Executive Summary

Fiscal developments until the 1st quarter of 2018

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In the 1st quarter of 2018, the General Government deficit was 434 M€, equal to 0.9% of the Gross Domestic Product (GDP) generated in the quarter, of which 0.1 p.p. already reflect some of the impact of the extraordinary expenditure on compensation relating to the 2017 forest fires. Net of the fiscal impact of the Caixa Geral de Depósitos (CGD) recapitalisation, the budget deficit recorded a year-on-year decrease of 471 M€ (1.1 p.p. of GDP), which came solely from central government's contribution.

The national statistics authority's preliminary estimate for the deficit is 0.2 p.p. of GDP above the target set in the 2018-2022 Stability Programme (0.7% of GDP), which is tighter than the initial commitment made in the 2018 State Budget (1.1% of GDP).

A primary surplus of 1 264 M€ had arisen by the end of March, equal to 2.7% of quarterly GDP, continuing the trend in primary surpluses recorded since the third quarter of 2015. The 0.7 p.p. of GDP improvement in the balance before interest accounted for almost two-thirds of the year-on-year improvement in the budgetary balance in the 1st quarter, while the remaining 0.4 p.p. stemmed from the decrease in interest payments, mainly because of the early repayments made to the International Monetary Fund.

The favourable developments in the primary balance in the 1st quarter are a positive sign for compliance with the Government target. Nevertheless, this target will have to be confirmed in the coming quarters. The developments in revenue and expenditure in the 1st quarter show that revenue, especially tax and social contributions revenue, made an important contribution to the decline in the fiscal imbalance. But the expenditure relating to the Novo Banco recapitalisation (to be recorded in the 2nd quarter) and the full payment of the Christmas bonus (in the 4th quarter) constrain the achieving of that goal. The possible occurrence of fiscal risks stemming from the uncertainty around the full recovery of the BPP guarantee and, on the other hand, the pressure on health and education spending, together with the uncertainty as to the outcome of the expenditure review measures, are important constraints that may compromise the achieving of the budgetary target.

Over this period the General Government revenue recorded year-on-year growth of 3.2%, fully explained by the rise in tax and social contributions revenue (4.8%). Revenue from taxation accounted for around three-quarters of this increase, as its growth (5.6%) was higher than the Ministry of Finance (MF) forecast for the year as a whole (3.1%). Indirect tax revenue rose by 7.2%, providing the largest contribution to the increase in tax revenue. The positive performance seen in net VAT revenue accounted for around half of the rise in indirect tax revenue as it recorded growth of 6.1% in the first three months of the year, up 1.1 p.p. on the annual goal set by the MF. Social contributions continued to show the positive developments in the labour market, although growth (3.3%) was below the Government forecast for the year as a whole (4.1%). This performance was negatively impacted by the change in imputed social contributions, despite actual social contributions recording year-on-year growth of 5%, slightly up on the 4.9% forecast in the 2018-2022 Stability Programme (SP/2018) and higher than the year-on-year change in paid employment (3.3%) in the 1st quarter.

Non-tax and non-contributions revenue recorded a year-on-year decrease of 6.3% in the quarter, due to the unfavourable performance of sales and other current revenue (-7.2%). This performance contrasts sharply with the annual growth forecast by the Ministry of Finance (11.5%).

Expenditure rose by 0.6%, down on the 2018-2022 Stability Programme forecast for the year as a whole (4.1%). Primary expenditure accounted for this growth, while the lower interest reduced the increase in public expenditure.

As regards current primary expenditure, the only items that experienced an increase and an unfavourable change against the Stability Programme 2018-2022 forecasts were subsidies (+30 M€) and “other current expenditure” (+202 M€, as a result of the early payment of a portion of the financial contribution to the EU budget). The performance of expenditure on employees and social transfers was influenced by the change in the way the Christmas bonus is paid. These items recorded decreases of 1.5% and 0.1% in the 1st quarter, respectively, although the 2018-2022 Stability Programme predicts increases of 2.1% and 3.2% for the year. Intermediate consumption fell by 0.7%, compared with an annual increase of 2.2% forecast in that budget programming document.

In terms of capital expenditure, Gross Fixed Capital Formation saw year-on-year growth of 9.8%, which fell short of the forecast for the year as a whole (34.2%). This increase is mainly explained by local government spending, while “other capital expenditure” grew by 44.5%, due above all to the payment of compensation to victims of the 2017 forest fires.

The public debt ratio rose to 126.4% of GDP at the end of the 1st quarter of 2018, following the sharp decrease seen the previous quarter. This outcome constitutes a 0.7 p.p. of GDP deterioration, and left the ratio farther away from the annual target laid down in the latest budget programming documents, as it stands 2.9 p.p. of GDP above the figure forecast in the 2018 State Budget and 4.2 p.p. above the 2018-2022 Stability Programme forecast. On the other hand, public debt net of central government deposits fell by 0.9 p.p., reaching 117.1% of GDP. In nominal terms this accounts for a 147 M€ fall in net debt compared to the previous quarter and, together with the 3 356 M€ rise in deposits, produces a 3 208 M€ increase in public debt. Therefore, the collection of deposits was the key factor in the debt developments over the quarter and not the budget deficit. In fact, the difference between the deficit and the change in debt was mainly due to transactions relating to “net purchase of financial assets”, mainly cash and deposits. This increase in deposits stems from the strategy for financing the 6 642 M€ repayment that fell due in June (PGB 4.45% 15 Jun 2008/2018).