

Brussels, 26 May 2016

Assessment of the 2016 Stability Programme for Portugal

(Note prepared by DG ECFIN staff)

CONTENTS

1.	INTI	RODUCTION	3
2.	MAG	CROECONOMIC OUTLOOK	4
3.	REC	CENT AND PLANNED BUDGETARY DEVELOPMENTS	6
	3.1.	Deficit developments in 2015	6
	3.2.	Medium-term strategy and targets	6
	3.3.	Measures underpinning the programme	8
	3.4.	Debt developments	11
	3.5.	Risk assessment	12
4.		MPLIANCE WITH THE PROVISIONS OF THE STABILITY A	
	4.1.	Compliance with EDP-related recommendations	14
	4.2.	Compliance with the debt criterion	16
	4.3.	Compliance with the MTO or the required adjustment path towards MTO	
5.	FISC	CAL SUSTAINABILITY	20
6.	FISC	CAL FRAMEWORK	22
7.	CON	NCLUSIONS	23
8.	ANN	NEX	24

1. Introduction

This document assesses Portugal's April 2016 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 29 April 2016 and covers the period 2016-2020. It was approved by the government on 21 April 2016 and presented on 27 April 2016 to the national parliament for a debate.

Portugal is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure (EDP) for Portugal on 2 December 2009. In 2013, the country was recommended to correct its excessive deficit by 2015. According to the notified general government deficit data, validated by Eurostat on 21 April, Portugal has not corrected its excessive deficit by the 2015 deadline recommended by the Council. On 18 May 2016, the Commission adpoted country-specific recommendations (CSRs) in the context of the European Semester. In the area of public finances, the Commission recommended Portugal to ensure a durable correction of its excessive deficit by 2016¹. The year following the correction of the excessive deficit, Portugal will be subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt ratio in 2016 is projected at 126.0% of GDP, exceeding the Treaty reference value of 60% of GDP, during the three years following the correction of the excessive deficit, Portugal is also subject to the transitional arrangements as regards compliance with the debt criterion, during which it should ensure sufficient progress towards compliance.

This document complements the Country Report published on 26 February 2016 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2016 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium-term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on the Commission forecast. Based on the Commission forecast, Section 4 assesses compliance with the rules of the SGP and consistency with the 18 May 2016 Commission fiscal CSR. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 provides a summary.

⁻

COM(2016) 342 final: Commission recommendation for a Council Recommendation on the 2016 national reform programme of Portugal and delivering a Council opinion on the 2016 stability programme of Portugal:

http://ec.europa.eu/europe2020/pdf/csr2016/csr2016 portugal en.pdf

2. MACROECONOMIC OUTLOOK

The recovery of the Portuguese economy remained modest in 2015. Real GDP grew by 1.5% and decelerated during the second half of the year mainly due to less buoyant investment growth. Private consumption strengthened in 2015 amid a significant drop in household savings and favourable labour market developments. Net external demand continued to detract from real GDP growth, but to a lesser extent than in 2014. The unemployment rate fell to 12.6% in 2015 as a consequence of strong job creation and a shrinking labour force. The labour market improvement lost momentum in early 2016 leaving the unemployment rate slightly above 12%. HICP increased to 0.5% in 2015 and despite the continuation of feeble energy prices, an increase in indirect taxes exerted upward pressures on consumer price inflation which stood at 0.4% in the first quarter of 2016.

The macroeconomic scenario underlying the Stability Programme expects real GDP growth to accelerate slightly from 1.8% in 2016 and 2017 to 2.0% on average per year over 2018-2020. Domestic demand is projected to continue its strong growth supported by expansionary fiscal policy measures, EU structural funds and improvements in the labour market. Private consumption is expected to continue growing strongly at 2.4% in 2016, on the back of fiscal policy measures targeted at increasing households' disposable income, a rise in the minimum wage and a projected further decrease in household savings. In the subsequent years, private consumption is forecast to grow at a more moderate pace of 1.8% on average per year, in line with some envisaged increases in the historically-low savings rate. Gross fixed capital formation (GFCF) is projected to pick up at 4.9% in 2016 and to lose momentum afterwards, thereby decelerating to 4.8% in 2017 and to 4.3% on average per year over 2018-2020, reflecting the assumed profile regarding the absorption of EU funds. Export growth is expected to remain subdued in 2016 with an annual growth rate of 4.3%, due to the feeble external demand, but is subsequently forecast to pick up at 4.9% on average per year in 2017-2020. Import growth is estimated to remain solid over 2016-2020, consistent with the favourable outlook for domestic demand. Overall, net exports are projected to contribute negatively to GDP growth, by 0.6 pp. in 2016 and by 0.1 pp. in 2017, before turning to a small positive contribution of 0.2 pp. in the next years. As regards the labour market outlook, employment is forecast to grow by around 1% on average per year over 2016-2020. Consequently, the unemployment rate is set to decline to 9% by the end of the programme horizon. HICP inflation is projected to increase strongly to 1.2% in 2016, mainly driven by higher taxation, and then to accelerate to 1.6% in 2017 and 1.8% on average per year over 2018-2020.

The macroeconomic scenario underlying the Stability Programme is more favourable than the Commission 2016 spring forecast. The Commission expects a more moderate economic recovery than the Portuguese authorities (real GDP growth of 1.5% and 1.7% in 2016 and 2017 respectively according to the Commission 2016 spring forecast, compared to the aforementioned 1.8% in both years in the Stability Programme). Regarding 2016, the more conservative scenario according to the Commission reflects a smaller contribution of domestic demand to GDP growth (1.6 pps. in the Commission 2016 spring forecast, compared to 2.4 pps. in the Stability Programme). Focusing on 2017, the discrepancy is significantly smaller and mainly stems from the different projections regarding the contribution of net exports to GDP growth. According to the Commission 2016 spring forecast, private consumption is expected to lose momentum over the forecast horizon due to higher indirect taxes and the slight recovery in energy price inflation In addition, the still high unemployment and high debt levels are projected to keep upward pressures on household savings over the medium term (private consumption growth of 1.8% and 1.7% in 2016 and 2017 respectively according to the Commission 2016 spring forecast, compared to 2.4% and 1.8% in the Stability

