Executive Summary

Fiscal developments until the 3rd quarter of 2018

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EXECUTIVE SUMMARY

Over the first three quarters of the year the general government budget balance recorded, for the first time, a surplus of 1 111 M€, equal to 0.7% of the Gross Domestic Product (GDP) generated over the period. This outcome, which already includes the net negative impact on the balance of temporary measures totalling 784 M€ (0.5% of the GDP over the period), reflects performance unparalleled in the quarterly statistics published by the INE since 1995. In that quarter, the general government balance recorded a surplus of 3082 M€ (that is to say, 6.0% of the GDP generated over the period), driven by a primary surplus of 4 900 M€ (equal to 9.6% of GDP), which was sufficient to reverse the deficit (2.0% of GDP) recorded in the first half of the year.

This change reflects revenue's favourable performance, where the increase in year-on-year terms represents more than double the increase in expenditure which, for the purposes of this analysis, does not consider the fiscal impact of the recapitalisation of the Caixa Geral de Depósitos (CGD) bank that took place in 2017. Excluding the effect of that transaction, the accumulated budget balance at the end of September recorded a year-on-year improvement of 1 859 M€, equal to 1.3 p.p. of GDP, which was almost entirely due to the contribution from the central government subsector.

The primary balance, which excludes interest charges, stood at 6 320 M€ up to September, which is another highest for the statistics available since 1995. That outcome reflects an accumulated year-on-year improvement of 1 493 M€ and consolidates the primary surpluses trend seen since the 3rd quarter of 2015.

After three quarters, revenue continues to be the aggregate that determines the improvement in the budget balance. Over this period general government (GG) revenue recorded accumulated year-on-year growth of 5.4%, higher than the Ministry of Finance estimate (MF) for 2018 (4.9%). Tax and contributions revenue was responsible for around 90% of the improvement. The rate of growth in direct taxes (6.3%) and indirect taxes (5.9%) was higher than the latest annual goal set by the MF for 2018 and accounted for two-thirds of the rise in GG revenue.

The dissipation of the negative impact of the early repayment of PIT refunds, which penalised that tax's net revenue in the first half of 2018, combined with the reduced CIT revenue from self-settlement in the 2nd quarter due to the postponing of the deadline for delivering periodic CIT returns, explains these taxes recovery and their larger contribution to the growth in tax revenue in the 3rd quarter, which led to higher accumulated growth than estimated by the MF for 2018.

As for indirect taxes, VAT revenue accounted for over half of the increase seen in indirect tax revenue up to September, which also represents higher growth than that expected by the MF for the year as a whole. The recovery in the labour market indicators continued to have a favourable influence on the growth in social contributions (4.2%). This rise was entirely the result of the positive change in actual social contributions (6.3%), since imputed social contributions fell by 3.3%, partially due to the change in the way Christmas bonuses were paid to general government employees.

Up to September non-tax and non-contributions revenue recorded growth of 4.5%, reflecting the its components' positive contributions, in particular that of sales where the actual growth (5.7%) was practically double the Ministry of Finance forecast (3%), and also capital revenue which benefitted in the 3rd quarter from the partial recovery of the State guarantee given to Banco Privado Português in 2010 (166.3 M€). Despite these developments, growth in non-tax and non-contributions revenue up to September was 1.5 p.p. below the MF estimate for 2018.

As for expenditure, year-on-year growth went from 3.0% in the 1st half of the year to 2.3% for the first three quarters of 2018 as a whole. This slowdown is explained by the more moderate growth in expenditure in the 3rd quarter. The lower growth also reflects the unfavourable 913.4 M€ impact in the 2nd quarter of 2018 stemming from the Novo Banco recapitalisation and the execution of guarantees relating to a group of investors commonly known as the "BES offended parties".

The increase in expenditure up to the end of the 3rd quarter of 2018 was around half that foreseen in the latest MF estimate (4.4%), having benefitted from the change in the way Christmas bonuses are paid. Excluding the effect of this change (which explains the decreases seen in compensation of employees and social transfers, when compared to the estimated annual increase in both items), the only expenditure item that experienced a year-on-year decrease was that relating to interest charges, which up to September declined at a slightly higher rate than forecast in the MF estimate. Intermediate consumption grew in line with the forecast in the MF estimate (2.2%), although the rate of growth in Gross Fixed Capital Formation up to the end of the 3rd quarter of 2018 (11.8%) fell short of the annual increase foreseen in that estimate (16.3%).

The public debt ratio remained at 125% of GDP, since in the 3rd quarter the growth recorded in the nominal value of debt was the same as that of nominal GDP (0.9%). Despite the stabilisation of the debt ratio, it still exceeds the MF forecasts set out in SB/2018 (123.5% of GDP) and in SP/2018 (122.2% of GDP), and the latest estimate for 2018 (121.2%), put forward in SB/2019. Public debt net of central government deposits fell by 2.9 p.p. of GDP, to stand at 115.3% at the end of the quarter under review. That change is explained by the 3 p.p. of GDP growth in central government deposits, considering the early repayment of the International Monetary Fund loan made in December and the maintaining of a financial reserve that provides prudent cover for borrowing requirements over the next twelve months. Therefore, the increase in cash and bank deposits (6 142 M€) had the greatest impact on the stock-flow adjustment (5 249 M€) whose effect on the nominal increase in debt (2 167 M€) was, nonetheless, mitigated by the budget surplus recorded in the 3rd quarter.

For the year as a whole, the fiscal developments up to the end of the 3rd quarter plus the public accounts information currently available (October and November), albeit incomplete, point to a smaller deficit in 2018 than the latest Ministry of Finance estimate (which points to a 0.7% of GDP deficit), published in DSB/2019, and is in line with the CFP estimate published in September (a deficit of 0.5% of GDP). This expectation is built upon the favourable outlook for both tax and contributions revenue, and a lower level of spending on social transfers in cash than estimated by the Ministry of Finance. That estimate assumes there are no significant changes in the public finance management mechanisms and only considers the partial recovery of the State guarantee given to Banco Privado Português. However, if that bank guarantee were to be fully recovered, it would have an additional favourable impact of 0.1% of GDP.

As regards debt, the available information suggests that in the final quarter of the year, the debt ratio will return to the downward path and converge on the new MF estimate. The early repayment of the IMF loan made in December will have contributed to this development. The achieving of the new MF estimate (121.2% of GDP) requires that, in that quarter, the public debt ratio fell by 3.8 p.p. of GDP. In annual terms, the achieving of that objective means a decrease of 3.6 p.p. of GDP, a figure that compares with the 3.4 p.p. decrease in debt put forward by the CFP in September and which would place the debt ratio at the end of the 2018 (121.3% GDP) practically in line with the MF estimate.