Executive Summary

General government budgetary developments until June 2019

CFP Report No. 11/2019

Lisbon, 31 October 2019

EXECUTIVE SUMMARY

Statistics Portugal (INE) preliminary estimate for the general government account in the first half of the year already reflects the incorporation of the new base of national accounts. The statistical revisions resulting from the change in the statistical base in the period 1995-2018, which include, among others, the clarification of the operations recording resulting from the update of the Deficit and Debt Manual (MDD), implied changes not only in the public balance and debt, but also in the level of the tax burden, public consumption and social benefits.

Between 1995 and 2018, the public debt ratio revised on average by 2.7 p.p. of GDP, with the period 2000-2010 concentrating the highest revision value (annual average of 4.4 p.p. of GDP). In terms of the headline budget balance, the year 2003 and the years 2010 to 2014 were those in which the revisions reached their greatest magnitude, ranging from 1.2 p.p. in 2003 to 0.2 p.p. of GDP in 2014.

The largest revisions in indicators expressed as a percentage of GDP occurred in 2017 and 2018 in the tax burden and public consumption. In these years, the effect of the revision of the value justifies around a quarter of the revision of the tax burden and approximately half of the revision of public consumption, the largest contribution being due to the GDP effect, as a result of its upward correction. For example, in 2018 the tax burden was revised 0.5 p.p. of GDP downwards from the previous series, due to the upward revision of nominal GDP (in 2284 M€), but also due to a downward reclassification of sales taxes by 235 M€. Of equal significance is the upward revision of the level of social benefits (annual average of +0.1 p.p. of GDP, or in nominal value +252 M€). This new statistical series increased the weight of social transfers in the structure of public expenditure, on average by around 0.3 p.p..

Reflecting the revision of the statistical basis, in the first half of the year the general government sector recorded a budget deficit of €789 million, corresponding to 0.8% of GDP generated in the first half of the year. This result reflects the recapitalisation of Novo Banco, which penalised public expenditure in the second quarter by €1149 million (i.e. 1.1% of GDP in the six-month period). Excluding the effect of this temporary and non-recurring measure, there would have been a budget surplus of 0.3% of GDP, a result close to the new annual estimate for the corrected balance of those measures (0.5% of GDP) presented in the Draft Budget Plan for 2020 (PPO/2020).

Compared to the same period in 2018, there was an improvement in the balance of 1.4 p.p. of GDP (of € 1366 million), mainly determined by the contributions of the central and local government subsectors. Excluding interest expenditure, the primary balance reached €2404 million in the first half, equivalent to 2.3% of GDP. The year-on-year increase in the primary surplus (1.2 p.p. of GDP) contributed more than four-fifths to the reduction of the budget deficit in the first six months of the year, with interest payments accounting for the remainder.

In this period, the year-on-year growth rate of general government revenue was 5.5%, above the new annual estimate of the Ministry of Finance (MF) of 4.1%, which is included in the PPO/2020. In nominal terms, revenue from general government increased by 2159 M€, mainly supported by the contribution of tax and contributory revenue (1542 M€), in particular tax revenue (924 M€), which accounted for around 60% of this variation. Tax revenue thus recorded a year-on-year rate of change (4.3%) higher than that estimated by the MF for 2019 (2.6%). Taxes contributed to this result, with emphasis, in individual terms, on the growth of net revenue from VAT (474 M€) and of revenue from personal income tax (153 M€). With regard to social contributions, their growth (5.4%), although lower than expected by the MF (6.1%), was exclusively due to the increase in actual social contributions (7%). Non-fiscal and non-contributory revenue made an equally favourable but less significant contribution to growth in general government revenue. This performance is justified by the increase in sales of the Autonomous Funds and Services and Local Government subsectors, as well as by the positive evolution of other current revenue, which reflects the higher volume of dividends distributed by Bank of Portugal and *Caixa Geral de Depósitos* [General Deposits Fund].

Public expenditure increased by 1.9% in the first half of the year, with a slowdown in its growth rate in the second quarter of 2019. The increase up to June is below that implied in the MF estimate for the year as a whole (3.2%) due to a more contained growth in current primary expenditure and a reduction in capital expenditure, in contrast to the increase estimated for the year as a whole. Interest charges decreased year-on-year for the seventeenth consecutive quarter, albeit at a slower pace than that underlying the MF estimate.

The largest contribution to the increase in public expenditure came from social transfers, but the growth rate of this item is below that implied in the MF estimate. Growth in compensation of employees through June is broadly in line with the MF estimate for the year as a whole, despite a sharper pace of wage and salary expenditure. These developments may pose a fiscal risk, given the increasing fiscal pressures in the second half of the year stemming from the unfreezing process schedule and the measure aimed at mitigating the years of service frozen in careers where progression depends on length of service.

Intermediate consumption was the only item of primary current expenditure to record a year-on-year reduction in the first half of the year, diverging from the annual increase estimated by the MF. The "other current expenditure" increased as a result of a higher level of transfers made as a financial contribution from Portugal to the EU budget. In terms of capital expenditure, Gross Fixed Capital Formation (FBCF) is growing below that implied in the MF's recent estimate for 2019. Other capital expenditure" decreased, despite already incorporating the greater impact of the payment of the Resolution Fund to Novo Banco, in the context of the contingent capitalisation mechanism (357 M€ more than in the same period of 2018).

