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Portuguese Public Finance Council

Analysis of the Draft State Budget for 2018

Portuguese Public Finance Council

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The Council began its work in February 2012 and its mission is to conduct an independent assessment of the consistency, compliance with the stated objectives and the sustainability of public finances, while promoting fiscal transparency, so as to contribute to the quality of democracy and of political economic decisions and so strengthen the State's financial credibility.

This Report uses the information available up to 3 March 2017.

In the publications section at www.cfp.pt, a spreadsheet containing all the figures used to build the charts and tables in this Report is available for download.

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OVERVIEW

After the Economic and Financial Adjustment Program (EFAP) came to an end in 2015, and the budget deficit in 2016 fell below the 3% of GDP limit which defines an “excessive deficit”, Portugal has entered in 2017 a period when both the economic and fiscal plans must focus on structural adjustment. In addition to the progress made, the country is benefitting from the favourable economic and financial climate, which brings into play the “stability and growth” option that is the bedrock of the Pact the country signed up when joining the Economic and Monetary Union, the preventive arm of which is now in force. Reducing public and private indebtedness remains a priority that heightens the need for adjustment, not only to comply with the rules, but also to promote the country’s development and social welfare.

Such an option supposes that, as well as defining generally consensual goals – growth in income and jobs, greater equality, efficient public services – fiscal policy also truly contributes to their sustainable achievement. This implies adhering to principles that put aside practices that have characterised Portuguese fiscal policy for decades. The first one is the Keynesian principle that covers short/medium-term implications and calls for using favourable conditions to build up sufficient fiscal space to adopt, when necessary, stabilisation measures without risking financial collapse. The second is of a structural nature and supposes concern for promoting efficient public spending and a tax policy that encourages private sector investment and saving. The preference for ignoring these principles at the fiscal policy level explains, to a large extent, the poor economic performance and high degree of indebtedness which are features of the Portuguese economy. Recognising the implications of these principles calls for substantive changes, not in terms of the policy goals, but rather in the direction fiscal policy must take to bring about their effective achievement.

The Draft State Budget for 2018 (DSB/18) incorporates some items that are part of this rationale, such as the commitment to reduce the fiscal deficit and debt ratio, prioritising compliance with European rules – now those that belong to the preventive arm of the Stability and Growth Pact (SGP) – and pursuing an expenditure review, albeit this task is still in its infancy. However, the aforementioned principles are still far from underlining the fiscal stance set out in the DSB.

As regards fiscal rules DSB/18 still mostly takes advantage of the favourable economic climate, while compliance with the rules is mostly concerned with annual numerical outcomes needed to avert the European Commission’s disapproval. In fact, the DSB proposes measures that use most of the leeway afforded by favourable external demand and financing conditions – measured by the increase in tax and social security contributions revenue and the decrease in interest payments – to increase investment, but also the less elastic components of primary expenditure.

On top of this the DSB takes full advantage of the ambiguity of the rules, and the frailties that are still a feature of public accounts reporting in Portugal, in order to formally comply with the SGP’s preventive arm, without truly reflecting its underlying structural nature. The

rules are based on the definition of a medium-term objective for the cyclically adjusted budgetary balance net of temporary and one-off measures. The specific rules governing the assessment of this objective are technically complex, including not only observed outcomes but also forecasts, and there is a certain degree of ambiguity which calls for judicious interpretation, for example when classifying measures as temporary.

These are the unavoidable characteristics of rules that apply in a wide range of situations and policies whose effects may only be assessed in the future. For this reason, compliance with the rules supposes a commitment to the principles which underlie the wording of the rule and goes beyond annual compliance with a numerical value. Not only the figures on which that value is based are necessarily subject to review, but also this exclusive concern is not sufficient to ensure the desired consistency with the stated goals. At the European level the recognition of this fact has led to a more demanding attitude in regard to the plausibility and/or prudence of the macroeconomic forecasts underlying the budgetary plans. In this context the Portuguese Public Finance Council (CFP) endorsed the short-term macroeconomic scenario underpinning DSB/18, whilst stressing the “advantage for the macroeconomic frameworks underlying the different budgetary programming documents to be produced for the medium-term. Only then will it be possible to evaluate the longer term effects of the adopted policies and their sustainability”, which continues not to be the case in this Draft.

Furthermore, as mentioned, the rule relates to the cyclically adjusted balance net of temporary and one-off measures. The cyclical adjustment is especially fallible given the circumstances of the Portuguese economy, which for decades has known serious instability, not only of a cyclical nature but also from exogenous shocks, both national and international. To recognise this fact does not, however, equate to undermining the importance of structural indicators, but rather to provide supplementary microeconomic and qualitative information and to give priority to the second of the aforesaid principles, that is to say, the promotion of efficient public expenditure and a tax policy that encourages private sector investment and saving, which will lead to sustained growth in potential output. We are dealing with a complex assessment that cannot be reduced to a single indicator, a fact the European framework takes into account in its fiscal policy coordination and surveillance procedures.

Lastly, another important aspect of the structural balance assessment is the exclusion of temporary and one-off measures. In this field the CFP’s assessment reaches conclusions that differ from the reasoning underlying DSB/18. This difference of opinion may be due in part to the shortage of information as to the nature of the transactions taken into consideration by the Ministry of Finance. This Report sets out in detail the reasons for the differences in interpretation, given the information available up to the time of publication. As well as the specific nature of the transactions in question, one matter that must be stressed in this context is the excessive importance of these transactions in the assessment of the structural balance implicit to DSB/18. Given the complexity of this assessment, the relative weight of these “measures” is coupled with the leeway provided by the favourable economic climate to fund the increase in the less elastic primary expenditure items, thus increasing the weakness of the forecast adjustment.

Even with reference to compliance with the numerical rules, it is not clear that it is actually guaranteed with respect to the period 2017/2018. In fact, on the basis of the information available and its own classification of temporary and one-off measures, the CFP estimates that the planned improvement in the structural balance underlying DSB/18 will be 0.1 p.p. in 2017 and 0.3 p.p. of GDP in 2018. These figures contrast with the recommended change of 0.6 p.p. of GDP each year, given the economic setting. Similarly, the deviation of planned growth in primary expenditure, net of discretionary revenue measures, exceeds on average the applicable benchmark by 1% of GDP in both years.

1 INTRODUCTION

Pursuant to article 7 of the Statutes of the Portuguese Public Finance Council (CFP), this report analyses the Draft State Budget for 2018 (DSB/2018). This Report was preceded by the CFP's Opinion on the macroeconomic forecasts underlying the State Budget prepared under the provisions of article 8 of the Budgetary Framework Law (Law no. 151/2015 of 11 September), article 6 (a) of the CFP's Statutes, approved by Law no.54/2011 of 19 October, as amended by Law no. 82-B/2014 of 31 December, article 4 (4) and article 6 (3) (f) of Regulation (EU) No. 473/2013 of the European Parliament and of the Council of 21 May 2013.

This report is divided into five chapters and one annex. The first chapter is the introduction and it describes the organisation of the document. The second chapter seeks to gauge whether the budget projections are consistent with the macroeconomic scenario and the planned measures, while the third chapter assesses the fiscal adjustment, the fiscal policy stance and the compliance with the current fiscal rules. The fourth chapter analyses the indebtedness forecast in DSB/2018 and the public debt developments. Lastly, the fifth chapter evaluates the forecasts for the subsector accounts. The Annex deals with the revision made in DSB/2018 to the initial forecast for the 2017 consolidated account set out in DSB/2017, and includes a series of detailed tables that were the basis for the condensed versions to be found in the various chapters of this report.

The general government budgetary aggregates have not been adjusted for the impact of temporary measures, one-off measures and special factors. However, whenever such an adjustment provides for a better assessment of the fiscal consolidation effort, it has been duly noted in the text.

This report benefitted from the additional information and clarifications provided by Ministry of Finance (MF) bodies, namely the Planning, Strategy and International Relations Office (GPEAR), the Directorate-General for Budget (DGO), and the Treasury and Public Debt Management Agency (IGCP) and the Ministry of Labour, Solidarity and Social Security.

2 CONSISTENCY OF BUDGET FORECASTS WITH THE MACROECONOMIC SCENARIO AND FISCAL POLICY MEASURES

The analysis made in this chapter is based on the information in the Draft State Budget for 2018 presented to Parliament on 13 October and the additional information provided to the CFP by the MF on 17 October, plus the information obtained at a technical meeting held on the 27th. The information obtained at that meeting was the subject of written clarifications received on the 27th and the 31st. Furthermore the EC website and the Government Portal contain an updated version of the Draft Budgetary Plan for 2018, bearing no publication date, which amends the information relating to the policy measures underlying the SB/2017 outturn estimate and DSB/2018, in regard to which the CFP has received no information from the MF.

In addition to a number of relevant items, the CFP only received information on the temporary and one-off measures that the MF has taken into account in the DSB on 27 October at the end of the day. As has always been the case with CFP reports on the DSB, the temporary and one-off measures used come from its own classification of such measures, justified case by case, and which in many cases differs from those used by the MF and by the EC. Box 1 contains detailed information on the measures the CFP has taken into consideration in this report.

Since a different set of measures (temporary and/or permanent) were used, the analysis in this chapter differs from that which would be obtained if the MF's classification were employed, in particular measures that would become temporary and not permanent. This is particularly relevant to the calculations shown in Tables 1 and 18 of this report and the conclusions to be drawn from them. Tables 19 and 20 are versions of Tables 1 and 18 based on the (permanent and temporary) measures mentioned by MF in Table 12 of the revised version of the Draft Budgetary Plan for 2018.

2.1 FROM THE 2017 ESTIMATE TO THE BUDGET FORECAST FOR 2018

For next year DSB/2018 forecasts a budget deficit of 1.0% of GDP, retaining the objective laid down in the Stability Programme published in April. In absolute terms this result corresponds to a budget deficit of 2034 M€, which takes as a starting point an estimated deficit of 2750 M€ for 2017. The forecast decrease in the budget deficit is based on increases of 3217 M€ in general government (GG) revenue and 2501 M€ in expenditure. Conceptually speaking the forecast for general government revenue and expenditure for the following year results from the combination of the forecast developments in these variables in a no-policy-change scenario with the direct fiscal impact of the new measures and second order effects produced by the interaction of these measures and the macroeconomic variables. Therefore, on the basis of the information provided by the

Ministry of Finance (MF), Table 1 provides a breakdown of the forecast developments in the GG account in 2018 due to the impacts of:

- The carry-over of measures approved in 2017; these effects are taken into account in the no-policy-change scenario;
- Macroeconomic developments and “other effects” taken into consideration on the no-policy-change scenario;
- Discretionary measures of a permanent nature (new policy measures), introduced in the policy measures scenario;
- Financial gains, which are not dependent on fiscal measures and improve or worsen the balance, and which include increases in central bank dividends (policy measures scenario);
- Temporary and one-offs forecast for 2018;
- A residual item, known as “other effects”, obtained from the difference that reflects the second order effects produced by the interaction of the new measures and the macroeconomic variables along with other unidentified effects which do not belong to the aforesaid categories.

All items shown in Table 1 are based on information provided by the Ministry of Finance (MF), except for the classification of temporary (or one-off) measures, for which the CFP is responsible and which is set out in Box 1.

Table 1 – From the 2017 estimate to the budget forecast for 2018 – policy measures with a budgetary impact in 2018 (M€)

	No Policy Change Scenario					Policy Change Scenario							
	MF Estimate 2017 (1)	One-off (2)	Adjusted Estim. 2017 (3)=(1)-(2)	Macroeconomic scenario and other effects (4)=(6)-(3)-(5)	Carry-over (5)	No Policy Change Scenario 2018 (6)	Financial Gains (7)	New Policy Measures (8)	No Policy Change + Policy Measures (9)=(6)+-(8)	Other effects (10)=(11)-(9)	MF unadjusted Forecast (11)=(13)-(12)	One-off (12)	MF Forecast (13)
REVENUE	83 507	450	83 057	3 362	-260	86 159	148	309	86 616	109	86 725	0	86 725
Tax and Contribution Revenue	71 064	0	71 064	2 317	-260	73 121		92	73 213	-110	73 103	0	73 103
Indirect taxes	28 880		28 880	1 043		29 923		180	30 103	63	30 166		30 166
Direct taxes	19 683		19 683	492	-260	19 915		-187	19 728	-148	19 580		19 580
Social contributions	22 502		22 502	781		23 283		99	23 382	-25	23 357		23 357
Non Tax and non contribution R	12 443	450	11 993	1 045		13 038	148	217	13 403	219	13 621		13 621
EXPENDITURE	86 257	82	86 175	1 674	154	88 003	0	81	88 084	621	88 705	54	88 758
Primary Expenditure	78 689	82	78 607	1 858	154	80 619	0	388	81 007	571	81 578	54	81 632
Intermediate Consumption	10 772		10 772	773		11 546		-144	11 402	-146	11 256		11 256
Compensation of employees	21 409		21 409	192		21 601		270	21 871	-391	21 480		21 480
Social Transfers	36 057		36 057	752	154	36 962		168	37 130	-92	37 038	18	37 056
Subsidies	1 010		1 010	78		1 088		-20	1 068	26	1 094		1 094
GFCF	3 224	-29	3 253	410		3 663		162	3 825	700	4 525		4 525
Other expenditure	6 217	111	6 106	-347		5 758		-48	5 710	473	6 184	36	6 219
Interest paid	7 569		7 569	-185		7 384		-307	7 077	49	7 126		7 126
BUDGET BALANCE	-2 750	368	-3 118	1 688	-414	-1 844	148	228	-1 468	-512	-1 980	-54	-2 034

Source: Ministry of Finance. CFP calculations. | Note: The macroeconomic scenario incorporates the impacts of macroeconomic developments on tax and contributions revenue and on expenditure, as well as other effects. For details on the various effects see Table 18 below. The CFP is responsible for the classification of the temporary (or one-off) measures, which is set out in Box 1. According to information from the MF, the budgetary impact of the temporary measure relating to “Fires” was split equally in social transfers between; “Other current expenditure” and “Other capital expenditure”. The totals may not necessarily match the sum of the individual items due to rounding.

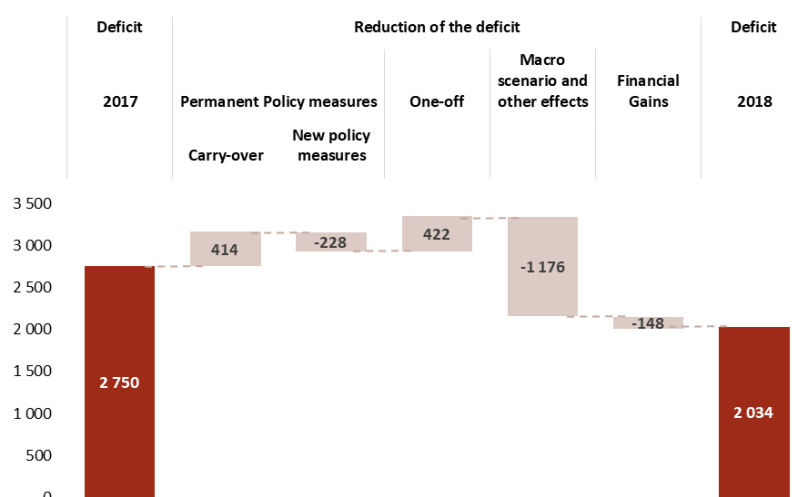
The improvement in the budgetary balance in 2018 as a direct result of the new policy measures is 228 M€ (equal to 0.1% of GDP), which is fully supported by the impact of revenue side measures. The contribution of these measures to the decline in the deficit totals 309 M€, the net outcome of measures that increase and measures that decrease revenue. Measures increasing revenue include the changes in special taxes on consumption

(STCs), raising the level of indirect taxes (180 M€), and the impact of social contributions flowing from the gradual unfreezing of civil service promotions (99M€). Non-tax and non-contributions revenue explains the remainder of the positive effect of revenue policy measures, reflecting above all the investment measures using European Structural and Investment Funds, where the impact on capital revenue is aimed mainly at supporting the increase in public investment (so this portion does not impact on the balance). Measures reducing revenue include the change in the PIT tax brackets. Table 18 below provides details on the policy measures with fiscal impact in 2018, based on the information provided to the CFP by the MF.

On the expenditure side the measures included in DSB/2018 involve a slight increase in total volume compared to the previous year. Around three-quarters (72%) of the forecast expenditure increase (718 M€) are explained by the gradual unfreezing of civil service promotions and changes to social expenditure, in particular the reforms in contributions paid over long periods, the extraordinary updating of pensions and the social benefit for inclusion (see Table 18 below). However, the negative impact on the balance is offset by measures that reduce expenditure by 637 M€, of which 330 M€ relate to primary expenditure (expenditure excluding interest) and 307 M€ to a decrease in interest, only partially justified by policy measures. Over four-fifths of the savings in primary expenditure estimated by the MF depends on the success of the measure entitled “expenditure review”, whose impact the MF estimates will be 287 M€, covering intermediate consumption, compensation of employees and “other current expenditure”.

However, the contribution of new policy measures is insufficient to compensate the net negative impact of measures approved the previous year. The negative impact of the carry-over effects from measures approved in 2017 (414 M€) results from a 260 M€ decrease in revenue and a 154 M€ increase in spending (see Table 1). On the revenue side, these effects reflect the impact of fully eliminating the surcharge on Personal Income Tax (PIT) in 2018, while expenditure reflects the effect of the extraordinary updating of pensions in 2018, a measure introduced in SB/2017. The effects of these 2017 measures cancel out the net fiscal impact of the new measures to cut the deficit set out in DSB/2018.

Chart 1 – From estimated deficit for 2017 to forecast deficit for 2018 (M€)



Source: MF. CFP calculations. Note: Positive/negative figures contribute to an increase/decrease in the deficit. The effect of one-off measures corresponds to the change in the measures taken into account by the CFP for 2018 and 2017; the impact of the “macro scenario and other effects” reflects the algebraic sum of columns 4 and 10 of Table 1. For details on permanent and one-off policy measures see Table 18 below.

The nominal decrease in the budget deficit forecast for 2018 is dependent upon the effects of the economic setting and unidentified “other effects”. Of the 717 M€ forecast decrease in the budget deficit in 2018, over 1100 M€ comes from the favourable impact of “macroeconomic and other effects”, which reflects the impact of the performance of the macroeconomic aggregates on the budget variables and “other unidentified effects”.¹ The positive impact on the balance of new policy measures to be introduced in 2018 (228 M€) is insufficient to offset the carry-over effects of measures introduced in 2017 (which have a negative impact of 414 M€). Thus, economic policy measures will produce a negative net (direct) effect of 186 M€ in 2018. According to the CFP classification, the change in the use of one-offs has an unfavourable impact on the balance of 422 M€.² The financial gains (+148M€), which correspond to the increase in dividends to be distributed by the Bank of Portugal (BoP) to the State in 2018 explain the remaining contribution to the forecast budget deficit in 2018. Note that some of the measures proposed for 2018 will also have significant effects in 2019 because their application extends beyond the time horizon of this SB. However, no details have been provided that would allow for an assessment of their impact in the coming years.

2.2 ANALYSIS OF PUBLIC REVENUE FORECAST IN DSB/2018

The MF predicts that the relative weight of general government revenue in GDP in 2018 will increase for the second year running. Following a decline in the relative weight of total GG revenue from 43.8% of GDP in 2015 to 43% in 2016, DSB/2018 points to a recovery in the relative weight of that aggregate’s in GDP (43.4% of GDP in 2017 and 43.5% in 2018). For 2018, the increase in the weight of total revenue in GDP will flow from growth in GG revenue (3.9%) higher than in nominal output (3.6%). The growth rates forecast for actual social contributions (5.0%), for the sale of goods and services (11.3%) and for “other current revenue” (7.9%) contribute to this situation.

¹ Assuming the MF classification of temporary and one-off measures for 2017 and 2018, the net impact on the balance of “other effects” quantified in column 10 of table 1 would be less negative and be -73 M€ (see Table 19 below). In chart 1, the “macro scenario and other effects” bar would read -1541 M€.

² The difference between the negative net impact of the temporary measures forecast for 2018 (54 M€) and the estimated net impact of the temporary measures for 2017 (368 M€), as detailed in Box 1.

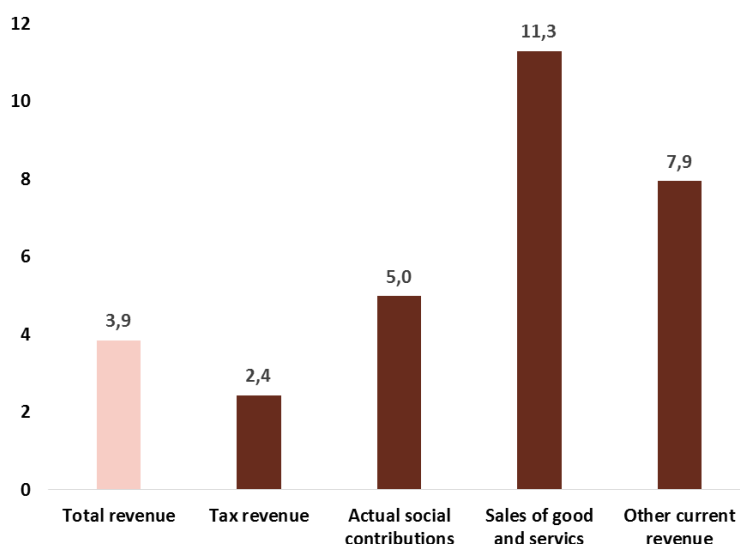
Table 2 – General government revenue and fiscal impact of the measures

	General government revenue										Measures
	% GDP					M€					M€
	2016	2017	2018	2016/17	2017/18	2016	2017	2018	2016/17	2017/18	2018
Total revenue	43,0	43,4	43,5	0,3	0,1	79 706	83 507	86 725	3 802	3 217	197
Current revenue	42,6	42,7	42,8	0,1	0,1	78 909	82 212	85 364	3 302	3 153	29
Tax revenue	25,1	25,2	25,0	0,2	-0,3	46 428	48 563	49 747	2 135	1 184	-267
Indirect taxes	14,8	15,0	15,1	0,2	0,1	27 347	28 880	30 166	1 533	1 287	180
Direct taxes	10,3	10,2	9,8	-0,1	-0,4	19 081	19 683	19 580	602	-103	-447
Social contributions	11,7	11,7	11,7	0,0	0,0	21 609	22 502	23 357	893	855	99
of which: actual soc. contr. received	9,1	9,2	9,3	0,1	0,1	16 929	17 736	18 621	807	885	52
Sales & other current rev.	5,9	5,8	6,1	-0,1	0,4	10 873	11 147	12 261	274	1 114	198
Sales	3,6	3,5	3,8	-0,1	0,3	6 625	6 789	7 557	164	767	0
Other current revenue	2,3	2,3	2,4	0,0	0,1	4 247	4 358	4 704	110	346	198
Capital transfers received	0,4	0,7	0,7	0,2	0,0	796	1 296	1 361	499	65	167

Sources: INE (2016) and Ministry of Finance (2017 and 2018). CFP calculations. | Note: The "Measures" column shows the budgetary impact from discretionary measures in 2018, and the carry-over effects on revenue resulting from prior to 2018 measures and financial gains. For more information on the measures taken into consideration see Table 18 below.