Programme). The expectations with regard to the growth of wages and salaries are fairly lower in the Commission 2016 spring forecast than in the Stability Programme as well (1.6% and 1.4% in 2016 and 2017 respectively according to the Commission 2016 spring forecast, compared to 2.4% and 2.0% in the Stability Programme). The discrepancy could be partly explained by the more cautious estimate of the pass-through from minimum wage increases to total wages in the economy. Furthermore, the Commission 2016 spring forecast projects investment to grow by 1.6% this year, rather than 4.9% according to the Stability Programme, mostly due to the more prudent assumptions used by the Commission as regards the persistent deleveraging pressures, the feeble external environment and the high volatility in financial markets. In 2017, however, investment growth is expected to be robust according to both the Commission forecast and the Stability Programme, backed by a projected surge in the absorption of EU funds. Finally, the Commission projects a lower GDP deflator increase (1.4% and 1.5% in 2016 and 2017 respectively according to the Commission 2016 spring forecast, compared to the 2.1% and 1.6% in the Stability Programme). One of the major sources of discrepancy is HICP inflation, which is significantly higher in the Stability Programme (0.7% and 1.2% in 2016 and 2017 respectively according to the Commission 2016 spring forecast, compared to the 2.1% and 1.6% in the Stability Programme).

The output gap as recalculated by the Commission following the commonly agreed methodology is expected to narrow gradually and its closure is projected in 2018. According to the Stability Programme, the output gap is narrowing at a more moderate pace and is forecast to close only by 2019, which reflects the Portuguese authorities' rather optimistic potential growth forecast in the medium-term.

Table 1: Comparison of macroeconomic developments and forecasts

	20	15	2016		2017		2018	2019	2020
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	1.5	1.5	1.5	1.8	1.7	1.8	1.9	2.0	2.1
Private consumption (% change)	2.6	2.6	1.8	2.4	1.7	1.8	1.8	1.8	1.8
Gross fixed capital formation (% change)	3.9	3.9	1.6	4.9	4.9	4.8	4.1	4.7	4.1
Exports of goods and services (% change)	5.2	5.2	4.1	4.3	5.1	4.9	4.9	4.9	4.9
Imports of goods and services (% change)	7.4	7.4	4.3	5.5	5.6	4.9	4.1	4.3	4.4
Contributions to real GDP growth:									
- Final domestic demand	2.4	2.5	1.5	2.4	1.9	1.9	1.7	1.8	1.9
- Change in inventories	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.9	-1.0	-0.1	-0.6	-0.1	-0.1	0.2	0.1	0.1
Output gap ¹	-2.3	-2.4	-1.1	-1.3	0.0	-0.6	0.0	0.7	1.3
Employment (% change)	1.4	1.4	0.9	0.8	0.7	0.7	1.0	1.0	1.2
Unemployment rate (%)	12.6	12.4	11.6	11.4	10.7	10.9	10.4	9.8	9.0
Labour productivity (% change)	0.1	0.1	0.6	1.0	1.1	1.1	0.9	1.0	0.9
HICP inflation (%)	0.5	0.5	0.7	1.2	1.2	1.6	1.7	1.8	1.8
GDP deflator (% change)	1.9	1.9	1.4	2.1	1.5	1.6	1.5	1.5	1.5
Comp. of employees (per head, % change)		-0.5	1.6	2.4	1.4	2.0	2.0	2.2	2.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.1	1.1	1.5	1.6	1.7	1.8	2.0	1.9	2.4

Note:

¹In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2016 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The general government deficit reached 4.4% of GDP in 2015, 1.7% of GDP higher than the 2.7% projected in the 2015 Budget and the 2015 Stability Programme. As compared to the 2015 Budget projections, the higher-than-expected headline deficit in 2015 was mainly due to the 1.4% of GDP one-off expenditure from the resolution of the *Banco Internacional do Funchal* (Banif), in the form of both capital injections and real estate asset purchases. The headline deficit of 4.4% indicates that Portugal has not met the 2015 deadline to correct the excessive deficit as recommended by the Council.

Excluding all one-offs, i.e. in addition to the budgetary impact stemming from the resolution of Banif also the 0.2% of GDP revenue-increasing impact from an anticipation to 2015 of corporate income tax for investment funds and the banking sector contribution for a planned transfer to the European Resolution Fund, the general government deficit reached 3.2% of GDP (as compared to a deficit net of one-offs of 3.3% of GDP in 2014), thus leading to only a small improvement of the starting position for 2016. Since the reduction of the headline deficit (net of one-offs) was based on cyclical factors rather than on additional structural measures, the structural balance deteriorated by about 0.6% of GDP in 2015.

The higher-than-expected general government deficit (excluding the budgetary impact stemming from the resolution of Banif) in 2015 as compared to the 2.7% of GDP planned in the 2015 Budget was mainly due to high revenue shortfalls not entirely compensated by lower expenditure. While overall revenue fell short of the target enshrined in the 2015 Budget by 1.0% of GDP (-0.3% of GDP for tax revenue and -0.7% for non-tax revenue²), this was mostly offset by lower interest expenditure (-0.4% of GDP) and lower public investment (-0.4% of GDP). Slippages in compensation of employees and intermediate consumption were mostly covered by budgetary contingency reserves.

3.2. Medium-term strategy and targets

In the Stability Programme, the government plans to correct the excessive deficit in 2016 and commits to make progress towards the MTO in the medium-term. The headline deficit is planned to decline to 2.2% of GDP in 2016, 1.4% in 2017, 0.9% in 2018, 0.1% in 2019, and to turn into a surplus of 0.4% of GDP in 2020 (Figure 1). According to the Stability Programme, the envisaged deficit reduction would be consistent with a gradual improvement in the (recalculated³) structural balance by around 0.35% of GDP per year towards the MTO – a structural surplus of 0.25% of GDP – that would be attained after the programme period⁴. The chosen MTO of 0.25% of GDP reflects the objectives of the SGP.

The planned headline deficit of 2.2% of GDP in the Stability Programme compares with a projection of 2.7% of GDP in the Commission 2016 spring forecast. The difference vis-à-vis

The lower non-tax revenue was in particular linked to lower transfers received from EU Funds due to the transition to the new programming period, lower sales and lower property income as compared to the 2015 Budget projections.

³ Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

There are no major differences between the structural balance projections in the Stability Programme itself and the Stability Programme's structural balance projections as recalculated by the Commission according to the commonly agreed methodology.

the authorities' projection reflects a less optimistic macroeconomic outlook for 2016 and the expected lower yield of some of the planned fiscal consolidation measures. Due to the limited volume of fiscal consolidation measures, the Commission 2016 spring forecast entails a deterioration of the structural balance by about ¼% of GDP, compared to the improvement of around ¼% projected in the Stability Programme. Similarly, under the customary no-policy-change assumption, the Commission expects the headline deficit to decline to 2.3% of GDP in 2017, while a stronger reduction, to 1.4% of GDP, is planned in the Stability Programme. Furthermore, according to the Commission 2016 spring forecast, the structural balance is projected to deteriorate by 0.3% of GDP in 2017, compared to the improvement of 0.3% of GDP planned in the Stability Programme.

In the Stability Programme, the decrease of headline and structural deficits in 2017 and the following years is underpinned by continuous economic growth of around 3.5% per year in nominal terms, leading to an almost proportional increase in tax revenue, while expenditure is projected to grow at a significantly slower pace. Underpinned by fiscal policy measures, intermediate consumption and interest expenditure are projected to remain broadly unchanged in nominal terms and compensation of employees and social transfers are also planned to increase below nominal GDP growth, thus leading to a decline of their relative weight over GDP over the programme horizon.

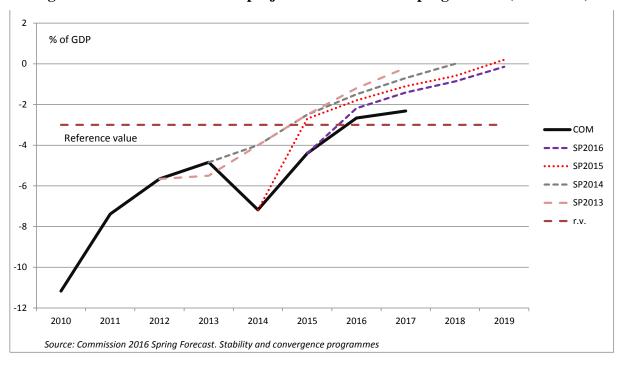


Figure 1: Government balance projections in successive programmes (% of GDP)

Table 2: Composition of the budgetary adjustment

(% of GDP)		20	16	201	17	2018	2019	2020	Change: 2015-2020
		COM	SP	COM	SP	SP	SP	SP	SP
Revenue	43,9	44,0	43,7	43,5	43,4	43,1	43,0	42,7	-1,1
of which:									
- Taxes on production and imports	14,5	15,0	14,9	14,8	14,9	14,9	14,8	14,7	0,2
- Current taxes on income, wealth, etc.	10,8	10,3	10,2	10,0	10,0	10,0	9,9	9,8	-1,1
- Social contributions	11,5	11,5	11,5	11,4	11,4	11,3	11,3	11,4	-0,2
- Other (residual)	6,9	7,2	7,1	7,3	7,2	7,0	7,0	6,8	-0,1
Expenditure	48,3	46,6	45,9	45,8	44,8	44,0	43,2	42,4	-5,9
of which:									
- Primary expenditure	43,7	42,2	41,5	41,5	40,6	39,9	39,2	38,6	-5,1
of which:									
Compensation of employees	11,3	11,2	11,1	11,0	10,8	10,5	10,2	10,0	-1,3
Intermediate consumption	5,9	6,3	6,2	6,1	5,9	5,7	5,5	5,4	-0,5
Social payments	19,2	18,9	18,6	18,7	18,4	18,2	18,0	17,7	-1,5
Subsidies	0,7	0,8	0,8	0,7	0,6	0,6	0,6	0,6	0,0
Gross fixed capital formation	2,2	1,9	1,9	2,0	2,0	2,0	2,1	2,0	-0,1
Other (residual)	4,4	3,1	3,0	3,1	2,9	2,8	2,9	2,8	-2,1
- Interest expenditure	4,6	4,5	4,4	4,3	4,2	4,1	4,0	3,8	-0,8
General government balance (GGB)	-4,4	-2,7	-2,2	-2,3	-1,4	-0,9	-0,1	0,4	4,8
Primary balance	0,2	1,8	2,2	2,0	2,8	3,2	3,8	4,2	4,0
One-off and other temporary measures	-1,2	0,2	0,2	0,2	0,2	0,0	0,0	0,0	1,2
GGB excl. one-offs	-3,2	-2,8	-2,3	-2,6	-1,6	-0,9	-0,1	0,4	3,5
Output gap ¹	-2,3	-1,1	-1,3	0,0	-0,6	0,0	0,7	1,3	3,6
Cyclically-adjusted balance ¹	-3,2	-2,1	-1,5	-2,3	-1,1	-0,9	-0,5	-0,3	2,9
Structural balance ²	-2,0	-2,2	-1,7	-2,5	-1,3	-0,9	-0,5	-0,3	1,7
Structural primary balance ² Notes:	2,6	2,2	2,7	1,7	2,9	3,2	3,5	3,5	0,9

Notes

Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

²Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

<u>Source</u> :

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

3.3. Measures underpinning the programme

As regards fiscal policy measures for 2017, the deficit-increasing carry-over of 0.4% of GDP of the main reversal measures taken in 2016 – i.e. the reversal of the Personal Income Tax surcharge (0.2% of GDP), the reversal of civil servant wage cuts (0.1% of GDP) and the reversal of VAT on restaurants from the standard rate of 23% back to the intermediate rate of 13% (0.1% of GDP) – is planned to be more than compensated by permanent consolidation measures amounting to around 0.6% of GDP – increases of other taxes (0.1% of GDP), nominal freeze of intermediate consumption except public-private partnerships (-0.2% of GDP), nominal freeze of other current expenditure (-0.1% of GDP), a public employment headcount reduction policy similar to the 2016 2:1 replacement rule (-0.1% of GDP) and savings in interest expenditure (-0.1% of GDP). While the overall effect on the general government accounts of higher public investment using EU structural funds is projected to be broadly neutral in line with the principle of budget neutrality of EU funds in national accounts, the 2017 budget balance is also set to benefit from the one-off impact stemming from the recovery of the guarantee to *Banco Privado Português* (BPP), amounting to EUR 450 million (0.2% of GDP).

