GENERAL GOVERNMENT BUDGET OUTTURN IN 2020

EXECUTIVE SUMMARY

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Balances, adjustment, and fiscal policy stance in 2020

In a year marked by the effects of the pandemic crisis caused by COVID-19, the General Government (General Government) returned to a budget deficit situation in 2020 (5.7% of GDP), after having achieved an annual surplus for the first time in 2019 (0.1% of GDP). The action of automatic stabilisers and the fiscal response to the economic and social effects triggered by that epidemiological phenomenon implied a significant deterioration of the fiscal balance in 2020, setting it at -5.7% of GDP, a worsening close to that seen in the 2009 financial crisis. The forecast surplus for the budgetary balance in 2020 (0.2% of GDP) presented in the State Budget for 2020 (OE/2020) quickly became outdated in view of the developments of the pandemic, which required the approval of a revised State Budget. The budgetary balance calculated by the national statistical authorities, although negative, was, nevertheless, less unfavourable than that forecast in the revised State Budget for 2020 (-7.0% of GDP) and than that anticipated in the estimate for 2020 underlying the POE/2021 (-7.3% of GDP). The deterioration of the PA balance in 2020 was due more than half to the direct budgetary impact of the pandemic crisis measures (2.3% of GDP) and the financial support measures to the airlines TAP Air Portugal and SATA Air Açores (0.7% of GDP). The 2020 one-off measures had an impact of -0.7 p.p. of GDP on the budgetary balance.

The primary balance, which excludes interest charges, returned to a deficit position in 2020 (-2.8% of GDP, or -5715 M€), interrupting the trend of primary surpluses that had been observed since 2015.

Excluding the effect of one-off measures, the general government budget balance was -5.0% of GDP in 2020, a result that reflects a worsening of 5.7 p.p. of GDP compared to 2019. The deterioration of the macroeconomic scenario caused by the pandemic crisis was the main factor behind this deterioration, to which was added, to a lesser extent, the action of discretionary policy, which largely reflects the exceptional measures to support employment and the economy adopted by the Government in response to the pandemic crisis. The lower interest burden, which, in 2020, benefited by 0.1 p.p. of the change in the balance adjusted for one-off measures, marginally mitigated these adverse effects.

Based on available information and on the common methodology adopted at the European Union level, correcting the budgetary balance for the effects of the economic cycle and one-off measures, the structural balance in 2020 is estimated at -2.1% of GDP. This result reflects a deterioration of the structural balance by 0.9 p.p. compared to 2019, which implies a departure from the path of convergence to the Medium-Term Objective (MTO), after five consecutive years of approaching that objective. The structural primary balance, which, affected by the impact of the fiscal response measures to the pandemic crisis, reflects an expansionary and countercyclical fiscal policy stance, contributed entirely to this evolution.

The impact of the measures in response to the pandemic crisis was not only on general government revenue and expenditure but also on contingent liabilities, which, through the guarantees granted to other sectors of the economy, greatly increased the risk exposure of general government in 2020. With an immediate budgetary impact, more than three quarters of the COVID-19 measures resulted in an increase in expenditure (by 3,562.2 M€; 1.7% of GDP) and the remainder in a reduction in revenue (by 1,076.9 M€; 0.5% of GDP), mainly reflecting the loss of tax and contributory revenue arising from support to companies. In addition to the direct impact of these measures on the fiscal balance, the general government has granted guarantees amounting to € 7,160 million in 2020, € 6212 million more than in 2019. The possible materialisation of part of this contingent liability may imply public expenditure in the future, with consequences on the public balance and debt.

The application of the Stability and Growth Pact requirements in the context of the pandemic crisis.

In the context of the pandemic crisis, the Council of the European Union activated for the first time the Stability and Growth Pact's general derogation clause (safeguard clause). This clause, which does not suspend the procedures of the Stability and Growth Pact, made it possible for Member States to depart from the normally applicable budgetary requirements. This amendment allowed Portugal and the other Member States in the preventive arm to "temporarily depart from the adjustment path to the medium-term budgetary objective (...), provided that this does not endanger fiscal sustainability in the medium term". This allowed for all budgetary measures deemed necessary to respond to the pandemic crisis to be taken in 2020.

The effects of the adoption of these measures, as well as those resulting from the action of automatic stabilisers, implied a significant worsening of the budget balance and public debt in Portugal in 2020. These developments led to a deficit above the 3% of GDP threshold and a public debt ratio of 133.8% of GDP, an increase that interrupted the downward trajectory of this indicator, reversing the reduction effort made in the previous three years.

The European Commission considered that no decision should be taken on the possibility of subjecting Member States to an Excessive Deficit Procedure. Notwithstanding this understanding, a recommendation of the Council of the European Union reaffirmed the need for Portugal to pursue, "as soon as economic conditions allow, budgetary policies aimed at achieving prudent medium-term budgetary positions and ensuring the sustainability of public debt, while enhancing investment".

