# Overview

## Analysis of the Stability Programme 2017-2021

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# OVERVIEW

*Analysis of the Stability Programme 2017-2021*

The objectives set out in the 2017-2021 Stability Programme (SP/2017) point to a gradual and continuous fiscal consolidation path and foresee a substantial improvement in the fiscal balance and a significant decrease in the public debt ratio over the next four years. Those objectives are appropriate for the Portuguese economy and comply with the national and European fiscal rules, except for the fiscal consolidation effort in 2017, since the forecast structural balance improvement is less than that required by the Portuguese budgetary framework law and the Stability and Growth Pact.

The forecast public debt ratio decrease, that deserves highlight, is key to any improvement in the market's perception of Portugal and its risk rating and to a stable improvement in its financing conditions. The strategy for reducing this ratio by a total of 21 p.p. of GDP over four years is based on the acumulation of primary surpluses (18.5 p.p. of GDP) and on a favourable economic juncture: the contribution of economic growth more than offsets the unfavourable impact of interest expenditure, leading to a favourable dynamic effect of 1.7 p.p. of GDP.

The programme foresees a cumulative improvement in the fiscal balance of 3.3 p.p. of GDP from 2016 to 2021 (i.e. €6405 million in the adjusted balance). According to SP/2017 the developments in the economy and budget variables under a no-policy-change scenario would be sufficient to ensure the elimination of the budget deficit and produce a small surplus in 2021.

In effect the largest contribution to the 5197 M€ improvement (equal to 2.6 p.p. of GDP) in the adjusted balance from 2017 to 2021 will come from the expected impact of the no-policy-change scenario (3647 M€), which accounts for 70% of the change, while the direct impact of policy measures only explains one quarter of the expected positive change (1337 M€).

Thus the estimated improvement in the balance is crucially dependent upon macroeconomic developments and the accurate forecasting of changes in the budget variables under a no-policy-change scenario. As for the macroeconomic developments, we draw attention to the observations made by the CFP in its Opinion, dated 18 April 2017, on the macroeconomic scenario underlying PE/2017, which are still pertinent:

> *A key element necessary to ensure the consistency of the scenario is a set of tax policy measures and other economic policy measures that allow the changes in the behaviour of economic agents implicit in the consumption and investment paths to materialize. While the developments projected by the SP/2017 scenario are the most conducive to a sustained growth of the Portuguese economy, past experiences show that neither the abundance of credit nor a favourable external environment are sufficient conditions to guarantee their fulfilment. A redirection of investment to the sector of tradable goods and policies that simulate households and firms' savings are necessary conditions for the changes in growth composition forecasted by the SP/2017 to materialize.*

*Excluding the possible effect of such measures, there are significant risks regarding the composition of economic growth forecasted in the SP/2017 for the period 2018-2021. In particular, the stabilization of the real private consumption growth around 1.6% per year over the whole period is unlikely to be consistent with the continued decline in the unemployment rate, and the acceleration of the average compensation per employee. Should the projected path for the private consumption deflator materialize, the stabilization of the private consumption growth in real terms also implies a stabilization of in nominal growth, at a pace of around 3.3% per year. Given the expected acceleration in disposable income growth and taking into account the historical behaviour of economic agents, the risks associated with a stronger growth of private consumption should not be ignored, namely the unfavourable impacts on exports and imports, as well as in the direction of private investment.*

*[…]*

*GFCF is a key variable in this scenario, not only because of its level, but also because of its projected path and the way it will be financed. Furthermore, developments in exports and imports are also depend on the measures that influence investment. The exports forecast implies gains in market share over the entire period 2018-2021, and although the scenario also forecasts labour productivity to grow at a faster pace than the compensation per employee in real terms, it is not clear whether this is sufficient to drive the market share gains. As for imports, the forecast of constant growth at the same pace of 2017 is dependent on the moderate growth of private consumption and on the composition of GFCF.*

Two observations must be made as regards the fiscal policy measures: whilst they focus mainly on expenditure, over four fifths of the expenditure cuts (1367 M€) are from efficiency gains to be obtained from unspecified measures that merely indicate targets. Important examples of this type of measure are the nominal freezing of intermediate consumption and of other current expenditure, which totals 1305 M€.

In conclusion, SP/2017 consecrates economic and budgetary goals deemed adequate in keeping with the sustainability of economic growth and Portuguese public finance, but it does not provide sufficient details in regard to the economic and fiscal strategy and policy measures required to achieve them. The lack of that proper explanation has been a feature of Portuguese Stability Programmes, thereby missing the opportunity to act as a framework for decision-making on which the credibility of the objectives and the ability to achieve them depend.