Public debt as a percentage of GDP fell to 121.2% in the year ending in the second quarter of 2019, resuming the downward trend begun in the second quarter of 2018. This result, which reflects a reduction of 2.5 p.p. of GDP in relation to the year ending in the previous quarter, maintains the debt ratio above the most recent estimate for 2019 (119.3% of GDP) presented by the MF under the PPO/2020. Compliance with this estimate implies that in the second half of this year there will be a reduction in that ratio of 1.9 p.p. of GDP. In contrast, net debt of deposits increased by 0.2 p.p. to 115.6% of GDP in the second quarter, justified by a higher decrease in deposits (2.7 p.p. of GDP) than that recorded for the Maastricht debt ratio (2.5 p.p.). This decrease in deposits, which reflects the financing of the repayment of the

Treasury Bond due in June, explains the contribution of the deficit-debt adjustment (-€ 4088 million) to the nominal reduction of public debt, although partly offset by the budget deficit recorded in the second quarter (€ 833 million).

For the year as a whole, the budgetary developments in the first half of the year and the available, albeit incomplete, information for the third quarter suggest that the annual estimate for the balance (of -0.1% of GDP) presented by the MF under the PPO/2020 can be expected to be met or exceeded. This outlook is anchored in the favourable performance of tax and contributory revenue, which remains above expectations (including the most recent estimate of the MF). This outlook is reinforced by the financial inflow obtained from the sale of the former *Feira Popular de Lisboa* land in the first half of the year and the execution of intermediate consumption and investment expenditure, which may be lower than initially forecast. Thus, notwithstanding the existence of factors that may condition fiscal developments until the end of the year, the new estimate of the MF seems to be attainable. Among these factors are, in particular, the costs of wage valuation policy measures in the general government and the continuity of budgetary pressures in the health and education sectors, as well as uncertainty about some measures with an impact on revenue (full recovery of the remainder of the State guarantee provided to Banco Português Privado) and expenditure (results of the measures to review expenditure).

This estimate, which is set around a balanced budget, does not differ significantly from the estimate of the budget surplus (0.1% of GDP) put forward by CFP in the macroeconomic and fiscal scenario update published in October. The difference between the balance foreseen in the DBP and the surplus of 0.1% of GDP estimated by CFP in October is explained both by the MF's update of the value of temporary and non-recurring measures, which impact on the balance is now less favourable, and by the estimated revenue, in which the CFP incorporates a more favourable outlook for tax revenue. Assuming the unchanged average reimbursement terms, in particular VAT, and notwithstanding the update of the impact of *one-off* measures, the CFP maintains the budget surplus estimate of 0.1% of GDP for 2019.

With regard to the evolution of public debt up to the end of the year, the CFP estimate points to a ratio of 118.5% of GDP, 0.8 p.p. of GDP lower than that presented by the MF in its most recent estimate. The difference in the estimate is justified by the profile of debt issues and redemptions considered in the second half of the year.

Table 1 - Public Finance Indicators (in millions of euros)

	2018S1	2019S1	2018	2019 (MF)
BUDGETARY AGGREGATES				
Total Revenue	**38 940**	**41 099**	**87 695**	**91 304**
Current revenue	**38 689**	**40 801**	**86 867**	**90 389**
Tax Revenue	21 606	22 530	51 637	52 972
Indirect taxes	14 573	15 254	30 956	32 037
Direct taxes	7 034	7 277	20 681	20 935
Social Contributions	11 384	12 001	23 835	25 300
Sales and other current revenue	5 699	6 269	11 395	12 117
Capital Revenue	252	298	829	915
Total Expenditure	**41 095**	**41 888**	**88 606**	**91 429**
Primary Expenditure	**37 762**	**38 695**	**81 708**	**84 872**
Current primary expenditure	34 852	35 861	75 399	78 404
Intermediate consumption	5 090	4 976	11 067	11 315
Compensation of employees	10 575	10 958	21 835	22 635
Social Benedits	16 582	17 117	37 099	38 743
Subsidies and other current expenditur	2 605	2 810	5 398	5 711
Capital expenditure	2 911	2 834	6 309	6 468
GFCF	1 481	1 574	3 795	4 162
Other Capital expenditure	1 430	1 259	2 514	2 306
Primary balance	**1 178**	**2 404**	**5 987**	**6 431**
Interest	**3 333**	**3 194**	**6 898**	**6 556**
Headline Budget balance	**-2 155**	**-789**	**-911**	**-125**
% of GDP of the period	**-2.2**	**-0.8**	**-0.4**	**-0.1**
One-off and temporary measures (impact on the b	-942	-1 149	-951	-1 150
impact on revenue	0	0	166	135
impact on expenditure	942	1 149	1 117	1 285
Adjusted budget balance from one-offs	**-1 213**	**360**	**40**	**1 025**
% of GDP of the period	**-1.2**	**0.3**	**0.0**	**0.5**
PUBLIC DEBT				
General government debt (nominal value)	**250 906**	**251 348**	**249 143**	**251 266**
% of GDP (year ended in the quarter)	**125.7**	**121.2**	**122.2**	**119.3**
Currency and deposits	29 950	31 153	30 795	n.d.
Debt securities	147 134	151 313	149 312	n.d.
Loans	73 822	68 882	69 036	n.d.
General government debt (nominal value)	**232 031**	**239 748**	**236 904**	**n.d.**
% of GDP (year ended in the quarter)	**116.2**	**115.6**	**116.2**	**n.d.**
OTHER INDICATORS				
Tax burden	30 663	32 218	70 764	73 428
Public Consumption	16 597	16 919	34 583	35 331
Current expenditure	38 185	39 055	82 297	84 961
Nominal GDP	99 659	103 081	203 896	210 619
Nominal GDP (year ended in the quarter)	199 619	207 318	203 896	210 619

Source: INE, MF. CFP calculations. | Notes: 2019 (MF) - New estimate for 2019 presented in the PPO/2020; n.a.: not available.