Revenue and expenditure in 2020

In 2020, public revenue recorded a decrease of 5%, lower than that observed for nominal GDP (-5.4%). Thus, the ratio of general government revenue to GDP rose to 42.8%, 0.2 p.p. more than in 2019. In absolute terms, the general government revenue fell by € 4,575 million, mainly determined by the tax revenue, and more specifically by tax revenue. Approximately four-fifths of the decrease in general government tax revenue was due to the negative evolution of revenue from indirect taxes (9.1%) mainly penalised by the reduction in net VAT revenue (-10.6%). With a less unfavourable performance, direct taxes recorded a decrease of 3.7%. This decrease was primarily due to the net revenue from corporate income tax (17.1%), which partly reflected the measures adopted as part of the response to the pandemic crisis, in contrast to the revenue collected from personal income tax, which recorded an annual increase of 3.1%. Social contributions recorded an annual growth of 1.2%, essentially based on the performance of actual social contributions (1.2%), whose dynamics was close to that observed for remunerations (1.1%). The contraction of nominal GDP at a steeper pace than that of direct tax revenue, as well as the increase in actual social contributions in a recessive macroeconomic context, increased the tax burden of general government by 0.3 p.p. of GDP, with this indicator rising to 34.6% of GDP in 2020. Non-tax and non-contributory revenue decreased by 9.2% in 2020, essentially due to the performance of sales of goods and services, the reduction of dividends distributed by the Bank of Portugal and the non-distribution of dividends by Caixa Geral de Depósitos. The capital revenue partially offset this fall with a growth of 19.9%, which partly reflected the increase in transfers from the European Union, under the financing of measures in response to the pandemic crisis.

The reduction of general government revenue in 2020 (by 5%) was less marked than the 6.3% drop forecast in the revised OE/2020, as a result of a favourable deviation of tax and contributory revenue from that forecast by the MF (-4.3% vs. -8.2% in the revised OE/2020). Compared to the initial State Budget 2020, there was a considerable divergence in almost all revenue items, given the outdated nature of this document in light of the economic and financial consequences of the pandemic crisis.

With regard to public expenditure, the growth of this aggregate accelerated from 2.5% in 2019 to 7.8% in 2020. In absolute terms, expenditure increased by € 7103 million in 2019, about half of which was due to the direct impact of exceptional support measures in the context of the COVID-19 pandemic. This impact was mainly on current primary expenditure, mainly on subsidies and social benefits, where there were significant increases. Personnel expenditure increased for the fifth consecutive year and is now closer to the absolute maximum value reached in 2010. Capital expenditure grew following an increase in GFCF, but above all in "other capital expenditure" due to the registration of the DGTF loan to TAP Air Portugal. Interest expenditure was the only expenditure that decreased in relation to the previous year, which was the sixth consecutive year. As a percentage of GDP, public expenditure increased by 5.9 p.p. in 2020, reaching 48.4% of GDP, the highest value since 2014. The size of this change in the ratio is influenced by a considerable effect of the denominator, as nominal GDP decreased by 5.4% in 2020.

Public expenditure was EUR 1,322 million below the value forecast in the revised OE/2020, a favourable deviation to which contributed primary current expenditure (namely intermediate consumption, social transfers and "other current expenditure") and, to a lesser extent, interest charges. Capital expenditure was in line with the revised State Budget for 2020, as the unfavourable deviation in "other capital expenditure" was offset by the fact that GFCF was again below forecasts. As in recent years, the lower implementation of investment supported by EU funds strongly contributed to this circumstance, which suggests the ineligibility in EU regulations of many Central Government (CA) investments under PT 2020. Compared to the initial State Budget for 2020, public expenditure was considerably higher, as would be expected, since this forecast was soon outdated due to the pandemic crisis. Even so, it should be noted that some items (intermediate consumption, social benefits, "other current expenditure" and GFCF) showed smaller deviations from the initial budget than from the revised forecast.

Subsectors in 2020

In 2020, all subsectors observed a deterioration of their balances. CA was the sub-sector that most contributed to the deterioration of the fiscal balance. The worsening of the deficit of this subsector by 10 thousand million euros, around 5.0 p.p. of GDP, represented more than four fifths of the negative change of 5.8 p.p. of GDP recorded for the general government balance. In the remaining subsectors, Regional and Local Government as a whole moved from a budget surplus of 589 M€ in 2019 to a deficit of 176 M€ in 2020, thus contributing 0.4 p.p. of GDP to the deterioration of the general government balance. With an equivalent contribution, the Social Security Funds (FSS) maintained a budget surplus, despite its reduction by 903 M€. However, the balance of this subsector benefited from the fact that the State transfers to finance the response measures to the pandemic crisis processed by the FSS were about 350 M€ higher than the amount of that expenditure.

Public debt in 2020

The public debt ratio interrupted its downward trend since 2017 by increasing by 16.8 p.p. of GDP to 133.6% of GDP in 2020. This evolution was due to: i) the dynamic effect (9.5 p.p.), largely influenced by the growth effect, followed by ii) the deficit-debt adjustment (4.5 p.p.), whose unfavourable contribution reflects the higher volume of deposits, and iii) the primary balance effect (2.8 p.p.), which in 2020 reversed the previously favourable contribution. CA debt net of deposits showed a similar behaviour, rising 11.7 p.p. to 123.9% of GDP. The debt ratio was, even so, below that forecast in the revised State Budget for 2020 (134.4%) and in the most recent MF estimate for 2020, underlying the State Budget for 2020 (134.8% of GDP).

In terms of financing, the relative position of the external sector continued to increase to 71% of total public debt in 2020 (68% in 2019), which was essentially due to the greater volume of debt held by the Eurosystem. In fact, the support programmes of the European Central Bank (ECB) in force in 2020, namely the Public Sector Purchase Programme (PSPP) and the Pandemic Emergency Purchase Programme (PEPP), allowed the reinforcement of asset purchases, raising the debt held by the Eurosystem to 23% of total general government debt. The debt held by the resident sector decreased further in 2020, justified, as in 2019, by the lower financing of the financial sector.