Conselho das Finanças Públicas
*Portuguese Public Finance Council*

# Macroeconomic forecasts underlying the 2019 Draft State Budget

## *Opinion of the Portuguese Public Finance Council*
**no. 02/2018**

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Conselho das Finanças Públicas
Portuguese Public Finance Council

The Portuguese Public Finance Council is an independent body, set up by article 3 of Law no. 22/2011 of 20 May that introduced the 5th amendment to the Budgetary Framework Law (Law no. 91/2001 of 20 August, republished by Law no. 37/2013 of 14 June).

The decision to set up the Council was taken following the publishing of the final report of the Taskforce to the European Council on economic governance in Europe, and became a reality in October 2010 after agreement was reached between the Socialist Party (PS), in Government, and the Social Democratic Party (PSD). The final version of its Statutes was approved by Law no. 54/2011 of 19 October.

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 Opinion uses the information available up to 11 October 2018.

# INTRODUCTION

This Opinion examines the macroeconomic forecasts underlying the Draft State Budget for 2019 (DSB/2019) and is framed by the "*Memorandum of Understanding (MoU) between the Ministry of Finance and the Portuguese Public Finance Council on the preparation of an opinion on the macroeconomic forecasts underlying the Stability Program and the Draft State Budget*", signed on 6 February 2015.[1]

Pursuant to the terms of the said MoU, on 18 August the Government formally notified the Portuguese Public Finance Council (CFP) that the DSB/2019 would be presented to Parliament on 15 October ("D" day for the purposes of the calendar included in section 5 of the MoU).

On 17 September, the CFP received a working version of the macroeconomic forecasts used in the no-policy-change scenario. On 28 September, the Ministry of Finance (MF) sent to the CFP a new version of the macroeconomic forecasts used in the no-policy-change scenario and the macroeconomic forecasts used in the programmatic scenario, which takes into account the policy measures planned by the Government in the document in question.

On 2 October, a meeting was held between the MF and the CFP staff at which the former provided a brief summary of the two scenarios and the table that identifies and presents a preliminary quantification of the measures considered. At that meeting, the CFP requested a series of additional information, of which only part was provided.

On 9 October, the MF sent the final version of the macroeconomic scenario without any new information on the policy measures included therein. This Opinion refers to the figures considered by the MF in its external and technical hypotheses and the macroeconomic forecasts underlying this programmatic scenario. Table 1 shows the main indicators regarding the latest information provided by the MF at this Opinion's cut-off date.

The methods and the analysis used in this Opinion are described in the aforementioned MoU. The CFP analysed the macroeconomic forecasts underlying the DSB/2019 with the following means:

a) The CFP technical staff's analysis of the forecasts;
b) Comparison with the forecasts made by the main institutions: European Commission (EC), Organization for Economic Cooperation and Development (OECD), International Monetary Fund (IMF), Bank of Portugal (BoP) and CFP;
c) The latest available statistics from the national statistical authorities — Statistics Portugal (INE) and BoP;
d) Oral and written technical clarifications provided by the MF regarding the forecasts made.

[1] Available on the CFP website.

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# MINISTRY OF FINANCE FORECASTS

## *Macroeconomic scenario underlying the 2019 Draft State Budget*

The macroeconomic scenario underlying DSB/2019 foresees a slowdown in output growth, which represents a slight downward revision for 2019 compared to the forecast underlying the 2018-2022 Stability Program (SP/2018). Under the current scenario, the MF predicts that 2018 will be marked by a slowdown of 0.5 p.p. in real GDP growth (2.3%) compared to the figure recorded in 2017 (2.8%). Domestic demand continues to be the main driving force behind economic growth, although its contribution is expected to fall by 0.4 p.p. relative to the observed figure in 2017 (3.1 p.p.). This development is mainly built on the significant slowdown in Gross Fixed Capital Formation (GFCF), whose real rate of change fell from 9.2% in 2017 to 5.2% in 2018. This downward trend is offset by an acceleration in the growth of real public consumption (from 0.2% in 2017 to 1.0% in 2018) and by private consumption growth, which stabilises at 2.3%. Net exports will continue to have the negative contribution observed in 2017 (-0.3 p.p.), while decreases are expected in the rates of growth of both exports (from 7.8% in 2017 to 6.6% in 2018), and imports (from 8.1% to 6.9% in the same period).

