

Key messages:

- **AIReF considers unlikely compliance with the deficit target of -2,2% of GDP included in the draft 2018 State Budget.**
- **The compliance with the deficit path planned for the SPU horizon is unlikely, with its likelihood decreasing overtime.**
- **Revenue forecasts included in the SPU are in line with AIReF's estimates.**
- **However, the expenditure evolution does not seem plausible as it would require over-compliance with the expenditure rule.**

Macroeconomic outlook

AIReF's has endorsed the macroeconomic scenario underlying the Stability Programme Update (SPU). The composition of growth for the period 2018-2021 is considered plausible. The expected path is based on domestic demand as the main driver of growth, mainly based on the positive evolution of investment. Expected growth for private consumption is deemed prudent, especially in the short term. AIReF estimates that the external sector's contribution to growth will be positive on average, although residual towards the end of the period.

Short-term fiscal outlook

AIReF considers compliance with the General Government deficit target of -2.2% GDP to be unlikely, as the expected improvement on the revenue side will be outbalanced by the new expenditure measures included in the draft 2018 General State Budget. In its report, AIReF recommended to set realistic targets and to review the existing fiscal framework, ensuring the consistency and stability of the fiscal rules and compliance with their underlying principles.

Medium-term fiscal outlook

AIReF considers unlikely the compliance with the deficit path planned for the 2018-2021 period, with its likelihood decreasing as the period progresses. The path for the General Government deficit-to-GDP ratio envisaged in the SPU reflects a reduction of 3.2 p.p. in the 2018-2021 period, reaching a surplus of 0.1% of GDP in 2021. Based on the analysis of the SPU macroeconomic and budgetary scenario, AIReF considers the Government's debt-to-GDP ratio projections to be feasible, particularly so in the short-term. Government estimates an accelerating debt reduction pace over the forecast horizon. The SPU expects that the debt-to-GDP ratio will reach 89,1% by the end of the period, remaining below AIReF's baseline scenario. In the medium-term a Non-Policy Change scenario would imply debt stabilizing around 90% of GDP according to AIReF projections. AIReF has published its English version of its DSA analysis on its website.

Strengthening the medium-term fiscal framework

AIReF considers that there is a need for a consistent medium-term budgetary planning that factors in both the economic, social and budgetary feasibility of the path planned and the sustainability of public finances. As the main medium-term budgetary instrument, the Government should prevent the SPU becoming a relatively formal exercise for setting a deficit reduction path, not based on detailed and quantifiable measures.

Chart 1: economic growth rates 2018-2021 (% change)

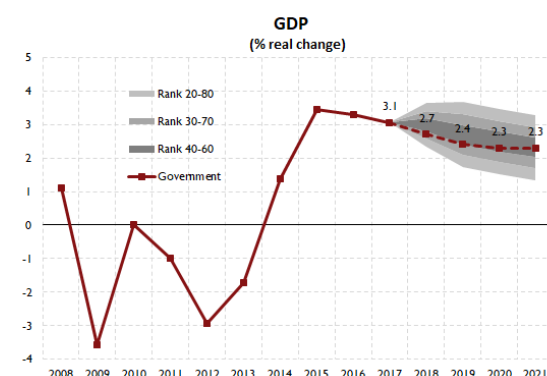


Chart 2: general government balance targets 2018-2021 (% GDP)

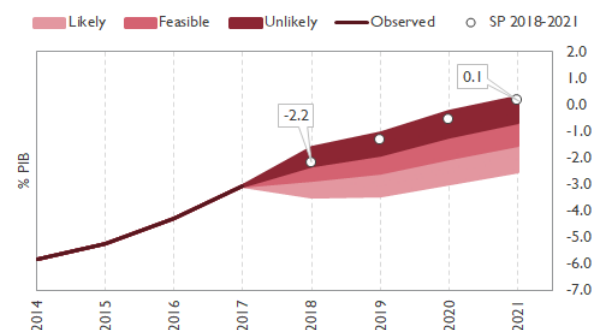
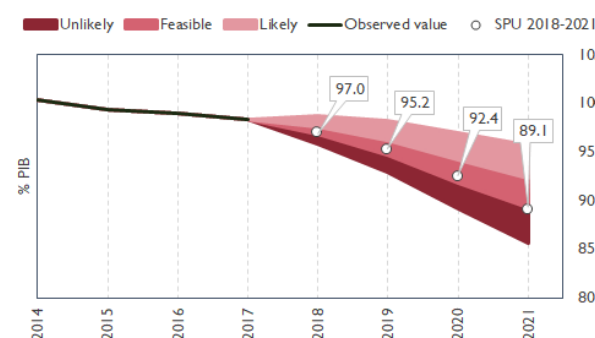


Chart 3: general government public debt to GDP 2018-2021



| SPU main indicators & 2018 March Deficits and Debt Reporting | 2017 | 2018 | 2019 | 2020 | 2021 | AIReF's assessment |
|--|------|------|------|------|------|--------------------|
| Real GDP growth (%) | 3.1 | 2.7 | 2.4 | 2.3 | 2.3 | feasible |
| GDP deflator (%) | 1,0 | 1.5 | 1.8 | 1.9 | 1.9 | likely |
| Output Gap (% GDP) | -1.6 | 0.1 | 1.2 | 2.0 | 2.6 | feasible |
| GG balance – targets (% GDP) | -3.1 | -2.2 | -1.3 | -0.5 | 0.1 | unlikely path |
| Central Government | -1.9 | -0.7 | -0.3 | 0.0 | 0.0 | unlikely* |
| Regional Governments | -0.3 | -0.4 | -0.1 | 0.0 | 0.0 | likely* |
| Local Governments | 0.6 | 0.0 | 0.0 | 0.0 | 0.0 | likely* |
| Social Security | -1.5 | -1.1 | -0.9 | -0.5 | 0.0 | very unlikely* |
| GG structural balance (% GDP) | -2.2 | -2.1 | -1.9 | -1.6 | -1.2 | unlikely |
| GG debt (% GDP) | 98.3 | 97.0 | 95.2 | 92.4 | 89.1 | feasible |

*Assessment only relevant for the 2018 draft State Budget