ECONOMIC AND FISCAL OUTLOOK 2021-2025

EXECUTIVE SUMMARY

March 2021

Conselho das Finanças Públicas
Portuguese Public Finance Council

Report
NO. 02/2021

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Macroeconomic prospects

In a scenario of unchanged policies, the projects a recovery in real growth of the Portuguese economy to 3.3% in 2021 and to 4.9% in 2022, from a contraction of 7.6% in 2020.

The projected dynamics of economic activity, under unchanged policies, is mainly due to the contributions of private consumption and exports. The gradual acceleration of the growth rate of private consumption is anticipated to 2.7% in 2021 and 6.0% in 2022, reflecting the realization of postponed consumption during the confinement periods, under the assumption of absence of restrictions on the supply side. As for exports of goods and services, growth is estimated to recover to 8.9% in 2021 and to 11.3% in 2022, driven by external demand directed to Portugal, assuming market share gains. In terms of the composition of exports, it is anticipated a more modest dynamic in the recovery of exports of services, associated with a more adverse environment in the tourism sector, in the perspective of the prevalence of restrictions on international travel in the short term.

Summary of the CFP (Public Finance Council) macroeconomic scenario
(change, %)

	2020	2021	2022	2023	2024	2025
Gross Domestic Product	**-7,6**	**3,3**	**4,9**	**2,5**	**2,1**	**1,7**
Private Consumption	-5,9	2,7	6,0	2,8	2,5	1,8
Public Consumption	0,4	3,6	0,6	0,9	0,9	0,9
Gross Fixed Capital Formation	-1,9	3,4	6,0	3,7	2,0	2,0
Exports	-18,6	8,9	11,3	5,0	3,2	3,2
Imports	-12,0	7,6	11,0	5,0	3,3	3,2
Contribution of domestic demand (p.p)	-4,6	3,0	5,0	2,6	2,2	1,8
Contribution of net exports (p.p)	-2,9	0,3	-0,1	-0,1	-0,1	-0,1
Unemployment rate (% of active population)	6,8	8,3	7,3	6,7	6,5	6,5
Employment	-2,0	-0,2	1,4	0,9	0,5	0,2
Net lending vis-à-vis the rest of the world (% of GDP)	0,1	0,0	0,0	0,0	0,0	0,0
Balance on goods and services (% of GDP)	-2,0	-1,8	-1,8	-1,9	-1,9	-1,9
Implicit GDP deflator	2,4	1,1	1,8	1,6	1,6	1,6
Harmonised Index of Consumer Prices	-0,1	0,8	1,4	1,6	1,7	1,7
Hiato do produto (% Produto potencial)	-5,5	-3,9	-1,1	-0,3	0,2	0,3

Sources: CFP projections (2021-2025) and INE (2020).

In this scenario, the Portuguese economy recovers in 2022 the pre-pandemic real GDP level (2019) and in the medium term, in the absence of additional measures to those considered, economic activity growth should converge to values around potential output growth (1.7%).

The macroeconomic recovery scenario is still conditioned by an environment of unusually high uncertainty. Among other factors, the economic environment in the short term will depend on the evolution of the pandemic, the possible measures needed to contain new outbreaks of the virus, the actual effectiveness of vaccines and the speed of the vaccination process of the population. As an assumption, the absence of any containment was considered from the 2nd half of 2021 onwards. This exercise in invariant policies includes the measures legislated for 2021 and the effect of measures from previous years and does not incorporate the effects of the Recovery and Resilience Mechanism, still subject to approval by the EU Council (in addition to the amounts already considered in the State Budget/2021).

A gradual improvement in labour market conditions is expected in the short term, associated with the expectation of economic recovery, still supported in 2021 by measures such as the simplified lay-off. The change in employment should recover to -0.2% in 2021, reflected in an increase in the unemployment rate to 8.3% of the labour force. In 2022, the pace of job creation in the economy is expected to pick up to a rate of 1.4% and the unemployment rate is expected to start its downward trajectory to values around 6.5% in the medium term.

The present CFP scenario estimates an increase in inflation, measured by the Harmonised Index of Consumer Prices (HICP), to 0.8% in 2021, followed by a contained acceleration and subsequent stabilisation around 1.7% in the medium term.

