Executive Summary

Analysis of the Stability Programme 2019-2023

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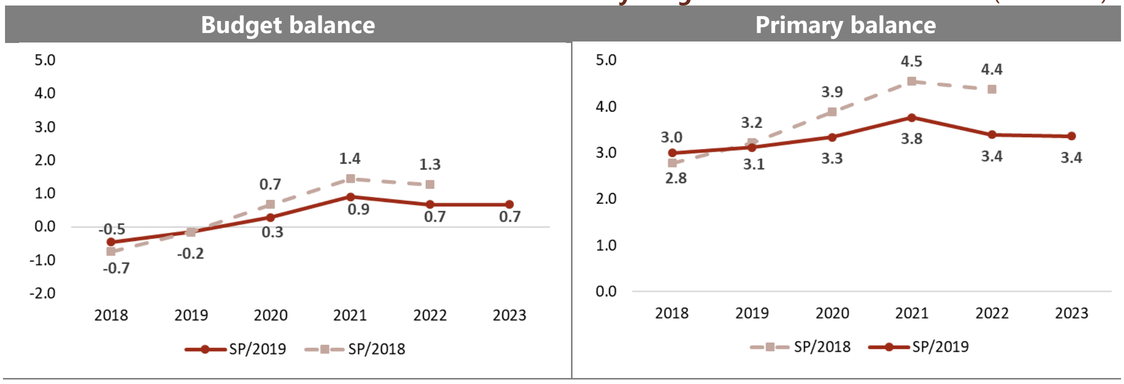
EXECUTIVE SUMMARY

The Stability Programme 2019-2023 (SP/2019) foresees an improvement in the trajectory of the budget balance, that should reach a surplus from 2020 onwards. However, compared to the April SP/2018, the trajectory of the overall balance and the primary balance was revised downwards.

General Government Balance forecast in the Stability Programmes of 2018 and 2019 (% of GDP)



Source: INE and Ministry of Finance. CFP calculations. | Note: non-adjusted values.

The exception is 2019 since the deficit forecast of 0.2% of GDP is maintained, despite the impact of the Novo Banco capital injection which is 749 M€ larger than foreseen in SB/2019. This is achieved through an upward revision in revenue and a lower forecast for public investment (GFCF). Over the three-year period 2020-2022, smaller budget surpluses are expected (-0.5 p.p. of GDP/year on average), even if expenditure on interest is being revised downwards (-0.3 p.p. of GDP/year on average). Therefore, the forecasts for the primary balance over that period are revised further downwards (-0.8 p.p. of GDP/year on average).

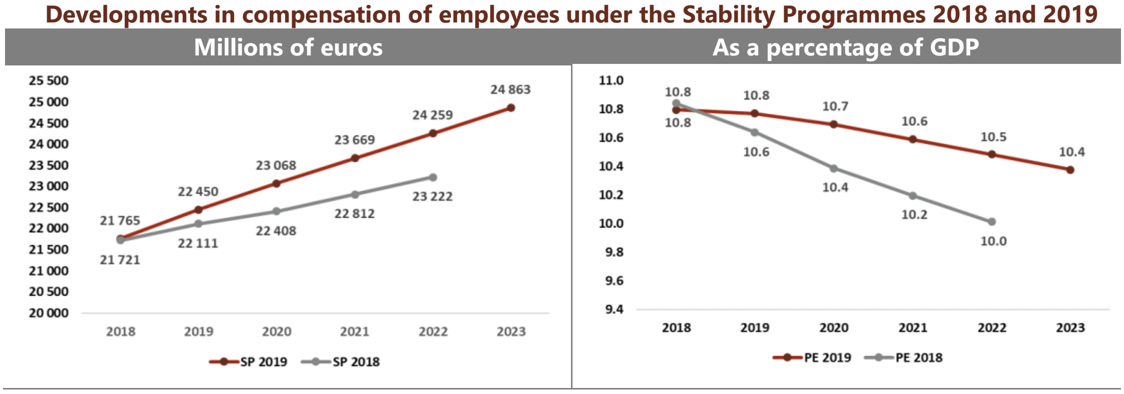
In net terms, the new policy measures contribute just marginally to the budget balance improvement between 2019 and 2023. From 2020 onwards, the Ministry of Finance expects that the overall effect of the policy measures represents an improvement of just 66 M€ in the budget balance.