**Table 1 – Macroeconomic forecasts underlying the DSB/2019**

| | 2017 | 2018 | 2019 |
|---|---|---|---|
| **Real GDP and components (change, %)** | | | |
| GDP | 2.8 | 2.3 | 2.2 |
| Private consumption | 2.3 | 2.3 | 1.9 |
| Public consumption | 0.2 | 1.0 | 0.2 |
| Investment (GFCF) | 9.2 | 5.2 | 7.0 |
| Exports | 7.8 | 6.6 | 4.6 |
| Imports | 8.1 | 6.9 | 4.8 |
| **Contributions to real GDP change (p.p.)** | | | |
| Domestic demand | 3.1 | 2.7 | 2.5 |
| Net exports | -0.3 | -0.3 | -0.3 |
| **Prices (change, %)** | | | |
| GDP deflator | 1.5 | 1.4 | 1.4 |
| Private consumption deflator | 1.2 | 1.3 | 1.4 |
| Public consumption deflator | 2.0 | 1.3 | 1.2 |
| GFCF deflator | 2.6 | 1.1 | 0.8 |
| Exports deflator | 3.3 | 1.8 | 1.7 |
| Imports deflator | 4.0 | 1.9 | 1.6 |
| HICP | 1.6 | 1.4 | 1.4 |
| **Nominal GDP** | | | |
| Change (%) | 4.4 | 3.8 | 3.6 |
| **Labour market (change, %)** | | | |
| Unemployment rate (% labour force) | 8.9 | 6.9 | 6.3 |
| Employment | 3.3 | 2.5 | 0.9 |
| Compensation per employees | 1.6 | 1.9 | 2.3 |
| Apparent labour productivity | -0.5 | -0.2 | 1.3 |
| **External sector (% GDP)** | | | |
| Net lending / net borrowing, total economy | 1.1 | 1.0 | 1.2 |
| Balance of goods and services | 0.8 | 0.7 | 0.7 |
| Balance of primary income and transfers | -0.6 | -0.7 | -0.6 |
| Capital account | 0.9 | 1.0 | 1.2 |
| Net lending / net borrowing, private sector | 2.0 | 1.7 | 1.4 |
| General government balance | -0.9 | -0.7 | -0.2 |
| **Cyclical developments** | | | |
| Potential GDP (change, %) | 1.6 | 1.9 | 2.0 |
| Output gap (% potential GDP) | 0.3 | 0.7 | 0.9 |
| **Assumptions** | | | |
| Foreign demand (change, %) | 5.1 | 4.8 | 4.2 |
| Short-term interest rate (annual average, %) | -0.3 | -0.3 | -0.1 |
| EUR-USD exchange rate (annual average) | 1.13 | 1.19 | 1.19 |
| Oil price (Brent, USD/barrel) | 54.8 | 72.9 | 72.2 |

Source: MF – Information provided on 9 October 2018.

For 2019, the MF forecasts a slight slowdown in the economy, predicting real GDP growth of 2.2%. The behaviour of domestic demand is once again the key factor underpinning these dynamics, with the MF foreseeing a decrease of 0.2 p.p. in domestic demand's contribution compared to 2018 (2.7 p.p.). This evolution also reflects a different composition of domestic demand compared to the estimate for 2018. The MF expects that the decline in domestic demand in 2019 to result from the slowdown in private consumption and in public consumption, with a decrease of the rates of change to 1.9% and 0.2%, respectively. The impact of the downward trend in these components should be lessened by the increase in GFCF, with rate of change rising by 1.8 p.p. to 7.0% in 2019. Under the current scenario, the contribution of external demand to the change in real GDP remains at -0.3 p.p. The MF predicts a similar evolution for the rates of change in exports and imports, as it expects a slowdown in exports from 6.6% to 4.6%, and a slowdown in imports from 6.9% to 4.8%.

Regarding the evolution of the prices, the MF expects a slight slowdown in the GDP deflator in 2018, dropping 0.1 p.p. to 1.4%. This performance reflects the slower growth in public consumption (from 2.0% to 1.3%), GFCF (from 2.6% to 1.1%) and exports (from 3.3% to 1.8%) deflators, which is partially offset by the increase in the private consumption deflator (from 1.2% to 1.3%) and the significant slowdown in the imports deflator (from 4.0% to 1.9%). In 2019, the continued growth in the GDP deflator (1.4%) reflects the slowdowns forecasted for public consumption (from 1.3% to 1.2%), GFCF (from 1.1% to 0.8%) and exports (from 1.8% to 1.7%) deflators, which are more than offset by the increase in the private consumption deflator (from 1.3% to 1.4%) combined with a new slowdown in growth of the imports deflator (from 1.9% to 1.6%). In 2018, the change in the private consumption deflator differs from the forecast for the Harmonised Index of Consumer Prices (HICP), which is expected to fall by 0.2 p.p. to 1.4%, a figure which the MF predicts will remain unchanged in 2019.

The MF foresees a growth rate of 3.8% in 2018 and 3.6% in 2019 for nominal GDP. In 2018, the slowdown in nominal GDP growth (compared to 4.4% in 2017) results from both the slowdown in real GDP and the forecast decrease in the deflator. In 2019, the slowdown in nominal GDP is mainly a consequence of the evolution of real GDP, since the growth in the deflator is expected to stabilise.

The MF's macroeconomic scenario foresees a generally positive outlook for the labour market, predicting a drop in the unemployment rate. Under the current scenario, the unemployment rate should fall by 2.0 p.p. in 2018 to 6.9%, and then drop to 6.3% in 2019. The outlook for employment is also favourable, although there is an expected slowdown, with the MF foreseeing growth rates of 2.5% in 2018 and 0.9% in 2019. Nominal average compensation per employee should increase by 1.9% in 2018, accelerating relative to the previous year (1.6%). Using the HICP as a deflator, real average compensation per employee is expected to accelerate and slightly increase the differential to the rate of change in apparent labour productivity, which once again should record a negative figure (-0.2%), albeit smaller than in 2017 in absolute terms. For 2019, the scenario predicts greater growth in nominal average compensation per employee (2.3%), along with a more expressive growth in productivity (1.3%).

