Conselho das Finanças Públicas

ECONOMIC AND FISCAL OUTLOOK 2023-2027

EXECUTIVE SUMMARY

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Macroeconomic outlook

This scenario is developed in a context in which the Portuguese economy is still affected by the high geopolitical uncertainty stemming from the Russian military aggression in Ukraine, by the impact of persistent inflationary pressures, despite the anticipation of its gradual fading, and by the deteriorating financing conditions of the economy. The exercise was concluded ahead of recent developments in banking institutions in the US and Switzerland and the latest monetary policy decisions by the European Central Bank (ECB).

The CFP macroeconomic scenario projects a significant deceleration of 5.5 p.p. in the growth rate of real gross domestic product (GDP), to 1.2% in 2023 (6.7% in 2022). For 2024 and 2025, the scenario forecasts a recovery in the growth rate of real GDP to 1.8% and 2.0%, respectively. In the medium term, and under a no-policy-change assumption, the growth rate of economic activity is expected to converge towards the growth rate of potential output (1.7%).

The deceleration projected for 2023 stems from the reduction in the contribution of both domestic demand and net exports. The dynamics of domestic demand is mainly driven by the anticipation of a significant deceleration of private consumption to 0.4% (5.7% in 2022) and, with less intensity, of gross fixed capital formation (GFCF) to 2.3% (2.7% in 2022). These result from the persistence of high levels of uncertainty and inflation, as well as from deteriorating financing conditions, which contribute to the erosion of consumer's purchasing power and the delay of investment decisions by the entrepreneurs.

The acceleration in the absorption of European funds associated with the Recovery and Resilience Plan (RRP) should affect the acceleration of the growth rate of total GFCF– albeit mostly through its public component – to 4.2% in 2024 and 5.1% in 2025. The gradual recovery path for private consumption should start from 2024 (0.7%), stabilizing around 1.2% in the medium term, along with the gradual decrease of inflationary pressures and the stabilization of interest rates.

Regarding exports of goods and services, it is estimated a considerable deceleration of 14.4 p.p. to 2.3% in 2023, reflecting an international landscape characterized by a slowdown in external demand and a slower recovery of market shares , despite some positive impact due to the expectation of decreasing inflationary pressures on commodity prices. For 2024 the GDP growth rate is projected to recover to 3.9%, consistent with the improvement in the international environment, and stabilize, in the medium term, at around 3.2%.

For the labour market, the pace of job creation is expected to decrease to 0.2% in 2023 ,and recover, in 2024, to 0.4%, reflecting the dynamics of economic activity projected for the period. The unemployment rate is expected to rise to 6.4% of the labour force in 2023 and to stabilise at this level in 2024, conditioned by a rising trend in the participation rate in the short term, in line with the recent dynamics of this indicator. In the medium term, the scenario forecasts a stabilization of the level of employment and a gradual reduction of the unemployment rate to 5.8%, reflecting demographic dynamics.

For inflation, the current scenario anticipates a gradual reduction in inflationary pressures over 2023 and 2024, projecting a deceleration in the growth of the Harmonized Index of Consumer Prices (HICP) to 5.9% in 2023 and 3.1% in 2024. The normalization of monetary policy by the European Central Bank, as well as the progressive fading of supply constraints should further contribute to reduce inflationary pressures over the forecast horizon.

Fiscal Outlook

Based on this macroeconomic scenario, the CFP presents the fiscal projection in a no policy change scenario, which, by definition, does not consider new policy measures, nor measures already announced but not legislated or quantified.

The projection points to a path of correction of the fiscal imbalance reaching a balanced position from 2025 onwards. This path increases the safety margin with respect to the 3% of GDP deficit limit, allowing for normal cyclical fluctuations without incurring in an excessive deficit situation.

The high growth of economic activity in 2022 and the effect of inflation on the increase in tax revenue contributed to a better budget result than that forecast by the Ministry of Finance (MF), which estimated a deficit of 1.9% of GDP. The CFP's budget estimate for 2022 points to a deficit of 0.5% of GDP. However, for 2023 the budget deficit is projected to increase to 0.6% of GDP due to the strong slowdown in economic growth, the impact of the implementation of energy-related measures, and the increase in civil service salaries. For 2024 a reduction in the budget deficit to 0.1% of GDP is anticipated, influenced mainly by the dissipation of the effect of the measures in response to the rise in fuel and energy prices, with a return to the pre-pandemic position with a stabilization in a balanced budget position being forecast for the following three years.