Growth in total general government revenue above the forecast change in nominal GDP is dependent upon the change in "Sale of goods and services" and the expected outcome of the policy measures included in DSB/2018. The actual impact of the measures that increase revenue as estimated by the MF will determine whether the growth objective stated in DSB/2018 (3.9%) is achieved, since in terms of tax revenue the existing policy measures are expected to produce a negative impact of 267 M€. The positive effects come from the impact of the policy measures relating to social contributions (99 M€), "other current revenue" (198 M€) and capital revenue (167 M€). Among non-tax and non-contribution revenue, mention must be made of the 11.3% growth in sales forecast in DSB/2018, for which no concrete justification is given, along with the 7.9% growth in "other current revenue", only partially explained by policy measures.

Chart 2 – Developments in main general government revenue items in 2018 (change, %)



Source: Ministry of Finance.

According to DSB/2018, general government tax revenue will grow at a slower rate than growth in nominal output, due to the decline in direct taxes. Next year, GG tax revenue should grow by 2.4% compared to the estimated figure for 2017. That positive change will be brought about by the 4.5% growth in indirect taxes, since direct taxes are expected to decrease by 0.5% versus 2017. This drop is explained by the expected decrease

in CIT revenue to be collected next year, which partially reflects this tax's exceptional performance in 2017³. PIT revenue is under pressure from the abolition of the surcharge and the changes to the tax brackets. Indirect taxes will grow as a result of policy measures and the developments forecast in the MF's macroeconomic scenario. Without the impact of the proposed policy measures covering indirect and direct taxes in 2018, tax revenue would rise by 3%, a sum that is still below the expected growth in nominal output (3.6%).

Table 3 – General government tax revenue and budgetary impact of measures, in national accounts

	General government tax revenue						Measures	y-o-y (%)
	% GDP			M€			M€	
	2017	2018	2017/18	2017	2018	2017/18	2018	
General Government tax revenue	25,2	25,0	-0,3	48 563	49 747	1 184	-267	2,4
Indirect Taxes	15,0	15,1	0,1	28 880	30 166	1 287	180	4,5
VAT	8,7	8,7	0,1	16 681	17 443	762	0	4,6
Petroleum Tax	1,8	1,8	0,0	3 480	3 687	207	n.d.	5,9
Tobacco Tax	0,8	0,8	0,0	1 490	1 606	116	n.d.	7,8
Tax on Alcohol and Alcoholic beverages	0,1	0,2	0,0	288	307	19	n.d.	6,6
Tax on high salt products	0,0	0,0	0,0	0	30	30	30	-
<i>Excise duties</i>	<i>2,7</i>	<i>2,8</i>	<i>0,1</i>	<i>5 258</i>	<i>5 630</i>	<i>372</i>	<i>180</i>	<i>7,1</i>
Vehicle tax	0,4	0,4	0,0	790	839	49	0	6,2
Tax on real estate transactions	0,4	0,5	0,0	818	941	123	0	15,0
Municipal Property Tax	0,8	0,8	0,0	1 541	1 618	77	0	5,0
Others	2,0	1,9	-0,1	3 792	3 695	-96	0	-2,5
Direct Taxes	10,2	9,8	-0,4	19 683	19 580	-103	-447	-0,5
PIT	6,4	6,3	-0,2	12 411	12 517	106	-447	0,9
CIT	3,4	3,0	-0,3	6 467	6 006	-461	0	-7,1
Others	0,4	0,5	0,1	805	1 057	252	0	31,3

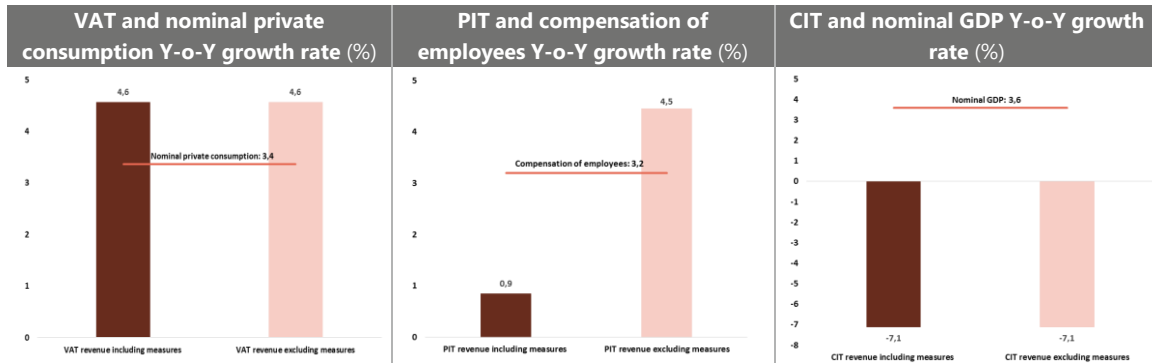
Source: Ministry of Finance (2017 and 2018). CFP calculations. | Notes: The estimate for "Other Indirect Taxes" and "Other Direct Taxes" comes from the difference between the total indirect and direct tax revenue included in DSB/2018 and the information provided by the MF as to the sum of the taxes set out in the above table. The "Measures" column reflects the MF's estimated budgetary impact of the discretionary measures in 2018 and carry-over effects on revenue from measures introduced prior to 2018. No detailed information is available on the impact of the measures relating to petroleum (ISP), tobacco (IT) and alcohol (IABA) taxes. For further information on the measures taken into consideration see Table 18 below.

In 2018, revenue from indirect taxes should record a higher growth rate than the expected change in GDP and in nominal private consumption. According to DSB/2018 general government revenue from indirect taxes should rise by 4.5% (1 287 M€) in 2018, with all taxes recording growth rates higher than that expected for Nominal GDP, with the exception of "Other indirect taxes" (-2.5%). The 1 287 M€ increase in indirect taxes is due, almost entirely (88.1%), to the expected increases of 762 M€ in VAT and of 372 M€ in STC. Since DSB/2018 contains no policy measures relating to VAT, there is an elasticity of 1.4 underlying the 4.6% growth projected for 2018, which is above the forecast 3.4% increase in nominal private consumption. As per MF clarifications this elasticity comes from revenue gains from other effects, such as combating fraud and tax invasion. The revenue from IMT (Tax on Real Estate Transactions) included in DSB/2018 estimates annual growth of 15%, and is the largest percentage change foreseen by the MF for indirect taxes. Since no policy measures are planned that have a bearing on this tax, the forecast increase is dependent upon the continuing dynamism recently seen in the real estate market. As regards excise duties (IECs), measures are to be introduced that will have an estimated impact of 180 M€, with 150 M€ coming from IT, IABA and ISP, through the updating of tax rates and the revoking of ISP exemptions, and the other 30 M€ from the introduction of a new tax on products high in salt. Excluding the impact of these measures, growth in indirect tax

³ In 2017 CIT revenue was positively driven by a particular transaction, conducted by a single entity and which increased the amount of collected tax by 235 M€. The MF did not identify that entity. Nonetheless, the media have reported it was EDP.

revenue would be 3.8% (1 107 M€), a figure still above the forecast changes in nominal GDP (3.6%) and nominal private consumption (3.4%). Accordingly, the elasticities implicit to indirect tax revenue, given the aforementioned economic bases, are greater than one and stand at 1.1. They also reflect gains the MF expects to obtain through fight against fraud and tax evasion in regard to the taxes in this category.

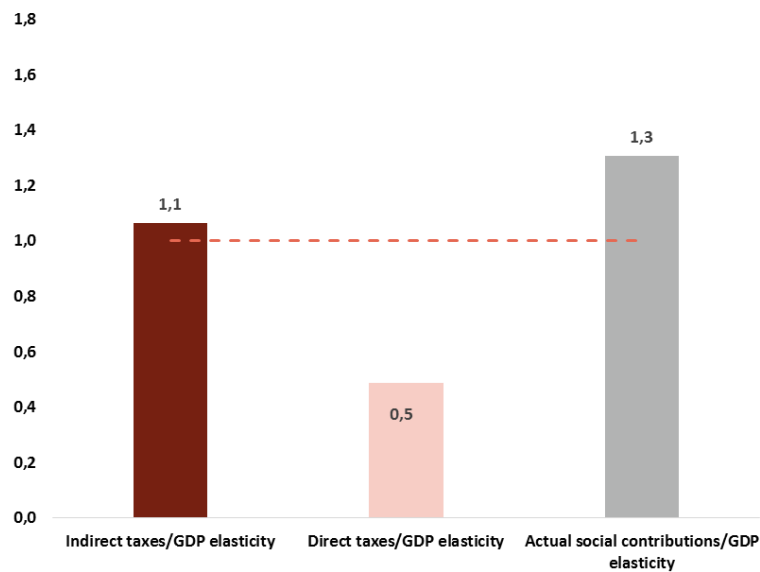
Chart 3 – Developments in main taxes and macroeconomic aggregates in 2018



Source: MF. CFP calculations. | Note: tvh stands for year-on-year change.

On the other hand revenue from direct taxes should fall compared to the estimated revenue for 2017 due to the decline in CIT revenue. Direct tax revenue should drop by 0.5% (-103 M€) in 2018, despite the expectation of 0.9% (106 M€) growth in PIT and a 31.3% (252 M€) increase in “Other direct taxes”, although no policy measures relating to this item have been identified. The apparently low growth in PIT is impacted by the abolition of the surcharge (-260 M€) and the changes to the tax brackets (-230 M€). These impacts are partially offset by the positive effect of the gradual unfreezing of civil service promotions (43M€). Ignoring the impact of policy measures, PIT revenue would grow by 4.5% in 2018, a figure which is higher than the 3.2% increase in earnings forecast by the MF. Therefore, direct tax revenue, net of measures, would record growth of 1.7%, which suggests an elasticity of 0.5 compared to nominal GDP. That elasticity is a conservative revenue forecast in light of the macroeconomic developments foreseen in DSB/2018 for next year. Nonetheless, it should be recalled that according to MF clarifications, CIT revenue was positively influenced by a particular transaction, conducted by a single entity and which increased the amount of tax collected by 235 M€, which suggests there will be a fall in revenue in 2018. Net of such effect, CIT revenue would grow 0.1% (vs. -7.1% forecast by the MF), and the implicit elasticity of direct taxes compared to nominal GDP would stand at 1.2, which implies its revenue will grow by more than the expected development in nominal output next year.

Chart 4 – Elasticities of indirect tax, direct tax and actual social contributions revenues compared to nominal GDP

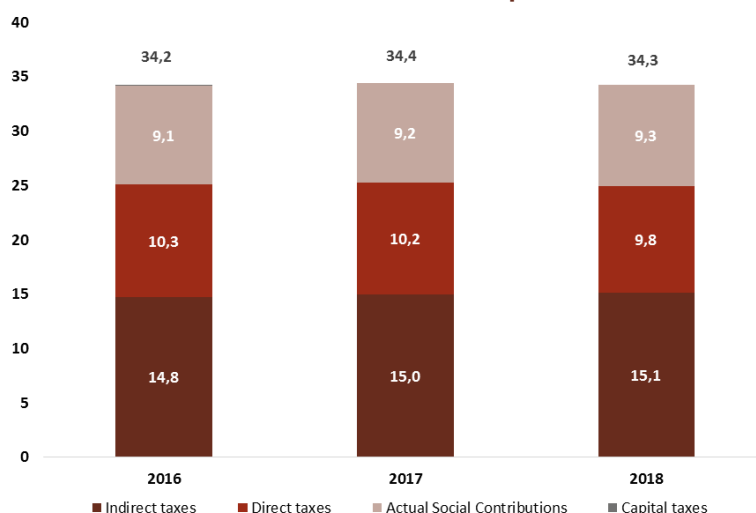


Source: MF. CFP calculations. Note: Elasticities have been calculated after deducting the impact of policy measures from forecast revenue for 2018.

According to the MF, actual social contributions should grow by more than the expected change in earnings. DSB/2018 assumes growth of 3.8% (855 M€) in social contributions, driven by the 5% (885 M€) growth in actual social contributions. Net of the effect of policy measures relating to the gradual unfreezing of civil service promotions (52 M€), the change in actual social contributions would be 4.7% (833 M€), i.e. higher than the MF forecasts for growth in nominal GDP (3.6%) and earnings (3.2%). Note that the implicit elasticities of actual social contributions compared to nominal GDP and to earnings are 1.3 and 1.5, respectively, which supposes a change larger than expected for the said macroeconomic aggregates.

The MF predicts a slight drop in the tax burden against the estimate for 2017. Following a 0.2 p.p. of GDP increase in 2017, the tax burden should fall to 34.3% of GDP the following year. This shall result from the fall in the relative weight of direct taxes from 10.2% of GDP in 2017 to 9.8% of GDP in 2018, due to the proposed PIT policy changes and the performance of CIT. The decrease in the weight of direct taxes more than offsets the increases in the relative weight of actual social contributions which will go from 9.2% of GDP in 2017 to 9.3% of GDP in 2018, and the relative weight of indirect taxes which will go from 15% of GDP in 2017 to 15.1% in 2018. The performance of the latter tax class reflects the developments in IECs and the greater than one elasticities forecast for GDP.

Chart 5 – Tax burden developments (as % of GDP)



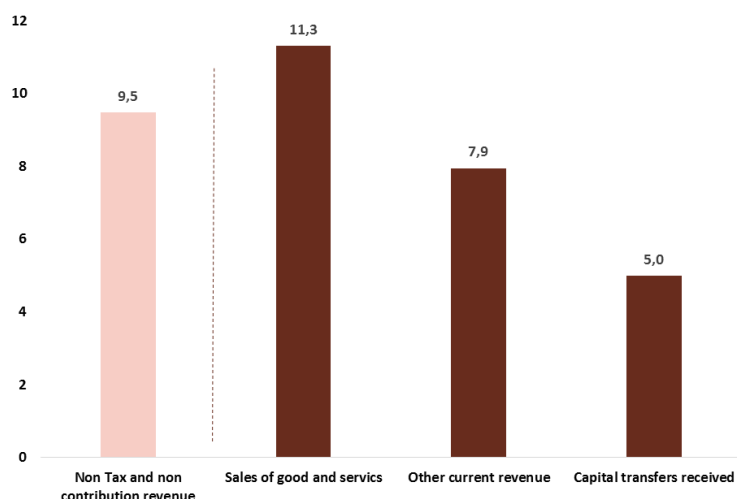
Source: INE (2016) and Ministry of Finance. CFP calculations. | Notes: The relative weight of capital taxes is minimal over the period and for this reason cannot be seen on the chart. The totals may not match the sum of the individual items as a percentage of GDP due to rounding.

In 2018, the goal set for non-tax and non-contribution revenue is dependent upon strong growth in sale of goods and services (of 767 M€). According to the MF, the annual change in sale of goods and services will be 11.3% and will provide around two-thirds of the growth in non-tax and non-contribution revenue (9.5%). The large increase in sales forecast for 2018 is not explained by policy measures, which constitutes a risk as regards the fulfilment of this forecast.^{4,5} As for “other current revenue” and capital revenue, the forecast annual growth of 7.9% and 5%, respectively, is mainly contingent (89%), on the effectiveness of the measures forecast by the MF for 2018. Net of the effects relating to the increase in BoP dividends (148 M€) and the “revenue review” (50 M€), “other current revenue” would only grow by 3.4%. However, the growth in capital revenue, excluding both the impact of the measure linked to the increase in structural funds (167 M€) in 2018 and of the recovery of the guarantee provided to BPP (450 M€) in 2017, would be fairly large, to the extent that a year-on-year change of 41.1% would be expected, which supposes a sharp increase in this account next year.

⁴ For the “Sale of goods and services” account the MF predicts growth of 0.2% (8 M€) in public accounting in 2018, compared to the estimate for 2017, which is significantly different from the forecast growth of 11.3% (767 M€) in the “Sale of goods and services” in national accounts. This difference adds to the risk indicated.

⁵ The sale of goods and services account in national accounts includes, among other items, a series of receipts under budgetary accounting (cash basis) and other items that are part of costs and revenue accounting. Examples include (i) Sale of Goods; (ii) Sale of Services; (iii) rents which are either classified as Sale of goods and services or as Property Income; (iv) some municipal indirect taxes; (v) NHS copayments, in addition to sales and “other current revenue” relating to the health system; (vi) provision of services and supplementary revenue relating to transport and infrastructure companies falling within the scope of the GG sector.

Chart 6 – Development in non-tax and non-contribution revenue in 2018 (change, %)



Source: Ministry of Finance.

2.3 ANALYSIS OF PUBLIC EXPENDITURE FORECAST IN DSB/2018

The MF forecasts point to a decrease in expenditure's relative weight in GDP (down 0.3 p.p.) in 2018, which is wholly dependent upon a decrease in interest charges, since primary expenditure is expected to rise by 0.1 p.p. of GDP. According to DSB/2018, expenditure's relative weight in GDP will fall by 0.3 p.p. next year to stand at 44.5% of GDP. The MF expects this decrease to be larger than that estimated for this year (0.2 p.p.) but less than that recorded in 2015 and 2016 (3.6 p.p. and 3.2 p.p., respectively). The decrease forecast for 2018 will be wholly dependent upon a cut in interest charges (0.4 p.p. of GDP), as primary expenditure is expected to rise (0.1 p.p. of GDP) as a result of a significant increase in the weight of GFCF - see Table 4. Note that the denominator has a strong impact on the analysis of these ratios, since the MF forecasts include a 3.6% growth in nominal GDP (around another 7000 M€ compared to 2017).

Table 4 – General government expenditure and forecast impact of measures

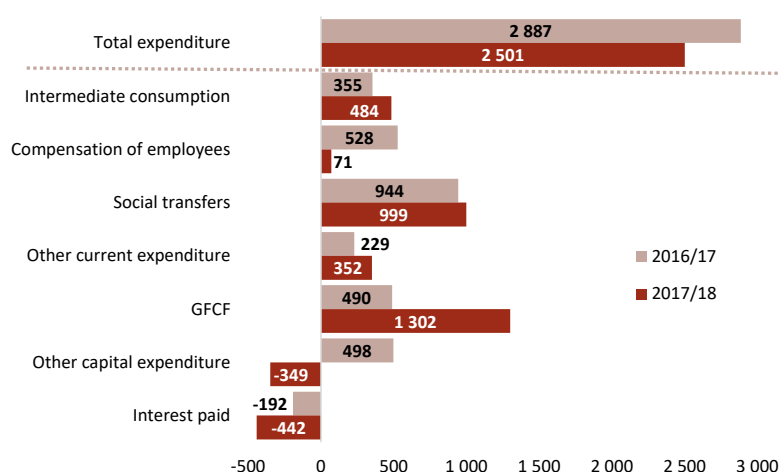
	General Government expenditure										Measures for 2018	
	% of GDP					M€					M€	
	2016	2017	2018	2016/17	2017/18	2016	2017	2018	2016/17	2017/18	Permanent	Temporary
Total expenditure	45,0	44,8	44,5	-0,2	-0,3	83 371	86 257	88 758	2 887	2 501	235	54
Primary expenditure	40,8	40,9	40,9	0,1	0,1	75 610	78 689	81 632	3 078	2 943	542	54
Primary current expenditure	38,9	38,5	38,2	-0,4	-0,3	72 058	74 148	76 139	2 091	1 990	344	36
Intermediate consumption	5,6	5,6	5,6	0,0	0,0	10 418	10 772	11 256	355	484	-144	
Compensation of employees	11,3	11,1	10,8	-0,2	-0,4	20 881	21 409	21 480	528	71	270	
Social transfers	19,0	18,7	18,6	-0,2	-0,1	35 113	36 057	37 056	944	999	322	18
other than in kind	17,1	16,9	16,8	-0,2	-0,1	31 730	32 505	33 449	775	945	322	18
in kind via market producers	1,8	1,8	1,8	0,0	0,0	3 383	3 552	3 607	169	55		
Subsidies	0,5	0,5	0,5	0,0	0,0	975	1 010	1 094	35	84	-20	
Other current expenditure	2,5	2,5	2,6	0,0	0,1	4 671	4 900	5 252	229	352	-84	18
Capital expenditure	1,9	2,4	2,8	0,4	0,4	3 552	4 540	5 493	988	953	198	18
GFCF	1,5	1,7	2,3	0,2	0,6	2 734	3 224	4 525	490	1 302	162	
Other capital expenditure	0,4	0,7	0,5	0,2	-0,2	819	1 316	967	498	-349	36	18
Interest paid	4,2	3,9	3,6	-0,3	-0,4	7 761	7 569	7 126	-192	-442	-307	

Source: INE and Ministry of Finance. CFP calculations. | Notes: the figures for 2017 match the MF estimate included in DSB/2018; the "Measures for 2018" column shows the fiscal impact of temporary and discretionary measures. The latter do not include the "Nominal freezing of intermediate consumption" nor the "Containment of Other current expenditure" set out in Table II.2.2. of the DSB/2018 Report because, according to additional clarification provided by the MF, and contrary to the wording of the report, the sums in question should not be interpreted as savings compared to the previous year, but rather be compared to a no-policy-change scenario in which growth would occur at the same rate as

nominal GDP. For detailed information on temporary measures and discretionary measures see Box 1 and Table 18, respectively.

In relative terms DSB/2018 points to a slowdown in expenditure's rate of growth, from 3.5% in 2017 to 2.9% in 2018, which is mainly based on a sharper decrease in expenditure on interest. In 2018 the increase in GG expenditure should reach 2501 M€, of which 1990 M€ relates to current primary expenditure - see Table 4 and Chart 7. An increase in capital revenue of around 953 M€ is also forecast, due to a significant increase in GFCF (1302 M€) and a fall in other capital expenditure (349 M€). The Ministry of Finance forecasts also point to a decrease of 442 M€ in expenditure on interest, which represents a faster rate of decrease in this expenditure (from 2.5% in 2017 to 5.8% in 2018) which – together with the slower growth in primary expenditure, down from 4.1% to 3.7% - explains the slowdown in GG expenditure forecast for 2018.

Chart 7 – Change in general government expenditure (M€)



Source: INE and Ministry of Finance. CFP calculations. | Note: the Chart does not include the change in spending on subsidies as it is less significant (+35 M€ from 2016/2017 and +84 M€ from 2017/2018); the change in "other current expenditure" in 2017/18 is influenced by the provisional appropriation for 2018 (495 M€).

The MF foresees expenditure on social transfers growing at a similar rate to the current estimate for 2017, although the various components will perform differently.

