Executive Summary

General government budget outturn 2018

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EXECUTIVE SUMMARY

Balances, adjustment and fiscal policy stance in 2018

In 2018, the General Government (GG) deficit stood at 0.5% of GDP returning to the nominal downward path seen in previous years. This outcome was better than expected by the Ministry of Finance (MF) and reflects a 2.5 p.p. of GDP decrease in the deficit compared to 2017, due in part to the baseline effect from the recapitalisation of the Stat-owned bank Caixa Geral de Depósitos. The primary balance consolidated the surplus trend reaching 6 043 M€ in 2018 (or 3% of GDP), more than three times the surplus recorded in 2017.

Excluding the effect of temporary and one-off measures, the GG budget balance improved by 0.8 p.p. of GDP in 2018, equal to half the improvement recorded in 2017 (1.6 p.p. of GDP). Three-quarters of that correction is explained by the favourable economic climate and by the decrease in interest charges due to the more favourable financial terms and the early repayment of the International Monetary Fund (IMF) loans, the final instalment of which was paid in December 2018.

Based on the information available and following the European Commission's common methodology to correct the budgetary deficit from the effects of the economic cycle and the temporary and one-off measures, the CFP estimates that the structural deficit corresponded to 0.7% of GDP in 2018. This indicator improved by 0.6 p.p. of GDP compared to 2017 and is on follows a convergence path towards the Medium-Term Objective (MTO). This improvement was brought about mainly by the 0.4 p.p. of GDP drop in interest charges, while the remaining 0.2 p.p. of GDP came from the improvement in the structural primary balance. On the basis of this information the (discretionary) fiscal policy stance was neutral in 2018. The CFP stresses that these calculations are sensitive to how one-off measures are classified.

Assessment of compliance with fiscal rules in 2018

The estimated structural balance complies with the general annual improvement rule laid down in the Budgetary Framework Law (0.5% of GDP), and also meets the requirements of the preventive arm of the Stability and Growth Pact (SGP) and the European Council (EU) recommendation to Portugal for 2018. The public debt rule was also complied with.

However, fiscal developments in 2018 were not consistent with the expenditure benchmark. The CFP estimates that nominal growth in primary expenditure net of discretionary measures and one-off and temporary measures was higher than the maximum recommended increase of 0.1%, and experienced a deviation that exceeded the 0.5% of GDP threshold, which may indicate there is a risk of a significant deviation (from the MTO convergence path). This non-compliance contrasts with the reading provided by the structural balance, which is explained by the fact that nearly two-thirds of the improvement in the structural balance results from the decline in interest charges, an item which is not included in the primary expenditure indicator.

Revenue and expenditure in 2018

In 2018 GG revenue grew by 5.5% (or 4 604 M€), up 1.5 p.p. on the change recorded in 2017. Revenue from taxes and social contribution (4 219 M€ or 5.9%), and other sources (386 M€ or 3.3%) rose for the first time since 2012. The growth in tax revenue accounted for around three-quarters of the observed increase in taxes and social contributions received. Direct tax revenue was up by 1 272 M€ (6.4%) on the previous year, and its performance was mainly explained by the growth in both PIT revenue (up 704 M€ or 5.6%) and CIT revenue (up 521 M€ or 8.3%). As for indirect taxes, over half of the 1 831 M€ (or 6.3%) rise in revenue came from VAT. Gross VAT revenue reflects the dynamic nature of consumption, and the net revenue from this tax also benefitted from a decrease in refunds. Social contributions recorded the same growth as in 2017 (4.9%), which reflected the ongoing recovery in the labour market. The tax burden rose by 0.9 p.p. of GDP, once again reaching a record high (35.2% of GDP). Revenue from other sources benefitted from the positive performance of all of its components, although growth in sales (286 M€ or 4.3%) accounted for around three-quarters of such growth.

General Government revenue was 1.1 p.p. higher than forecast by the Ministry of Finance in the State Budget for 2018. This outcome was due entirely to the contribution from taxes and social contributions, especially tax revenue where the growth rate (6.4%) was almost three times the forecast in SB/2018.

As regards public expenditure, the rate of growth of this aggregate rose from 1.6% in 2017 to 4.4% in 2018, excluding the baseline effect stemming from the recapitalisation of CGD. The main contributions to this increase came from two transactions relating to the financial sector: the increase in Novo Banco share capital and the call of guarantees covering the group of investors commonly known as the "BES injured parties", which had an overall impact of 1 072.6 M€ on capital expenditure. Growth in primary current expenditure also rose to 3.3% in 2018 with social transfers accounting for almost half of that growth. All expenditure items rose compared to 2017, with the exception of interest and subsidies. Net of the impact of temporary and one-off measures, general government expenditure rose by 3.5% in 2018 to stand at 43.4% of GDP thus reducing its weight as a percentage of GDP for the fifth year running.

Public expenditure was lower than forecast in the Budget since the positive deviation recorded in capital expenditure was more than offset by the negative deviation in primary current expenditure, where only compensation of employees was higher than originally forecast. Capital expenditure exceeded the budgeted figure for 2018, mainly due to the impact of some transactions that were not originally foreseen, and related to the financial sector and to local and regional government expenditure. Gross fixed capital formation was the item that fell the shortest from the forecast figure for 2018, and its growth rate was less than half that underlying the original budget, compared to the provisional outturn for 2017.

Subsectors in 2018

Central Government was responsible for the improvement in the General Government budget balance in 2018, even if the baseline effect from the recapitalisation of the CGD in 2017 is excluded. Although the decline in the Regional and Local Government (RLG) surplus affected the improvement in the GG balance in absolute terms, when measured as a percentage of GDP, the contribution of that subsectors to the change in the budget balance was approximately nil. However, in the Social Security Funds (SSF) subsector the decline in the surplus in 2018 had a negative impact of 0.2 p.p. of GDP on the overall General Government deficit.