The Commission 2016 spring forecast already fully factored in the precise information on the additional impact of EU funds on public investment and the recovery of the BPP guarantee. The continuation of the 2016 expenditure containment measures regarding personnel replacement policy and the nominal freeze of intermediate consumption and other current expenditure could also be partially taken into account at conservative yield estimates in the Commission 2016 spring forecast. Due to their lack of specification, however, the forecast could not factor in further consolidation measures, such as the unspecified additional tax increases, the savings from reinforced control of social benefits allocation, inter alia, explaining part of the difference between the Commission forecast and the Stability Programme deficit projections for 2017.

As regards fiscal policy measures for the 2018-2020 period, on the revenue side, no significant new measures are planned in the Stability Programme. On the expenditure side, the deficit-increasing impact of the low-wage income tax credit in 2018 and of public employment career development incentives is planned to be more than compensated by continued expenditure restraint regarding intermediate consumption and other current expenditure in combination with lower interest expenditure. Overall, the fiscal policy measures are planned to have a deficit-decreasing net impact of 0.3% of GDP in both 2018 and 2019. This impact is projected to fall to 0.2% of GDP in 2020 as higher productivity incentives and lower projected yields from expenditure freezes are estimated to be only partially compensated by higher estimated savings in interest payments. The projected overall incremental impact of investment using EU structural funds continues to be neutral over 2018-2020 in line with the budget neutrality of EU funds in national accounts.

Main budgetary measures

Main budgetary measures									
Revenue	Expenditure								
20	2017								
 Carry-over impact of the reversal of the personal income tax surcharge (-0.2% of GDP) Carry-over impact of the reduction of the VAT rate on restaurants (-0.1% of GDP) Increase of revenue in other taxes (+0.1 % of GDP) 	 Carry-over impact of reversal of civil servant wage cuts (+0.1% of GDP) Higher investment linked to EU structural funds (EU funds received plus national counterpart) (+0.15% of GDP) Public employment headcount reduction policy (-0.1% of GDP) 								
 BPP guarantee recovery (one-off measure) (+0.2% of GDP) Additional revenue from EU structural funds 	 Nominal freeze of intermediate consumption except PPPs (-0.2% of GDP) Enhanced monitoring of the attribution of 								
(+0.15% of GDP)	social benefits (-0.05% of GDP) • Savings in interest expenditure (-0.1% of GDP)								
	Nominal freeze in other current expenditure (-0.1% of GDP) The state of GDP is a state of GDP in the								
	• Investment policy (-0.1% of GDP)								

20	018
Additional revenue from EU structural funds (+0.1% of GDP)	• Impact on compensation of employees of public employment headcount reduction policy and career development incentives (+0.1% of GDP)
	• Low-wage income tax credit (+0.1% of GDP)
	• Higher investment linked to EU structural funds (EU funds received plus national counterpart) (+0.1% of GDP)
	• Nominal freeze of intermediate consumption except PPPs (-0.2% of GDP)
	• Savings in interest expenditure (-0.1% of GDP)
	• Nominal freeze in other current expenditure (-0.1% of GDP)
20	019
• Additional revenue from EU structural funds (+0.1% of GDP)	• Impact on compensation of employees of public employment headcount reduction policy and career development incentives (+0.1% of GDP)
	• Higher investment linked to EU structural funds (EU funds received plus national counterpart) (+0.1% of GDP)
	• Nominal freeze of intermediate consumption except PPPs (-0.2% of GDP)
	• Savings in interest expenditure (-0.2% of GDP)
20)20
• Lower revenue from EU structural funds (-0.1% of GDP)	• Impact on compensation of employees of public employment headcount policy and career development incentives (+0.1% of GDP)
	• Lower investment linked to EU structural funds (EU funds received plus national counterpart) (-0.1% of GDP)
	Nominal freeze of intermediate consumption except PPPs (-0.1% of GDP)
	• Savings in interest expenditure (-0.2% of GDP)

Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

3.4. Debt developments

General government gross debt has increased markedly since 2007, in the context of the global financial crisis and subsequent economic recession, high headline deficits and the reclassification of off-balance items and entities inside general government. This resulted in a debt-to-GDP ratio of 130.2% by end-2014. The government debt-to-GDP fell only slightly to 129.0% by end-2015, due to the postponement of the Novo Banco sale, the Banif resolution operation and statistical revisions. The Stability Programme projects this ratio to be on a firm downward path, expecting it to reach 124.8% by end-2016, mainly due to projected sales of financial assets, and at 122.3% in 2017 (Figure 2). Based on the assumptions of increasing primary surpluses, in a context of low interest rates and nominal GDP growth at around 3.5% from 2018 onwards, the debt-to-GDP ratio is projected to decrease rapidly further to 118.7% at end-2018, 114.5% at end-2019 and 110.3% at end-2020.

The main stock-flow adjustments impacting on the debt projections are related to the planned sales of financial assets, including of Novo Banco, in 2016.

The Commission 2016 spring forecast predicts a somewhat higher general government debt-to-GDP ratio in both 2016 and 2017, due to the projected higher deficits and lower nominal GDP growth.

Table 3: Debt developments

(0/ of CDD)	Average	2015	2016		2017		2018	2019	2020
(% of GDP)	2010-2014	2015	COM	SP	COM	SP	SP	SP	SP
Gross debt ratio ¹	118.6	129.0	126.0	124.8	124.5	122.3	118.7	114.5	110.3
Change in the ratio	9.3	-1.2	-2.9	-4.2	-1.5	-2.5	-3.6	-4.2	-4.2
Contributions ² :									
1. Primary balance	2.9	-0.2	-1.8	-2.2	-2.0	-2.8	-3.2	-3.8	-4.2
2. "Snow-ball" effect	4.6	0.3	0.9	-0.3	0.3	0.1	0.1	0.0	-0.2
Of which:									
Interest expenditure	4.4	4.6	4.5	4.4	4.3	4.2	4.1	4.0	3.8
Growth effect	1.0	-1.8	-1.8	-2.2	-2.1	-2.2	-2.3	-2.3	-2.3
Inflation effect	-0.8	-2.4	-1.7	-2.6	-1.9	-1.9	-1.8	-1.7	-1.7
3. Stock-flow	1.8	-1.3	-2.0	-1.6	0.2	0.2	-0.4	-0.3	0.1
adjustment	1.0	-1.3	-2.0	-1.0	0.2	0.2	-0.4	-0.3	0.1

Notes:

End of period.

²The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Commission 2016 spring forecast (COM); Stability Programme (SP), Comission calculations.