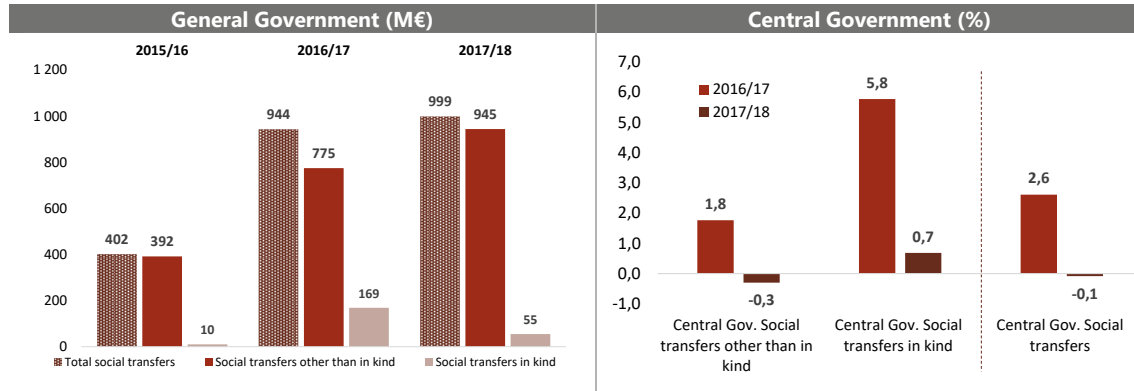
According to DSB/2018, the annual change in social transfer expenditure next year (+2.8%) will be slightly up on the 2.7% estimated in DSB/2018 for 2017.⁶ Nonetheless, the MF predicts higher growth among social transfers other than in kind (from 2.4% to 2.9%) and a slowdown in the growth of social transfers in kind, from 5% to 1.5%.⁷ In absolute terms the

⁶ Achieving the estimate for 2017 included in DSB/2018 requires expenditure on social transfers to be up 442 M€ on the figure forecast in SB/2017 (of which 351 M€ relate to social transfers in kind).

⁷ That slowdown should be explained by the central government subsector, where the MF predicts an increase in social transfers in kind of only 0.7% in 2018, following an estimated increase of 5.8% in 2017. DSB/2018 also points to this subsector's expenditure on social transfers other than in kind falling by 0.3% in 2018, following an increase of 1.8% estimated for 2017 (see right-hand panel of Chart 8). This change does not appear to be consistent with the 1.8% increase forecast for expenditure on pensions paid by the CGA (which accounts for 87% of central government spending on social transfers other than in kind forecast for 2018). The CFP sought clarification of the forecast decrease from the MF, and was informed that it was explained by the expected cut in ADSE pay-as-you-go expenditure. Given that the

forecast increase in GG expenditure on social transfers for next year (999 M€) is almost wholly explained by social transfers other than in kind (945 M€) – see left-hand panel of Chart 8. This increase will result from the regular updating of social security and CGA pensions,⁸ from the net effect of discretionary measures of a permanent nature set out in DSB/2018 (see paragraph below), from a rise in the number of pensioners and the updating of the social support index (IAS).⁹ On the other hand, the impact of the expected improvement in the labour market in 2018 should allow spending on unemployment benefit to fall by 59 M€ (-4.3%).¹⁰

Chart 8 – Annual change in social transfers



Source: INE and Ministry of Finance. CFP calculations. | Notes: the changes relating to the periods 2016/17 and 2017/18 are those included in DSB/2018; CG – central government.

The unfavourable impact of the discretionary measures proposed for 2018 will mainly fall on social transfer expenditure. Of particular note is the carry-over effect of the extraordinary updating that took place from August 2017 (154 M€ in regard to the increase in pensions worth 1.5 times the IAS or less), to which the impact of the new extraordinary updating of said pensions will be added in August 2018 (35 M€). Also of note is the impact of the measures relating to the introduction of a supplementary social inclusion transfer (84.7 M€) and more favourable retirement conditions for those who have made contributions over long periods (48 M€).¹¹

2018 appropriation for ADSE expenditure on health services is practically the same as this year's, that explanation implies that this item of spending will be much larger than the initial forecast for 2017 (at the end of September 2017 the expenditure in question had an outturn level of 84%).

⁸ As in 2017, pensions will be subject to the regular update from January next year, but the existing rules (articles 5 and 6 of Law no. 53-B/2006, as amended by article 250 of the SB/2017 Law) imply a greater fiscal impact in 2018. In effect, since the average annual growth rate of GDP over the last two years is greater than or equal to 2% and less than 3%, next year the updating of pensions worth up to twice the IAS amount will match the rate of inflation (which will be higher than it was in 2017) and therefore they will be raised by at least 0.5 p.p.. On the other hand the existing rules state that, unlike this year, pensions exceeding twice the IAS amount will be updated in 2018.

⁹ According to additional information provided by the MF, the number of old-age pensioners should rise by 0.1% in 2017 and 0.6% in 2018 while the updating of the IAS on 1 January 2018 will have an impact on social transfer expenditure of around 22 M€.

¹⁰ The MF predicts a decrease of 0.6 p.p. in the unemployment rate to 8.6% in 2018.

¹¹ Although they do not appear in Table II.2.2. of the main fiscal policy measures in the DSB/2018 Report, note the impact of the abolition of the deduction currently made when disability pensions are converted into old-age pensions at the age of 65, and of the 794 M€ impact of extending the effects of changes introduced in 2016 and 2017 to family allowance, social integration income, solidarity supplement for the elderly and parenthood transfers.

The forecast change in compensation of GG employees in 2018 do not appear to be consistent with the fiscal impact of the planned measures, namely the gradual unfreezing of civil service promotions.

DSB/2018 suggests the relative weight in GDP of compensation of employees, after stabilising at 11.3% in 2016, will fall to 11.1% in 2017 and to 10.8% in 2018. Given the estimate for 2017, DSB/2018 foresees an increase of just 71 M€ (0.3%) in compensation of GG employees in 2018, following an estimated rise of 528 M€ (2.5%) in 2017 – see left-hand panel of Chart 9.¹² That MF forecast is based on a sharp slowdown in the rate of growth in compensation of employees within the central government subsector (see right-hand panel of Chart 9), which does not seem consistent with the beginning of the gradual unfreezing of civil service promotions.¹³ In effect the MF estimates that the gross impact of the unfreezing will total 353 M€ in 2018, and an appropriation of 130 M€ has been made in the Finance programme to cover the impact on central government expenditure funded by general revenue.¹⁴ As well as the effects of unfreezing promotions, compensation of employees will be under pressure from the effects of: the restoring of collective labour contracts (22 M€);¹⁵ the new wage conditions for nurses (15 M€); the restoring of overtime and supplementary work payments (7 M€); and the extraordinary rectification of precarious employment in GG.¹⁶ The only discretionary measures that lead to savings in compensation of employees stem from a drop in absenteeism among general government employees (60 M€) and the application of the “2 in for every 3 out” rule (23 M€).^{17,18} Accordingly compensation of employees is clearly undervalued. The effect of underestimating compensation of employees has already arisen this year: in SB/2017 the implicit increase in compensation of GG employees compared to 2016 was a mere 94 M€, but according to the new MF estimate for 2017 the increase should be 528 M€. Thus, as in 2017, the budget outturn throughout 2018 will necessarily require the appropriation for compensation of employees to be increased via either the provisional appropriation and/or the budget reserve. As these sums are reflected in other current expenditure, this approach reduces budget transparency.

¹² The MF estimates that the gross impact of restoring pay in 2017 will total 318 M€.

¹³ The MF forecasts from a public accounts standpoint even point to a decrease of 6.3% in 2018 in compensation of central government employees under the “Basic and Secondary Education and School Administration” programme.

¹⁴ Phased payment of the pay increases is provided for in article 19 of Bill no. 100/XIII. In 2018 the unfreezing will be 25% on 1 January and 50% on 1 September. DGO Circular no. 1387 of 3 August 2017 stated that in 2018 the departments and entities should not budget for sums aimed at supporting the cost of the progressive restoring of promotions, in relation to the part funded, directly or indirectly, by general revenue. Entities with their own revenue should budget for 1/3 of the total cost of any progressive restoring of promotions.

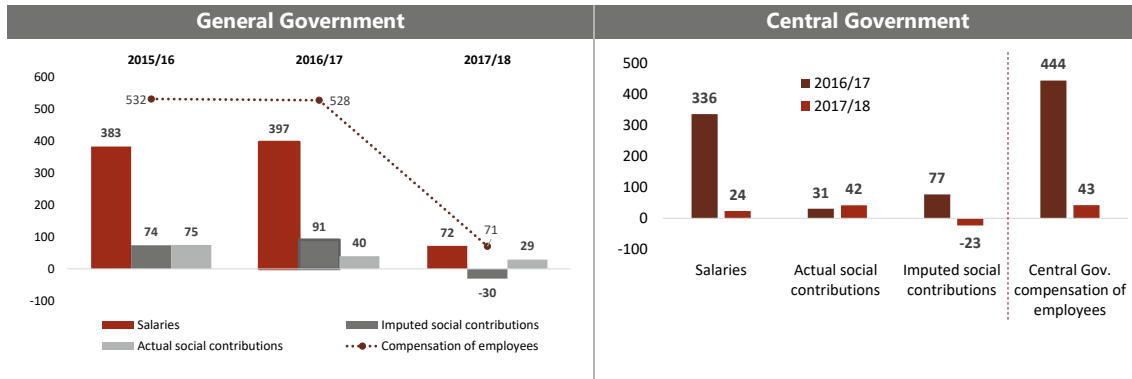
¹⁵ Pursuant to article 21 of Law no. 42/2016 of 28 December.

¹⁶ The MF estimates that hiring people whose current labour relationship with the State is precarious will have zero effect on the GG balance, as the expenditure will simply be reclassified from intermediate consumption to compensation of employees.

¹⁷ In the DSB/2018 Report the MF retains the estimated saving of 122 M€ published in SB/2017 relating to the effect of applying the “one new employee for every two GG staff leaving” rule in 2017. However, DGAEP figures for the 1st half of 2017 (without the impact of the extraordinary rectification of precarious employment in GG) suggest an increase of 1.3% in the number of employees across GG compared to the same period the previous year and a 0.6% rise since the beginning of this year.

¹⁸ According to additional information provided by the MF, besides the sums mentioned in the text there is a 50 M€ saving on compensation of employees flowing from the retirement of currently active members of the Ministry of Defence and the GNR.

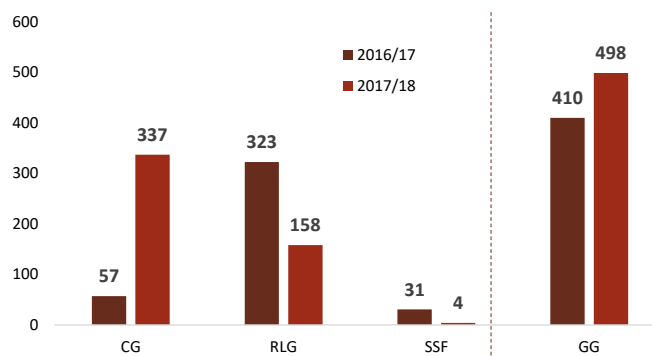
Chart 9 – Annual change in compensation of employees (M€)



Source: INE and Ministry of Finance. CFP calculations.

The rate of growth in intermediate consumption should rise from 3.4% in 2017 to 4.5% in 2018, despite the forecast savings from the expenditure review. According to DSB/2018 intermediate consumption will record an increase of 355 M€ this year and 484 M€ in 2018.¹⁹ Excluding expenditure on PPP (which should fall by 14 M€ next year) the expected increase for the remaining intermediate consumption is 5.3% or 498 M€ (of which 337 M€ relates to central government subsector for which the MF estimates a mere increase of 57 M€ in 2017) – see Chart 10. This increase is higher than the MF forecasts for the inflation rate (1.4%) and nominal growth in GDP (3.6%), despite the savings expected from the public expenditure review (144 M€). Note that while the budget reserve for 2018 stands at 451 M€, only 5 M€ has been included in the expenditure forecast, and the other 446 M€ have been deemed savings. According to the MF, the GG account for 2018 is net of retentions totalling around 590 M. Therefore, it may be assumed that this sum will not be spent. Lastly, it should be noted that intermediate consumption as a percentage of GDP will remain at 5.6% for the fourth year running.

Chart 10 – Change in intermediate consumption excluding PPP (M€)



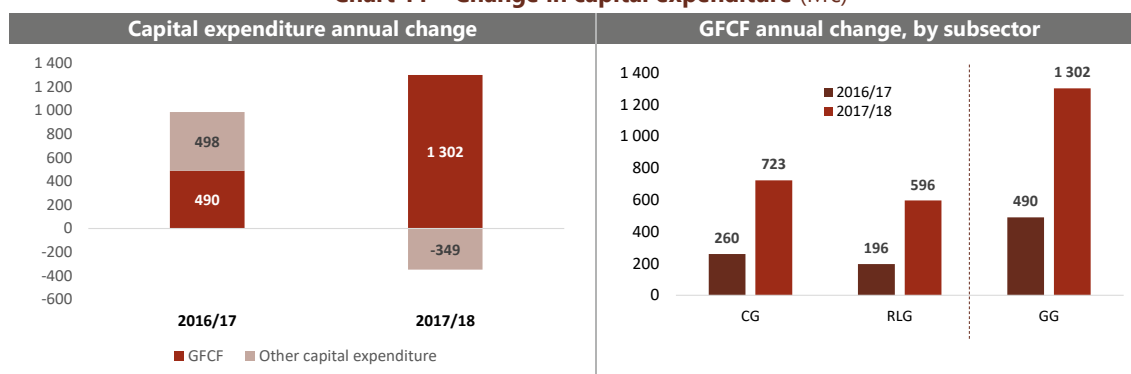
Source: INE and Ministry of Finance. CFP calculations. Note: CG – central government; RLG – regional and local government; SSF – social security funds; GG – general government.

¹⁹ In order to achieve the estimate for 2017 as per DSB/2018 intermediate consumption must be 92 M€ above the figure forecast in SB/2017.

Excluding the provisional appropriation, the MF forecasts a 2.9% decrease in other current expenditure. In line with the procedure followed in previous years, the amount forecast for this account includes the provisional appropriation (which in 2018 stands at 495 M€). However, in the outturn estimate published for 2017 the provisional appropriation (535 M€) is not included in this account, and is wholly reassigned to shore up other expenditure accounts. This different treatment of the provisional appropriation leads to an apparent increase of 7.2% in other current expenditure. Excluding the provisional appropriation from the DSB/2018 forecast for 2018, we conclude that there will be a decrease of 2.9% (143 M€) in “other current expenditure” to which savings under the expenditure review must contribute. On the other hand, a payment of 144 M€ is to be made next year to Greece under its adjustment programme (of which 83.6 M€ relate to 2017) and there is to be a 16% increase in the financial contribution to the European Union budget.

DSB/2018 points to a rise of 21% in capital expenditure, given the strong growth in GFCF in 2018. The MF estimates that the relative weight of GFCF in GDP will increase by 0.2 p.p. in 2017 and by 0.6 p.p. in 2018, to reach 2.3% of GDP. DSB/2018 predicts an increase in the rate of GFCF growth from the estimated 17.9% in 2017 to 40.4% next year. The estimated spending on GFCF is 4525 M€, which accounts for an increase of 1302 M€ compared to the estimate for 2017. It is the largest contribution to GG expenditure in 2018. As can be seen in the right-hand panel of Chart 11 the forecast rise in GFCF is explained both by central government (+723 M€) and regional and local government (+596 M€), and is partially grounded in the investment leverage provided by European funds under the Portugal 2020 programme.²⁰ Note, however, that in recent years GFCF has always fallen well short of the initial forecast: the current MF estimate for 2017 suggests that GFCF will actually be 953 M€ lower than the SB/2017 forecast.

Chart 11 – Change in capital expenditure (M€)



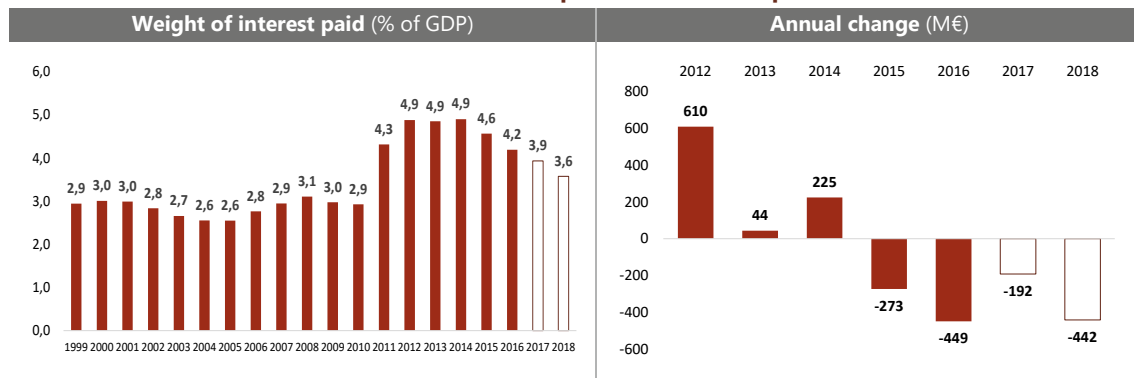
Source: INE and Ministry of Finance. CFP calculations. | Notes: the chart in the right-hand panel does not include the social security subsector because the respective expenditure is small; CG – central government; RLG – regional and local government; GG – general government.

²⁰ The MF estimates that in 2018 the public investment brought about by European funds will be 1182 M€. This figure represents an increase of 66% on the total cumulative outturn forecast for the end of this year, corresponding to an increase of around 470 M€. The GFCF allocation for 2018 includes the sum of 100 M€ allocated to the national contribution, (equal to the sum taken into account in SB/2017).

The forecast 349 M€ decrease in other capital expenditure in 2018 is driven by some transactions relating to 2017. The MF estimates that this account will record an increase of 498 M€ in 2017, as a result of expenses relating to the conversion of deferred tax into tax credits (160 M€), of the enforcement of guarantees given to victims of the BES collapse (150 M€) and of swap contracts entered into by the transport operators, STCP and Carris (111 M€). A 349 M€ decrease in this account is forecast for 2018 (see left-hand panel of Chart 11), driven by these baseline effects, while next year is also expected to record the conversion of deferred tax, although on a smaller scale (120 M€). Excluding these effects in 2017 and 2018, there is an implicit decrease of 49 M€ in other capital expenditure. Lastly, it is noted that while the recapitalisation of the CGD bank began in the 1st quarter of 2017, the deadline for the decision as to its recording in national accounts is March 2018, the date of the 1st EDP notification relating to 2017.

According to DSB/2018 expenditure on interest is the only current expenditure item that will record a nominal decrease in 2018. Expenditure on interest should total 7126 M€ in 2018 (a drop of 442 M€ against the estimate for 2017) and so help offset the growth in total GG.²¹ It will be the fourth consecutive year in which this item has decreased, and in cumulative terms the annual changes total 1357 M€ over the period (see right-hand panel of Chart 12). The expenditure on interest developments forecast for 2018 accounts for a decrease of 5.8%. Although an increase in nominal debt stock of around 3200 M€ is forecast in 2018, the fall in the implicit interest rate will sustain the decrease in interest payments. This cut in the implicit interest rate stems from the improvement in public debt borrowing terms and the early repayment of the IMF loan undertaken in 2017 which, according to the MF, should generate savings of 307 M€. As a percentage of GDP, general government spending on interest should continue to follow the downward path seen in recent years to stand at 3.6% in 2018 (down 0.4 p.p. of GDP on the estimated ratio for 2017, although still 0.6 p.p. of GDP above the figure recorded in 2010).

Chart 12 – Developments in interest paid



Source: INE and Ministry of Finance. CFP calculations.

²¹ According to the estimate for 2017 included in DSB/2017 report expenditure on interest will be 728 M€ below the estimate in SB/2017 (which contained an implicit increase of 536 M€ compared to 2016) – see Box 3.

3 ASSESSMENT OF FISCAL ADJUSTMENT, FISCAL POLICY STANCE AND COMPLIANCE WITH RULES

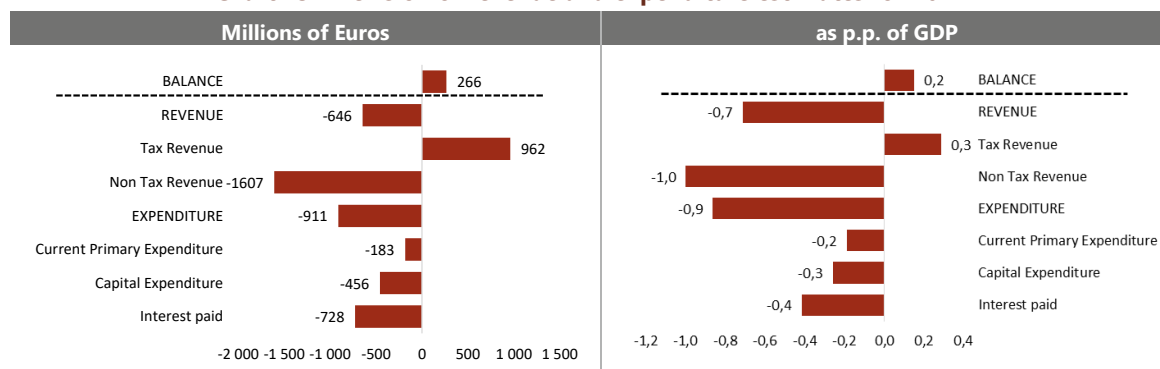
When reading the analysis in this section it is important to bear in mind the following: 1) when evaluating compliance with the budgetary balance rule the denominator used was nominal GDP, as defined in the Budgetary Framework Law. 2) the structural balance calculated below is based on the classification of temporary measures and one-offs according to CFP criteria (see Box 1) and on the cyclical components calculated in line with the common methodology adopted within the European Union, accepting the assumptions made by the Ministry of Finance. In this regard the recalculation of the output gap made by the CFP gave rise to figures that differ from those published in the DSB/2018 Report, despite the necessary information and the time horizon being identical. That difference affects the assessment of the structural balance and the consequent adjustment that Portugal is obliged to make under the preventive arm of the Stability and Growth Programme (SGP).

3.1 BUDGETARY BALANCES

The MF estimate for the nominal GG deficit in 2017 suggests it will be smaller than forecast in SB/2017 and in SP/2017. That estimate sets the 2017 deficit at 1.4% of GDP, against the 1.6% of GDP deficit in SB/2017 and the 1.5% advanced later by the MF in SP/2017. If that estimate proves to be true, it will represent a downward revision of 0.2 and 0.1 p.p. of GDP, respectively, as well as a correction of the fiscal imbalance larger than those published in the two budget framework planning documents. The improvement in the macroeconomic framework, reflected in the higher than expected growth in output and employment, with positive knock-on effects on tax and contribution revenue, together with the improved public debt borrowing terms that have led to lower interest charges, explain the more favourable development of 2017 General Government balance.

The revised estimate for the 2017 balance, compared to the SB/2017 forecast is explained above all by expenditure. Box 3 compares the two forecasts for the 2017 account: the one included in DSB/2018 and the one included in SB/2017. The MF estimate points to expenditure on interest accounting for the largest contribution to the downward revision in expenditure, backed up, on a smaller scale, by capital expenditure (see chart 13). This update has led to a downward revision in the level of expenditure both in absolute terms (-911 M€) and as a ratio of GDP (-0.9 p.p. of GDP). By contrast, despite the expected increase in tax and contribution revenue (+1150 M€) compared to the SB/2017 forecast, the revenue estimate has been revised downwards, in absolute terms and as a ratio of GDP. The decrease in the volume of revenue expected from the sale of goods and services, “Other current revenue” and capital revenue (-1796 M€; -1 p.p. of GDP) justifies this revision.