The DSB/2019 foresees a slight decrease in the net borrowing capacity of the economy in 2018 to 1.0% of GDP. Such performance is brought about by the deterioration (-0.2 p.p.) in the current account to a zero balance, which is only partly offset by the slight improvement (+0.1 p.p.) in the capital account (1.0% of GDP). In 2019, the MF predicts a recovery in the net borrowing capacity of the economy to 1.2% of GDP, as a consequence of the +0.1 p.p. improvement in the current account balance (0.1% of GDP) and the capital account balance (1.2% of GDP).

The MF scenario points to a continued increase in potential GDP, estimating a rate of change of 1.9% in 2018 and 2.0% in 2019. The output gap (0.3% in 2017) continues to widen, as it remains positive and increases to 0.7% of potential GDP in 2018 and 0.9% in 2019.

The external hypotheses developed for the Portuguese economy have an overall negative impact on the macroeconomic scenario under analysis. The MF expects a gradual slowdown in external demand for Portuguese goods and services, with growth falling from 5.1% in 2017 to 4.8% in 2018 and 4.2% in 2019, as it predicts a worsening of the economic context for the Portuguese exports. Regarding the short-term interest rate (3-month Euribor), the current scenario foresees a negative figure (-0.3%) in 2018, which should improve (to -0.1%) in 2019. The assumed improvement in the euro-US dollar exchange rate, from 1.13 in 2017 to 1.19 in 2018, has a potentially adverse effect on Portuguese exports, but it mitigates the negative impact of the forecast increase in the price of oil in the international markets; the MF estimates that the average price of a barrel of Brent will increase to 72.9 dollars in 2018, decreasing slightly to 72.2 dollars in 2019.

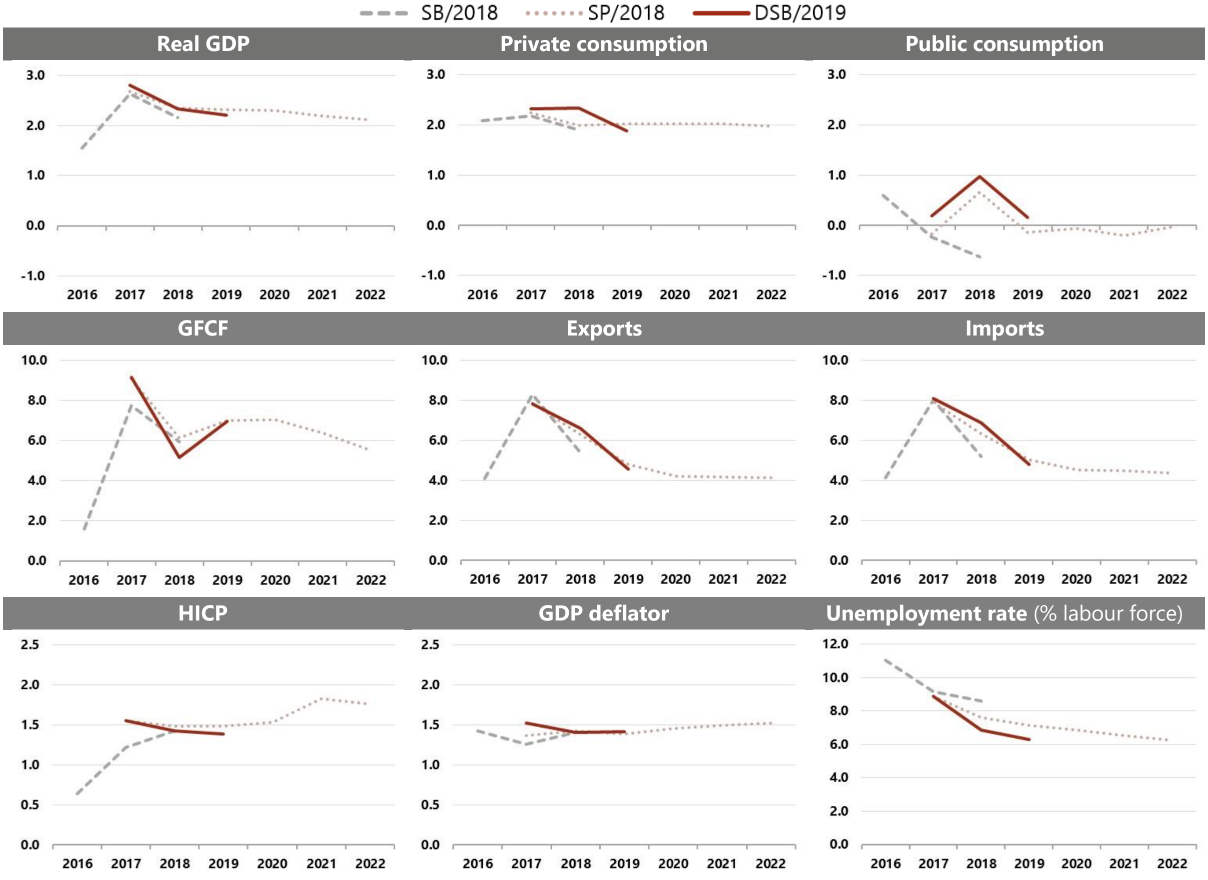
### *Comparison with previous MF forecasts*

This section compares the scenario published in the DSB/2019 with the previous MF macroeconomic forecasts, in particular those underlying the SP/2018 and the SB/2018.

