Portugal

Conselho das Finanças Públicas
Portuguese Public Finance Council

Country note, January 2019

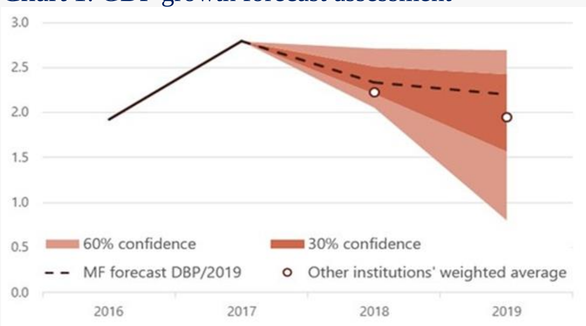
Key messages:

- **The Portuguese economy recovery seems to slow down but still likely to grow above 2% in 2018 and close to but below 2% in 2019**
- **Fiscal deficit is expected to be below 0.7% of GDP in 2018 and will decline further in 2019 if policy stance is kept**
- **Further fiscal consolidation is necessary to achieve the medium-term objective of a structural surplus**
- **The major policy goal of gross debt ratio reduction has been achieved by the Government**

Macroeconomic outlook

After the exceptional GDP growth in 2017, the outlook for 2018 is positive but slowing, with growth around 2,2%, on the back of domestic demand. CFP has endorsed the MoF's forecast for 2019 but signaled that it was not a prudent scenario, as required by the Budgetary Framework Law. The fiscal deficit reduction effort has persisted. Also, a financial market friendly orientation focused on debt reduction and budget balance control, committed to EC rules, supported confidence. Yet, still high external (public and private) debt levels make the economy sensitive to the significant geopolitical risks that remain in the background. All forecasters assume a deceleration in GDP growth from 2019 onwards, derived either from a level effect and/or a lack of evidence of structural reform impetus. The reduction of unemployment rate has been a major positive trait of recent economic developments that seems to be slowing down, with a possible negative effect on economic sentiment and on consumers and business confidence.

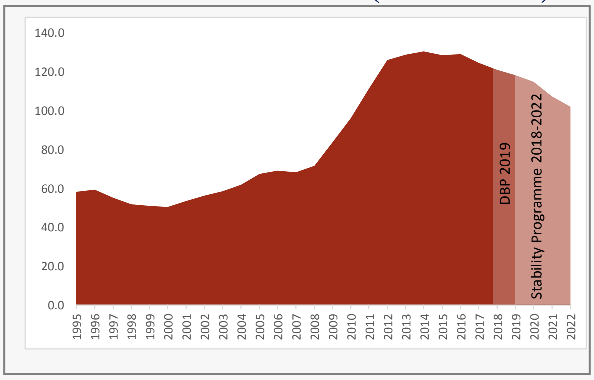
Chart 1: GDP growth forecast assessment



Short-term fiscal outlook

The General Government deficit official target for 2018 set in the Stability Programme is 0.7% of GDP (revised down from 1.1%); in September, under a no-policy change assumption CFP projected a reduction to 0,5%. The primary surplus is forecasted by the Government to reach 2.7% of GDP in 2018 and 3.1% in 2019. For 2019 the Government plans a deficit of 0.2% of GDP. In September CFP projected a deficit of 0.2% of GDP without considering a further capital injection in the bank Novo Banco amounting to 0.2% of GDP later assumed in the DBP.

Chart 2: Gross debt-to-GDP ratio (Maastricht def.)



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 2020, according to the latest Stability Programme. The structural balance in 2018 is currently estimated at -1.0% of GDP in the DBP and at -0.8% in 2019. According to the SGP rules it will have to be reduced at an annual pace of 0.6 p.p. of GDP.

Given the high public debt, the main fiscal challenge is to keep 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 Draft Budget Plan primary surpluses and economic growth will be the main drivers behind the projected debt ratio decline .

Fiscal framework and national fiscal rules

The implementation of the new Budget Framework Law adopted in September 2015 is still a challenge. Due to be to be implemented in 3 years' time it will likely be postponed by at least a year. Delays are also observable in the implementation of the essential public accounting standards reform towards an accrual system based on IPSAS, also legislated in late 2015.

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

Key indicator forecast

		2017	2018 f	2019 f	2020 f	2021 f	2022 f
Real GDP growth rate (MoF)	[% y-to-y]	2.8	2.3	2.2	2.3	2.2	2.1
Real GDP growth rate (CFP)			2.2	1.9	1.7	1.7	1.6
Output Gap- MoF	[% of PGDP]	0.3	0.7	0.9	0.8	0.9	0.8
Output Gap- CFP	[% of PGDP]	0.4	0.8	0.6	0.6	0.7	0.7
GG balance - MoF.	[% of GDP]	-3.0	-0.7	-0.2	0.7	1.4	1.3
GG balance - CFP	[% of GDP]		-0.5	-0.2	-0.1	0.6	0.3
GG debt - MoF	[% of GDP]	124.8	121.2	118.5	114.9	107.3	102.0
GG debt - CFP	[% of GDP]		122.2	118.7	116.4	110.1	106.1
GG structural balance - MoF	[% of PGDP]	-1.0	-0.6	-0.3	0.3	0.6	0.9
GG structural balance - CFP	[% of PGDP]	-1.0	-0.7	-0.5	-0.4	-0.2	0.0

Note: excluding the impact of CGD recapitalization CG balance in 2017 was -0.9.

Sources:
2017- *Portugal Statistics; Bank of Portugal; EC*
2018-2019 *- PT Ministry of Finance 2019 DBP*
2020-2022 *PT Ministry of Finance - Stability Program for 2018-2022, April 2018*
2018-2022 *PT CFP - Report no. 02/2018: Public Finance: Position and Constraints*
2018-2022 *update (no policy change projections), September 2018*
f *– forecast*
Confidence interval for real GDP growth

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