Chart 13 – Revision of revenue and expenditure estimates for 2017



Source: INE, MF. CFP calculations. Note: The figures have been adjusted for temporary measures and one-off measures (see Box 1). A positive/negative figure for expenditure corresponds to an unfavourable/favourable deviation, while the opposite is the case with revenue.

For 2018, the DSB retains the deficit objective laid down in SP/2017, pursuing a fiscal imbalance correction that continues to benefit more from interest's contribution and the economic recovery than from the net impact of structural measures. The fiscal imbalance correction for 2018 will reflect a 0.4 p.p. of GDP decrease in the deficit, due mainly to the favourable effect of expenditure on interest and the positive impact of the economic cycle, which are sufficient to cancel out the temporary effects on the balance. The decrease in the deficit forecast in DSB/2018 (0.4 p.p. of GDP) is smaller than in SP/2017 (0.5 p.p.), which is also the case when temporary effects are excluded, giving rise to an estimated decrease of 0.6 p.p., a figure that compares with the 0.7 p.p. underlying SP/2017. If the forecast decrease in the deficit in 2018, adjusted for temporary effects (0.6 p.p.) becomes true it will be lower than the MF estimate for 2017. Expenditure on interest should make a larger contribution to the decrease in the deficit in 2018, unlike in 2017, when the MF estimates that primary balance will provide a larger contribution to this decrease.

Table 5 – Budget indicators

	% GDP				Change (p.p. GDP)			
	2015	2016	SB/2018		2015	2016	SB/2018	
			2017	2018			2017	2018
Primary	0,2	2,2	2,5	2,6	2,4	2,0	0,3	0,1
Actual (headline)	-4,4	-2,0	-1,4	-1,0	2,8	2,4	0,6	0,4
Adjusted of temporary & one-off measures	-3,1	-2,4	-1,6	-1,0	0,5	0,7	0,8	0,6
Cyclically adjusted	-3,5	-1,5	-1,6	-1,5	2,1	2,0	-0,1	0,1
Structural	-2,2	-1,9	-1,8	-1,5	-0,2	0,3	0,1	0,3
Structural primary	2,4	2,3	2,1	2,1	-0,6	-0,1	-0,2	0,0
<i>memo items</i>								
temporary measures	-1,3	0,4	0,2	0,0	2,3	1,7	-0,2	-0,2
output gap*	-1,8	-1,0	0,4	0,9	1,4	0,8	1,3	0,6
cyclical component	-0,9	-0,5	0,2	0,5	0,7	0,4	0,7	0,3
interest payments	4,6	4,2	3,9	3,6	-0,3	-0,4	-0,3	-0,4

Source: INE, MF. CFP calculations. Note: *as percentage of potential output. The semi-elasticities used match those of the EC, where the output gap was calculated in line with the Community methodology. Temporary and one-off measures reflect the CFP classification, which does not match that used by the MF. The changes do not necessarily match the differences in the figures as a percentage of GDP due to rounding.

The improvement in the budgetary balance forecast by the MF in the DSB for 2018 is based on a large primary surplus, a necessary contribution to ensure a sustained downward path for the public debt ratio. The positive development in the budgetary balance before interest, that began in 2015 continues for the fourth year running. For 2018 the MF forecasts an improvement in the primary balance (of 0.1 p.p. of GDP) founded on revenue's contribution (0.1 p.p.).

However, the budget deficit forecast for 2018 in national accounts is down by more than one third on that from a cash accounting standpoint, an outcome that may be a risk factor. That difference of 1320 M€ (0.7 p.p. of GDP) reflects the major adjustment between the two accounting standpoints, explained almost entirely by the adjustments relating to accrual accounting. Over three-quarters of the strong positive impact of that adjustment (1277 M€; 0.6 % of GDP) is explained by the time adjustments that the MF predicts for taxes and social contributions (+336 M€), for accrued interest (234 M€) and the settling of previous years' debts to suppliers (421M€).²² The size of the adjustment between accounting systems forecast for 2018 (1320 M€) contrasts with the estimate for 2017 (-280M€); this implies a shift away from the outcome in cash accounting terms, which under current reporting conditions is the speedier means for monitoring the public accounts and is significantly faster than the national accounts statistics.

Box 1 – Temporary measures taken into account by the CFP in 2017 and 2018

Identifying the temporary measures and one-off measures, along with the cyclical component, is a key element to calculate the structural balance. The specifications on the implementation of the Stability and Growth define one-off and temporary measures as measures having a transitory budgetary effect that does not lead to a sustained change in the intertemporal budgetary position. Therefore, this type of measure should not have a permanent effect on the budget deficit. Thus, in order to be able to identify the fiscal consolidation effort in structural terms, the budget aggregates are adjusted for such effects.

The MF provided CFP with supplementary information on a series of measures (and other effects) that the MF classifies as temporary and one-off measures and which are shown in the table below.

Medidas One-off		
	2017	2018
Receita		
IRC	235.0	-235.0
BPP	450.0	
Total	685.0	-235.0
Despesa		
F-16 Romania	-29.0	
DTA	160.0	120.0
Lesados BES	150.0	
Swaps STCP, Carris	110.0	
Incêndios		53.5
Pagamentos à Grécia (ANFA and SIMP)		83.6
Total	391.0	257.1
Saldo	294.0	-492.1

The classification of temporary and one-off measures that the CFP has adopted is in line with the five basic principles set out in the European Commission publication *"Guiding Principles for the Classification of One-Off Measures"*,

²² As regards the series of "other adjustments", which do not stem from accruals accounting, their contribution is practically zero (41M€), since they reflect the impact of various adjustments in different directions.

Report on Public Finances in EMU 2015, Institutional Paper 14, 2015, Part II, Chapter 3, pp. 52-65 and which are:

- I- One-off measures are intrinsically non-recurrent;
- II- The one-off nature of a measure cannot be decreed by law or by an autonomous government decision;
- III- Volatile components of revenue or expenditure should not be considered one-off;
- IV- Deliberate policy actions that increase the deficit do not, as a rule, qualify as one-offs;
- V- Only measures having a significant impact on the General Government balance should be considered one-offs.

Taking into account these principles and the information the CFP has in its possession, it considers that some of the temporary and one-off measures identified in the above table are not one-offs. Principle IV recognises the existence of a strong presumption that deliberate policy actions that increase the deficit are of a structural nature. To set aside this presumption requires a measure that genuinely follows principle I or carefully evaluates: 1) the probability of the action becoming recurrent; ii) the degree of Government control (in the sense of principle IV); and iii) the risk of giving poor incentives to economic policymakers with respect to transparency and global sustainability of public finance

The CFP requested additional clarifications in regard to some items on the above list, which have not yet been received. Therefore, the CFP is unaware of the list of one-off measures that the European Commission will take into consideration.

CIT – This table identifies a fluctuation in CIT revenue in 2017 and 2018 attributable to market transactions of a single company that should not be considered a temporary measure. First of all, the change in revenue does not stem from a policy measure, but rather from a series of financial transactions conducted in the market by a private company. Not only does that reflect the intrinsic volatility of CIT, but nothing allows us to say that transactions of this type will not occur in 2018, undertaken by the same or other companies, nor to assess the outcomes. As the European Commission states in the aforesaid publication, the one-off concept should not be used to level out the volatility of certain revenue and expenditure items, above all when *"the volatility of some components of revenue and expenditure does not even result from a policy measure and also for this reason does not qualify as a one-off measure."* Furthermore the impact in 2017 was never referred to in the monthly analysis of public revenue, and is not even addressed in the SB Report when analysing the CIT forecast for 2018 or the estimate for 2017.

DTA – According to the information provided it is the conversion of Deferred Tax Assets into capital of one (or more) bank(s). That conversion does not result from a policy measure, but rather from a mechanism laid down in specific legislation, that may be used by banks over an extended period, not limited to the maximum two-year period laid down for classification as a temporary measure. To be deemed a one-off it would have to be defined as an exceptional support to the financial system. So far, this has only included capital injections in financial institutions that are in difficulty, which is not apparent in this case. Bearing in mind the prudence required when classifying transactions that increase the deficit, as per principle IV, it is not likely that this transaction should be classified as a temporary measure.

Victims of the BES collapse – According to the information received at the clarification meeting, this is a personal guarantee from the State that has a high chance of being enforced in the context of the "BES investors victims case". The personal guarantee from the State was provided under Law 69/2017, in Article 71 (1). The exact circumstances of this event are unknown as is the global amount of the guarantee. According to national accounting standards it may be deemed an expense, but it is a policy measure that increases the deficit and does not constitute exceptional support to the financial system, so its classification as a temporary measure appears to clash with principle IV.

Payment to Greece – It is the payment to Greece of the interest on loans granted. The reasoning given by the MF diverges between the explanation given in the table and that provided orally to the CFP. In the former case it seems to correspond to a financial transaction to be borne by the Bank of Portugal; in the latter it is a direct State-to-State transfer. The information received indicates that it is a payment in 2018 of a sum relating to 2017, and, in fact, the respective sum is recorded in the public accounts in the estimate for 2017 in SB/2018. Therefore, even after settlement is made in 2018 the figure in national accounts will refer to 2017.

The table below identifies the temporary measures or one-off measures taken into account by the CFP when analysing the public accounts for 2017 and 2018, underlying DSB/2017. The transaction described as "Swaps STCP, Carris" was accepted as a temporary measure to the extent that it was taken to put an end to the debt assumed by these companies in 2014.

Table 6 – Impact of temporary measures on budgetary balance

	M€			% GDP		
	2016	2017	2018	2016	2017	2018
Temporary measures, one-off measures and special factors (balance impact)	780	368	-54	0,4	0,2	0,0
Revenue	745	450	0	0,4	0,2	0,0
Pre-Paid Margins	302			0,2		
Exceptional scheme for settling tax and social security debts	443			0,2		
BPP Guarantee Recovery		450			0,2	
Expenditure	-34	82	54	0,0	0,0	0,0
One-off payments to the EU Budget	77			0,0		
Sale of F-16 to Romania	-111	-29		-0,1	0,0	
Debt assumptions (STCP and Carris*)		111			0,1	
Forest fires			54			0,0

Source: INE and Ministry of Finance. | Note: CFP calculations and classification. The totals do not necessarily match the sum of the individual items as a percentage of GDP due to rounding.

For 2018 the CFP only considered one measure to be temporary, the expenditure relating to forest fires.

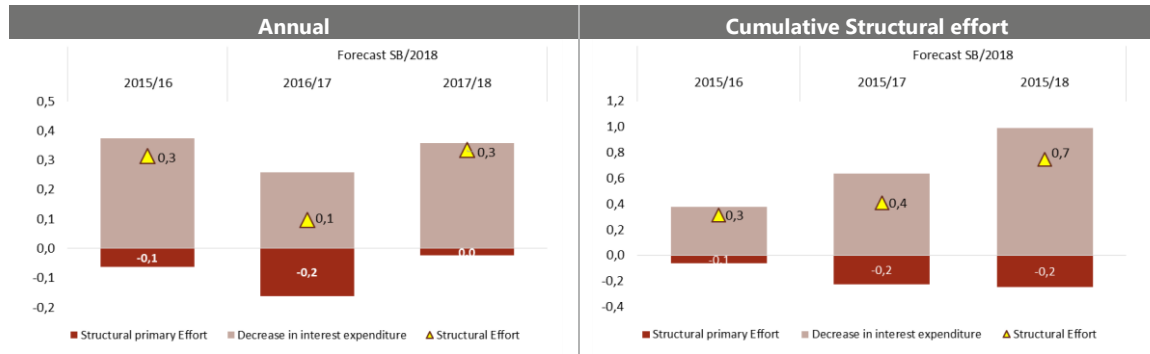
The CFP classification to identify temporary measures may be revised in the light of additional information on the nature of the transactions underlying the list provided by the MF.

3.2 FISCAL ADJUSTMENT AND FISCAL POLICY STANCE

The structural balance underlying DSB/2018 will ensure the existence of a safety margin in 2018 capable of meeting cyclical fluctuations without entering into an excessive deficit situation. As already noted in CFP's September report on Position and Constraints 2017-2021 ([Situação e Condicionantes 2017-2021](#)), the safety margin relating to the 3% of GDP ratio for the nominal budget deficit will be obtained from 2018. The structural balance calculation made by the CFP uses the CFP classification of temporary and one-off measures and recalculates the output gap in line with the Community methodology. The figure of 1.5% of GDP calculated for 2018 represents an outcome which, given past volatility of the economic cycle and the budget's sensitivity to cyclical fluctuations, is below the "minimum benchmark" which is currently set at 1.6% of GDP (GDP (see the European Commission publication [Vade Mecum on the Stability and Growth Pact](#))). This benchmark is relevant to the extent that it makes it possible not to activate the automatic stabilisers in response to the normal cyclical fluctuations of the economy and at the same time ensures a budget deficit below the 3% of GDP benchmark.

Despite the decrease in the fiscal imbalance, the fiscal effort measured by the change in the structural balance is based on the favourable contribution of interest charges. The forecast improvement in the structural balance in 2018 will continue to benefit wholly from the favourable contribution of interest charges, unlike the impact of the discretionary measures taken by the Government (see chart 14). The cumulative effects from 2016 to 2018 show a positive change of 0.7 p.p. of GDP in the structural balance that depends entirely on the contribution of interest charges which was sufficient to overcome the negative contribution of the policy measures (-0.2 p.p.) adopted in those years.

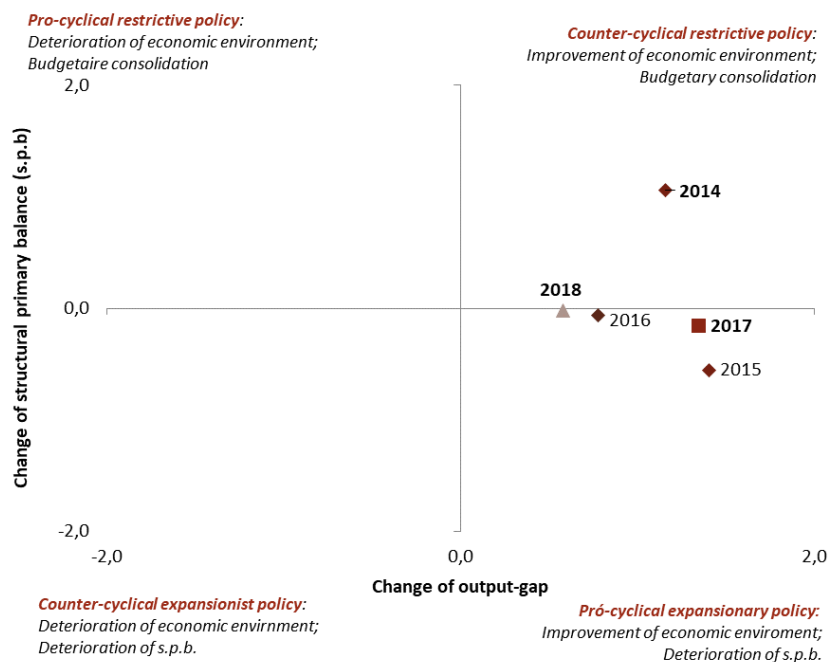
Chart 14 – Fiscal effort (as p.p. of GDP)



Source: INE, MF. CFP calculations. Note: the figures are net of the cyclical effect and the impact of temporary measures and one-off measures (see Box 1).

Under the aforementioned structural balance recalculation the fiscal policy stance is still neutral. This assessment is measured by the change in the structural primary balance, which allows us to determine whether fiscal policy is deliberately expansionist or restrictive. For 2018, the recalculation conducted by the CFP on the structural primary balance underlying the structural balance points to zero change in this indicator when compared to the positive impact of the economic cycle on the budgetary balance. Within this context of an improved economic climate in which the structural primary balance remains unchanged, the fiscal policy is deemed to have a neutral stance.

Chart 15 – Fiscal policy and cyclical position [2014-2018]



Source: INE and MF. CFP calculations. | Note: (i) The fiscal policy is assessed by the change in the structural primary balance; (ii) The cyclical position of the economy is evaluated by the change in the output gap, given by the difference between GDP growth rates and potential GDP. E- Estimate, P – Forecast.

3.3 COMPLIANCE WITH FISCAL RULES

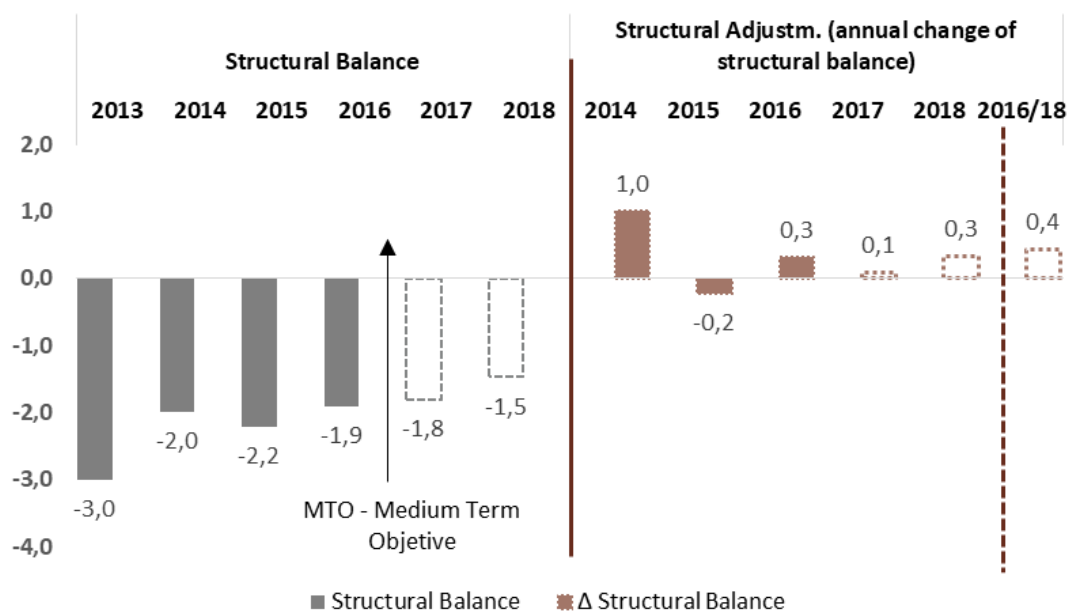
Following the revoking of the excessive deficit procedure, Portugal is now subject to the preventive arm of the Stability and Growth Pact. These require: (i) the achieving of sufficient progress to reach the medium-term budgetary objective; (ii) the change in the aggregate, corrected for (primary) expenditure net of revenue related discretionary measures, not exceeding a lower rate than the medium-term growth benchmark of potential GDP (expenditure benchmark); and (iii) compliance with a public debt transitional rule. Those requirements, with some minor differences, can be found in the Budgetary Framework Law (BFL).

Based on the information available and its own classification of temporary and one-off measures, the CFP estimates that the planned improvement in the structural balance underlying SB/2018 will total 0.3 p.p. of GDP in 2018 and 0.1 p.p. in 2017. This calculation is based on the budgetary balances published in DSB/2018, the output gap underlying the Government's macroeconomic forecast recalculated according to the common methodology and the CFP's classification of temporary and one-off measures.²³ DSB/2018 indicates a change of 0.5 p.p. in 2018 and 0.2 p.p. of GDP in 2017. Taking into account the economic setting the recommended change for each of the two years is 0.6 p.p. of GDP.²⁴

²³ If the Ministry of Finance's quantification of temporary and one-off measures were used, an improvement of 0.5 p.p. of GDP in 2018 (and 0.1 p.p. of GDP in 2017) would be obtained.

²⁴ Based on the matrix published in Interpretative Communication, COM (2015) 12 of 13 January, which was the basis for the drawing up of the "*Commonly agreed position on Flexibility in the Stability and Growth Pact*", which was formally endorsed by ECOFIN on 12 February 2016, its application determines that each Member-State's adjustment path towards its MTO shall take into account its economic situation as well as the sustainability of its public finance. In Portugal's case, for the time horizon covered by SB/2017, the minimum adjustment must be greater than 0.5 p.p. of GDP as the country has a public debt level exceeding 60% of GDP and an output gap of between -1.5% and 1.5% of GDP. The EC has stated that it takes an adjustment greater than 0.5 p.p. as a minimum adjustment of 0.6 p.p. of GDP.

Chart 16 – Structural balance adjustment (% and p.p. of GDP)



Source: INE and Ministry of Finance. CFP calculations. Note: The structural figures are net of the economic cycle effect and the net impact of temporary measures and one-off measures (see Box 1). The CFP classification of temporary measures and one-off measures does not match that employed by the MF. As per CFP calculation, this difference is particularly relevant to the change in the structural balance in 2017 and 2018.

Growth in the aggregate corrected for net primary expenditure exceeds the benchmark in both 2017 and 2018. The deviation from the planned growth in primary expenditure net of revenue related discretionary measures exceeds, on average, by 1% of GDP the applicable benchmark in both years (see Box 2).²⁵ If this deviation comes to be, it will point to the need for an overall assessment that could lead to the opening of a significant deviation procedure.

The forecast adjustment path differs from the benchmark figures. A deviation from the recommended figure in either of the indicators (change in the structural balance and change in net expenditure) leads to the need for an overall assessment, pursuant to Regulation 1466/97 and the Code of Conduct.²⁶ A deviation greater than or equal to the benchmark of 0.5% of GDP in a single year, or cumulatively in two consecutive years, in either of those indicators may lead to the opening of a significant deviation procedure, on the basis of an *ex-post* overall assessment (which takes place in Spring) and not an *ex-ante* assessment based on budgetary plans, taking the structural balance as a reference.²⁷ The overall assessment takes into account possible discrepancies between the two indicators, so as to identify which one better reflects the specific situation of the case in question and which fundamentally upholds the assessment's conclusions.

²⁵ The aggregate in question does not represent total general government public spending but rather corrected primary expenditure (see the explanation provided in Box 2).

²⁶ The latest version of the Specifications on implementation of the Stability and Growth Pact is available at <http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf>.

²⁷ An *ex-post* assessment takes into account the output gap underlying the forecasts on which its recommendations are based (the freezing principle), which may differ from this *ex-ante* assessment.

The different scale of the deviation in each of the two indicators stems, above all, from the changes in revenue and interest and the effects of the financial crisis. In effect, the forecast decrease in interest benefits the structural balance, but it is not reflected, by definition, in primary expenditure. Furthermore, the revenue windfalls in excess of the response to the economic cycle have benefitted the structural balance, but are not reflected in expenditure. Lastly, in its analysis of the 2017/2021 Stability Programme, the European Commission stated that the benchmark applicable to expenditure based on potential GDP growth in the medium-term was penalised by the negative potential growth estimated for the recent crisis years.²⁸

Taking into account the scale of the deviations in both indicators there is a need for an overall assessment based on the results achieved so as to gauge the existence of a significant deviation. Except when the budget plans a serious risk of not complying with the Pact, which is not the case, the overall assessment of a significant deviation is an *ex-post* assessment that takes place in Spring.²⁹ The assessment may cover the deviation in terms of the 2017 requirement or in regard to 2017 and 2018 together.

Box 2 – Expenditure Benchmark

Context, logic and goal of expenditure benchmark.