Public debt in 2018

The ratio of public debt (Maastricht definition) was 121.5% of GDP, 2 p.p. down on the figure forecast in the State Budget for 2018 and 0.7 p.p. down on the 2018 Stability Programme forecast. Compared to the previous year, the debt ratio fell by 3.3 p.p. of GDP. The major contributor to this outcome was the primary balance (3 p.p.), followed by the dynamic effect (0.9 p.p.) which more than offset the unfavourable impact of the stock-flow adjustment (0.6 p.p.).

As for borrowing, the non-resident sector continued to be Portugal's largest creditor, holding 67% of total public debt. This is due, on the one hand, to the slight reduction in debt under the Economic and Financial Assistance Programme (from 23% in 2017 to 21% in 2018) as the IMF loan was repaid and, on the other hand, by the purchases made under the European Central Bank's Public Sector Purchase Programme. In the resident sector, which holds 33% of public debt, the financial sector continues to hold around 20% of Portuguese public debt.

Table 1 – Public Finance indicators (% of GDP)

	2012	2013	2014	2015	2016	2017	2018
Total Revenue	**42,9**	**45,1**	**44,6**	**43,8**	**42,8**	**42,7**	**43,5**
Current revenue	**41,1**	**44,0**	**43,6**	**43,0**	**42,3**	**42,3**	**43,1**
Tax Revenue	22,9	25,1	25,2	25,4	24,9	25,1	25,7
Indirect taxes	13,9	13,7	14,2	14,5	14,7	14,9	15,3
Direct taxes	9,0	11,4	11,0	10,9	10,2	10,1	10,4
Social Contributions	11,4	12,0	11,8	11,6	11,6	11,7	11,8
Sales and other current revenue	6,9	6,8	6,6	6,1	5,8	5,6	5,5
Capital Revenue	**1,8**	**1,1**	**1,0**	**0,8**	**0,6**	**0,4**	**0,4**
Total Expenditure	**48,5**	**49,9**	**51,8**	**48,2**	**44,8**	**45,7**	**44,0**
Primary Expenditure	**43,6**	**45,1**	**46,9**	**43,6**	**40,6**	**41,8**	**40,5**
Current primary expenditure	**40,4**	**41,9**	**40,7**	**39,4**	**38,7**	**37,4**	**37,3**
Intermediate consumption	5,8	5,6	5,7	5,6	5,5	5,4	5,4
Compensation of employees	11,7	12,5	11,9	11,3	11,2	10,9	10,8
Social Benedits	19,6	20,4	19,7	19,3	18,9	18,3	18,2
Subsidies and other current expenditure	3,3	3,3	3,4	3,2	3,1	2,7	2,9
Capital expenditure	**3,3**	**3,2**	**6,2**	**4,3**	**1,9**	**4,4**	**3,2**
Primary balance	-0,8	0,0	-2,3	0,2	2,2	0,9	3,0
Interest	4,9	4,9	4,9	4,6	4,2	3,8	3,4
Headline Budget balance	**-5,7**	**-4,8**	**-7,2**	**-4,4**	**-2,0**	**-3,0**	**-0,5**
One-off and temporary measures	-0,1	0,3	-3,6	-1,3	0,4	-2,2	-0,5
Adjusted budget balance from one-offs	**-5,6**	**-5,2**	**-3,6**	**-3,1**	**-2,4**	**-0,8**	**0,0**
Cyclical component	-2,1	-2,2	-1,7	-0,9	-0,3	0,4	0,7
Structural balance	**-3,5**	**-3,0**	**-1,9**	**-2,2**	**-2,1**	**-1,2**	**-0,7**
Change in structural balance	3,1	0,5	1,0	-0,3	0,1	0,8	0,6
Primary Structural Balance	**1,4**	**1,9**	**3,0**	**2,4**	**2,1**	**2,6**	**2,8**
Change in structural balance	3,6	0,5	1,1	-0,6	-0,3	0,5	0,2
Public debt	**126,2**	**129,0**	**130,6**	**128,8**	**129,2**	**124,8**	**121,5**
Change in public debt, breakdown:	14,8	2,8	1,6	-1,8	0,5	-4,5	-3,3
Primary deficit	0,8	0,0	2,3	-0,2	-2,2	-0,9	-3,0
Dynamic effect or snowball effect	10,0	3,5	2,8	-0,3	-0,4	-1,6	-0,9
Stock-flow adjustment	4,0	-0,6	-3,5	-1,4	3,1	-2,0	0,6
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Implicit interest rate	*4,2%*	*3,9%*	*3,9%*	*3,7%*	*3,4%*	*3,1%*	*2,9%*
Other fiscal indicators							
Tax burden	31,7	34,0	34,2	34,4	34,0	34,3	35,2
Current expenditure	45,3	46,8	45,6	43,9	42,9	41,3	40,8
Public Consumption	18,5	19,1	18,6	18,1	17,9	17,5	17,3

Source: INE, BoP and CFP calculations. | Note: (i) the figures for 2012 to 2018 are influenced by the effect of one-off measures as described in Table 20 below. Table 18, also below, sets out the account net of one-off measures for 2017 and 2018; (ii) The changes were calculated in comparison to the previous year and may not match the differences in the figures as a percentage of GDP due to rounding; (iii) The cyclical component was calculated according to the EC's common methodology for (new) semi-elasticities, based on the output gap resulting from the macroeconomic projections in the CFP report "Position and Constraints" published in March 2019.