The MF forecast that real GDP growth for 2018 remains unchanged in comparison to the scenario published in the SP/2018 (2.3%), and slightly above the SB/2018 scenario (+0.1 p.p.). The MF has revised upwards the expected growth in private consumption for 2018 (2.3%) compared to the figures published in the SP/2018 (+0.3 p.p.) and the SB/2018 (+0.4 p.p.). For 2018, the estimated change in public consumption (1.0%) also constitutes an upward revision of +0.3 p.p. compared to the SP/2018 and of +1.6 p.p. compared to the SB/2018. On the other hand, the expected growth in GFCF (5.2%) has undergone the most significant downward revision compared to previous scenarios (-1.0 p.p. relative to the SP/2018 and -0.7 p.p. relative to the SB/2018). For 2018, the MF foresees growth rates of 6.6% in exports and 6.9% in imports, which constitute revisions of +0.3 p.p. and +0.6 p.p. compared to the SP/2018 and +1.2 p.p. and +1.7 p.p. compared to the SB/2018, respectively. Thus, the current forecast predicts the contribution of domestic demand (+2.7 p.p.) to be larger than previous forecasts (+0.2 p.p. in the SP/2018 and +0.5 p.p. in the SB/2018), while it expects the contribution of net exports to GDP growth (-0.3 p.p.) to be slightly more negative than in the previous scenarios (-0.2 p.p. in the SP/2018 and 0.0 p.p. in the SB/2018).

For 2019, the MF forecasts a slight slowdown in real GDP (2.2%), which reflects the minor downward revision (-0.1 p.p.) in the growth rate presented in the SP/2018. Domestic demand provides a slightly smaller contribution to this change (2.5 p.p.), as do net exports (-0.3 p.p.), which constitute revisions of -0.1 p.p. compared to the SP/2018, in both items. These revisions are partly the result of the forecast growth in private consumption (1.9%), which is 0.1 p.p. lower than previously forecast and the smaller contribution from exports (4.6%), where the change is revised downwards by 0.2 p.p. compared to the SP/2018 projection.

**Chart 1 – Comparison of forecasts included in the DSB/2019, the SP/2018 and the SB/2018** (change, %)




Source: MF – DSB/2019, SP/2018 and SB/2018.

Compared to the previous scenario, the MF expects a slight downward revision in inflation as measured by the HICP and the rate of change in the GDP deflator to remain unchanged, while it expects a more significant drop in the unemployment rate:

- The current estimate for growth in the GDP deflator of 1.4% in 2018 and 2019 remains unchanged for both years compared to the figures published in the SP/2018 and the SB/2018. The estimated growth in HICP (1.4%) has been revised slightly downwards compared to the SP/2018 (-0.1 p.p. for both 2018 and 2019).
- The unemployment rate falls more sharply than forecasted in the SP/2018, having been revised by -0.7 p.p. in 2018 and -0.9 p.p. in 2019, as it reaches figures of 6.9% and 6.3% of the labour force in 2018 and 2019, respectively (compared to the SB/2018 the current forecast for 2018 is lower by 1.7 p.p.).

### Box 1 – Forecasts and projections for the Portuguese economy

The MF estimate for real GDP growth in 2018 is 2.3%, which is equal to the figure projected by the IMF and the BoP and 0.1 p.p. above the CFP, EC and OECD projections. The MF forecast for growth in private consumption in 2018 (2.3%) equals the CFP's and is higher than the OECD estimate (1.9%), but lower than the BoP projection (2.4%). According to the MF, public consumption should grow by 1%, a figure that is above the OECD and the BoP projections (0.7%), but below the CFP expectations (1.2%). As for the change in GFCF, the MF points to growth of 5.2%, which is lower than the estimates published by the CFP (5.3%) and the OECD (5.9%), but higher than the BoP projection (4%). Thus, the MF estimates that domestic demand will contribute 2.7 p.p. to GDP growth in 2018, a figure above the 2.3 p.p. and 2.6 p.p. of the OECD and CFP, respectively. As regards the external sector, the MF predicts export growth of 6.6%, a more optimistic estimate than those of the other institutions, whose projections range from the 5% of the BoP to the 6.5% of the IMF. The MF scenario also includes strong growth in imports (6.9%), which means the MF estimate for net exports is negative (-0.3 p.p.). This figure is in between the contributions projected by the CFP (-0.4 p.p.) and the OECD (-0.2 p.p.). In terms of price evolutions, the MF predicts a 1.4% change in the HICP, which is in line with the BoP and EC estimates, and falls within the OECD (1.1%) and IMF (1.7%) forecasts. The MF expects the GDP deflator to grow by 1.4%, in line with the CFP and OECD projections, but lower than the figure put forward by the IMF (1.6%). The MF forecast for the unemployment rate stands at 6.9%, and is equal to the CFP estimate, but lower than the projections of the OECD (7.5%), IMF and BoP (7%). Also concerning the labour market, the MF scenario predicts employment will rise by 2.5%, which is below the CFP projection (2.6%), but higher than the growth expected by the BoP (2.3%), OECD (2%) and IMF (1.9%). The MF forecast for the economy's net borrowing capacity (1% of GDP) is lower than the CFP (1.5% of GDP) and BoP (1.4% of GDP) estimates, and is penalised by the primary income and transfers balance.

