Executive Summary

Public Finance:

Position and Constraints 2019-2023 (Update)

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EXECUTIVE SUMMARY

CFP projections for the Portuguese economy point to a continued slowdown in economic activity in the period of 2019-2023.

In a no-policy change scenario, the reduction in real GDP growth observed in 2018 is expected to continue over the medium term: from 1.9% in 2019 to 1.5% in 2023.

Overview of the macroeconomic scenario of the CFP (change, %)

	2018	2019	2020	2021	2022	2023
Gross Domestic Product	2.4	1.9	1.7	1.7	1.6	1.5
Private consumption	3.1	2.1	1.9	1.8	1.5	1.4
Public consumption	0.9	0.7	1.2	1.0	1.1	1.2
Gross Fixed Capital Formation	5.8	7.6	5.2	4.0	3.2	3.0
Exports	3.8	2.7	3.1	3.3	3.5	3.2
Imports	5.8	4.6	4.0	4.0	3.8	3.6
Domestic demand (p.p.)	3.2	2.7	2.1	2.0	1.8	1.7
Net exports (p.p.)	-0.8	-0.8	-0.4	-0.3	-0.2	-0.2
Unemployment rate (% active pop.)	7.0	6.2	6.0	6.0	6.0	5.9
Employment	2.3	1.2	0.6	0.5	0.3	0.3
Net lending (% GDP)	1.2	0.4	0.0	-0.2	-0.5	-0.7
Balance of goods and services (% GDP)	0.1	-0.6	-1.0	-1.2	-1.4	-1.7
GDP deflator	1.6	1.3	1.1	1.1	1.1	1.1
HICP	1.2	0.3	0.6	1.1	1.2	1.2
Output gap (% potential GDP)	1.7	1.6	1.1	0.8	0.6	0.3

Sources: INE (2018) and CFP projections (2019-2023).

The reduction expected for 2019 reflects, on the one hand, the slowdown in export growth due to a less favourable international environment and external demand and, on the other, the moderation of the expansion of domestic demand, in particular private consumption.

The projected growth path represents a scenario of convergence of the economy over the medium term to its potential. This perspective indicates the maturing of the expansion phase of the economic cycle and the existence of constraints to potential growth of the Portuguese economy, namely low productivity, insufficient investment to restore the capital stock and the ratio of investment to GDP to pre-crisis levels in 2009 and unfavourable demographic trends.

The contribution of domestic demand to GDP growth is expected to slow down over the projection horizon, from 3.2 p.p. in 2018 to 2.7 p.p. in 2019 and gradually to 1.7 p.p. in 2023. Net exports are expected to maintain their negative contribution to growth at -0.8 p.p. in 2019, with a gradual recovery to -0.2 p.p. by 2023. This dynamic is reflected in the deterioration of the balance of goods and services from 2019 onwards, which will turn into a negative balance, as well as a negative external balance from 2021 onwards.

An analysis of the contributions of GDP components net of imports reveals that private consumption and exports are the main growth factors of the Portuguese economy in the projections.

The evolution of the economic activity should be accompanied by an improvement in labour market conditions in 2019, with projected growth of 1.2% in employment and a reduction in the unemployment rate to 6.2%. In the medium term, progressively lower growth in employment is anticipated, from 0.6% in 2020 to 0.3% in 2023, which is reflected in the stabilisation of the unemployment rate at around 6.0%. In turn, this scenario projects an inflation (measured by the HCPI growth rate) of 0.3% for 2019, an acceleration to 0.6% in 2020 and a stabilization at 1.2% in the medium term.

The current medium-term budgetary scenario points to a budget surplus of 0.1% of GDP in the current year, anticipating by one year the MF's forecast for the elimination of the budgetary imbalance. In the absence of further policy measures, the medium-term projection of the CFP shows positive budgetary balances until 2023.

