

ANALYSIS OF THE DRAFT STATE BUDGET FOR 2027

EXECUTIVE SUMMARY

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Balance, fiscal policy stance and net expenditure

The fiscal forecast underlying the Draft State Budget for 2027 (DSB/2027) points to a surplus of 0.1% of GDP in 2027, an improvement of 0.1 percentage points compared with the Government's estimate for 2026. The reduction in expenditure (3.0 percentage points of GDP) is slightly greater than that in revenue (2.9 percentage points), reflecting above all the end of loan-financed RRP expenditure.

The DSB/2027 Budget Plan forecasts a further widening of the central government deficit to 2.8% of GDP, the highest level since 2017, excluding the pandemic period. As in the previous year, this widening is offset mainly by the surplus of the Social Security Funds (FSS), and to a lesser extent by the surplus of regional and local government. However, unlike in 2025, the surplus of the Social Security Funds (FSS) is not sufficient to fully offset the Central Government deficit. Consequently, fiscal performance remains dependent on the FSS sub-sector, a sub-sector particularly exposed to the vagaries of the economic cycle.

Net Expenditure

The DSB/2027 Report indicates that the net expenditure trajectory will be met in 2027; however, this depends on methodological assumptions that significantly influence the calculation of the cumulative deviation. The DSB/2027 Report presented by the Ministry of Finance forecasts a cumulative deviation of 0.5% of GDP for 2027 after defence flexibility and 0.9% of GDP before flexibility. However, this figure for the cumulative deviation, which is below the 0.6% of GDP threshold permitted in the control account, is sensitive to certain methodological choices. Furthermore, the DSB/2027 Report does not include sufficient information to support the claim that the cumulative increase in defence expenditure (in national accounts) will amount to 0.4 percentage points of GDP compared with 2021.

Projected fiscal developments for revenue and expenditure in 2027

In this executive summary, fiscal developments relating to revenue and expenditure are net of the RRP effect, given that this programme ends in 2026.

The forecast for public revenue is broadly consistent with the macroeconomic scenario of the DSB/2027, which projects a stabilisation of the tax burden. According to the Ministry of Finance, in 2027 the share of public revenue will fall by 0.1 percentage points of GDP. The tax burden is expected to remain at 35% of GDP, with the increase in the share of actual social security contributions (0.3 percentage points of GDP) offsetting a reduction of the same magnitude in tax revenue. Excluding the impact of the policy measures envisaged by the Ministry of Finance, tax and social security revenue would grow by 5.0%, broadly in line with nominal GDP. However, the forecast for PIT partly reflects the positive effect in 2027 of the one-off reduction in withholding tax due to take place in November 2026.

The DSB/2027 points to an increase in public expenditure of 0.4 percentage points of GDP, to 42% of GDP, driven by interest payments. In nominal terms, the projected growth in expenditure excluding the RRP, which slows from 6.9% in 2026 to 5.7% in 2027, stems from trends in primary current expenditure, namely social benefits and staff costs. Capital expenditure is expected to rise by 8.2%, mainly driven by investment funded from domestic sources (excluding RRP loans). As for interest charges, the DSB/2027 points to an increase of €1.5 billion, almost double the figure indicated in the 'unchanged policies' scenario provided by the Ministry of Finance to the Assembly of the Republic on 31 August and above the CFP's projection, which suggests a possible overestimation. Conversely, the fiscal forecast for some expenditure items appears to be underestimated, particularly non-cash social benefits not related to pensions. In the absence of a response to the requests for clarification, it was not possible to assess the consistency of the Ministry of Finance's forecast for capital expenditure components with economic policy measures and the macroeconomic scenario.

Public Debt

The DSB/2027 forecasts that the public debt ratio will fall to 84.5% of GDP in 2027, continuing its downward trajectory. This reduction of 3.0 percentage points of GDP stems from nominal economic growth and the maintenance of primary surpluses, partially offset by an increase in interest expenditure, which rises from 2.0% to 2.4% of GDP, and by a deficit-debt adjustment of 0.9 percentage points of GDP. In absolute terms, public debt increases by €3,000 million. The Ministry of Finance forecasts that the State's gross borrowing requirements will rise by €4,900 million in 2027, mainly due to an increase in net borrowing requirements associated with the acquisition of financial assets and the redemption of Treasury Bonds (OT). OTs remain the main source of funding, but their share of net funding falls to 65% (81% in 2026), with greater recourse to Treasury Bills, against a backdrop of rising market interest rates. In July 2026, the refinancing profile of the portfolio complied with the defined

limits, but the greater weight of Treasury Bills and variable-rate debt increases the exposure of interest charges to movements in market rates.

Assessment of the fiscal scenario in the DSB/2027

An assessment of the fiscal forecast underlying the DSB/2027 suggests that the fiscal trajectory presented by the Ministry of Finance (MF) is plausible. Although factors with a potential impact on the results remain, notably the statistical treatment of the closure of the RRP, the MF's forecast (in line with the CFP's projection) points to a fiscal position close to balance in 2027. The differences between the Ministry of Finance's forecast and the CFP's projection relate mainly to the composition and quantification of certain fiscal aggregates. These differences would be mitigated if the measures not sufficiently specified in the Ministry of Finance's forecast were incorporated.

Based on the updated CFP budget projection, net expenditure in 2026 and 2027 is expected to continue to grow at a rate exceeding the commitment made by the Portuguese State in the National medium-term fiscal-structural plan (MTP). The CFP projects that net expenditure will grow by 7.6% annually in 2026 and by 3.5% in 2027. Taking as a starting point the cumulative deviation in 2025 in the monitoring account established by the European Commission, the cumulative deviation, after taking into account the flexibility associated with the national derogation clause relating to defence expenditure, is expected to amount to 1.1% of GDP in 2026 and 2.0% of GDP in 2027, above the maximum threshold of 0.6% of GDP.

The slowdown in net expenditure growth in 2027 reflects a reduction in the fiscal impulse compared with 2026, giving fiscal policy a restrictive stance. This translates into a fiscal impulse of 0.7% of GDP, driven by expenditure funded by the national budget (0.3% of GDP) and by the reduction in expenditure financed by European funds (0.4% of GDP), linked primarily to the decline in RRP grants. This stance contrasts with that forecast for 2026, a year in which an expansionary fiscal impulse of 1.4% of GDP is estimated.

Fiscal Risks

The fiscal forecast for 2027 entails downside risks. Among the risks identified, the following stand out: (i) lower-than-expected growth in the economy's total wage bill, affecting income from PIT and social security contributions; (ii) a smaller-than-expected impact of the measure to combat fraud in the fuel sector; (iii) the adoption of policy measures that could jeopardise the fiscal targets set out in the DSB/2027; (iv) the possibility that the Resolution Fund may have to compensate certain common creditors and of BES; (v) the materialisation of public expenditure associated with general

government contingent liabilities, relating to claims by private partners in public-private partnerships (PPPs) and other ongoing legal proceedings, as well as public guarantees, notably those relating to the youth housing scheme, those granted to SATA by the Regional Government of the Azores, and those associated with credit lines to private companies.

On the other hand, there are factors that may improve the fiscal outlook. These include: (i) a more favourable than expected trend in prices or economic activity, reflected in tax revenue; (ii) a smaller-than-expected increase in interest charges; and (iii) a more restricted use of expenditure allocations relating to fiscal restraint measures.