Under the preventive arm to which Portugal became subject in 2017, Member-States must meet their medium-term budgetary objectives (MTO) within the time horizon of their stability programmes. Progress towards the MTO is assessed annually by the Commission and the Council, on separate occasions from an *ex-ante* and *ex-post* perspective. That progress is analysed in the context of an overall assessment, which is based on both the change in the structural balance and compliance with the expenditure benchmark. The latter indicator has become increasingly important, in that the monitoring of the structural balance is not by itself sufficient to provide an accurate and broad picture of fiscal developments. On the other hand, non-compliance with budgetary targets tends to result mainly from the expenditure dynamics, which is more directly dependent upon the discretionary action of the policymakers, unlike revenue where change is to a large extent driven by the macroeconomic forces that influence it (private consumption, employment, earnings and Gross Domestic Product). Here, the aim of compliance with the expenditure benchmark is to avoid trends that increase growth in expenditure as a percentage of GDP, unless they are suitably offset by revenue side policy measures. This rule does not limit the level of public spending, but rather allows the policymakers to choose its scale, provided any increase in expenditure brought about by such choices is accompanied by revenue side policy measures and does not take advantage of gains flowing from the economic climate. It is on this basis that the setting of the expenditure benchmark involves a growth rate that is net of revenue side discretionary measures and any legally prescribed increases in revenue.

This rule seeks to overcome the uncertainty around the structural balance and is designed to strengthen automatic stabilisation, ensuring a sustainable expenditure path which creates room for fluctuations in revenue in different phases of the economic cycle, while at the same time favouring the implementation of a fiscal policy that tends to be counter-cyclical and guarantees more robust public finance in the medium-term.

Calculation of the expenditure benchmark

The expenditure benchmark is based on setting the relevant expenditure and on calculating the benchmark figure. The expenditure benchmark calculation compares the rate of growth in the corrected expenditure aggregate with the reference rate. The result of this assessment determines whether or not there was compliance with the benchmark.

²⁸ A time horizon of 10 years places average potential GDP growth below the potential GDP growth underlying the structural balance for 2018.

²⁹ In an *ex-ante* assessment the conclusion there is a significant deviation risk merely indicates that if the budget forecast is confirmed by the outturn, the Member-State will record a significant deviation from the MTO adjustment path. At the time of an *ex-post* assessment (which takes place after the EC Spring forecasts) the opening of a significant deviation procedure at the EU level could be triggered. The main goal of such a procedure is to strongly encourage the Member-States to make sufficient progress towards the MTO at times when the economic climate is more favourable so as to guarantee compliance with the requirements of the SGP's preventive arm.

Corrected expenditure aggregate

Calculating the corrected expenditure aggregate, from total public expenditure, produces an aggregate whose sole aim is to establish that expenditure which is dependent upon policymakers' control. Therefore, it excludes from total public expenditure all spending that is not a result of discretionary Government action, namely:

- the cyclical component of unemployment benefit, since it depends on economic cycle conditions;
- interest payments, to the extent they are inherited from the past and liability for this expense cannot be attributed to the Government;
- expenditure relating to EU funds, since they are not financed by general government;
- average amount of public investment not covered by European funds in the current year and in the three previous years, so as to avoid the calculation being affected by peaks in the public investment cycle.

This corrected expenditure aggregate is then adjusted for revenue side discretionary measures and any legally prescribed increases in revenue increases. Following the aforementioned corrections, the corrected expenditure aggregate is calculated in nominal terms and as the respective growth rate. For the purposes of comparison with the reference rate the growth rate in real terms is used, calculated on the basis of the GDP deflator.

Reference rate

It is the indicator used to make a comparison with the corrected expenditure aggregate. The calculation of this indicator, which is known as the reference rate, is determined by the difference between the average medium-term rate of potential GDP growth for years t-5 to t+4 and the convergence margin which is the ratio between the required adjustment as a percentage of GDP (0.6% in Portugal's case) and the ratio of primary expenditure to GDP of the previous year. In simplified terms the reference rate assumes revenue growth in line with the medium-term rate of potential GDP growth. Thus, possible deviations of the corrected expenditure aggregate from the aforesaid reference rate may lead to budget deviations.

The reference rate is calculated differently for Member-States that have reached their MTO and those that have not yet reached it. It should also be mentioned that Member-States that exceed their MTO, under Articles 6(3) and 10(3) of Regulation 1466/97, are no longer obliged to comply with the expenditure benchmark.

Assessment of the indicator

The aim of assessing the expenditure benchmark is to gauge whether the rate of growth in corrected expenditure aggregate, net of discretionary revenue (referred to above), contributes to a suitable adjustment path towards the MTO or if it is in line with the medium-term rate of potential GDP growth for countries that have already reached the MTO. Growth in the corrected expenditure aggregate should be compatible with potential economic growth. The growth in that expenditure will depend how far the Member-State is from the MTO, which reflects the effort demanded of the Member-State. In the case of Portugal, which has still not reached its MTO, it is obliged to contain growth in that spending below the rate of potential GDP growth.

The result of this indicator is assessed on two different occasions, from an *ex-ante* and *ex-post* perspective. A deviation is deemed significant if it is greater than or equal to 0.5 p.p. of GDP in one year, or cumulatively in two consecutive years. In other words, if the deviation is at least 0.5 p.p. of GDP in a single year or at least 0.25 p.p. on average over two consecutive years. In this way, from an *ex-ante* perspective, the deviation is classified as a "significant deviation risk", while under the *ex-post* standpoint, it may lead to the triggering of a significant deviation procedure, if so confirmed by the overall assessment.

Setting the benchmark in the context of an overall assessment

Under an overall assessment the additional correction consists of excluding the one-off measures that affect revenue and expenditure. This adjustment is taken into account in the overall assessment framework, at the same time as the assessment of compliance with the fiscal effort measured in terms of the change in the structural balance.

The Portuguese case: Setting the expenditure benchmark

Gauging compliance with the rule is based on the calculation algorithm employed by the European Commission (EC). The information the CFP used to calculate the deviation was based on the data provided by the Ministry of Finance for the 2017 and 2018. The table below summarises the relevant items that contribute to the deviation calculation.

Table 7 – Calculation of expenditure benchmark ('000 M€)

Expenditure benchmark		2017	2018
(1)	General government expenditure	86,3	88,8
(2)	Interest expenditure	7,6	7,1
(3)	Government expenditure on EU programmes fully matched by EU funds revenue	1,3	1,8
(4)	Nationally financed gross fixed capital formation t	2,6	3,0
(5)	Annual average nationally financed gross fixed capital formation t-3 to t	2,5	2,7
(6)	Cyclical unemployment expenditure	-0,2	-0,2
(7)	Total discretionary revenue measures	0,7	-0,1
(8)	One-offs on the revenue side	0,5	0,0
(9)	One-offs on the expenditure side	-0,1	-0,1
(10)	One-offs	0,4	-0,1
(11)	Total discretionary revenue measures net of one-offs	1,0	0,3
(12)	Corrected expenditure aggregate* (nominal) = G - Int - EU - (I - lav) - Uc	77,4	79,8
(13)	Corrected expenditure aggregate net one-offs* (nominal)	77,4	79,7
(14)	Corrected expenditure aggregate net of DRM and RML* (nominal)	76,7	79,9
(15)	Corrected expenditure aggregate net of DRM, RML and one-offs* (nominal)	76,4	79,4
(16)	Net public expenditure annual growth in % (nominal)	3,1	3,1
(17)	Net public expenditure annual growth corrected for one-offs in % (nominal)	2,7	2,6
(18)	GDP deflator (% change)	1,3	1,4
(19)	Net public expenditure annual growth in % (real)	1,9	1,7
(20)	Net public expenditure annual growth corrected for one-offs in % (real)	1,4	1,2
Expenditure benchmark			
(21)	Applicable expenditure benchmark rate (real)	-1,4	-0,8
(22)	Applicable expenditure benchmark rate (nominal)	-0,2	0,6
EB deviation			
(23)	Deviation in year t (in national currency)	-2,5	-2,0
(24)	GDP (nominal)	192,2	199,4
(25)	Deviation in year t (in % GDP) **	-1,3	-1,0
(26)	Average deviation in t-1 and t (in % GDP)		-1,1
EB deviation adjusted for one-offs			
(27)	Deviation in year t (in national currency)	-2,1	-1,6
(28)=(24)	GDP (nominal)	192,5	199,4
(29)	Deviation in year t (in % GDP) **	-1,1	-0,8
(30)	Average deviation in t-1 and t (in % GDP)		-0,9

Source: Ministry of Finance. CFP calculations. | Note: ** A positive/negative figure for expenditure corresponds to an unfavourable/favourable deviation, while the opposite is the case with revenue; (a) MDR - Discretionary revenue measures.

Calculation formulae: **(11)**=(7)-(8); **(12)**=(1)-(2)-(3)-(4)+(9)-(6);**(13)**=(12)+(9);**(14)**=(12)-(7);**(15)**=(13)-(11);**(16)**=100*[(14)-(12)_{t-1}]/(12)_{t-1}; **(17)**=100*[(15)-(13)_{t-1}]/(13)_{t-1}; **(19)**=100*[(1+(16)/100)/(1+(18)/100)-1];**(20)**=100*[(1+(17)/100)/(1+(18)/100)-1]; **(22)**=100*[(1+(21)/100)*(1+(18)/100)-1];**(23)**=[(22)-(16)]/100*(12)_{t-1}; **(25)**=(23)/(24)*100; **(26)**=Mean[(25)_{t-1};(25)]; **(27)**=[(22)-(17)]/100*(13)_{t-1}; **(29)**=(27)/(28)*100; e **(30)**=Average [(29)_{t-1};(29)].

The result of the calculation represents a corrected expenditure aggregate deviation from the reference rate which should be -1.3% of GDP in 2017 and -1.0% in 2018 (a negative figure indicates a surplus in relation to the benchmark, see table note). These deviations are greater than the maximum limit of 0.5% of GDP, and so constitute a significant deviation in 2018. Assessing the indicator over two consecutive years (2017 and 2018) also produces a significant deviation risk, since the maximum cumulative limit is 0.5% of GDP, (in other words 0.25% of GDP in each year), a figure that compares with the -1.1% of GDP calculated. Excluding the impact of temporary and one-off measures, the expenditure deviation is smaller (-0.9% of GDP), but is still above the maximum limit.

Any conclusion as to compliance with the debt reduction rule in the transitional period is sensitive to the way the structural balance is measured. Under the European Council decision of 12 June 2017,³⁰ which formally closed the excessive deficit procedure, Portugal became subject to compliance with the transitional debt rule from 2017-2019. During this three-year transitional period which follows the closing of an EDP, Portugal will have to make sufficient progress in terms of reducing the debt ratio.³¹ According to CFP

³⁰ Decision no. 10001/17 of 12 June 2017 of the European Council addressed to the Portuguese Republic - Council Decision abrogating Decision 2010/288/EU on the existence of an excessive deficit in Portugal ([Decisão do Conselho que revoga a decisão 2010/288/EU sobre a existência de um deficit excessivo em Portugal](#)).

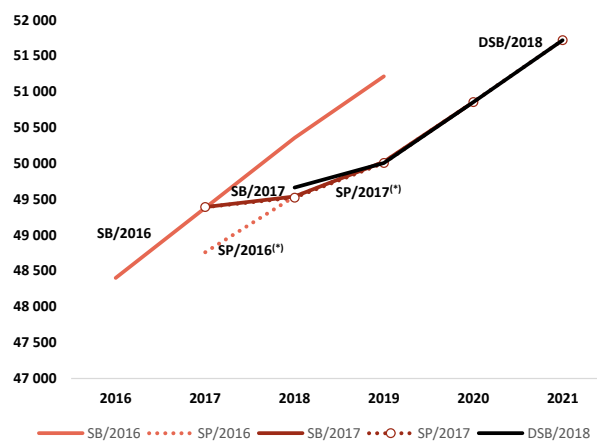
³¹ Progress is assessed annually, both *ex-ante* and *ex-post*, comparing it with the minimum linear structural adjustment (MLSA). The minimum linear structural adjustment path should take into account the impact of the economic cycle and

calculations, based on the performance of the public debt ratio forecast by the MF for 2018 to 2021, compliance with the transitional excess debt correction rule — the minimum linear structural adjustment (MLSA) — is not guaranteed over the three years of the transitional period. In 2018, the minimum linear structural adjustment needed to ensure compliance with the debt criterion that year requires a change in the structural balance of 0.5 p.p. of GDP, a figure that is not reached when the improvement in the structural balance is recalculated by the CFP. However, if we use the structural balance change published by the MF compliance with the debt criterion is met.

3.4 MULTI-ANNUAL FRAMEWORK OF BUDGETARY PLANNING (MFBP)

As in the previous year, the 2018 Draft State Budget revises upward the expenditure limits for 2018 compared to those set out in the Stability Programme. DSB/2017 (published in October 2016) revised upwards for that year the level of central government expenditure covered by general revenue in comparison with the Stability Programme that had been made public in April 2016. The identical situation arises with DSB/2018 which updates the MFBP for the period 2018 to 2021, increasing the expenditure limit for the respective year compared to the figure in SP/2017, while retaining the limits set out in that document for the following years. The latest multi-annual expenditure ceilings of the MFBP (Chart 17) show that, despite the final 3 years of the time horizon of each MFBP remaining relatively stable from SB/2016 onwards, there has always been an upward revision compared to the SP in the year to which each budget relates. However, it is noted that under the Budgetary Framework Law³², the annual updating of the MFBP by way of the State Budget Law should be undertaken in line with the objectives laid down in the SP.

Chart 17 – Recent multi-annual expenditure ceilings established in the MFBP (M€)



Source: Ministry of Finance. CFP calculations. | Notes: (*) Draft updates to MFBP, with no legal weight and not voted on by Parliament. The limits relating to SB/2016 were approved by a separate law (Law no. 7-C/2016 of 31 March).

the debt reduction reference standard. For further details see [Relatório do CFP n.º 3/2014](#). In 2020 Portugal will have to ensure compliance with the general rule (a cut of one-twentieth).

³² Article 12-D of BFL.

DSB/2018 provides for an expenditure limit in 2018 above that projected in SP/2017, which is equal to the limit legally in force. SP/2017, published last April, incorporated a draft update of the MFBP which slightly updated the limits for the 2018-2020 period in comparison to those approved by Law no. 7-C/2016 of 31 March, as per the wording of the SB/2017 Law, and retained the limit for 2017. As for 2018, the SP included a forecast 16 M€ below the limit, while DSB/2018 set a limit of 49 665 M€³³, up 143 M€ on that projected in SP/2017 – Chart 17. The alteration to the limit arose from the increases in the “Economic” area clusters (+171 M€), since the limits of the “Sovereignty” and “Security” clusters were revised slightly downwards and the “Social” area remained practically unchanged (see left-hand panel of Chart 18).³⁴

Almost the entire increase in the 2018 limit, compared to the limit forecast in SP/2017, is concentrated in the “Economic” area cluster. This cluster includes the 481 M€ increase in the “Finance and General Government” Programme, which includes the appropriations centralised in the MF³⁵ to meet, for instance, the unfreezing of Civil Service promotions and the settling of debts. On top of that there is the expected increase in Portugal’s contribution to the EU budget. Mention must be made of the drop in spending associated with the other programmes in that cluster which is not sufficient to offset that increase. Therefore, despite the limit on the “Public debt management” Programme falling by 153 M€ as a result of the expected savings on interest, and the “Economy” Programme seeing a decrease of 158 M€, the cluster as a whole records a rise of 171 M€. In the “Social” cluster, which accounts for over half the expenditure subject to the MFBP, although the “Health” Programme records a significant increase (264 M€)³⁶ this is more than offset by the drop in expenditure on the “Work, Solidarity and Social Security” Programme (-318 M€), as DSB/2018 does not provide for an extraordinary transfer to cover the Social Security System (SSS) deficit.

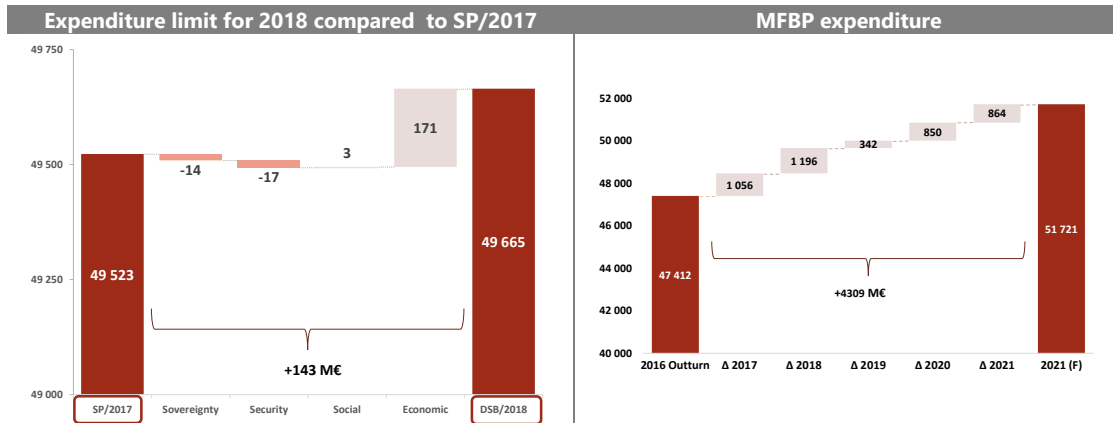
³³ As per article 258 of Bill n.º 100/XIII.

³⁴ Under article 12-D (5) of the BFL the spending limits relating to each programme cluster are binding for the second economic year of the MFBP (which in this case is 2018). However, article 1 (2) of Law no. 7-C/2016 states that the spending limits for the years 2017 to 2019 are indicative.

³⁵ They total 619.9 M€, up 116.9 M€ on the figure forecast in SB/2017.

³⁶ According to additional information provided by the MF, this is intended in part to “(...) bear the cost of medicines and diagnostic exams and compensation of employees, reflecting in 2018 the carry-over of higher expenditure growth in 2017”.

Chart 18 – Expenditure limits subject to MFBP (M€)



Source: Ministry of Finance. CFP calculations. | Notes: "Δ" stands for the forecast change versus the previous year; the change in 2018 comes from the MF estimate of this year's outturn.

The 2017 outturn estimate included in the DSB/2018 Report suggests that effective central government expenditure covered by general revenue will be 923 M€ below the respective ceiling laid down in Law no 7-C/2016. The MF estimate for CG expenditure covered by general revenue is 48 468.4 M€ (25.2% of GDP). If we assume this estimate is correct, and bearing in mind the updating of the MFBP for 2018, central government expenditure covered by general revenue should increase successively in the coming years, resulting in an overall increase of 4309 M€ over the five-year period 2017-2021 (see right-hand panel of Chart 18).

Maintaining the limits projected in SP/2017 for 2019 to 2021 implies more demanding expenditure management in the year immediately after the one to which DSB/2018 relates. Maintaining the limits for the last three years of the MFBP implies that the increase for 2019 will become just 342 M€ and not the 484 M€ previously set out in the draft updating of MFBP underlying SP/2017.

The expenditure limit for 2018 in the new MFBP is consistent with the deficit objective in national accounts (1.0% of GDP). Table 8 contains a Top-Down exercise showing the consistency between those two benchmarks. Starting from the budgetary balance forecast in national accounts (-2034 M€) and taking into consideration the adjustments bridging the two accounting standpoints, we may calculate the GG deficit in public accounting terms (-3353 M€).³⁷ The central government (CG) balance is calculated by the difference between this sum and the forecast balances for the regional and local government subsectors and social security funds. On the basis of the sums forecast for central government revenue, we may calculate the maximum effective expenditure for this subsector (which corresponds to revenue plus the figure for the budget deficit in this case).

³⁷ In 2018 the MF budget deficit forecast in national accounts is lower than that forecast in public accounts, as was the case in 2016. For 2017 the MF estimate set out in DSB/2018 points to a deficit in national accounts (2750 M€) that is higher than the deficit in public accounts (2470 M€).

Finally, maximum central government expenditure covered by general revenue³⁸ (49 665 M€) is equal to the difference versus the expenditure covered by own revenue.³⁹

Table 8 – From the balance in national accounts to the expenditure limit in MFBP for 2018 (M€)

1. General Government budget balance (EDP)	-2 034
2. Adjustments to the cash basis accounts balance	-1 320
Accrual (Commitments adjustments - Cash)	-401
Taxes and Social contributions	-336
Difference between interested paid and accrued	-234
Other accounts receivable (-)	877
Other accounts payable (+)	-708
Differences due to General Government perimeter	0
Other adjustments	-918
3. General Government Balance (cash basis) [(1)+(2)]	-3 353
a) Regional and Local Government Balance	930
b) Social Security Balance	974
4. Central Government Balance [(3)-(a)-(b)]	-5 256
c) Revenue	60 923
Tax revenue	43 735
Other current revenue	14 749
Capital transfers received	2 439
d) CG maximum Expenditure Limit [(c)-(4)]	66 180
e) Financed by own Revenues	16 515
5. CG limit for expenditure financed by general revenue (MFBP) [d)-(e)]	49 665

Source: MF. CFP calculations. | Note: CG – Central government.

³⁸ It is essentially expenditure covered by taxes. The MFBP does not include expenditure covered by own revenue from services (for example, fees). See [Glossário de Finanças Públicas do CFP](#).

³⁹ For the 2019-2021 period the available information does not permit an assessment of the consistency of the expenditure limits set out in MFBP with the budgetary objectives defined in national accounts. Note that as in previous years there is still no compliance with the provisions of article 12-D (6) of the BFL, which requires that projections for the four following years relating to general revenue and own revenue for central government bodies and the social security subsector be published along with the MFBP.

4 INDEBTEDNESS, GROSS BORROWING REQUIREMENTS AND PUBLIC DEBT DEVELOPMENTS

4.1 INDEBTEDNESS AND STATE BORROWING REQUIREMENTS

2017

According to the DSB/2018 Report, the increase in State direct debt in 2017 will be lower than the figure forecast in SB/2017. According to the MF, State direct debt will be 239 300 M€ at the end of 2017, which corresponds to increased indebtedness of 5 000 M€ compared to the end of 2016, measured by cash flows (Table 9). SB/2017 estimates there will be an increase in State net direct indebtedness of 9 500 M€ in the year in question, while the estimate in DSB/2018 is lower by 4 600 M€. This difference is explained mainly by the larger early repayments of International Monetary Fund (IMF) loans, but also by lower net borrowing through Bonds (TBD) and Treasury Bills (TB). On the other hand, the revised estimate points to greater use of savings products and “other debt”. Of special note within this account is the issuing of medium and long-term debt, in particular Floating Rate Treasury Bonds (FRTBD) to the sum of 2 200 M€, and the Banco Santander Totta loan, under the agreement relating to the payment of swaps by public corporations which totalled 2 300 M€.