Budgetary prospects

The medium-term budgetary projection points to a more favourable evolution of the fiscal balance than in September. The preliminary estimate calculated by the national statistical authorities for 2020 was a deficit of 5.7% of GDP, a result that implied a less significant deterioration of the budget balance compared to the estimate in that exercise, thus constituting a less unfavourable starting point for the medium-term projection of the fiscal scenario.

The incorporation of the CFP's new macroeconomic scenario, which reflects a recovery in economic activity over the projection horizon, contributes to a progressive reduction in the budget deficit until 2025, without, however, reaching equilibrium. For 2021 the CFP projects a budget deficit of 4.1% of GDP reflecting 1.1% of GDP of estimated impact for the measures to combat the pandemic, as a result of a new period of general containment, which forced the extension of the effects of the response measures to the pandemic crisis during the current year.

In 2022, the deficit is projected to decrease to 2.1% of GDP, mainly due to the reversal of all fiscal policy measures in response to COVID-19 adopted in 2021 and favourable economic developments. For the following years, the deficit balance is projected to evolve from 1.8% of GDP in 2023 to 1.5% of GDP in 2025.

The primary balance, which excludes interest payments, is projected to return to a surplus position from 2022 onwards (inclusive), resuming the consolidation path of primary surpluses interrupted in 2020 and 2021.

Summary of the CFP fiscal scenario (% of GDP)

	2020	Projeção CFP				
		2021	2022	2023	2024	2025
Total revenue	**42,8**	**43,5**	**42,2**	**42,0**	**41,9**	**41,7**
Tax and contributory income	36,9	36,5	36,2	36,0	36,0	35,9
Tax revenue	24,3	24,1	24,2	24,2	24,2	24,2
Tax contributions	12,6	12,4	12,0	11,9	11,8	11,7
Non-tax and non-contributory revenue	5,8	6,9	6,1	6,0	5,9	5,9
Primary expenditure	**45,6**	**44,9**	**41,9**	**41,4**	**41,2**	**41,0**
Primary current expenditure	41,5	41,1	38,7	38,2	37,9	37,7
Capital expenditure	4,1	3,8	3,2	3,2	3,2	3,2
Primary balance	**-2,8**	**-1,5**	**0,3**	**0,6**	**0,7**	**0,8**
Interest	2,9	2,7	2,5	2,4	2,3	2,3
Total Expenditure	**48,4**	**47,6**	**44,4**	**43,8**	**43,5**	**43,2**
Budgetary balance	**-5,7**	**-4,1**	**-2,1**	**-1,8**	**-1,6**	**-1,5**
Balance adjusted for one-off measures	-5,1	-4,4	-2,1	-1,8	-1,6	-1,5
Public debt	**133,6**	**131,5**	**125,1**	**121,7**	**119,1**	**117,1**

Sources: CFP projections (2021-2025) and INE (2020).

Total general government revenue in 2021 is projected to grow above GDP, mainly influenced by higher transfers from the EU and the effects of one-off measures related to the return of the commission paid to the European Financial Stabilisation Fund (EFSF) (pre-paid margin) in the amount of € 1.088 million and the recovery of the remaining amount related to the BPP guarantee (€ 71 million), reaching 43.5% of GDP. Excluding the impact of one-off measures, total revenue would be 42.9% of GDP. For the remaining time horizon, the evolution as a percentage of GDP is strongly determined by the projected GDP trajectory, which, being higher than the variation of the macroeconomic bases of social contributions, direct taxes, and sales, causes the revenue share of GDP to decline from 42.2% in 2022 to 41.7% in 2025.

Public expenditure is expected to decrease as a share of nominal GDP between 2020 and 2025, by 5.2 p.p. of GDP, reaching 43.2% in 2025. This reduction reflects the downward dynamics of current primary expenditure (-3.7 p.p. of GDP), capital expenditure (-0.9 p.p. of GDP) and interest expenditure (-0.6 p.p. of GDP). In 2021, the measures implemented within the scope of COVID-19 will also impact on the level of current primary expenditure. From 2022 onwards, the evolution of current primary expenditure is determined, not only by the macroeconomic framework implicit in the budgetary scenario, but also by the reversal of the measures to support households and companies adopted to mitigate the effects caused by the pandemic in 2021.