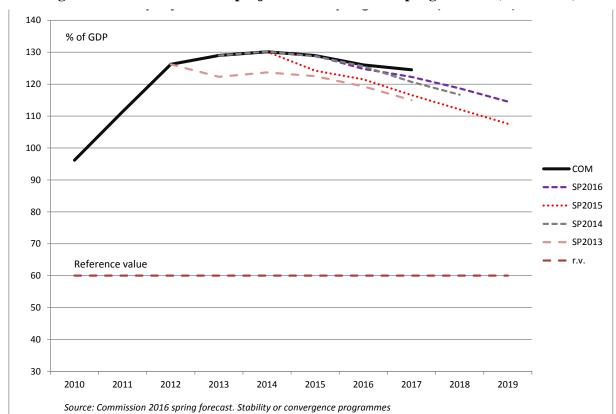


Figure 2: Government debt projections in successive programmes (% of GDP)

3.5. Risk assessment

There appears to be a number of short- and medium-term risks to the programme's budgetary strategy, in particular regarding the required structural adjustment in 2016 and 2017 and the favourable economic growth assumptions over the programme horizon.

As regards 2016, the Stability Programme plans a headline deficit of 2.2% of GDP, while the Commission 2016 spring forecast projects 2.7% of GDP. According to the Commission forecast, risks to the correction of the excessive deficit by the 2016 deadline remain on account of uncertainties surrounding the macroeconomic outlook, possible spending slippages and potential lack of agreement on further consolidation measures for 2016 and 2017.

As regards 2017, consolidation measures in the programme have not been sufficiently specified, and macroeconomic assumptions are more optimistic than in the Commission 2016 spring forecast. The effective yield of the insufficiently specified consolidation measures (increase in other taxes, freeze of intermediate consumption and of other current expenditure, public sector headcount reduction policy, inter alia) may in particular not be sufficient to fully compensate the substantial additional carry-over impact in 2017 of the main reversal measures taken in 2016 (concerning the Personal Income Tax surcharge, the public sector wage cuts and the VAT rates on restaurants).

As regards the outer years 2018-2020, there appears to be a risk linked to the continued rather optimistic economic growth assumptions underpinning the programme targets. Moreover, the reduced amount of planned consolidation measures risks also being insufficient to effectively achieve the planned moderate annual improvements of the structural balance. The growing expected yields from savings in interest expenditure appear particularly vulnerable to any potential hikes in interest rates over the programme horizon.

By potentially preventing the budgetary strategy from materialising, the above-mentioned risks would also jeopardize the planned debt developments, slowing down the decrease of the debt-to-GDP ratio. Given its high current level, at above 125% of GDP, debt developments would also be particularly sensitive to any significant increase in interest rates.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council recommendations addressed to Portugal and May 2016 Commission proposal for a CSR

On 21 June 2013, the Council recommended Portugal under Article 126(7) of the Treaty to correct its excessive deficit by 2015. To this end Portugal should put an end to the present excessive deficit situation by 2015. According to the Council recommendation, Portugal should bring the headline deficit to 5.5 % of GDP in 2013, 4.0 % of GDP in 2014 and 2.5 % of GDP in 2015, which is consistent with an improvement in the structural balance of 0.6 % of GDP in 2013, 1.4 % of GDP in 2014 and 0.5 % of GDP in 2015, based on the Commission services updated 2013 spring forecast. Portugal should implement measures amounting to 3½% of GDP to confine the 2013 deficit to 5.5% of GDP. These included the measures defined in the 2013 Budget Law and additional measures included in the Supplementary Budget, namely, reductions in the wage bill, increased efficiency in the functioning of public administration, lower public consumption and better use of Union funds. Portugal should, building on the Public Expenditure Review (PER), adopt permanent consolidation measures worth at least 2.0 % of GDP in view of attaining a headline deficit of 4.0 % of GDP in 2014. Portugal should aim at streamlining and modernising the public administration, addressing redundancies across the public sector functions and entities, improving the sustainability of the pension system and achieving targeted cost savings in individual line ministries. Portugal should adopt the necessary permanent consolidation measures to achieve the 2015 deficit target of 2.5% of GDP.

On 18 May 2016, in the context of the European Semester, the Commission issued a recommendation for a Council recommendation to Portugal in the form of a CSR⁵. In the area of public finances, the Commission recommended the Council to recommend to Portugal to ensure a durable correction of the excessive deficit in 2016, reducing the general government deficit to 2.3% of GDP in 2016, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. This would be consistent with an improvement in the structural balance of 0.25% of GDP in 2016. Thereafter, Portugal should achieve an annual fiscal adjustment of at least 0.6% of GDP in 2017. In line with its duty to monitor the implementation of the excessive deficit procedure under Article 126 of the Treaty, the Commission will come back to the assessment of the situation of Portugal in early July.

-

⁵ COM (2016) 342 final

4.1. Compliance with EDP-related recommendations

Compliance with the June 2013 EDP recommendation

According to the EDP notification of the 2015 general government deficit on 31 March 2016 and its validation by Eurostat on 21 April 2016, the 2015 deficit came out at 4.4% of GDP. Hence, Portugal did not correct its excessive deficit by the 2015 deadline recommended by the Council in 2013. Taking into account the negative impact of 1.4% of GDP stemming from the financial sector support in the Banif resolution at the end of 2015 and also the deficit-reducing one-off measures, estimated at around 0.2% of GDP, the headline deficit net of one-offs would have reached 3.2% of GDP according to the Commission 2016 spring forecast.

Since the deficit reduction (excluding the impact of one-offs) was based on cyclical factors rather than on additional structural measures, the structural balance is estimated to have deteriorated by about 0.6% of GDP in 2015, falling significantly short of the 0.5% of GDP improvement recommended by the Council. The cumulative fiscal effort over 2013-2015 is estimated at 1.1% of GDP, also significantly below the 2.5% of GDP recommended by the Council. After correction for the effects of revised potential output growth and revenue windfalls/shortfalls, the adjusted cumulative fiscal effort is estimated at -0.1% of GDP, thus even more distant from the 2.5% recommended structural effort⁶. The amount of measures implemented until June 2014 was deemed in line with the targets under Portugal's economic adjustment programme. Thereafter, the amount of permanent consolidation measures for 2014 was significantly reduced to around 1.5% of GDP in the projection underlying the 2015 Budget, thus falling clearly short of the recommendation to take at least 2.0% of GDP of additional measures in 2014. For 2015, the amount of permanent fiscal consolidation measures was further reduced to around 0.6% of GDP in the 2015 Budget and the headline target was set at 2.7% of GDP. Thus, the planned structural consolidation measures were insufficient to achieve the recommended 2015 deficit target of 2.5 % of GDP, which was confirmed by the 2015 deficit outturn.