CFP fiscal projections (% GDP), no-policy change scenario

	2018	2019	2020	2021	2022	2023
Total revenue	**43.0**	**43.5**	**43.4**	**43.6**	**43.0**	**42.7**
Current revenue	42.6	43.1	42.9	42.7	42.5	42.2
Tax revenue	25.3	25.4	25.4	25.3	25.3	25.3
Indirect taxes	15.2	15.3	15.3	15.4	15.4	15.4
Direct taxes	10.1	10.1	10.0	10.0	9.9	9.9
Social contributions	11.7	12.0	11.9	11.9	11.8	11.7
Sales and other current revenue	5.6	5.7	5.6	5.5	5.4	5.3
Capital revenue	0.4	0.4	0.5	0.9	0.5	0.5
Total expenditure	**43.5**	**43.4**	**43.0**	**42.8**	**42.6**	**42.5**
Primary expenditure	**40.1**	**40.3**	**39.9**	**39.8**	**39.7**	**39.6**
Primary current expenditure	**37.0**	**37.1**	**36.9**	**36.6**	**36.4**	**36.2**
Intermediate consumption	5.4	5.1	5.1	5.1	5.1	5.1
Compensation of employees	10.7	10.8	10.8	10.7	10.5	10.4
Social benefits	18.2	18.3	18.2	18.0	17.9	17.9
Subsidies and other current expenditure	2.6	2.8	2.8	2.8	2.8	2.8
Capital expenditure	**3.1**	**3.1**	**3.0**	**3.2**	**3.3**	**3.4**
Primary balance	**2.9**	**3.3**	**3.4**	**3.8**	**3.3**	**3.1**
Interest	3.4	3.1	3.1	3.0	2.9	2.9
Budget balance	**-0.4**	**0.1**	**0.3**	**0.8**	**0.3**	**0.2**
Adjusted Budget balance from one-off measures	**0.0**	**0.7**	**0.6**	**0.5**	**0.3**	**0.2**
Structural balance	**-0.9**	**-0.2**	**0.0**	**0.1**	**0.0**	**0.0**
Public Debt	**122.2**	**118.5**	**116.2**	**112.5**	**108.9**	**106.5**

Sources: INE, BdP (2018) and CFP projections (2019-2023).

The path of fiscal aggregates points to a reduction in the share of total public revenue and expenditure by 0.9 p.p. of GDP over the projection period. These developments reflect a lower nominal growth of the components of these aggregates than of their macroeconomic bases.

The reduction in current primary expenditure explains the reduction in the share of expenditure in GDP, reflecting the reduction in the share of compensation of employees costs (by 0.4 p.p. of GDP), social benefits (by 0.4 p.p. of GDP) and intermediate consumption (by 0.1 p.p. of GDP). In the opposite direction, capital expenditure is expected to increase by 0.3

p.p. of GDP, as a result of a greater execution of projects financed by EU funds, the recovery of the General Government capital stock and the strengthening of public investment in the field of infrastructure and a higher amount of capital injections into Novo Banco by activation of the Contingent Capital Facility.

Interest expenditure is expected to decline by 0.3 p.p. of GDP in the period from 2019 to 2023. This downward trajectory, which benefits the fiscal balance, is determined by the projected evolution of the stock of public debt, the favourable evolution of interest rates and the effect of nominal GDP growth.

The expected behaviour of total general Public Administration revenue for the period under review also points to a reduction of 0.9 p.p. of GDP, fully reflecting the expected evolution of current revenue with capital revenue remaining stable vis-à-vis GDP growth. In this period, tax revenue is expected to decline by 0.2 p.p. of GDP, to which direct taxes contribute fully, since indirect taxes are expected to increase their share by 0.1 p.p.

The CFP projects a decrease in the public debt-to-GDP ratio from 122.2% at the end of 2018 to 106.5% in 2023, a reduction of 15.7 p.p. of GDP compared to a 9 p.p. decrease in the previous five years.

As part of the assessment of compliance with the requirements of the preventive arm of the Stability and Growth Pact (SGP), budget surpluses are projected to increase the safety margin with respect to the 3% of GDP ratio to the nominal government deficit. Thus, the Medium-Term Objective (MTO) is expected to be achieved in 2020 and maintained over the remaining projection horizon, with the stabilisation of a structural balanced fiscal position. In parallel with these developments, compliance with the rule to correct excess debt in the period 2019 to 2023 should also be ensured.

The CFP anticipates an external environment with modest growth in the global economy, in particular in the euro area. The risks associated with the projections are essentially associated with the international economic context, namely those resulting from the tensions of protectionist escalation, the deceleration of the Chinese economy, the uncertainty associated with Brexit and the tensions in the Middle East, in particular (i) the effects of the deceleration of the economy on the evolution of tax revenue, (ii) the potential impact of measures to support the financial sector and public sector entities (such as SATA Air Açores), and (iii) the implementation of budgetary pressures on the more rigid components of public expenditure (expenditure on social benefits and personnel expenditure) as risks.