For 2019, the MF foresees real GDP growth of 2.2%, which is a slowdown compared to 2018, but nonetheless is more optimistic than the projections of the EC (2%), CFP (1.9%) and IMF (1.8%). All the institutions concerned expect an economic slowdown in 2019 with the exception of the OECD, which predicts GDP growth to equal the MF projection (2.2%). Under the MF scenario, private consumption growth should slow to 1.9%, which is in line with the OECD projection and 0.1 p.p. lower than the CFP estimate. As for public consumption, the MF predicts the rate of growth to slow to 0.2%, and this forecast falls within the 0.1% decrease in the OECD scenario and the 0.7% growth expected by the CFP. Thus, the MF estimates that the GFCF growth rate should rise to 7% in 2019, which is in line with the increase expected by the OECD, but differs from the minor slowdown projected by the CFP. Nonetheless, the MF estimates that the contribution of domestic demand will decline to 2.5 p.p., which is slightly higher than the 2.3 p.p. contribution expected by both the OECD and the CFP. On the external level, and reflecting the expected slowdown in the growth rates of exports (4.6%) and imports (4.8%), the MF expects net exports to have a negative contribution (-0.3 p.p.). Note that the other institutions also foresee a slowdown in foreign trade and estimate that export growth will range from 4.3% (OECD) and 4.7% (IMF) and import growth from 4.7% (OECD) and 5.5% (IMF). Therefore, as predicted by the MF, both the CFP and the OECD expect net exports to make a negative contribution. In terms of prices, the rate of change in the HICP under the MF scenario should remain at 1.4%, a figure in line with that projected by the CFP, but lower than the projections of the OECD (1.7%), EC (1.6%) and the IMF (1.6%). As for the GDP deflator, the rate of change foreseen by the MF (1.4%) is in between the 1.3% growth predicted by the OECD and the 1.6% growth projected by the IMF and CFP. Under the MF scenario, the unemployment rate should fall to 6.3%, a figure that lies in between the 6.1% projected by the CFP and the 6.7% estimated by the IMF. Regarding the change in employment, the MF forecast (0.9%) is lower than the estimates of the IMF (1.2%), CFP (1.2%) and OECD (1.3%). According to the MF, the economy's net borrowing capacity should stand at 1.2% of GDP in 2019, a figure which is below the amount projected by the CFP (1.4% of GDP). As in 2018, the lower net borrowing capacity forecast by the MF is due to a more pessimistic forecast for the primary income and transfers balance.

Note that the MF scenario already includes the final figures for the 2016 Annual National Accounts and the new preliminary figures for the 2017 Quarterly National Accounts, which most of the other institutions' projections do not. It also includes policy measures for 2019, while the majority of the other institutions' scenarios are produced under the no-policy-change assumption.

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## Table 2 – Projections and forecasts for the Portuguese economy