The overall picture reflected by the structural effort indicator is negatively affected by: (i) the changeover to ESA2010 as well as other methodological revisions (estimated total impact of about -0.8% of GDP over 2013-2015, mostly impacting in 2013), and (ii) the fact that estimated yields from fight against tax fraud were not recorded as discretionary fiscal measures. However, even if both factors were fully considered, the adjusted change in the structural balance would continue to fall significantly short of the recommended cumulative target of 2.5% of GDP.

Table 4: Compliance with the requirements of the corrective arm in 2015

(% of GDP)	2015
	COM
Headline balance	
Headline budget balance	-4,4
EDP requirement on the budget balance	-4,4 -2,5
Fiscal effort - change in the structural balance	
Change in the structural balance ¹	-0,6
Cumulative change ²	1,1
Required change from the EDP recommendation	0,5
Cumulative required change from the EDP recommendation	2,5
Fiscal effort - adjusted change in the structural balance	
Adjusted change in the structural balance ³	0,1
of which:	0.0
correction due to change in potential GDP estimation ($lpha$)	0,0
correction due to revenue windfalls/shortfalls (eta)	-0,6
Cumulative adjusted change ²	-0,1
Required change from the EDP recommendation	0,5
Cumulative required change from the EDP recommendation	2,5
Fiscal effort - calculated on the basis of measures (bottom-up a	approach)
Fiscal effort (bottom-up) ⁴	
Cumulative fiscal effort (bottom-up) ²	
Requirement from the EDP recommendation	
Cumulative requirement from the EDP recommendation	
NY .	-

Notes

¹Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on programme is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology. Change compared to *t-1*.

Source:

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

Consistency with the May 2016 fiscal country-specific recommendation

The Stability Programme confirms the 2016 Budget's headline deficit target of 2.2% of GDP for 2016, thus planning a correction of the excessive deficit in 2016. According to the Stability Programme, this would be consistent with an improvement of the structural balance of 0.3% in 2016.

²Cumulated since the latest EDP recommendation.

³ Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.

⁴The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

Based on the Commission 2016 spring forecast, the general government deficit is however projected to reach 2.7% of GDP in 2016, compared with the headline deficit target of 2.3% of GDP in the new Commission fiscal CSR. Moreover, according to the Commission 2016 spring forecast, the structural balance is projected to deteriorate by around 0.25% of GDP in 2016, which falls short of the recommended structural improvement of 0.25% of GDP in the new Commission fiscal CSR.

Table 5: Consistency with the May 2016 fiscal country-specific recommendation

(% of GDP)	20)16				
(% 01 GDF)	SP	COM				
Headline balance						
Headline budget balance	-2,2	-2,7				
Commission recommendation on the budget balance	-2	-2,3				
Fiscal effort - change in the structural balance						
Change in the structural balance ¹	0,3	-0,2				
Required change from the Commission recommendation	0	0,25				
Notes						
¹ Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural						

¹Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on programme is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology. Change compared to *t-1*.

Source:

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

4.2. Compliance with the debt criterion

Assuming the timely and durable correction of Portugal's excessive deficit situation by the 2016 deadline recommended by the Council, the country will be subject to the requirements of the preventive arm of the SGP from 2017 onwards and subject to the transitional debt rule in the period 2017-2019⁷.

According to the second paragraph of Article 2(1a) of Council regulation (EC) 1467/97.

Table 6: Compliance with the debt criterion

	2017		
	SP	COM	
Gross debt ratio	122,3	124,5	
Gap to the debt benchmark ^{1,2}			
Structural adjustment ³	0,3	-0,3	
To be compared to:			
Required adjustment ⁴	().6	

Notes:

Source:

Commission 2016 spring forecast (COM); Stability Programme (SP), Comission calculations.

As the calculation of the minimum linear structural adjustment (MLSA) requires data for 2021 for its forward-looking benchmark, it has not been possible to recalculate the MLSA based on the assumptions of the Stability Programme. The Stability Programme itself states that Portugal complies with the debt reduction requirements without explicitly referring to a calculation of the required MLSA.

According to the Commission 2016 spring forecast and taking into account the Output Gap Working Group t+10 projections for the outer years, the required MLSA is 0.6% of GDP in 2017. The 2017 planned change in the structural balance of 0.3% of GDP as per the Stability Programme would thus not ensure full compliance with the required adjustment. According to the Commission forecast, the change in the structural balance is expected to be of -0.3% of GDP in 2017, consequently further below the required adjustment. Thus, Portugal would not make sufficient progress towards compliance with the debt criterion in 2017.

¹ Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDPs that were ongoing in November 2011.

⁴ Defines the remaining annual structural adjustment over the transition period which ensures that - if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.

4.3. Compliance with the MTO or the required adjustment path towards the MTO

Assuming that Portugal effectively corrects its excessive deficit by 2016 as planned in the Stability Programme, it would be subject to the preventive arm of the SGP as of 2017 and would have to ensure compliance with the MTO or the required adjustment towards the MTO.

Portugal would be required to pursue an annual structural adjustment towards the MTO of 0.6% of GDP in 2017.

According to the structural balance trajectory set out in the Stability Programme (also as recalculated by the Commission using the commonly agreed methodology), the MTO of a structural surplus of 0.25% of GDP will not be reached within the programme horizon, i.e. it will only be reached after 2020. This is because the Stability Programme only plans an average improvement of the structural balance by around 0.35% of GDP per year (0.33% in 2017 as recalculated by the Commission). The programme thus plans some deviation from the required adjustment path towards the MTO in 2017 and thereafter. According to the information provided in the Stability Programme, the growth rate of government expenditure, net of discretionary revenue measures, in 2017 is planned to exceed the applicable expenditure benchmark rate (-1.4%), leading to some deviation of 0.4% of GDP. Thus, both indicators point to a broadly similar gap vis-à-vis the requirement, suggesting a risk of some deviation from the recommended adjustment path towards the MTO.

