Executive Summary

Fiscal developments until the end of the 2nd quarter 2017

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In the 1st half of 2017 the budget deficit was 1.9% of GDP generated in the period, of which 0.1 p.p. of GDP already reflects part of the impact of the recovery of Banco Privado Português (BPP) guarantee, a temporary and one-off measure the Ministry of Finance forecast for this year. This outcome still exceeds the targets set by the Government (a deficit of 1.6% of GDP in the State Budget for 2017 and 1.5% in the 2017-2021 Stability Programme), although it is a greater improvement in year-on-year terms than forecast for the year as a whole in both budgetary planning documents. Various general government subsectors contributed to this year-on-year improvement, with the social security funds subsector recording an additional 0.5 p.p. of GDP surplus, the highest outcome as a percentage of GDP (1.8%) since 2008.

The primary balance, which excludes expenditure on interest, continued the surplus trend seen since the third quarter of 2015. A year-on-year improvement of 0.9 p.p. of GDP in the primary balance, combined with a 0.3 p.p. decrease in interest payments, led to a 1.2 p.p. of GDP improvement in the headline balance (greater than the Ministry's forecast for the year as a whole).

In the 1st half of 2017 fiscal developments revealed revenue made the larger contribution to correcting the budget imbalance, with the assistance of a favourable contribution from expenditure.

Total GG revenue slowed in the 2nd quarter, and in the 1st half of the year saw growth of 2.2%, which is below the SB/2017 forecast (+5.6%). Tax revenue was responsible for this slowdown, as a result of the unfavourable performance of direct taxes, in particular PIT revenue which reflected the change in the intra-annual nature of refund payments. Putting aside the negative impact of the early repayment of PIT refunds on GG revenue, year-on-year growth in total revenue would have been 5.1%, in the 1st half of the year which is slightly down on the 5.6% forecast in the SB/2017, but well above the 2.2% effectively recorded in the period. As regards tax revenue, that adjustment would lead to year-on-year growth of 5.3%, which is more than double the figure laid down in SB/2017 (+2.5%). Note also the very positive performance of net CIT revenue, which was driven by the revenue from self-settlement, in the 1st half of the year and exceeded the goal for annual growth set out in SB/2017. Indirect taxes revenue increased across the board and gave rise to year-on-year growth in the 1st half of the year in excess of the annual goal under SB/2017. Net VAT revenue grew faster in the 2nd quarter, despite a sharp rise in refunds. Special Taxes on Consumption (STC) recorded lower growth than that foreseen in SB/2017 (6.0%) although they recovered in the 2nd quarter of the year,

Social contributions revenue continued to grow faster than forecast in SB/2017, sustained by the positive performance of actual contributions which reflected the steady improvement in the labour market throughout 2017.

Non-tax and non-contributions revenue still made a favourable contribution to revenue growth, although changes in the individual components were below the SB/2017 forecasts. Nonetheless, it should be noted that three quarters of the rise in capital revenue's growth rate stems from the recovery of part of a State guarantee provided for a loan to BPP granted by six banks in 2008.

General government expenditure recorded a favourable development in the 1st half of 2017, having fallen 0.5% in year-on-year terms, compared to the 4.6% increase set out in SB/2017. A deciding factor in this outcome was the expenditure on interest, which accounted for around four fifths of the decrease. There was a fall in current primary expenditure albeit smaller. The performance of these two components of expenditure contrasts with the respective increases set out in SB/2017. In regard to current primary expenditure, social transfers expenditure made the largest contribution to the favourable performance of this sub-aggregate in the first six months. Social transfers reflect the path taken by social security pension expenditure that has benefitted from the change in the way the Christmas bonus is paid, and by unemployment benefit which has fallen 4.5 times faster than forecast in SB/2017. Running in the opposite direction is the increase in compensation of employees, which in the first half of the year grew by 0.7%, up on the 0.5% set out in SB/2017. This deviation was mainly due to spending on wages and salaries which for the year as a whole is likely to end up higher than forecast in SB/2017. Spending on intermediate consumption and "other current expenditure" rose by less than the Ministry of Finance forecast for the whole twelve months.

As for capital expenditure, gross fixed capital formation (GFCF) grew by 1.2%, well below the SB/2017 figure (52.8%), showing a level of outcome in the 1st half of 2017 even lower than that recorded in the same period the previous year. The "other capital expenditure" account recorded marginal growth and did not reflect any impact of the recapitalisation of the CGD bank that took place in the 1st quarter of 2017.

The public debt ratio (Maastricht definition) rose to 132.1% of GDP at the end of the 2nd quarter, an increase of 1.7 p.p. compared to the previous quarter. The increase in debt was significantly greater than the budget deficit recorded in the 2nd quarter, and the difference between the deficit and the change in debt was mainly due to "net purchase of financial assets" transactions, in particular cash and deposits. However, despite the recorded increase, the latest estimate provided by the Ministry of Finance, under the 2nd EDP notification, points to a debt ratio of 127.7% of GDP. This downward revision in the Government estimate compared to the one published in SP/2017 implies a 4.4 p.p. decrease in the final quarter of the year, to be achieved partly by the repayment of the Treasury Bills maturing in October 2017 (to the sum of around 6000 M€).

Recently in its Report no. 7/2017, the Portuguese Public Finance Council projected a deficit of 1.4% of GDP and a debt ratio of 126.8% for 2017, net of the impact of financial system support measures.