Table 9 – Forecast breakdown of borrowing in 2017 (M€, cash flows)

Borrowing breakdown	2017E (SB 2017)		2017E (DSB 2018)		Diference DSB/2018 vs. SB/2017	
	Net balance	Weight (%)	Net balance	Weight (%)	Amount	p.p.
SC + TC	1 000	10,5	2 500	50,2	1 500	39,7
Treasury Bills	626	6,6	19	0,4	-607	-6,2
Treasury Bonds	8 710	91,3	7 275	146,1	-1 435	54,9
Economic Adjustment Programme	-1 501	-15,7	-8 365	-168,0	-6 864	-152,3
Other debt	709	7,4	3 550	71,3	2 841	63,9
Total	9 543	100,0	4 978	100,0	-4 565	

Source: MF. CFP calculations. | Notes: F = Forecast; E = Estimate; SC = Savings Certificates and TC = Treasury Certificates; Other debt = CEDIC, CEDIM, other short-term debt, other medium and long-term debt, other non-euro-denominated debt and swaps capital flows.

In 2017 the State’s gross borrowing requirements, from the public accounts standpoint, should be 8 500 M€ above the forecast made in SB/2017. This increase is due to the greater volume of repayments and cancellation of permanent debt (+8 600 M€) (Table 10). The repayments include the payments to the IMF and the increased refunding of TBD, which more than compensated the reduced volume of savings products and short-term debt repayments. In the case of net borrowing requirements, the net purchase of financial assets in excess of the SB/2017 forecast (1 300 M€ above the initial forecast, having been influenced by the CGD capitalisation) was offset by the budget deficit being lower than expected (-1 400 M€).

Table 10 – Borrowing requirements forecasts in 2017 (M€)

Borrowing requirements	2017E (SB 2017)		2017E (DSB 2018)		Diference DSB/2018 vs. SB/2017	
	Amount	Weight (%)	Amount	Weight (%)	Amount	p.p.
1. Net borrowing requirements (a) + (b) - (c)	9 609	22,2	9 514	18,4	-95	-3,8
a) Budget deficit	6 606	15,3	5 196	10,0	-1 410	-5,2
b) Net Acquisition of Financial Assets (except privatizations)	3 003	6,9	4 318	8,3	1 315	1,4
c) Privatization revenues	0	0,0	0	0,0	0	0,0
2. Amortizations and cancellations [debt settled] (d) + (e) + (f) + (g) + (h)	33 628	77,8	42 225	81,6	8 597	3,8
d) SC + TC	2 400	5,6	1 700	3,3	-700	-2,3
e) Short-term debt in euros	22 895	53,0	22 439	43,4	-456	-9,6
f) Medium long term debt in euros	7 176	16,6	9 872	19,1	2 696	2,5
g) Non-euro currency debt	1 501	3,5	8 365	16,2	6 864	12,7
h) Swaps capital flows (Net)	-344	-0,8	-151	-0,3	193	0,5
3. Gross borrowing requirements (1) + (2)	43 237	100,0	51 738	100,0	8 501	

Source: MF. CFP calculations. | Notes: F = Forecast; E = Estimate. SC = Savings Certificate and TC = Treasury Certificates.

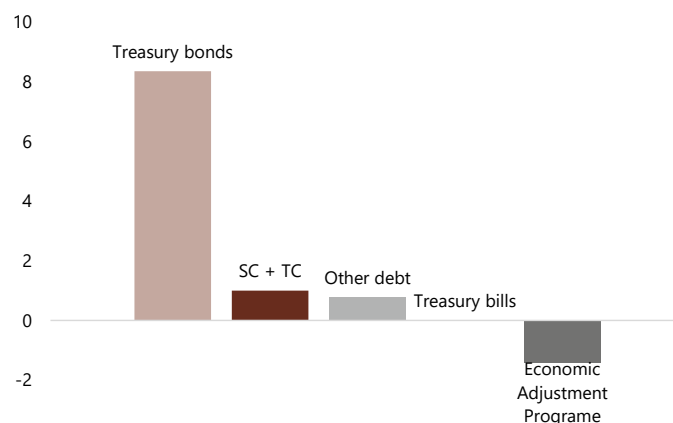
2018

The direct global indebtedness limit laid down in the SB/2018 Bill is 10 200 M€.⁴⁰ This figure is consistent with the borrowing requirements set out in the budget Bill which are the result of: i) the central government budget deficit (in public accounting terms) (5 300 M€); ii) net consolidated purchase of financial assets (4 400 M€); and iii) the retentions from central government expenditure (600 M€).

As in previous years, in 2018 most borrowing will take the form of TBD. Savings Certificates (SC) and Treasury Certificates (TC) and FRTBD are also expected to increase, although less than in 2017 (Chart 19). There is likely to be a negative contribution from loans under the Economic and Financial Assistance Programme (EFAP), i.e. early repayments of the IMF loan amounting to 1 400 M€. Overall, net borrowing is forecast to stand at 8 700 M€, in cash flow terms, while TB stock should remain unchanged.

⁴⁰ See article 113 (1) of DSB/2018.

Chart 19 – Breakdown of borrowing in 2018 ('000 M€, cash flows)



Source: MF. CFP calculations. | Notes: Other debt includes CEDIC, CEDIM, other short-term debt, other medium and long-term debt, other non-euro-denominated debt and swaps capital flows.

From the public accounts standpoint the State's gross borrowing requirements in 2018 should decrease significantly. The decrease of 10 800 M€ will result from the lower volume of repayments and cancellations of permanent debt (from 42 200 M€ in 2017 to 30 200 M€), which more than offsets the greater net borrowing requirements (which go from 9 500 M€ to 10 800 M€) (Table 11).

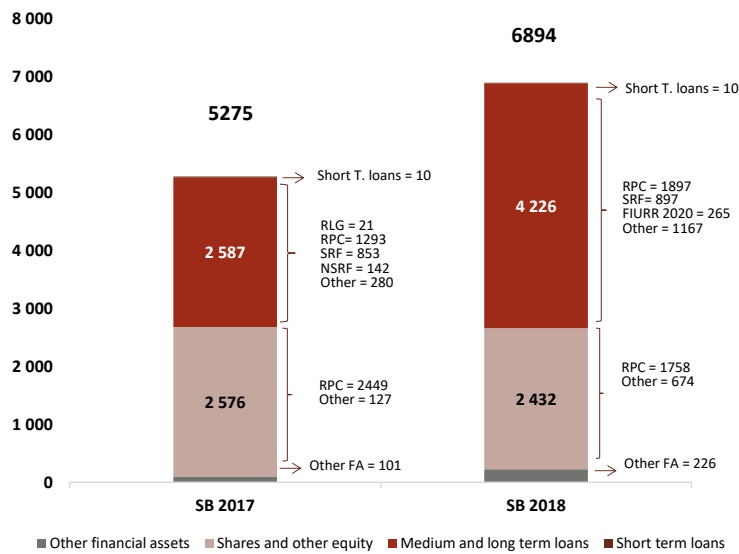
Table 11 – State borrowing requirements in 2016-2018 (M€)

Borrowing requirements	2016		2017E		2018P		Δ 2017/16		Δ 2018/17	
	Amount	Weight (%)	Amount	Weight (%)	Amount	Weight (%)	Amount	%	Amount	%
1. Net borrowing requirements (a) + (b) - (c)	7 717	17	9 514	18	10 782	26	1 797	23	1 268	13
a) Budget deficit	6 132	13	5 196	10	5 438	13	-936	-15	242	5
b) Net Acquisition of Financial Assets (except privatizations)	2 128	5	4 318	8	5 344	13	2 190	103	1 026	24
c) FRDP appropriation	-542	-1	0	0	0	0	542	0	0	0
2. Amortizations and cancellations [settled debt] (d) + (e) + (f) + (g) + (h)	38 472	83	42 225	82	30 145	74	3 753	10	-12 080	-29
d) SC + TC	778	2	1 700	3	1 036	3	922	119	-664	-39
e) Short-term debt in euros	22 326	48	22 439	43	21 055	51	113	1	-1 384	-6
f) Medium long term debt in euros	11 047	24	9 872	19	6 772	17	-1 175	-11	-3 100	-31
g) Non-euro currency debt	4 647	10	8 365	16	1 436	4	3 718	80	-6 929	-83
h) Swaps capital flows (Net)	-326	-1	-151	0	-154	0	175	-54	-3	2
3. Gross borrowing requirements (1) + (2)	46 189	100	51 738	100	40 926	100	5 549	12	-10 812	-21

Source: MF. CFP calculations. | Notes: F = Forecast; SC + TC = Saving Certificates + Treasury Certificates.

The greater net borrowing requirements in 2018 arise from the nominal increase in the budget deficit in public accounting terms (200 M€) and the net purchase of financial assets (1000 M€). Compared to SB/2017 there is an increase in total expenditure on financial assets (+1 600 M€) to 6 900 M€, resulting mainly from greater spending on medium and long-term loans (Chart 20). In this account the increase is justified by i) the change in RPC (Reclassified Public Corporations) loans of +600 M€, in particular the Metro Porto loan (expenditure of 800 M€) and the Metropolitan de Lisboa loan (500 M€) and ii) the sum now allocated to the Resolution Fund (900 M€). It is likely that the sum allocated to the Single Resolution Fund (900 M€) will be postponed (this expenditure has been budgeted repeatedly since SB/2016, but has never been spent).

Chart 20 – Expenditure on financial assets (M€)

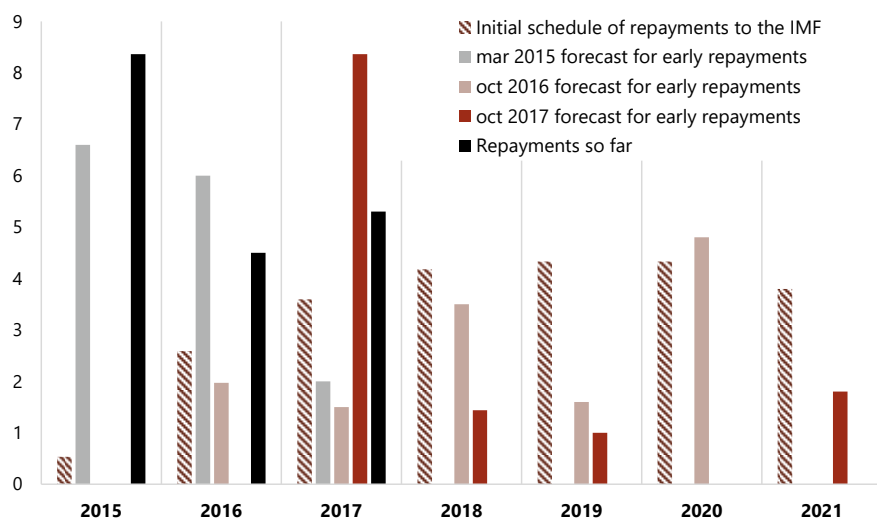


Source: DGO and MF. CFP calculations. | Notes: F - Forecast; RPC – Reclassified Public Corporations; SRF – Single Resolution Fund; IFFRU - Financial Instrument for Urban Rehabilitation and Revitalization; NSRF - National Strategic Reference Framework; FA – Financial Assets.

The permanent debt repayments and cancellations should fall in 2018, and will come to carry less weight in gross borrowing requirements. The main contribution will come from the lower volume of early repayments to the IMF scheduled for next year. However, a decrease in permanent debt instrument repayments and cancellations is expected.

The early repayment of IMF loans should continue in the coming years, subject to market conditions. Since 2015 early repayments have totalled 18 200 M€, and they are predicted to reach 3 100 M€ by the end of the year. Thus the amount to be repaid from 2018-2021 is significantly lower than initially forecast (Chart 21).

Chart 21 – IMF loan repayments ('000 M€)



Source: MF and IGCP. | Notes: information from the documents *Notes on recent economic developments* of 17 March 2015; *Notes on the State Budget Report for 2017* of 21 October 2016, and *Presentation to investors* of 18 October 2017, all available on the IGCP website.

4.2 DEBT DYNAMICS

After the 2016 increase in the debt ratio, it is now expected to follow a downward path in 2017-2018. The MF forecasts that in 2017 Maastricht debt as a percentage of GDP will do more than reverse the increase seen in 2016, when the ratio was 130.6%, compared to 130.1% in 2015. In 2018 debt should once again fall, to 123.5% of GDP. That development is driven by greater economic growth, since the numerator is expected to increase by 2 000 M€ in nominal terms to 242 900 M€ in 2017, and by 3 200 M€ to 246 100 M€ in 2018. These forecasts fall within the international institutions' projection intervals (Table 12).

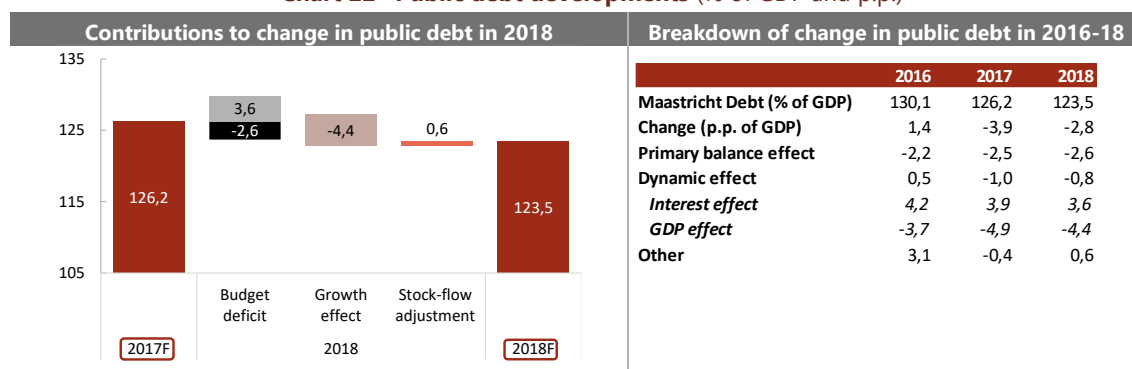
Table 12 – International institutions' public debt forecasts (% GDP)

Institution	2017	2018
EC	128,5	126,2
OECD	128,6	126,5
IMF	125,7	122,5
MF	126,2	123,5

Sources: OECD – *Economic Outlook No 101*, June 2017; IMF – *World Economic Outlook*, October 2017; MF – DSB/2018, October 2017; EC – *European Economic Forecast*, May 2017.

The primary balance and the dynamic effect will contribute to the decrease in debt in 2017-2018. The main factor behind the decrease in the debt ratio is the forecast primary surplus. The effect of GDP growth will be higher, in absolute terms, than the interest effect, thus resulting in a dynamic effect that favours a decrease in the debt ratio in the two years of the forecast (Chart 22). Over the two years of the forecast the contribution of the stock-flow adjustment to the change in public debt is expected to be practically zero⁴¹.

Chart 22 –Public debt developments (% of GDP and p.p.)



Source: MF and CFP calculations. | Note: the contribution of the budget deficit consists of the sum of the primary balance impact (-2.6 p.p.) and the interest effect (+3.6 p.p.).

As a percentage of GDP general government expenditure on interest should maintain on the downward path that began in 2015, reaching 3.9% in 2017 and 3.6% in 2018 (Table 13). The main contributor to this performance will be the price effect, due to the

⁴¹ Among the stock-flow adjustments in 2017 note the use of deposits (5 100 M€), the shares and other holdings account (2 600 M€) and other adjustments (2 200 M€). In 2018, note the adjustments in the national accounts (1 300 M€, equal to 0.7% of GDP), in particular the RPC accruals adjustment (0.4% of GDP) and Pension Funds (0.3% of GDP), which are partially offset by the neutrality of funds account (-0.4% of GDP).

lower implicit interest rate forecast for 2017 and 2018 (3.1% and 2.9%, respectively, compared to 3.2% in 2016). In the latter year, the stock effect will be significant as it reaches 0.1 p.p. of GDP. In nominal terms interest payable in 2017 totals 7 600 M€, which represents a drop of 200 M€ compared to 2016. In 2018 nominal interest is expected to decrease again, by 400 M€.

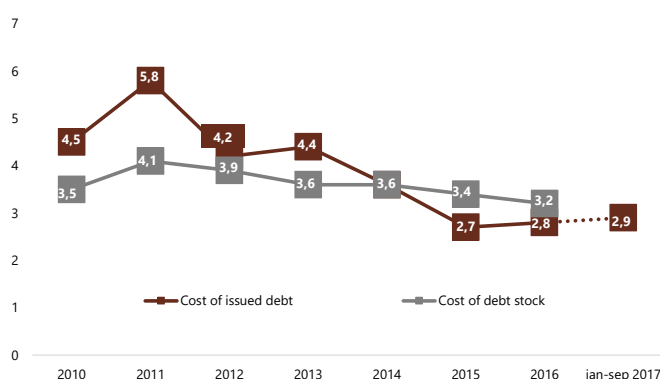
Table 13 – Contributions to change in interest

Year	Public debt stock (% of GDP)	Public Debt average stock (% do GDP)	Interest (% of GDP)	Implicit interest rate(%)*	Interest weight change (p.p.)	Contributions to interest Δ		
						Stock effect (p.p.)	Price effect (p.p.)	Cross effect (p.p.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2014	130,6	129,8	4,9	3,8	0,05	0,08	-0,03	0,00
2015	128,8	129,7	4,6	3,5	-0,34	-0,01	-0,33	0,00
2016	130,1	129,4	4,2	3,2	-0,38	-0,01	-0,37	0,00
2017E	126,2	128,2	3,9	3,1	-0,26	-0,04	-0,22	0,00
2018F	123,5	124,8	3,6	2,9	-0,36	-0,10	-0,26	0,01

Source: MF. CFP calculations. Formulae: Current year = t and previous year = $t-1$; PD = public debt; **(1)** = PD/GDP; **(2)** = $[(1)_{t-1} + (1)_t] / 2$; **(3)** = Interest / GDP; **(4)** = $(3)_t / (2)_t$; **(5)** = $[(4)_{t-1} * ((2)_{t-1} - (2)_t)] + [(2)_{t-1} * ((4)_t - (4)_{t-1})] + [(2)_t - (2)_{t-1}] * ((4)_t - (4)_{t-1})$; **(6)** = $(4)_{t-1} * ((2)_{t-1} - (2)_t)$; **(7)** = $(2)_{t-1} * ((4)_t - (4)_{t-1})$; **(8)** = $((2)_t - (2)_{t-1}) * ((4)_t - (4)_{t-1})$.
 * Note: the implicit interest rate shown here differs from that in DSB/2018 to the extent it has been calculated through the average debt stock in the current year and the preceding year (column (2)), whereas the latter is based solely on the preceding year's debt stock. Nonetheless, despite these methodological differences, the figures shown are similar to those in DSB/2018 for 2017-18.

In 2017, the average cost of State direct debt issued up to the end of the third quarter was higher than the cost of the two preceding years.⁴² The cost of State direct debt stock⁴³ was 3.2% in 2016, which compares with a cost of 2.8% for State direct debt issued this year (Chart 23). From January to September 2017, State direct debt issued had an average cost of 2.9%, so the increased cost trend, compared to last year's issues, is likely to continue over the year. Non-consolidated State direct debt issued accounted for 98.4% of consolidated GG debt at the end of September.

Chart 23 – Cost of State direct debt (%)



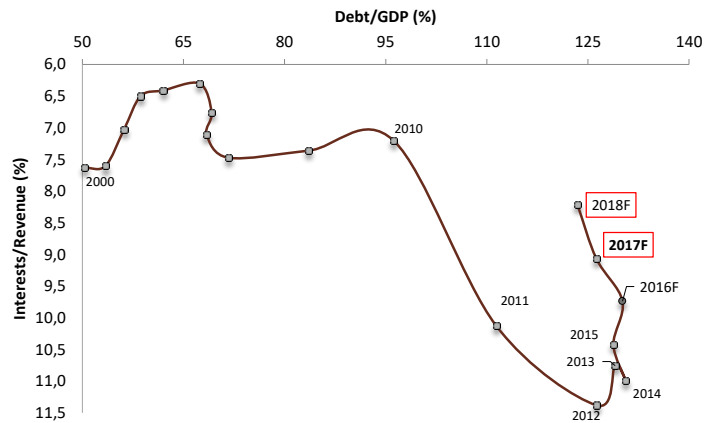
Source: IGCP and CFP calculations.

⁴² The cost of debt issued corresponds to the weighted average cost of the TB, TBD and Medium Term Notes issued.

⁴³ The cost of debt stock corresponds to the ratio between State subsector interest in National Accounts and the average State direct debt balance at the end of years t and $t-1$.

As in the previous two years, debt affordability in 2017 e 2018 is expected to be favourable and there will a decrease in the interest / GG revenue ratio (Chart 24). The debt affordability ratio seeks to analyse a country's ability to support within its budget all expenses relating to its debt. Contributions to this favourable dynamic will come from (i) the decrease in nominal interest; (ii) the increase in GG revenue (from 79 700 M€ in 2016 to 83 500 M€ and 86 700 M€ in 2017 and 2018, respectively) and (iii) the expected higher growth in GDP than in nominal public debt, both in 2017 and in 2018.

Chart 24 – Debt affordability



Source: MF. CFP calculations.

The EC includes Portugal in a group of countries that may face significant medium-term sustainability challenges. Taking as a starting point the goal of achieving debt ratio of 60% of GDP by 2030, the risks facing Portugal are high. It will be necessary to make an additional cumulative adjustment (compared to the no-policy-change scenario) of 6.1 p.p. of GDP in the structural primary balance from 2019-23 (S1 indicator)⁴⁴. On the other hand, the EC says that Portugal does not face greater risks in the long-term. The indicator that calculates the structural primary balance adjustment required to stabilise the debt ratio over an infinite horizon, where that adjustment remains constant indefinitely (S2)⁴⁵, is 1.3 p.p. of GDP, below the medium risk level limit. The MF calculations differ from EC's to the extent that the latter take into account a higher level of debt in the base year, as well as a lower initial structural primary balance. Thus, the S1 indicator included in DSB/2018 indicates an average risk for the medium-term, while S2 points to a low risk.

Table 14 – Medium and long-term sustainability indicators for Portugal (p.p. of GDP)

	MF	EC
S1	2,4	6,1
S2	0,0	1,3

Sources: MF and CE – *Debt Sustainability Monitor* (January 2017).

⁴⁴ S1: the country is a low medium-term risk if the indicator is less than 0 p.p.; a medium risk if it is between 0 p.p. and 2.5 p.p. and a high risk if it is over 2.5 p.p.

⁴⁵ S2: the country is a low long-term risk if the indicator is less than 2 p.p.; a medium risk if it is between 2 p.p. and 6 p.p. and a high risk if it is over 6 p.p..

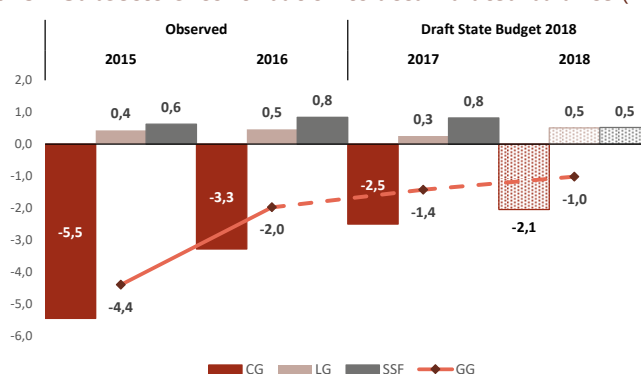
5 GENERAL GOVERNMENT ACCOUNT BY SUBSECTOR

The estimate for the GG Account for the year concerned and the year after is usually broken down by institutional subsector: Central Government (CG), Regional and Local (RLG) Government and Social Security Funds (SSF). The flows between subsectors (for example, transfers from one to another) are excluded when calculating consolidated GG revenue and expenditure, which explains why the sum of the various subsectors revenue and expenditure may be greater than the GG total as a whole.