From 2018 to the end of the forecast time horizon, the relative weight of General Government revenue is expected to fall by 0.5 p.p. of GDP, and a slight decrease in the tax burden is expected – down 0.4 p.p. of GDP, after having reached 35.2% of nominal GDP in 2018.

SP/2019 foresees a smaller decrease in the weight of public expenditure in GDP than in the previous Programme, due to the contributions of both primary expenditure and interest. The Ministry of Finance expects that compensation of employees and social benefits, which together accounted for around two-thirds of public expenditure in 2018 (29.0% of GDP) will contribute to the decline in the expenditure ratio up to 2023 (of -0.4 and -0.2 p.p. of GDP, respectively).

However, until 2023 the Ministry of Finance predicts nominal increases in compensation of employees and social benefits, although they are accommodated by the higher growth foreseen for nominal GDP. Regarding compensation of employees, for 2022 the Programme considers an additional expenditure of 0.5 p.p. of GDP compared to the amount forecast in SP/2018 (an upward revision of 1 037 M€). For social benefits, the increase is of 0.4 p.p. of GDP or 869 M€ that year, of which 531 M€ relate to social transfers in kind (including support for tariff reduction of public transport and the system of gratuity of textbooks in state's basic education and secondary schools).

Developments in compensation of employees under the Stability Programmes 2018 and 2019



From 2018 to 2023, SP/2019 predicts a decrease in the public debt ratio from 121.5% to 99.6% of GDP, although at a slower rate than stated in the previous budgetary planning document. The forecast for the primary balance explains over three-quarters of the decrease in the public debt ratio.

As regards structural adjustment, SP/2019 points to less favourable structural balances between 2020 and 2022 (down 0.7 p.p. of GDP) compared with those foreseen in the SP/2018. Taking into consideration the macroeconomic scenario underlying SP/2019, the planned improvement in the structural balance forecast for 2019 suggests there is a risk of a deviation from the adjustment path recommended by the EU Council.

The *ex-ante* assessment conducted by the CFP on SP/2019 points to a risk of a deviation from the adjustment path recommended to meet the Medium-Term Objective (MTO), which is not the case in 2020, as the MTO will be achieved and exceeded that year. For the later years of the Programme the Ministry of Finance foresees a budget position that is above the MTO.

Also, in regard to 2019, the progress forecast by the Ministry of Finance is not consistent with the expenditure benchmark set by the European Council and even constitutes a risk of a significant deviation, since, unlike the structural balance, this indicator does not benefit from the decrease in interest charges nor from the unexpected revenue gains.

The debt ratio developments forecast by the Ministry of Finance suggests Portugal will comply with the transitional debt rule in 2019 and with the general rule from 2020 until the end of the forecast time horizon.

As regards fiscal risks, the budget balance performance depends, on the achievement of forecast revenue, and on the ability to implement policy measures that contain expenditure growth. Revenue developments are subject to the risks underlying the macroeconomic forecasts contained in SP/2019, which were stressed by the CFP in its Opinion1/2019 of 15 April. A more unfavourable macroeconomic scenario would be reflected in the public finance path with a negative impact on the budget balance and public debt.

On the expenditure side, the CFP has repeatedly drawn attention to the risk associated with fiscal pressures on the rigid expenditure items (wages and social benefits). The upward revision in compensation of employees presented in this SP, compared to earlier ones, confirms that these pressures exist and recent developments in this area suggest that forecasts presented are likely to be optimistic.

In addition to the risks from policy measures, there are also pressures regarding the potential impact of support for the financial sector. In the case of Novo Banco, the MF projections only take into account partial use of the amount available under the Contingent Capitalisation Mechanism (2 941 M€ out of a total of 3 890 M€). Public finance faces an additional risk, since Novo Banco's total capital ratio could fall below the capital requirement demanded by the supervisory authority. In such case the State might have to provide additional funds in order for the bank to comply with the Capital Backstop.