| *Year* | 2017 | 2018 | | | | | | 2019 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Institution and publication* | | OECD | EC | CFP | IMF | BoP | MF | OECD | EC | CFP | IMF | MF |
| *Publication date* | | May18 | Jul18 | Sep18 | Oct18 | Oct18 | Oct18 | May18 | Jul18 | Sep18 | Oct18 | Oct18 |
| **Real GDP and components (change, %)** | | | | | | | | | | | | |
| GDP | 2.8 | 2.2 | 2.2 | 2.2 | 2.3 | 2.3 | 2.3 | 2.2 | 2.0 | 1.9 | 1.8 | 2.2 |
| Private consumption | 2.3 | 1.9 | - | 2.3 | - | 2.4 | 2.3 | 1.9 | - | 2.0 | - | 1.9 |
| Public consumption | 0.2 | 0.7 | - | 1.2 | - | 0.7 | 1.0 | -0.1 | - | 0.7 | - | 0.2 |
| Investment (GFCF) | 9.2 | 5.9 | - | 5.3 | - | 4.0 | 5.2 | 6.8 | - | 5.2 | - | 7.0 |
| Exports | 7.8 | 5.8 | - | 5.7 | 6.5 | 5.0 | 6.6 | 4.3 | - | 4.5 | 4.7 | 4.6 |
| Imports | 8.1 | 6.4 | - | 6.3 | 6.8 | 5.1 | 6.9 | 4.7 | - | 4.8 | 5.5 | 4.8 |
| **Contributions to real GDP growth (p.p.)** | | | | | | | | | | | | |
| Domestic demand | 3.1 | 2.3 | - | 2.6 | - | - | 2.7 | 2.3 | - | 2.3 | - | 2.5 |
| Net exports | -0.3 | -0.2 | - | -0.4 | - | - | -0.3 | -0.1 | - | -0.3 | - | -0.3 |
| **Prices (change, %)** | | | | | | | | | | | | |
| GDP deflator | 1.5 | 1.4 | - | 1.4 | 1.6 | - | 1.4 | 1.3 | - | 1.6 | 1.6 | 1.4 |
| Private consumption deflator | 1.2 | 1.1 | - | 1.1 | - | - | 1.3 | 1.3 | - | 1.4 | - | 1.4 |
| Public consumption deflator | 2.0 | 1.3 | - | 1.3 | - | - | 1.3 | 1.1 | - | 2.4 | - | 1.2 |
| GFCF deflator | 2.6 | 1.1 | - | 0.9 | - | - | 1.1 | 1.5 | - | 1.4 | - | 0.8 |
| Exports deflator | 3.3 | 1.5 | - | 1.7 | - | - | 1.8 | 0.4 | - | 1.4 | - | 1.7 |
| Imports deflator | 4.0 | 1.1 | - | 1.8 | - | - | 1.9 | 0.4 | - | 1.5 | - | 1.6 |
| HICP | 1.6 | 1.1 | 1.4 | 1.3 | 1.7 | 1.4 | 1.4 | 1.7 | 1.6 | 1.4 | 1.6 | 1.4 |
| **Nominal GDP** | | | | | | | | | | | | |
| Change (%) | 4.4 | 3.5 | - | 3.6 | 3.9 | - | 3.8 | 3.5 | - | 3.5 | 3.4 | 3.6 |
| Level ('000 M€) | 194.6 | 199.9 | - | 200.0 | 200.6 | - | 202.0 | 206.9 | - | 207.1 | 207.5 | 209.3 |
| **Labour market (change, %)** | | | | | | | | | | | | |
| Unemployment rate (% active pop.) | 8.9 | 7.5 | - | 6.9 | 7.0 | 7.0 | 6.9 | 6.6 | - | 6.1 | 6.7 | 6.3 |
| Employment | 3.3 | 2.0 | - | 2.6 | 1.9 | 2.3 | 2.5 | 1.3 | - | 1.2 | 1.2 | 0.9 |
| Compensation per employee | 1.6 | 1.0 | - | 1.6 | - | - | 1.9 | 2.0 | - | 2.1 | - | 2.3 |
| Apparent labour productivity | -0.5 | 0.2 | - | -0.4 | - | - | -0.2 | 0.9 | - | 0.6 | - | 1.3 |
| **External sector (% GDP)** | | | | | | | | | | | | |
| Net lending | 1.1 | - | - | 1.5 | - | 1.4 | 1.0 | - | - | 1.4 | - | 1.2 |
| Current account | 0.2 | -0.3 | - | 0.7 | 0.0 | - | 0.0 | -0.5 | - | 0.5 | -0.3 | 0.0 |
| Balance of goods and services | 0.8 | 1.3 | - | 0.8 | - | 1.3 | 0.7 | 1.1 | - | 0.6 | - | 0.7 |
| Balance of primary income and transfers | -0.6 | -1.6 | - | -0.1 | - | - | -0.7 | -1.6 | - | -0.1 | - | -0.6 |
| Capital account | 0.8 | - | - | 0.8 | - | - | 1.0 | - | - | 0.8 | - | 1.2 |
| **Cyclical developments** | | | | | | | | | | | | |
| Potential GDP (change, %) | - | 1.1 | - | 1.8 | - | - | 1.9 | 1.2 | - | 2.0 | - | 2.0 |
| Output gap (% potential GDP) | - | -2.7 | - | 0.8 | 0.1 | - | 0.7 | -1.8 | - | 0.6 | 0.5 | 0.9 |
| **Public finance (% GDP)** | | | | | | | | | | | | |
| Budget balance | -3.0 | -0.7 | - | -0.5 | -0.7 | - | -0.7 | -0.2 | - | -0.2 | -0.3 | -0.2 |