The CFP's fiscal scenario anticipates a decrease in the weight of public expenditure in nominal GDP between 2023 and 2027, from 45% to 43.4% of GDP. This evolution is entirely justified by the downward dynamic of current primary expenditure (-2.1 p.p.), given that capital expenditure should increase its share of GDP (+0.6 p.p.) as well as the interest burden (+0.5 p.p.). It should also be noted that the reduction projected for current primary expenditure in 2023 and 2024 is determined by the macroeconomic framework implicit in the fiscal scenario, by the new policy measures included in the State Budget for 2023, but also by the reversal: (i) of the emergency measures caused by the effect of the pandemic; (ii) of some measures to mitigate the geopolitical shock and (iii) of the measures to support household income and with effect only in 2022.

Total revenue is projected to decline by 0.6 p.p. of GDP over the time horizon, to 43.4% of GDP in 2027. The evolution of revenue shall be determined by the evolution of current revenue (-0.9 p.p. of GDP between 2022 and 2027), given that the share of GDP held by capital revenue is forecast to increase (+0.4 p.p.). The expected values for revenue are influenced by the intertemporal profile of transfers received relative to the RRP and structural funds throughout the projection horizon, particularly in the budget headings "capital revenue" and "other current revenue", having a neutral effect on the budgetary balance.

After in 2022 the debt ratio settled below the pre-pandemic period of 2019, this indicator is expected to decline by 18 p.p. over the projected horizon, reaching 95.9% of GDP in 2027. Between 2023 and 2027, the debt trajectory is essentially determined by a favourable dynamic effect, which shows a higher contribution from GDP growth (of -22 p.p. of GDP in accumulated terms) than from the interest rate (11.9 p.p. of GDP in accumulated terms). The primary balance effect should contribute 11.3 p.p. of GDP to the decrease of the ratio. A sensitivity analysis that increases the financing costs by 50 basis points in each year of this period indicates an impact of 0.5 p.p. of GDP on the public debt ratio at the end of the projection time horizon.

Risks

The current macroeconomic scenario by the CFP is characterized by high uncertainty, with risks mainly leaning upwards for the inflation rate and downwards for the economic activity. The persistence of the war in Ukraine, the rise in commodity prices due to China's economic reopening, the possible easing of inflationary expectations over the medium term and the transmission of inflationary dynamics to the less volatile components of the consumer price index (CPI) may lead to a higher and more persistent inflation rate than currently projected by the CFP. Consequently, the monetary authorities of the largest economies may accelerate the pace of monetary policy normalisation, harming both domestic demand, due to the impact that the rise of interest rates has on an a highly indebted economy, such as Portugal, and external demand, due to a slowdown of the economies of the main trading partners of the Portuguese economy. Finally, and notwithstanding the fact that the present scenario already envisages an implementation rate of the RRP below 100%, it should be noted that the implementation may still be lower than the assumed threshold, which would jeopardise the current projection for the real GFCF.

At the budgetary level, it is necessary to take into account the possibility that the trajectory for the General Government balance may prove less favourable, due to the effect of automatic stabilisers, in a context of high uncertainty regarding macroeconomic projections. In this context, reference should be made to the pressure on current primary expenditure, namely social transfers and compensation of employees.

Additionally, over the horizon of the CFP budgetary projection, some risks remain that may penalise the budgetary balance, arising, namely, from: i) requests by concessionaries of public-private partnerships to restore the financial balance; ii) the possibility of default by beneficiaries of public guarantees; iii) the ongoing restructuring process of the TAP and SATA groups may entail additional financial support; iv) disputes regarding the amount attributable to deferred tax assets; v) the possible use, even if partial, of the remaining amount of 485 M€ under the Novo Banco Contingent Capitalisation Agreement, even if the restructuring process has already been finalised; vi) the timeliness and definitive terms of the sale of the public holding in EFACEC.