The Commission 2016 spring forecast projects a deterioration of the structural balance by 0.3% of GDP in 2017. This suggests a risk of significant deviation on the basis of the structural balance pillar (by 0.9% of GDP) from the required structural improvement of 0.6% of GDP. According to the Commission 2016 spring forecast, the growth rate of government expenditure, net of discretionary revenue measures in 2016 will exceed the applicable expenditure benchmark rate (-1.4%), leading to a deviation of 0.7% of GDP, also above the 0.5% of GDP threshold for a significant deviation. Therefore, both the structural balance and the expenditure benchmark pillar point to a risk of a significant deviation in 2017 based on the Commission 2016 spring forecast.

In sum, deviations from the required adjustment towards the MTO are projected according to both the (recalculated) programme scenario and the Commission 2016 spring forecast. While the (recalculated) programme scenario points to a risk of some deviation, the Commission 2016 spring forecast points to a risk of significant deviation from the adjustment path towards the MTO in 2017, based on both the structural balance and the expenditure benchmark pillars.

Table 7: Compliance with the requirements under the preventive arm

Table 7. Comphance with the requirements under the preventive arm							
2017							
0,25							
-2	2,5						
-	-						
Not at	MTO						
20	17						
SP	COM						
0,6							
rected ⁵ 0,6							
0,3	-0,3						
-0,3	-0,9						
in EDP	in EDP						
-1,4							
-0,4	-0,7						
in EDP	in EDP						
Overall	Significant						
assessment	deviation						
in EDP	in EDP						
	0, -2 Not at 20 SP 0, 0, 0, 0, 1, 1, -0,4 in EDP Overall assessment						

Notes

Source:

Stability Programme (SP); Commission 2016 spring forecast (COM); Commission calculations.

¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

² Structural balance = cyclically-adjusted government balance excluding one-

³ Based on the relevant structural balance at year t-1.

⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

⁷ The difference of the change in the structural balance and the corrected required adjustment.

⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

5. FISCAL SUSTAINABILITY

The analysis in this section includes the long-term budgetary projections of age-related expenditure (pension, health care, long-term care, education and unemployment benefits) from the 2015 Ageing Report⁸ published on 12 May 2015.

General government gross debt is on a decreasing path under the Commission's latest long-term projections after the spring forecast based on the no policy-change assumption as from 2017. Nevertheless, given the very high starting point and the relatively low projected average yearly decrease, the debt-to-GDP ratio is expected to fall below 120% only in 2023. Assuming full implementation of the Stability Programme scenario, public debt would be on a considerably steeper downward path, implying that the debt-to-GDP ratio would fall below 100% in 2023. For a more detailed debt sustainability analysis including sensitivity to various adverse shocks please see Annex 2, pp. 39-40 of the third post-programme surveillance report⁹.

Portugal does not appear to face fiscal sustainability risks in the short run. Nonetheless, there are some indications that gross and net public debt, gross financing needs, the net international investment position, as well as the level and the change in the share of non-performing loans may pose potential challenges.

Portugal appears to face high fiscal sustainability risks in the medium term as measured by the medium-term sustainability indicator S1. The medium-term sustainability gap shows that reducing the debt ratio to 60% of GDP by 2030 would require an overall adjustment effort of 5.4% of GDP until 2022. This high medium-term sustainability gap is primarily related to the current high level of government debt. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at 2.7% of GDP, leading to a substantially lower but still high medium-term risk. Overall, risks to fiscal sustainability over the medium term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would substantially decrease those risks.

In the long term, Portugal appears to face low fiscal sustainability risks as measured by the long-term sustainability gap S2, i.e. the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, which is 1.2% of GDP. This is primarily related to the relatively low overall projected long-term cost of ageing, in particular as regards pensions. Full implementation of the programme would put the S2 indicator at -0.9% of GDP leading to a further reduced long-term risk.

Risks would be higher if the structural primary balance reverts to the lower values observed in the past. It is therefore appropriate for Portugal to continue to implement measures that reduce government debt.

_

⁸ See http://ec.europa.eu/economy/finance/publications/european/economy/2015/ee3/en.htm

See http://ec.europa.eu/economy finance/publications/eeip/pdf/ip022 en.pdf

Table 8: Sustainability indicators

Time horizon				cy Change nario	Stability / Convergence Programme Scenario		
Short Term			LO	W risk			
S0 india	cator ^[1]			0.3			
	Fiscal subindex (2015)		0.4	HIGH risk			
	Financial & competitive	eness subindex (2015)	0.2	LOW risk			
Medium Term			ніс	iH risk			
DSA ^[2]			HIG	iH risk			
S1 india	cator ^[3]		5.4	HIGH risk	2.7	HIGH risk	
of v	vhich			•	•	•	
	IBP		0.7		-2	1	
	Debt Requirement			4.6	4	.8	
	CoA		0.1		-0.1		
Long Term			LOW risk		LOW risk		
S2 india	cator ^[4]			1.2	-().9	
of v	vhich						
	IBP			0.7	-1	3	
	CoA			0.5	0	.4	
	of which						
		Pensions	-	0.2	-(0.6	
		нс		1.8	1	.6	
		LTC		0.2	0	.2	
		Other	-	1.3	-0).9	

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.

- [1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.
- [2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections. See Fiscal Sustainability Report 2015.
- [3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.
- [4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

As regards compliance with national numerical fiscal rules, the 2015 budgetary outcome appears to indicate that the observed evolution of the structural balance as estimated by the programme ¹⁰ did not comply with the rule of a minimum annual adjustment of the structural balance by 0.5% of GDP as long as the medium-term objective is not reached, as laid down in Article 12-C (6) of the currently applicable Budget Framework Law (BFL)¹¹.

The planned improvement of the structural balance by 0.3% of GDP in 2016 in a normal cyclical position also appears to indicate some planned deviation from the 0.5% minimum improvement of the structural balance in 2016.

From 2017 to 2020, the planned improvement of the structural balance of around 0.35% of GDP on average appears to plan some average deviation by 0.15% of GDP from the 0.5% of GDP minimum improvement laid down in the Budget Framework Law. As regards the debt rule laid down in Article 10-G(1) BFL referring to the provisions of Article (2) of Council Regulation (EC) 1467/97 for the preventive arm, while the planned reduction may fall short of the transitional debt rule in 2017, compliance appears to be ensured from 2018 onwards.