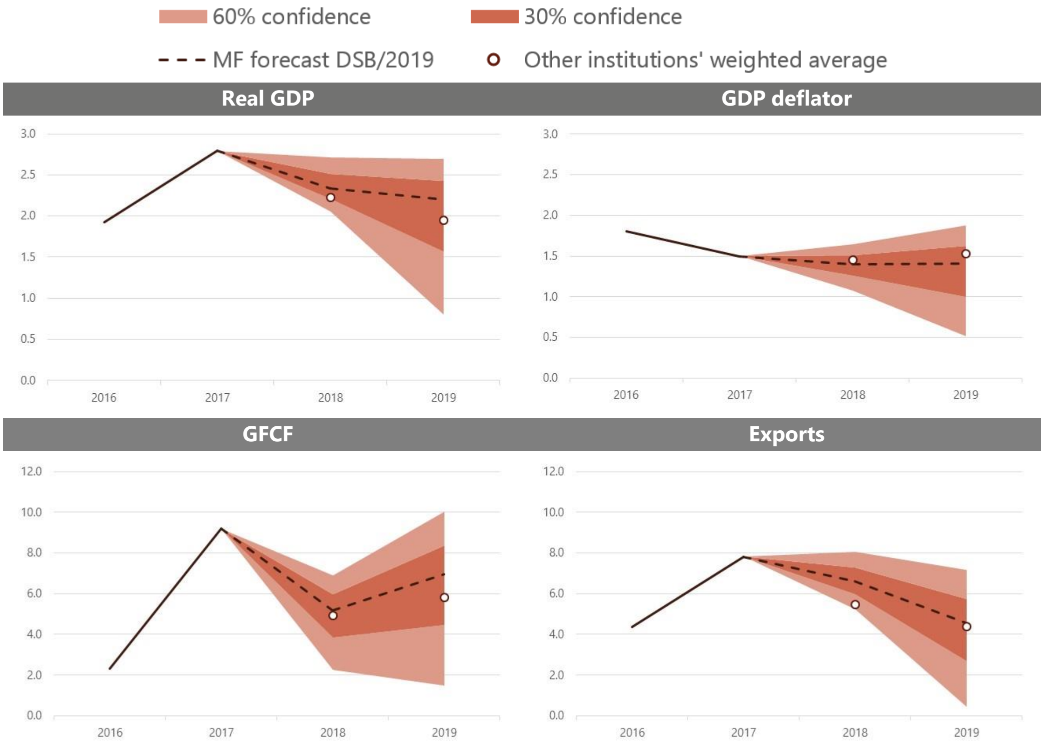
Sources: 2017: Statistics Portugal. 2018-2019: OECD - *Economic Outlook No* 103, May 2018; EC - *Summer 2018 Interim Economic Forecast*, July 2018; CFP – Public Finance: Position and Constraints 2018-2022 – Update, September 2018; IMF – *World Economic Outlook*, October 2018; BoP – Economic Bulletin, October 2018; MF - DSB/2019, October 2018.

ANALYSIS OF FORECASTS

The macroeconomic scenario underlying the DSB/2019 maintains the expected growth path for the Portuguese economy in 2018 and revises slightly downwards growth for 2019 compared to the scenario presented in the SP/2018. This scenario carries downside risks in 2019, resulting mainly from GFCF growth.

The analysis of the macroeconomic scenario underlying the DSB/2019 takes into account the degree of risk inherent to the MF forecasts. In order to account for this risk and uncertainty, asymmetric confidence intervals for the forecasts were calculated (a probability density function associated with the forecasts), on the basis of the past performance of the MF forecasting model.[2] The results are shown in Chart 2.

**Chart 2 – Forecasting intervals for MF forecasts** (change, %)

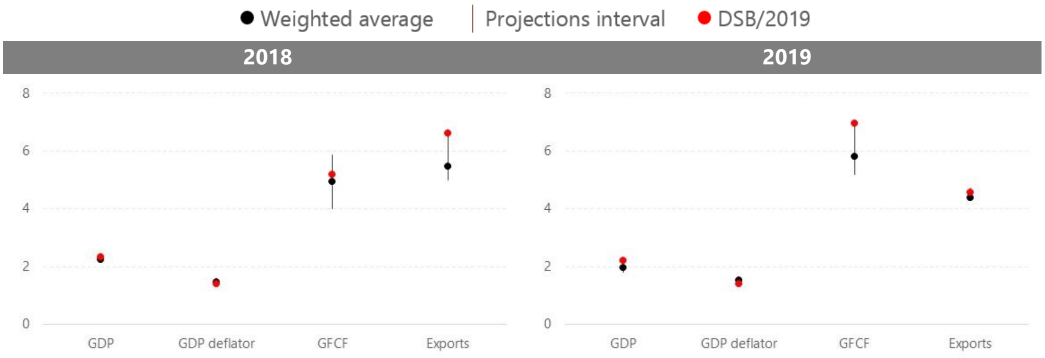



Source: DSB/2019; CFP – confidence intervals calculated on the basis of State Budget reports 1997-2017; see note to Chart 3 on the weighted average calculations.

Furthermore, on the basis of other institutions' projections for the Portuguese economy (see Table 2), the MF macroeconomic forecasts are contextualized in the distribution of existing projections, as well as the weighted average of those projections (Chart 3).

[2] Taking as a starting point the State Budget reports published from 1997-2017, the CFP calculate the confidence intervals relating to the MF forecasts on the basis of the respective forecasting errors, i.e., the difference between the forecast and observed figures. The greater the uncertainty relating to a particular forecast, the wider the confidence region associated with that point (and the lighter its shading). The forecast intervals taken into consideration are asymmetric, which means different probabilities are allocated to positive and negative deviations.

**Chart 3 – DSB/2019 forecasts framework** (change, %)




Source: DSB/2019; CFP calculations – the weighted average of the growth rates published by the other institutions (OECD, EC, CFP, IMF and BoP) is calculated by weighting the respective indicator of each institution (Table 2) according to the degree of information available at the time the projection was made. The percentage represents the time elapsed between the publication of the projections of the said institutions and the date the DSB was delivered. For indicator $j$ of institution $i$, the weight ($P_{j,i}$) is obtained from the following formula: $P_{j,i} = \frac{1-D_{j,i}/360}{P_j}$, where $D_{j,i}$ is the number of days (in a year comprising 360 days) between the date the DSB was delivered and the publication of the institution's $i$ projections, and $P_j = \sum_{i=1}^{n}(1 - D_i/360)$. The interval of the projections is defined by the full sample of the forecasts made by the institutions listed in Table 2, including the MF.

