 M€), which reached a minimum in the ESA 2010 series (since 1995), both in absolute terms and as a percentage of GDP. These factors made up for the unfavourable deviations recorded in compensation of employees and social transfers, both related to how the Civil Servants Pension Agency (CGA) was handled when preparing the 2016 State Budget.

Expenditure subject to the limit set in the Multi-annual Budgetary Planning Framework increased compared to 2015 due to the reversal of the salary cuts and the reclassification of certain earmarked revenue that impacted on the expenditure financed by general revenue. However that expenditure was lower than the limit approved for 2016 under Law no. 7-C/2016 of 31 March.

Subsectors in 2016

In 2016 the budget outturn revealed positive contributions from all general government subsectors with the exception of Regional and Local Governments. Over the year only the latter contributed to the worsening of the deficit, since the budget surplus recorded was lower than in 2015. Performance in the final quarter was decisive, since up to the 3rd quarter they had contributed to the decrease in the deficit. As for Central Government, its contribution was positive in every quarter, albeit more marked in the final quarter, due to the impact of the Banif resolution in the 4th quarter of 2015. Social Security Funds (SSF) also recorded positive performance across the year, especially in the final quarter.

Public debt in 2016

Debt (Maastricht definition), as a percentage of GDP, was higher than the MF forecasts, with the ratio at the end of 2016 (130.4% of GDP) exceeding the forecasts made in the State Budget and the Stability Programme by 2.7 p.p. of GDP and 5.6 p.p. of GDP, respectively.

The debt ratio rose by 1.4 p.p. of GDP in 2016, compared to a decrease of 1.6 p.p. in 2015. This was due to the fact that the 2.2 p.p. of GDP improvement in the primary surplus was not sufficient to offset the unfavourable effects of: i) the stock-flow adjustment (3.1 p.p.), mainly by way of an increase in cash and bank deposits; and ii) the dynamic effect (0.5 p.p.). In terms of borrowing, the largest public debt creditor (Maastricht definition) continues to be the rest of the world (including official creditors) which, as a whole, accounts for 68% of debt finance. Loans under the Economic Adjustment Programme for Portugal loans and the Eurosystem's programmes together account for 42% of the total. Private individuals continue to increase their relative exposure, while corporate lending, excluding trade credit, continues to carry negligible weight.