The CFP projection expects the debt ratio to resume a downward trajectory in 2021, decreasing 2.1 p.p. to 131.5% of GDP. Notwithstanding this downward trend over the projected horizon, according to the assumptions of this exercise, the debt ratio will still be above the pre-pandemic period in 2025: 117.1%, compared to 116.8% of GDP in 2019. The increase in nominal GDP is decisive for the evolution of the debt path. In 2021 the dynamic effect (-3.0 p.p.), strongly influenced by the growth effect, counteracts the unfavourable impact of the primary balance effect (+1.5 p.p.), which, together with the favourable impact of the deficit-debt adjustment (-0.6 p.p.), determines the decrease of the ratio (-2.1 p.p.). Between 2022 and 2025 the unfavourable impact of the primary balance reverses, contributing to the decrease in the ratio (by -0.6 p.p. on average), while the dynamic effect (-3.0 p.p. on average) continues to reflect the referred favourable evolution of economic activity and the decrease, albeit at a more gradual pace, of the unfavourable contribution of the interest effect.

Although a slight gradual rise in the long-term interest rate was considered, it should remain at historically low levels, with little impact on the cost of new issues and interest charges, thus allowing the implicit interest rate of the debt stock to remain around 2%.

Risks

The prolongation of the current pandemic crisis lends the current projection exercise of the CFP a still particularly high level of risk and uncertainty. The main macroeconomic risks are directly or indirectly related with the evolution of the pandemic situation and are mostly of a downward nature, which may affect not only the recovery of the Portuguese economy but also that of its main economic partners. They stand out: i) the possibility that the vaccination process may occur more slowly than expected, or the emergence of new variants of the virus, which could slow down the reduction and elimination of the measures to contain the pandemic and delay the expected economic recovery; ii) the increased risk of insolvencies in the corporate sector and, consequently, of higher unemployment and lower household income, which associated with the high indebtedness in the economy increases the risk of an increase in non-performing loans, especially after the end of moratoria, with an impact on liquidity conditions in the economy; and iii) the high level of indebtedness of corporations, households and the general government carries downward risks to the maintenance of favourable financing conditions in the economy over the projection horizon.

The main upside risk to the macroeconomic scenario in the medium-term stems from the Next Generation EU instrument, namely its central element - the Recovery and Resilience Mechanism, designed to help repair the economic and social damage caused by the coronavirus pandemic. At the closing date of this report, the respective national programme is under negotiation with the European Commission, and its final version, which will be subject to approval by the Council of the EU, has not yet been submitted.

At the budgetary level, there is a risk that the control of the pandemic will take longer to be achieved than expected, resulting in an unfavourable impact on the budgetary balance that would result from the prolongation of the measures adopted in COVID-19. In the case of the tax deferral measure, the payment of these tax obligations could be jeopardised in the event of insolvency situations.

There is also a potentially high risk on the budgetary balance and on the public debt ratio in the coming years, arising from a possible activation of the state guarantees granted under some pandemic response measures. At the end of 2020, the total guarantees issued under credit lines to support the economy amounted to 6.4 billion euros, corresponding to more than 90% of the use of the lines in force. The losses initially estimated for the same lines due to the execution of public counter-guarantees were 1.1 billion euros. In 2021 three more lines have already been created, for a total of 1.2 billion euros, part of which with the possibility of conversion into non-repayable grants (up to 20%).

The following downward risks on the budgetary balance are also of note: the possibility of full use of the € 3.89 billion provided for in the Novo Banco Contingent Capitalisation Agreement and that the impact of State support to TAP may be greater than that envisaged in the budgetary balance for 2021 in national accounts (€ 500 million), as well as the risk inherent in further public intervention in TAP over the coming years; the potential impact of support measures to other public sector entities, namely in the transport sector, particularly affected by the pandemic; the materialisation of budgetary pressures on current primary expenditure, namely on social benefits (effect on pension expenditure due to population ageing), staff expenditure (promotions and promotions) and intermediate consumption (related to the claims of private partners under PPP projects).

In the area of public debt, the main risks are related to the evolution of interest rates on Treasury Bonds over the next few years and a possible unfavourable impact arising from the use of refundable loans under the National Recovery and Resilience Plan.