In general, the macroeconomic forecasts for 2018 underlying the DSB/2019 point towards an outlook for the Portuguese economy that matches the expectations of the main institutions, including the CFP's (see Box 1 and Charts 2 and 3).

In comparison with the macroeconomic forecasts included in the SP/2018, despite there being no change in real GDP growth, growth in its various components has been revised. The upward revision in the expected change in private consumption, public consumption and exports of +0.3 p.p. in each component, is offset by the downward revision in GFCF growth (-1.0 p.p.) and the upward revision in imports (+0.6 p.p.).

For 2018, the MF forecasts are generally close to the weighted average of the projections of the remaining institutions, with the exception of the estimate for exports growth, which defines the upper limit on the interval shown (Chart 3). Nonetheless, the weighted average of the projections falls within the 60% confidence interval of the MF forecasts for exports in 2018 (Chart 2). While there remains a significant downside risk, especially at a time when the external context is accumulating signs of an economic slowdown, this effect is mitigated by the fact that the MF estimate for imports in 2018 is higher than that of the remaining institutions (see Table 2).

Therefore, the forecasts for 2018 disclosed in the scenario under analysis do not substantially alter the conclusions published in April in the CFP's Opinion on macroeconomic forecasts underlying the Stability Programme 2018-2022 and frame the forecasts for this year in a most likely scenario for the Portuguese economy, considering the assumptions made for this year and to the current economic environment and related risks.

For 2019, DSB has revised GDP growth slightly downwards (-0.1 p.p. to 2.2%) compared to the scenario published by the MF in the SP/2018, although defining the upper limit for the latest projections available for the Portuguese economy for 2019 (Chart 3). For the same year, the projections made by the other institutions point to a sharper slowdown in the Portuguese economy. The weighted average of the other institutions' projections for real GDP growth (1.9%) falls within the 30% confidence interval of the MF forecasts (Chart 2).

Regarding public consumption, it is not clear what measures have been taken into consideration in the DSB/2019, nor was sufficient information provided to validate the volume-price effect of the measures underlying the scenario. The CFP requested additional information on the composition of public consumption underlying the scenario in question, as well as on the underlying volume and price changes, which had not been provided until this Opinion's cut-off date. Thus, in nominal terms, there are upside risks linked to public consumption that could have a direct impact on GDP and indirect effects via disposable income and private consumption if the measures are aimed at the compensations in the public sector.

As for GFCF, the downward revision in growth in 2018, compared to the SP/2018, is not reflected in growth in 2019, having been considered not only policy measures which are not detailed in the information provided to the CFP, but also a series of major investments by the private sector, which were not made available to the CFP. The weighted average of the other institutions' projections (Charts 2 and 3) falls within the 30% confidence interval of the MF forecasts, but away from the point forecast. In fact, in the projections interval, the MF forecast is the one that defines the upper limit. Unlike the other institutions concerned, which project a no-policy-change scenario, the MF forecasts consider policy measures that could lead to an increase in investment growth. However, the investment taken into account in this scenario is mainly private, and the implicit public policy measures have not been described yet, even less their respective impacts, which could justify the underlying forecast. In addition, as already mentioned, no identification is made of specific investment projects that the private sector has decided to undertake. Thus, in the medium-term, the GFCF growth forecast is optimistic, increasing the downside risk implicit in the real GDP growth forecast.

In general, the MF forecasts for 2019 are close to the weighted average of the projections of the other institutions included in Table 2, with the exception of the GFCF growth forecast. The differences, even in GFCF (considering the asymmetric band that assumes a larger area for negative deviations), fall within the 30% confidence interval (Chart 2). Taking into account this framework and the underlying risks, this scenario may be considered a likely scenario, but not the most likely.

## CONCLUSION

The following conclusion takes into account the principles of Article 8 of the Budgetary Framework Law (Law No. 151/2015 of 11 September): "The budget projections underlying the budgetary programming documents shall be based on the most likely macroeconomic scenario or on a more prudent scenario". The same guiding principle for the use of realistic forecasts when conducting fiscal policy is also contained in European legislation, particularly in the Stability and Growth Pact and in the Council Directive 2011/85/EU of 8 November 2011 which sets the requirements for budgetary frameworks of the Member States.

In accordance with Article 4 (4) of the Regulation No 473/2013 of the European Parliament and of the Council of 21 May 2013, as a result of the assessment carried out, **the Portuguese Public Finance Council endorses, albeit with reservations, the macroeconomic forecasts underlying the 2019 draft state budget, considering that:**

1. **Based on the most recent information available for the national and international economic outlook the forecasts for the year 2018, the base year for the document under analysis, fit in a most likely scenario for the Portuguese economy;**

2. **The forecasts for 2019, although within the limit of likelihood of the forecasts, contemplate increased downside risks to economic growth, which arise in particular from the GFCF forecast. In this way, contrary to the provisions of the Budgetary Framework Law, the macroeconomic scenario underlying the 2019 draft state budget cannot be considered as the most likely scenario or a more prudent scenario;**

3. **The reservations to the forecasts for 2019 are mainly due to the lack of additional information requested and not provided in a timely manner to the CFP.**