5.1 COMPARATIVE VIEW

Since 2013 the RLG and SSF subsectors have recorded positive budgetary balances, and DSB/2018 predicts the situation will continue, with an improved RLG surplus and a reduced SSF surplus. The largest contributor to the GG deficit will be CG, where the balance is influenced by spending on transfers to the other subsectors, in particular the transfers required under the respective finance laws. In the case of RLG, DSB/2018 foresees a 530 M€ increase in the budget surplus which means the forecast balance is now more than double the balance estimated by the MF for 2017. This change in RLG offsets almost entirely the expected negative change in the SSF balance, down 550 M€, which is why DSB/2018 does not foresee any extraordinary SB transfer next year to compensate the Social Security System (SSS)⁴⁶ – Chart 25 and Table 15.

Chart 25 – Subsectors' contribution to accumulated balance (% of GDP)



Source: INE and Ministry of Finance. CFP calculations. | Note: The total may not match the exact sum of the figures shown in the chart for each subsector due to rounding.

Table 15 – Change in balance by subsector (M€)

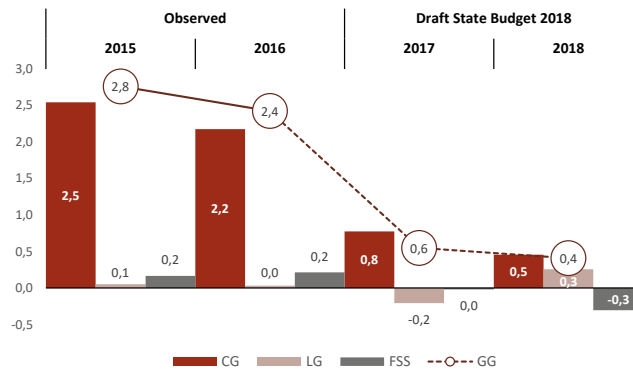
Subsector	DSB/2018		
	2017	2018	Change 2017/2018
CG	-4 826	-4 089	737
RG	73	134	61
LG	417	886	469
RLG	490	1 020	530
SSF	1 586	1 036	-550
GG	-2 750	-2 034	717

Source: Ministry of Finance. CFP calculations.

⁴⁶ The MF estimate for the extraordinary SB transfer to compensate the Pay-as-you-go Previdential system for 2017 (429.6 M€) is equal to the budgeted sum in SB/2017 of which 322.2 M€ (75% of the total, see DGO, SEO September) had been paid up to the end of September.

DSB/2018 predicts the largest contribution to the decrease in the deficit will come from CG, and be 0.5 p.p. of GDP. The decrease in the CG deficit forecast in DSB/2018 is 737 M€. For the SSF subsector the deterioration in the budgetary balance is 550 M€ (-0.3 p.p. of GDP), which is offset by the expected increase of 530 M€ (0.3 p.p. of GDP) in the regional and local subsector surplus, when compared with the MF estimate for 2017 for these subsectors (Table 15 and Chart 26). If the scale of each subsector's budget is taken into account, the largest effort towards improving the deficit takes place in RLG. However, according to the MF's current estimate, this subsector will contribute to an increase in the deficit (of 0.2 p.p. of GDP) in 2017, a reversal of the improvement expected initially and which underlies SB/2017.

Chart 26 – Subsectors' contribution to decrease in the deficit (p.p. of GDP)



Source: INE and Ministry of Finance. CFP calculations. | Note: The total may not match the exact sum of the figures shown in the chart for each subsector due to rounding.

The revenue and expenditure structure differs among general government subsectors. Of particular note in RLG revenue is the relative weight of transfers from other GG subsectors, especially in the case of LG since the Regional Governments have their own tax revenues (e.g. VAT, CIT and PIT collected by or attributed to these regions) which are more significant and account for over half (53%) of total revenue forecast for 2018.⁴⁷ As for SSF most of the revenue (63%) comes from social contributions, while for CG tax revenue makes up 72% of the total. In terms of expenditure, social transfers amount to almost all (86%) the forecast SSF expenditure, while capital expenditure carries greater weight in RLG than in the other subsectors (12% and 23%, respectively, of total expenditure forecast for RG and LG in 2018). According to DSB/2018, this pattern suffers no significant changes from 2017 to 2018, and the largest differences can be found in the SSF subsector, where the relative weight of social contributions increase by around 2 p.p. to the detriment of other current revenue, and in the LG subsector where the relative weights of capital revenue and expenditure rise by 3 p.p. and 4 p.p., respectively.⁴⁸

⁴⁷ In the case of LG, tax revenue accounts for 35% of forecast total revenue for 2018.

⁴⁸ Note that under the DSB around 43% of GG investment (GFCF) for 2018 will be undertaken by LG.

5.2 ANALYSIS OF REGIONAL AND LOCAL GOVERNMENT SUBSECTOR

As the subnational budgets of the Autonomous Regions and of the municipalities and boroughs are independent, they are approved by their respective decision-making bodies.⁴⁹ Both the estimate for 2017 and the forecast for 2018 analysed below match the figures produced by the MF in DSB/2018.

DSB/2018 provides for an improvement in the Regional and Local Government budget surplus which more than doubles the balance estimated by the MF for 2017. The implicit improvement in the GG account for 2018 is 530 M€, compared to an estimated surplus for 2017 of 490 M€, around half of the SB/2017 forecast (971 M€). Underlying that improvement is growth in the subsector's revenue (10.7%) in excess of the growth in expenditure (6.5%), which is essentially brought about by an increase in Community funds revenue (of 613 M€, and contributing 5.2 p.p. to the total change in revenue), by tax revenue (3.4 p.p.) and by other current revenue (3.0 p.p.). The latter budget aggregate includes the majority of transfers made under the Regional Finance Law and the Local Finance Law from the State subsector to RLG.⁵⁰ In the case of tax revenue, the expected greater revenue is based on the increase in the two main local taxes, IMI and IMT, especially the latter (123 M€; 15%).⁵¹ In terms of expenditure DSB/2018 foresees a substantial increase in investment (596 M€), which constitutes the largest contribution (5.1 p.p.) to growth in RLG spending, and which is supported by the likely increase in Community co-funding.⁵²

As with SB/2017, DSB/2018 retains the suspension of the use of the formula for calculating local authority funds laid down in the Local Finance Law⁵³, and replaces it with discretionary decisions.⁵⁴ The suspending of this method implies less revenue from transfers

⁴⁹ As with DSB/2017, at the time DSB/2018 was submitted to Parliament the budgets for the autonomous regions of Madeira and the Azores had not been approved, nor had the majority of local authority budgets. Under the budgetary framework laws for each autonomous region (Law no. 28/92 of 1 September and Law no. 79/98 of 24 November, respectively), regional budgets must be approved by 15 December of the year preceding that to which they relate. In the case of municipalities, plan options and budget proposals for the following years must be approved by the November session of the Municipal Assembly, while for boroughs local authority legislation (Law no. 75/2013, de 12 September) provides that approval must be granted in the fourth ordinary session of the Borough Assembly which should take place in November or December.

⁵⁰ Taking into account the information from the public accounts standpoint included in the DSB/2018 Report on the transfers under the local and regional finance laws, these increase by 38 M€ (1.5%) to 2612 M€ in the case of LG and by 15 M€ (3.1%) to 508 M€ in the case of RG. The capital revenue included in the transfers to LG is the appropriation made by the Financial Equilibrium Fund (FEF) which, according to Table XIX attached to DSB/2018, will be 190 M€, accounting for a decrease of 1 M€ compared to 2017. Also of note is the 24 M€ increase in SSF subsidies to LG.

⁵¹ In the case of IMI the MF estimate for 2017, which includes municipalities and boroughs (they are entitled to the IMI on rural buildings and 1% of IMI on urban buildings collected in their areas), implies a change of 1.8% compared to 2016, with DSB/2018 predicting an increase of 5% for 2018 (77 M€). However, according to the budget outturn figures of municipalities up to September of this year, the year-on-year rate of change in IMI is -0.3%. If this situation continues until the end of the year it will give rise to a lower starting point than forecast in DSB/2018. However, we recognise the difficulty of making a forecast focused on IMI revenue, bearing in mind the non-existence of a single rate on property, on top of the complexity introduced by the various amendments to the tax legislation, especially in regard to surcharges, rebates and exemption that may be approved by municipal assemblies.

⁵² In particular in LG where DSB/2018 forecasts an increase of 41% in investment compared to 2017 and an increase in Community funds revenue that is four times larger than in the current year.

⁵³ Law no. 73/2013 of 3 September, which approved the Financial Rules for Local Authorities and Intermunicipal Entities, commonly known as the Local Finance Law – LFL.

⁵⁴ According to information from the MF, the amounts were calculated bearing in mind growth of around 1.5% in transfers to municipalities and boroughs. The same rate of change was applied to SB transfers to metropolitan areas and intermunicipal communities.

relating to local authorities' sharing of public resources and on the other side of the equation results in less expenditure on transfers from the State to Local Government than would arise if the distribution criteria set out in the Local Finance Law were applied.⁵⁵

Local and regional public finance bring some risk when account is taken of DSB/2018 and its estimate, which predicts a substantial improvement in the subsector's budgetary balance. Mention must be made of the risks highlighted in the DSB/2018 Report itself in regard to public entities falling outside the scope of the RLG subsector (e.g. regional and local public corporations). On top of this there is the possibility of an upward revision of transfers to RG, stemming from the updating of the variables which determine the respective distribution (in particular national GDP and GDP of each region).⁵⁶ As for Local Government, DSB/2018 provides for strong incentives to the implementation of projects financed by Community funds, by creating more flexible rules, in regard to both the Law of Commitments and Overdue Payments and the Local Finance Law, as regards the expenditure linked to those projects.⁵⁷ In addition municipalities that comply with the total debt limit forecast in the LFL are excluded from application of the LCPA.⁵⁸ As for RG, the provisions of DSB/2018 consider, as was exactly the case in SB/2017, the contracting of loans to finance projects co-funded by European funds to be an exception to the rule that imposes no increase in the net indebtedness of each region.

⁵⁵ Despite tax revenue based on distribution (net revenue collected from VAT, PIT and CIT from a cash standpoint in 2016 net of the sums assigned to other GG subsectors) having recorded a decline against the previous year (of 0.1%), there is a difference between the percentage that would be distributed to municipalities and boroughs under the LFL and the final sums approved and set out in Tables XIX and XX attached to the SB, respectively. Therefore, and despite this difference being less than in the previous year, and assuming that the maximum ceiling of an annual change of 5% laid down in the LFL for these transfers would be reached by all authorities, it is estimated that the failure to fully apply the criteria laid down in the LFL will give rise to savings of around 92 M€.

⁵⁶ See article 59 (4) of DSB/2018.

⁵⁷ The increase in LG investment expenditure is borne by the expected increase in Community funds. According to DSB/2018 (article 65 (1 to 4)) when calculating the funds available, the sums corresponding to approved applications and relating to the respective commitments to be assumed in the year may be taken into account (under SB/2017 account was taken of 50% of the sums requested in Community fund refund applications, regardless of their payment or refund by the operational programmes). In addition the provision on the non-existence of available funds does not prevent applications to co-financed projects. Note that the SB/2016 Law amended Law no. 73/2013 of 3 September, in the sense it excluded from the limit on total debt loans intended to finance national projects co-funded by Community funds.

⁵⁸ See article 65 (5) and (6) of DSB/2018.

5.3 ANALYSIS OF SOCIAL SECURITY FUNDS SUBSECTOR

The MF forecasts a 550 M€ decrease in the Social Security Funds (SSF) budgetary balance in 2018, as a result of the increase in expenditure (1051 M€) being greater than the expected increase in revenue (501 M€).

Table 16 – Social Security Funds Account

	SOCIAL SECURITY FUNDS			
	2017 E	2018 P	M€	%
Total Revenue	25 684	26 184	501	1,9%
Current Revenue	25 682	26 178	496	1,9%
Indirect taxes	1 003	1 060	57	5,7%
Social Contributions	15 743	16 621	878	5,6%
Sales and other current revenue	8 933	8 495	-439	-4,9%
Sales	26	52	26	97,2%
Other current revenue	8 907	8 443	-464	-5,2%
<i>of which:</i>				
State Budget transfers to comply with SSFL	6 737	6 626	-111	-1,7%
Extraordinary SB trf to comply with SSS deficit	430	0	-430	-100,0%
Capital transfers received	2	7	5	229,3%
Total Expenditure	24 098	25 149	1 051	4,4%
Current Expenditure	24 054	25 126	1 071	4,5%
Compensation of employees	251	255	5	1,8%
Intermediate Consumption	96	100	4	3,9%
Social Benefits	20 720	21 701	981	4,7%
Other than in kind	20 613	21 587	974	4,7%
Pensions	15 881	16 688	807	5,1%
Unemployment benefits and employment support	1 363	1 304	-59	-4,3%
Sickness benefits	561	565	4	0,7%
Maternity and paternity benefits	514	536	22	4,2%
Social Insertion Income	347	357	11	3,0%
Solidarity Supplement for the Elderly	207	218	10	5,0%
Family benefits	695	732	37	5,3%
Other social benefits	1 045	1 187	142	13,6%
in kind	107	114	7	6,7%
Subsidies and other current expenditures	2 988	3 070	82	2,8%
Capital Expenditure	44	23	-21	-47,1%
Social Security Balance	1 586	1 036	-550	-

Source: Ministry of Finance. CFP calculations. | Notes: E - Estimate; F - Forecast; SSFL – Social Security Framework Law; SSS – Social Security System.

The SSF revenue forecast for 2018 is built on the predicted improvement in the macroeconomic context, particularly economic growth and the continued positive developments in the labour market and earnings. According to DSB/2018, total revenue should grow by 1.9% (501 M€), while social contributions revenue grows 5.6% (878 M€). That forecast constitutes a potential risk factor as regards budget outturn, since the nominal growth in earnings forecast for 2018 is 3.2%⁵⁹, a figure which already reflects the forecast rise in employment of 0.9%.

Unlike in previous years, there is a drop of 1.7% (111 M€) in SB transfers under the Social Security Framework Law (SSFL) intended to finance the Social Protection and Citizenship

⁵⁹ In 2018, the change in earnings involves an increase of 0.3% in General Government sector compensation of employees, which implies growth in earnings among the other sectors of the economy of around 4.1%.

System.⁶⁰ Mention must be made of the elimination of the extraordinary State Budget transfer, since the need to compensate the Pay-as-you-go Previdential system is over, due to the expected development in social contribution revenue and the decrease in expenditure linked to unemployment benefits. The Pay-as-you-go Previdential System has seen significant improvements in its budgetary performance and, for the second year running, is expected to produce a surplus, of 311.2 M€ in 2018. Finally, DSB/2018 also predicts revenue of 120 M€ for the Social Security Financial Stabilisation Fund (SSF), consisting of 50 M€ and 70 M€ from the IMI surcharge⁶¹ and allocated CIT revenue, respectively.

The change in SSF revenue forecast in the DSB includes non-quantified measures. Some of these measures are efficiency gains related to contributions and debt collecting, which should they not arise may present an additional budget outturn risk.

SSF expenditure should record growth of 4.4% (1051 M€) in 2018, which is largely explained by the developments in social transfers (1.3 p.p. up on the forecast included in SB/2017). The performance of social transfers reflects above all the increased spending on pensions of 5.1% (807 M€). This increase is mainly explained by:

- i. the updating pursuant to articles 4 to 7 of Law no. 53-B/2006 of 29 December and to article 6 (1) of Law no. 52/2007 of 31 August, as well as the amendments introduced by Law no. 42/2016 of 28 December. This update, undertaken for the first time since 2009, is based on the developments in the GDP growth rate and the CPI without housing⁶²;

	If GDP < 2%	If 2% <= GDP < 3%	If GDP >= 3%
Pensions < 2 IAS	CPI	Max (CPI + 0,2*GDP; CPI + 0,5 p.p)	CPI + 0,2*GDP
2 <= Pensions < 6 IAS	CPI - 0,5 p.p.	CPI	CPI + 0,125*GDP
Pensions <= 6 IAS	CPI - 0,75 p.p.	CPI - 0,25 p.p.	CPI

- ii. the updating of the pensions payable under the convergent social protection scheme laid down in article 6 of Law no. 52/2007 of 31 August as amended by Law no. 11/2008 of 20 February;
- iii. the extraordinary updating of pensions from August 2018, (impact of 154M€), that seeks to put an end to the process of compensating for loss of purchasing power due to the updating of pensions being suspended from 2011 to 2015;
- iv. updating of the social support index (IAS) under Law no. 53-B/2006 of 29 September;
- v. the coming into force⁶³ of early retirement without penalty rules for those paying contributions over very long periods, where the expected impact is 48 M€; and lastly

⁶⁰ In 2018, the Central Government (State) transfer to the Solidarity Subsystem will fall by around 364.7 M€. In the opposite direction there will be an increase in the transfers to the Family Protection and Social Work Subsystems of 242 M€ and 39.4 M€, respectively.

⁶¹ Under DSB/2018 the IMI surcharge is expected to provide gross revenue of 130 M€. However, the net revenue forecast for the Social Security Funds subsector is substantially lower (50 M€), due to the collection costs and the estimate for PIT and CIT refunds to taxpayers. According to MF clarifications the difference arises from the transfer of real estate to the rental market which entitles the owner to deduct the surcharge.

⁶² The time period for the benchmark indicators is the "average annual growth rate for the last two years, ending in the 3rd quarter of the year prior to the one to which the update relates or in the immediately previous quarter, in regard to GDP". As for the CPI without housing the period taken into account is the "average change in the last 12 months in the consumer price index (CPI), without housing, available on 30 November of the year prior to that to which the update relates".

⁶³ Came into force on 1 October 2017, but fiscal impacts were only considered from January 2018 (Decree-Law no. 126-B/2017 of 6 October).

- vi. the incorporation of the carry-over effect (79 M€) of the extraordinary updating of 10€ or 6€ per pensioner, in the case of pensions whose overall amount was less than or equal to 1.5 times the IAS, that took place in August 2017.

The aforementioned updates determine the price effect in the change in pension expenditure, where there is an increase of 4.65% in the case of old-age pensions, 2.88% in survivor's pensions and 6.54% in disability pensions. In addition the growth in pensions expenditure also reflects the increase in the number of pensioners, known as the volume effect, of 0.6% for old-age pensions and decreases of 0.1% and 6.6% in survivor's and disability pensions, respectively.

Unemployment benefit and job support are expected to decrease 4.3% (59 M€), continuing to benefit from the improvement in the level of employment and the drop in the rate of unemployment⁶⁴. DSB/2018 retains the extraordinary measure introduced in 2017, i.e. support to the long-term unemployed⁶⁵. In 2018 the updating of the IAS has an estimated impact on Social Security expenditure of 5.3 M€ relating to unemployment benefits.

The remaining social transfers, excluding pensions and unemployment benefits, contribute 233 M€ to the increase in SSF subsector spending. This is mainly the result of the forecast increases in (i) the social inclusion transfer⁶⁶ (84.7 M€), (ii) family allowance (37 M€), (iii) parenthood transfers (22 M€), (iv) social integration income (10.5 M€) and (v) solidarity supplement for the elderly (10.4 M€). Lastly mention must be made of the increase in expenditure on subsidies and other current expenditure which is explained by current transfers to vocational training courses and social work supported by the European Social Fund, and administrative expenses.

⁶⁴ The implicit rate of change in employment is 0.9% in 2018 against a rate of 2.7% in 2017. As for the unemployment rate the forecast is a 0.6 p.p. drop to 8.6% in 2018.

⁶⁵ The granting of a six month payment to the long-term unemployed registered at a job centre who are no longer entitled to unemployment benefit.

⁶⁶ The transfer was implemented in 2017 through the introduction of the basic component, and the supplementary component is expected to be introduced in 2018. This social transfer is designed to compensate the non-specific cost of a disability, plus the granting of a supplement, on the basis of the solidarity principle and fight against poverty.

ANNEX

Box 3 – Revisions from 2017 forecast (SB/2017) to DSB/2018 estimate

The downward revision in the general government deficit to 1.4% of GDP in 2017 reflects a 0.2 p.p. of GDP change compared to the SB/2017 forecast (1.6% of GDP). This outcome was brought about entirely by the contribution from the change in the expenditure estimate which is down 911 M€ (0.9 p.p. of GDP), since revenue is 646 M€ (-0.7 p.p. of GDP) below the forecast published in SB/2017.

The expenditure revision is essentially explained by the cut in expenditure on interest against the forecast figure (-728 M€, -0.4 p.p. of GDP) and by the decrease in primary expenditure (-183 M€, 0.4 p.p. of GDP). The change in primary expenditure is determined by the lower volume of "other current expenditure" (-601 M€, -0.3 p.p. of GDP), of capital expenditure (-456 M€, -0.3 p.p. of GDP) and of subsidies (-94 M€, -0.1 p.p. of GDP). The decrease underlying the change in capital expenditure reflects the performance of Gross Fixed Capital Formation (GFCF) (-953 M€; -0.5 p.p. of GDP), since "other capital expenditure" has risen compared to SB/2017 (497 M€, 0.3 p.p. of GDP). On the contrary, compensation of employees are revised by 434 M€ (0.1 p.p. of GDP), indicating an underestimation in SB/2017, as well as social transfers which rise by 442 M€ (0.1 p.p. of GDP).

Table 17 – Difference between the 2017 estimate and the initial forecast in SB/2017

	2017					
	SB/2017	SB/2018	% of GDP		Deviation from SB/2017	
			SB/2017	SB/2018	M€	p.p. of GDP
Total revenue	84 153	83 507	44,1	43,4	-646	-0,7
Current revenue	82 251	82 212	43,1	42,7	-39	-0,4
Tax revenue	47 601	48 563	24,9	25,2	962	0,3
Indirect taxes	28 169	28 880	14,8	15,0	711	0,2
Direct taxes	19 432	19 683	10,2	10,2	251	0,0
Social contributions	22 313	22 502	11,7	11,7	189	0,0
of which: actual soc. contr. received	17 393	17 736	9,1	9,2	343	0,1
Sales & other current revenues	12 337	11 147	6,5	5,8	-1 190	-0,7
Capital transfers received	1 902	1 296	1,0	0,7	-606	-0,3
Total expenditure	87 168	86 257	45,7	44,8	-911	-0,9
Primary expenditure	78 871	78 689	41,3	40,9	-183	-0,4
Current primary expend.	73 875	74 148	38,7	38,5	273	-0,2
Intermediate consumption	10 680	10 772	5,6	5,6	92	0,0
Compensation of employees	20 975	21 409	11,0	11,1	434	0,1
Social transfers	35 615	36 057	18,7	18,7	442	0,1
not in kind	32 414	32 505	17,0	16,9	91	-0,1
in kind	3 201	3 552	1,7	1,8	351	0,2
Subsidies	1 104	1 010	0,6	0,5	-94	-0,1
Other current expenditure	5 501	4 900	2,9	2,5	-601	-0,3
Capital expenditure	4 996	4 540	2,6	2,4	-456	-0,3
GFCF	4 177	3 224	2,2	1,7	-953	-0,5
Other capital expenditures	820	1 316	0,4	0,7	497	0,3
Interest paid	8 297	7 569	4,3	3,9	-728	-0,4
General government balance	-3 016	-2 750	-1,6	-1,4	266	0,2
Primary Balance	5 281	4 819	2,8	2,5	-463	-0,3
Tax burden	63 891	63 215	33,5	32,8	-676	-0,6

Source: Ministry of Finance. CFP calculations. | Note: A positive/negative figure for expenditure corresponds to an unfavourable/favourable revision, while the opposite is the case with revenue.

