Portugal

Country note, June 2017

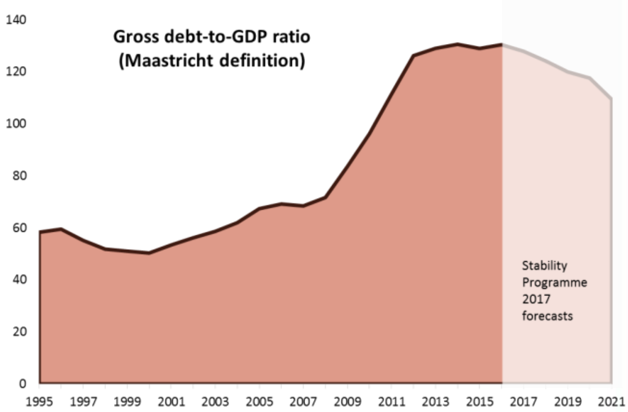
Conselho das Finanças Públicas
Portuguese Public Finance Council

Key messages:

- **The Portuguese economy is recovering, and will likely growth above 2% in 2017**
- **Fiscal deficit in 2016 was 2% of GDP, and will decline further in 2017 (the official target is 1.5%, CFP's no policy change scenario projects 1.7%)**
- **Further fiscal consolidation is necessary to achieve the medium-term objective of a structural surplus**
- **Reduction of the gross debt ratio is the major policy goal**
- **Adoption of IPSAS and implementation of the new budget framework law are key issues**

Macroeconomic outlook

After the marked GDP growth since the second half of 2016, the outlook for 2017 is positive, with growth clearly above 2%, on the back of net external demand (led by tourism) and public and private investment, according to all recent forecasts. CFP has endorsed the MoF's forecast for 2017. The change in fiscal policy, towards a more financial markets friendly orientation and renewed commitment to EC rules, supported a boost on consumer, business and investor confidence. Yet, significant geopolitical risks remaining in the background must considered due the very high external debt level. With the exception of MoF's all other known forecasts assume a deceleration from 2018 onwards either as level effect and/or lack of evidence of structural reform impetus.



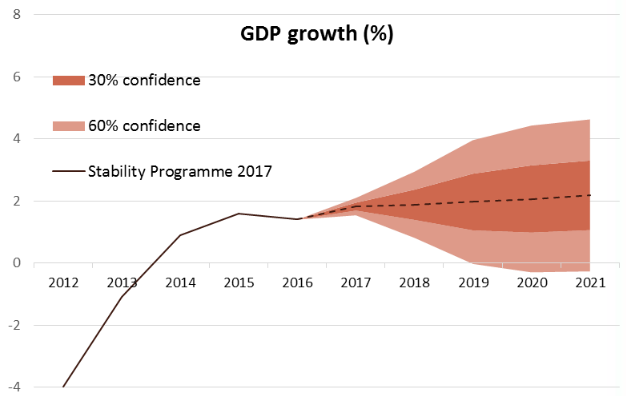
Short-term fiscal outlook

In 2016 the General Government deficit amounted to 2% of GDP (2.4% excluding one-offs), and is expected to be further reduced in 2017. The official target for 2017 is 1.5% of GDP; in March, under a no-policy change assumption CFP projected a deficit of 1.7% of GDP (1.9% excluding one-offs). The primary surplus amounted to 2% of GDP. In June 2017, the Council of the European Union abrogated the Excessive Deficit Procedure (opened in 2009). Consequently, Portugal is now under the preventive arm of the Stability and Growth Pact.

Medium-term fiscal outlook

The Medium Term Objective is a structural budget balance surplus of 0.25% GDP, which the Government expects to achieve in 2021, according to the latest Stability Programme. The structural deficit in 2016 is currently estimated at 2.1% of GDP (2% according to the European Commission), and will have to be reduced at an annual pace of 0.6 p.p. of GDP according to the SGP rules.

Given the high public debt, the main fiscal challenge is to put the debt ratio on a clear declining trend. This is important to secure market confidence that will further ease the fiscal consolidation efforts. According to the latest Stability Programme primary surpluses and economic growth will be the main drivers behind the projected decline of the debt ratio.



Fiscal framework and national fiscal rules

Portugal has for a long time focused on the annual dimension of fiscal policy, disregarding the medium term implications of current decisions. This has led to tax instability and a pro-cyclical fiscal stance, which were detrimental to growth and to confidence levels. To change this, Portugal adopted in September 2015 a new Budget Framework Law (BFL), to be implemented in 3 years' time. The law envisages a new way to design and implement fiscal policy. The change aims to effectively integrate fiscal policy in a medium term economic policy framework, and promote a modern and efficient public financial management, reinforcing accountability. A reform of public accounting standards towards an accrual system based on IPSAS was also legislated in late 2015, and is being implemented, although with some delay. A comprehensive spending review framework is still absent.

CFP is of the opinion that full implementation of the fiscal framework improvements is crucial to an effective medium-term planning of fiscal policy that would pave the way to more sustainable growth.

Key indicator forecast

		2016 p	2017 f	2018 f	2019 f	2020 f	2021 f
Real GDP growth rate (MoF)	[% y-to-y]	1.4	1.8	1.9	2.0	2.1	2.2
Real GDP growth rate (EC)	[% y-to-y]		1.8	1.6	-	-	-
Output Gap- MoF	[% of P.GDP]	-0.8	-0.1	0.2	0.4	0.8	1.1
Output Gap- EC	[% of P.GDP]		0.4	1.0	-	-	-
GG balance - MoF	[% of GDP]	-2.0	-1.5	-1.0	-0.3	0.4	1.3
GG balance - EC	[% of GDP]		-1.8	-1.9	-	-	-
GG debt - MoF	[% of GDP]	130.4	127.9	124.2	120.0	117.6	109.4
GG debt - EC	[% of GDP]		128.5	126.2	-	-	-
GG structural balance - MoF	[% of P.GDP]	-1.9	-1.7	-1.1	-0.5	0.0	0.3
GG structural balance - EC	[% of P.GDP]		-2-2	-2.4	-	-	-

Sources:

Ministry of Finance - Stability Program for 2017-2021, April 2017;

CE - European Economic Forecast Spring 2017, May 2017

p – provisional statistics by Statistics Portugal and Bank of Portugal for 2016;

f – forecast

Confidence interval for real GDP growth based on 1998- 2016 MoF Stability Programme's forecast errors.

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