An unfavourable change in total revenue compared to the forecast (-646 M€, -0.7 p.p. of GDP), partially cancels the contribution from the decrease in the aforesaid expenditure. The estimate for this budget aggregate is influenced by the large revision in the "sales and other current revenue" account which falls by 1190 M€ (-0.7 p.p. of GDP). The significant decrease in these variables suggests they were underestimated when SB/2017 was prepared. Similarly the estimate for capital revenue is reduced by 606 M€, contributing to the unfavourable developments in revenue. Tax and contributions revenue, benefitting from the improvement in the macroeconomic context, records more favourable performance, with the updated estimates standing at +962 M€ and +189M €, respectively.

It should be stressed that the analysis of the contributions measured as a percentage of GDP is strongly influenced by the upward revision in nominal GDP (+1643 M€).

Table 18 – From 2017 estimate to budgetary forecast for 2018 – details of policy measures with fiscal impact in 2018 (M€)

	2017			2018					
	Estimate	One-off	Adjusted Estimate	Carry-over measures 2016	Financial Gains	One-off	New Policy Measures	Macroeconomic scenario and other effects	MF Forecast
	(1)	(2)	(3) = (1)-(2)	(4)	(5)	(6)	(7)	(8) = (9)-(3)-(4)-(5)-(6)-(7)	(9)
REVENUE	83 507	450	83 057	-260	148	0	309	3 471	86 725
Tax and Contribution Revenue	71 064	0	71 064	-260	0	0	92	2 207	73 103
Indirect taxes	28 880	0	28 880	0	0	0	180	1 107	30 166
Tax on products with high salt percentage							30		
Other changes to special consumption taxes							150		
Direct taxes	19 683	0	19 683	-260	0	0	-187	344	19 580
Income tax surcharge elimination				-260					
PIT intervals change							-230		
Public administration careers gradual unfreeze							43		
Social contributions	22 502	0	22 502	0	0	0	99	756	23 357
Public administration careers gradual unfreeze							99		
Non Tax and non contribution Revenue	12 443	450	11 993	0	148	0	217	1 264	13 621
EU Structural Funds							167		
Increase in BdP dividends					148				
BPP Guarantee Recovery		450							
Revenue review							50		
EXPENDITURE	86 257	82	86 175	154	0	54	81	2 294	88 758
Primary Expenditure	78 689	82	78 607	154	0	54	388	2 430	81 632
Intermediate Consumption	10 772	0	10 772	0	0	0	-144	628	11 256
Nominal freeze of intermediate consumption except PPPs							0		
Spending Review							-144		
Compensation of employees	21 409	0	21 409	0	0	0	270	-199	21 480
Public administration careers gradual unfreeze							353		
Public employment control (2 per 1)							-23		
Spending Review							-60		
Social Benefits	36 057	0	36 057	154	0	18	168	660	37 056
Special pension access regime for long term careers							48		
Pension's update				154			35		
Social benefit for inclusion of the disabled							85		
Forest fires							18		
Subsidies	1 010	0	1 010	0	0	0	-20	104	1 094
EU Structural Funds							-20		
GFCF	3 224	-29	3 253	0	0	0	162	1 110	4 525
Sale of F-16 to Romania		-29							
EU Structural Funds							162		
Other expenditure	6 217	111	6 106	0	0	36	-48	126	6 219
EU Structural Funds							36		
Nominal freeze in other current expenditure							0		
Debt assumptions (STCP and Carris swaps)		111							
Forest fires							36		
Spending Review							-84		
Interest paid	7 569	0	7 569	0	0	0	-307	-135	7 126
Savings in interest expenditure							-307		
BUDGET BALANCE	-2 750	368	-3 118	-414	148	-54	228	1 176	-2 034

Source: Ministry of Finance. CFP calculations. | Note: The macroeconomic scenario incorporates the impacts of the macroeconomic developments in tax and contributions revenue and in expenditure, as well as other effects. The figures in column 8 match the sum of columns 4 and 10 of Table 1. For a breakdown of one-off measures see Box 1. The totals may not necessarily match the sum of the individual items due to rounding.

Table 19 – From 2017 estimate to budgetary forecast for 2018 based on the MF classification of one-offs – policy measures with fiscal impact in 2018 (M€)

	No Policy Change Scenario					Policy Change Scenario							
	MF Estimate 2017 (1)	One-off (2)	Adjusted Estim. 2017 (3)=(1)-(2)	Macroeconomic scenario and other effects (4)=(6)-(3)-(5)	Carry-over (5)	No Policy Change Scenario 2018 (6)	Financial Gains (7)	New Policy Measures (8)	No Policy Change + Policy Measures (9)=(6)+-(8)	Other effects (10)=(11)-(9)	MF unadjusted Forecast (11)=(13)-(12)	One-off (12)	MF Forecast (13)
REVENUE	83 507	685	82 822	3 597	-260	86 159	148	309	86 616	344	86 960	-235	86 725
Tax and Contribution Revenue	71 064	235	70 829	2 552	-260	73 121		92	73 213	126	73 339	-235	73 103
Indirect taxes	28 880		28 880	1 043		29 923		180	30 103	63	30 166		30 166
Direct taxes	19 683	235	19 448	728	-260	19 915		-187	19 728	87	19 815	-235	19 580
Social contributions	22 502		22 502	781		23 283		99	23 382	-25	23 357		23 357
Non Tax and non contribution R	12 443	450	11 993	1 045		13 038	148	217	13 403	219	13 621		13 621
EXPENDITURE	86 257	392	85 866	1 983	154	88 003	0	81	88 084	417	88 501	257	88 758
Primary Expenditure	78 689	392	78 297	2 168	154	80 619	0	388	81 007	368	81 375	257	81 632
Intermediate Consumption	10 772		10 772	773		11 546		-144	11 402	-146	11 256		11 256
Compensation of employees	21 409		21 409	192		21 601		270	21 871	-391	21 480		21 480
Social Transfers	36 057		36 057	752	154	36 962		168	37 130	-92	37 038	18	37 056
Subsidies	1 010		1 010	78		1 088		-20	1 068	26	1 094		1 094
GFCF	3 224	-29	3 253	410		3 663		162	3 825	700	4 525		4 525
Other expenditure	6 217	421	5 796	-38		5 758		-48	5 710	270	5 980	239	6 219
Interest paid	7 569		7 569	-185		7 384		-307	7 077	49	7 126		7 126
BUDGET BALANCE	-2 750	294	-3 044	1 614	-414	-1 844	148	228	-1 468	-73	-1 541	-492	-2 034

Source: Ministry of Finance. CFP calculations. | Note: The macroeconomic scenario incorporates the impacts of the macroeconomic developments in tax and contributions revenue and in expenditure, as well as other effects. For details of the various effects see Table 20 below. The classification of temporary measures (or one-offs) matches that used by the MF, shown in Box 1. According to information provided by the MF, the fiscal impact of the temporary measure relating to “Fires” was shared between Social transfers, “Other current expenditure” and “Other capital expenditure”. Given the unavailability of information, the equal split of the sums is merely indicative. The totals may not necessarily match the sum of the individual items due to rounding.

Table 20 – From 2017 estimate to budget forecast for 2018 based on the MF classification of one-offs – details of policy measures with fiscal impact in 2018 (M€)

	2017			2018					
	Estimate	One-off	Adjusted Estimate	Carry-over measures 2016	Financial Gains	One-off	New Policy Measures	Macroeconomic scenario and other effects	MF Forecast
	(1)	(2)	(3) = (1)-(2)	(4)	(5)	(6)	(7)	(8) = (9)-(3)-(4)-(5)-(6)-(7)	(9)
REVENUE	83 507	685	82 822	-260	148	-235	309	3 941	86 725
Tax and Contribution Revenue	71 064	235	70 829	-260	0	-235	92	2 677	73 103
Indirect taxes	28 880	0	28 880	0	0	0	180	1 107	30 166
Tax on products with high salt percentage							30		
Other changes to special consumption taxes							150		
Direct taxes	19 683	235	19 448	-260	0	-235	-187	814	19 580
Income tax surcharge elimination				-260					
PIT intervals change							-230		
Public administration careers gradual unfreeze							43		
Corporate income tax (CIT)		235				-235			
Social contributions	22 502	0	22 502	0	0	0	99	756	23 357
Public administration careers gradual unfreeze							99		
Non Tax and non contribution Revenue	12 443	450	11 993	0	148	0	217	1 264	13 621
EU Structural Funds							167		
Increase in BdP dividends					148				
BPP Guarantee Recovery		450							
Revenue review							50		
EXPENDITURE	86 257	392	85 865	154	0	257	81	2 401	88 758
Primary Expenditure	78 689	392	78 297	154	0	257	388	2 536	81 632
Intermediate Consumption	10 772	0	10 772	0	0	0	-144	628	11 256
Nominal freeze of intermediate consumption except PPPs							0		
Spending Review							-144		
Compensation of employees	21 409	0	21 409	0	0	0	270	-199	21 480
Public administration careers gradual unfreeze							353		
Public employment control (2 per 1)							-23		
Spending Review							-60		
Social Benefits	36 057	0	36 057	154	0	18	168	660	37 056
Special pension access regime for long term carriers				154			48		
Pension's update							35		
Social benefit for inclusion of the disabled							85		
Forest fires							18		
Subsidies	1 010	0	1 010	0	0	0	-20	104	1 094
EU Structural Funds							-20		
GFCF	3 224	-29	3 253	0	0	0	162	1 110	4 525
Sale of F-16 to Romania		-29							
EU Structural Funds							162		
Other expenditure	6 217	421	5 796	0	0	239	-48	232	6 219
EU Structural Funds							36		
Nominal freeze in other current expenditure							0		
Debt assumptions (STCP and Carris swaps)		111							
Forest fires							36		
Spending Review							-84		
Deferred Tax Assets (DTA)		160					120		
Compensation of BES clients		150							
Payments to Greece						84			
Interest paid	7 569	0	7 569	0	0	0	-307	-135	7 126
Savings in interest expenditure							-307		
BUDGET BALANCE	-2 750	293	-3 043	-414	148	-492	228	1 540	-2 034

Source: Ministry of Finance. CFP calculations. | Note: The macroeconomic scenario incorporates the impacts of the macroeconomic developments in tax and contributions revenue and in expenditure, as well as other effects. The figures in column 8 match the sum of columns 4 and 10 of Table 19. For a breakdown of one-off measures see Box 1. The totals may not necessarily match the sum of the individual items due to rounding.

Table 21 – General government account (M€)

	2013	2014	2015	2016	DSB/2018	
					2017	2018
Total revenue	76 787	77 196	78 751	79 706	83 507	86 725
Current revenue	74 840	75 451	77 351	78 909	82 212	85 364
Tax revenue	42 731	43 564	45 598	46 428	48 563	49 747
Indirect taxes	23 320	24 561	26 069	27 347	28 880	30 166
Direct taxes	19 411	19 003	19 529	19 081	19 683	19 580
Social contributions	20 449	20 457	20 783	21 609	22 502	23 357
of which: actual soc. contr. received	15 139	15 576	16 182	16 929	17 736	18 621
Sales & other current rev.	11 660	11 430	10 970	10 873	11 147	12 261
Capital transfers received	1 948	1 744	1 400	796	1 296	1 361
Total expenditure	85 032	89 598	86 669	83 371	86 257	88 758
Primary expenditure	76 774	81 115	78 459	75 610	78 689	81 632
Current primary expend.	71 380	70 398	70 793	72 058	74 148	76 139
Intermediate consumption	9 611	9 847	9 994	10 418	10 772	11 256
Compensation of employees	21 317	20 515	20 349	20 881	21 409	21 480
Social transfers	34 785	34 088	34 711	35 113	36 057	37 056
other than in kind	31 520	30 810	31 338	31 730	32 505	33 449
in kind via market producers	3 265	3 278	3 373	3 383	3 552	3 607
Subsidies	1 031	1 230	1 124	975	1 010	1 094
Other current expenditure	4 636	4 718	4 616	4 671	4 900	5 252
Capital expenditure	5 394	10 717	7 666	3 552	4 540	5 493
GFCF	3 701	3 446	4 045	2 734	3 224	4 525
Other	1 693	7 271	3 620	819	1 316	967
Interest paid	8 258	8 483	8 210	7 761	7 569	7 126
General government balance	-8 245	-12 402	-7 918	-3 665	-2 750	-2 034
Primary balance	13	-3 919	292	4 096	4 819	5 093
Tax burden	57 872	59 140	61 780	63 357	66 298	68 367
Current expenditure	79 638	78 881	79 003	79 818	81 717	83 265
Public debt	219 715	226 031	231 540	241 061	242 948	246 144
Nominal GDP	170 269	173 079	179 809	185 179	192 453	199 381

Source: INE and MF.

Table 22 – Adjusted general government account (M€)

	2013	2014	2015	2016	DSB/2018	
					2017	2018
Total revenue	75 508	77 196	78 621	78 960	83 057	86 725
Current revenue	73 560	75 451	77 221	78 466	82 212	85 364
Tax revenue	41 686	43 564	45 468	46 032	48 563	49 747
Indirect taxes	22 964	24 561	25 939	27 243	28 880	30 166
Direct taxes	18 721	19 003	19 529	18 788	19 683	19 580
Social contributions	20 215	20 457	20 783	21 561	22 502	23 357
of which: actual soc. contr. received	14 905	15 576	16 182	16 882	17 736	18 621
Sales & other current rev.	11 660	11 430	10 970	10 873	11 147	12 261
Capital transfers received	1 948	1 744	1 400	495	846	1 361
Total expenditure	84 332	83 412	84 206	83 405	86 176	88 705
Primary expenditure	76 074	74 929	75 996	75 644	78 607	81 578
Current primary expend.	71 380	70 398	70 793	71 981	74 148	76 103
Intermediate consumption	9 611	9 847	9 994	10 418	10 772	11 256
Compensation of employees	21 317	20 515	20 349	20 881	21 409	21 480
Social transfers	34 785	34 088	34 711	35 113	36 057	37 038
other than in kind	31 520	30 810	31 338	31 730	32 505	33 431
in kind via market producers	3 265	3 278	3 373	3 383	3 552	3 607
Subsidies	1 031	1 230	1 124	975	1 010	1 094
Other current expenditure	4 636	4 718	4 616	4 594	4 900	5 234
Capital expenditure	4 694	4 531	5 203	3 664	4 459	5 475
GFCF	3 701	3 446	3 866	2 845	3 253	4 525
Other	993	1 085	1 336	819	1 206	950
Interest paid	8 258	8 483	8 210	7 761	7 569	7 126
General government balance	-8 825	-6 216	-5 585	-4 445	-3 118	-1 980
Primary balance	-566	2 267	2 625	3 316	4 450	5 146
Tax burden	56 592	59 140	61 650	62 914	66 298	68 367
Current expenditure	79 638	78 881	79 003	79 741	81 717	83 230
Public debt	219 715	226 031	231 540	241 061	242 948	246 144
Nominal GDP	170 269	173 079	179 809	185 179	192 453	199 381

Source: INE and MF.

Table 23 – General government account (% of GDP)

	2013	2014	2015	2016	DSB/2018	
					2017	2018
Total revenue	45,1	44,6	43,8	43,0	43,4	43,5
Current revenue	44,0	43,6	43,0	42,6	42,7	42,8
Tax revenue	25,1	25,2	25,4	25,1	25,2	25,0
Indirect taxes	13,7	14,2	14,5	14,8	15,0	15,1
Direct taxes	11,4	11,0	10,9	10,3	10,2	9,8
Social contributions	12,0	11,8	11,6	11,7	11,7	11,7
of which: actual soc. contr. received	8,9	9,0	9,0	9,1	9,2	9,3
Sales & other current rev.	6,8	6,6	6,1	5,9	5,8	6,1
Capital transfers received	1,1	1,0	0,8	0,4	0,7	0,7
Total expenditure	49,9	51,8	48,2	45,0	44,8	44,5
Primary expenditure	45,1	46,9	43,6	40,8	40,9	40,9
Current primary expend.	41,9	40,7	39,4	38,9	38,5	38,2
Intermediate consumption	5,6	5,7	5,6	5,6	5,6	5,6
Compensation of employees	12,5	11,9	11,3	11,3	11,1	10,8
Social transfers	20,4	19,7	19,3	19,0	18,7	18,6
other than in kind	18,5	17,8	17,4	17,1	16,9	16,8
in kind via market producers	1,9	1,9	1,9	1,8	1,8	1,8
Subsidies	0,6	0,7	0,6	0,5	0,5	0,5
Other current expenditure	2,7	2,7	2,6	2,5	2,5	2,6
Capital expenditure	3,2	6,2	4,3	1,9	2,4	2,8
GFCF	2,2	2,0	2,2	1,5	1,7	2,3
Other	1,0	4,2	2,0	0,4	0,7	0,5
Interest paid	4,9	4,9	4,6	4,2	3,9	3,6
General government balance	-4,8	-7,2	-4,4	-2,0	-1,4	-1,0
Primary balance	0,0	-2,3	0,2	2,2	2,5	2,6
Tax burden	34,0	34,2	34,4	34,2	34,4	34,3
Current expenditure	46,8	45,6	43,9	43,1	42,5	41,8
Public debt	129,0	130,6	128,8	130,2	126,2	123,5

Source: INE and MF.

Table 24 – Adjusted general government account (% of GDP)

	2013	2014	2015	2016	DSB/2018	
					2017	2018
Total revenue	44,3	44,6	43,7	42,6	43,2	43,5
Current revenue	43,2	43,6	42,9	42,4	42,7	42,8
Tax revenue	24,5	25,2	25,3	24,9	25,2	25,0
Indirect taxes	13,5	14,2	14,4	14,7	15,0	15,1
Direct taxes	11,0	11,0	10,9	10,1	10,2	9,8
Social contributions	11,9	11,8	11,6	11,6	11,7	11,7
of which: actual soc. contr. received	8,8	9,0	9,0	9,1	9,2	9,3
Sales & other current rev.	6,8	6,6	6,1	5,9	5,8	6,1
Capital transfers received	1,1	1,0	0,8	0,3	0,4	0,7
Total expenditure	49,5	48,2	46,8	45,0	44,8	44,5
Primary expenditure	44,7	43,3	42,3	40,8	40,8	40,9
Current primary expend.	41,9	40,7	39,4	38,9	38,5	38,2
Intermediate consumption	5,6	5,7	5,6	5,6	5,6	5,6
Compensation of employees	12,5	11,9	11,3	11,3	11,1	10,8
Social transfers	20,4	19,7	19,3	19,0	18,7	18,6
other than in kind	18,5	17,8	17,4	17,1	16,9	16,8
in kind via market producers	1,9	1,9	1,9	1,8	1,8	1,8
Subsidies	0,6	0,7	0,6	0,5	0,5	0,5
Other current expenditure	2,7	2,7	2,6	2,5	2,5	2,6
Capital expenditure	2,8	2,6	2,9	2,0	2,3	2,7
GFCF	2,2	2,0	2,2	1,5	1,7	2,3
Other	0,6	0,6	0,7	0,4	0,6	0,5
Interest paid	4,9	4,9	4,6	4,2	3,9	3,6
General government balance	-5,2	-3,6	-3,1	-2,4	-1,6	-1,0
Primary balance	-0,3	1,3	1,5	1,8	2,3	2,6
Tax burden	33,2	34,2	34,3	34,0	34,4	34,3
Current expenditure	46,8	45,6	43,9	43,1	42,5	41,7
Public debt	129,0	130,6	128,8	130,2	126,2	123,5

Source: INE and MF.

LIST OF ABBREVIATIONS

Abbreviations	Stands for
AIMI	Property tax surcharge
BFL	Budgetary Framework Law
BoP	Bank of Portugal
BPP	<i>Banco Privado Português</i>
CES	Extraordinary social solidarity contribution
CFP	Portuguese Public Finance Council
CG	Central Government
CGA	<i>Caixa Geral de Aposentações</i>
CGD	<i>Caixa Geral de Depósitos</i>
CIT	Corporate income tax
CSI	Solidarity Supplement for the Elderly
DGO	Directorate-General for Budget
DSB	Draft State Budget
EC	European Commission
EDP	Excessive Deficit Procedure
EFAP	Economic and Financial Adjustment Program
EFSF	European Financial Stability Facility
EU	European Union
EUR	Euro
FRTBD	Floating Rate Treasury Bonds
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GG	General Government
GPEARI	Planning, Strategy and International Relations Office
IABA	Tax on Alcohol and Alcoholic beverages
IAS	Social support index
IEC	Excise duties
IGCP	Treasury and Public Debt Management Agency
IGFSS	Social Security Financial Management Institute
IMF	International Monetary Fund
IMI	Municipal Property Tax
IMT	Tax on real estate transactions
INE	Statistics Portugal
IS	Stamp Duty
ISP	Petroleum Tax
ISV	Vehicle tax
IT	Tobacco Tax
IUC	Single Road Tax
LG	Local Government
M€	Million euros
MF	Ministry of Finance
MFBP	Multi-annual Framework of Budgetary Planning
MLP	Medium and Long Term
MTO	Medium-Term budgetary Objective
MTSS	Ministry of Labour, Solidarity and Social Security
NBR	Net borrowing requirements
OECD	Organization for Economic Co-operation and Development
p.p.	Percentage points
Parpública	<i>PARPÚBLICA – Participações Públicas, SGPS, S.A.</i>
PD	Public Debt

Abbreviations	Stands for
PERES	<i>Programa Especial de Redução de Endividamento ao Estado</i> [2016 exceptional scheme for settling tax and social security debts]
PIT	Personal Income Tax
PPL	Draft Law
PPP	Public-private partnership
RF	Resolution Fund
RG	Regional Government
RLG	Regional and Local Government*
RMMG	Minimum monthly entitlement
RPC	Reclassified Public Corporations
RSI	Social Insertion Income
SB	State Budget
SC	Savings Certificates
SFA	Autonomous Funds and Services
SGP	Stability and Growth Pact
SGPS	<i>Sociedade Gestora de Participações Sociais</i> [Holding Company]
SP	Stability Programme
SS	Social Security
SSB	Social Security Budget
SSF	Social Security Funds
SSFL	Social Security Framework Law
SSS	Social Security System
STCP	<i>Sociedade de Transportes Colectivos do Porto</i>
TB	Treasury Bills
TBD	Treasury Bonds
TC	Treasury Certificates
TFEU	Treaty on the Functioning of the European Union
VAT	Value Added Tax
VPT	Taxable patrimonial value

* RLG corresponds to the "Local Government" ESA 2010 definition.

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