The macroeconomic forecasts underlying the Stability Programme have been endorsed by the Portuguese Fiscal Council in an opinion attached to the programme. In the opinion, the Council points at downside risks for the entire programme period 2016-2020, in particular as regards the assumptions on growth of exports and investment.

The Stability Programme does not explicitly state that it also constitutes the national medium-term fiscal plan in line with Article 4(1) of regulation 473/2013. The legal references contained in the opinion of the Fiscal Council however indicate that the Stability Programme is assumed to also constitute the national medium-term fiscal plan.

A deterioration by 0.5% of GDP as compared to the 2014 estimate of -1.5% of GDP included in the 2016 budget report.

Law n.° 41/2014 of 10 July (Eighth modification of Law n.° 91/2001, of 20 August) (Budget Framework Law)

7. CONCLUSIONS

In 2015, Portugal achieved a headline deficit of 4.4% of GDP, which was above the recommended target of 2.5% of GDP and above the Treaty reference value of 3% of GDP. Therefore, Portugal did not correct its excessive deficit by the 2015 deadline recommended by the Council. The fiscal effort indicators also point to a shortfall in the structural effort, based on the change in both the unadjusted and adjusted structural balance in 2015 and in cumulative terms over 2013-2015, as well as on the permanent consolidation measures taken under the programme and thereafter.

The Stability Programme plans the correction of the excessive deficit situation in 2016 and an annual average improvement of the structural balance of around 0.35% of GDP in the years thereafter. This path implies an average 0.25% annual deviation from the required adjustment path towards the MTO from 2017 to 2020.

Based on the Commission 2016 spring forecast, the headline deficit is expected to decrease to 2.7% of GDP in 2016 and further to 2.3% of GDP in 2017. A durable correction of the excessive deficit by 2016 as planned in the Stability Programme may be subject to risks as the projected margin below the Treaty reference value of 3% of GDP appears insufficient in view of high uncertainties regarding economic and budgetary developments. As the structural deficit is projected to slightly increase, the fiscal effort is not in line with the 0.25% of GDP recommended in the 18 May 2016 Commission fiscal CSR, while in line with its duty to monitor the implementation of the excessive deficit procedure under Article 126 of the Treaty, the Commission will come back to the assessment of the situation of Portugal in early July.

Assuming that the excessive deficit is corrected in a timely and durable manner by 2016, Portugal would be subject to the requirements of the preventive arm of the SGP as of 2017.

Based on the Stability Programme, both the structural balance and the expenditure benchmark pillars of the preventive arm point to a risk of some deviation from the recommended adjustment path towards the MTO in 2017. By contrast, according to the Commission 2016 spring forecast, there appears to be a risk of a significant deviation from the required adjustment towards the MTO in 2017. Portugal is also not forecast to comply with the transitional debt rule in 2017.

8. ANNEX

Table I. Macroeconomic indicators

	1998-	2003-	2008-	2013	2014	2015	2016	2017
Core indicators	2002	2007	2012		-			
	2.0		1.0	1.1	0.0	1.5	1.5	1.7
GDP growth rate	3,0	1,1	-1,3	-1,1	0,9	1,5	1,5	1,7
Output gap ¹	2,4	-0,7	-2,0	-5,1	-3,8	-2,3	-1,1	0,0
HICP (annual % change)	3,1	2,7	1,9	0,4	-0,2	0,5	0,7	1,2
Domestic demand (annual % change) ²	3,5	1,1	-2,7	-2,0	2,2	2,4	1,5	1,9
Unemployment rate (% of labour force) ³	5,6	8,4	12,0	16,4	14,1	12,6	11,6	10,7
Gross fixed capital formation (% of GDP)	27,2	23,0	19,8	14,8	14,9	15,0	15,0	15,3
Gross national saving (% of GDP)	18,7	14,1	11,9	15,4	15,1	15,1	15,4	16,0
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-3,8	-4,8	-7,6	-4,8	-7,2	-4,4	-2,7	-2,3
Gross debt	52,6	65,1	97,8	129,0	130,2	129,0	126,0	124,5
Net financial assets	-39,2	-53,4	-71,6	-98,7	-108,5	-108,8	n.a	n.a
Total revenue	39,4	40,7	41,6	45,1	44,5	43,9	44,0	43,5
Total expenditure	43,1	45,6	49,2	49,9	51,7	48,3	46,6	45,8
of which: Interest	3,0	2,7	3,6	4,9	4,9	4,6	4,5	4,3
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-5,3	-4,8	-2,1	3,5	5,8	4,7	3,2	3,1
Net financial assets; non-financial corporations	-106,0	-122,2	-140,1	-148,4	-138,2	-133,6	n.a	n.a
Net financial assets; financial corporations	3,2	2,2	5,1	12,8	12,2	13,3	n.a	n.a
Gross capital formation	14,4	13,0	11,6	9,2	10,0	9,8	10,1	10,3
Gross operating surplus	19,7	19,7	20,9	21,3	21,3	22,1	22,5	23,0
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	1,6	1,7	3,0	3,6	2,7	0,8	1,0	0,9
Net financial assets	100,7	100,0	101,7	117,9	120,2	119,7	n.a	n.a
Gross wages and salaries	38,5	37,3	36,4	34,7	34,3	33,7	33,6	33,2
Net property income	4,6	5,4	5,9	6,1	6,0	5,7	5,8	5,8
Current transfers received	20,8	21,8	24,2	26,7	25,6	25,5	25,1	24,9
Gross saving	7,9	6,2	6,0	5,5	4,0	2,9	3,0	3,0
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-7,5	-7,9	-6,7	2,3	1,4	1,1	1,5	1,7
Net financial assets	46,0	77,0	111,9	122,8	121,4	116,0	n.a	n.a
Net exports of goods and services	-9,8	-8,0	-5,8	1,0	0,4	0,8	1,1	1,3
Net primary income from the rest of the world	-1,3	-2,1	-3,1	-1,3	-1,6	-2,1	-2,1	-2,0
Net capital transactions	1,8	1,5	1,4	1,6	1,4	1,2	1,2	1,2
Tradable sector	44,0	40,8	40,1	41,6	41,6	41,6	n.a	n.a
Non tradable sector	43,5	46,1	47,7	46,3	45,9	45,4	n.a	n.a
of which: Building and construction sector	6,6	6,0	5,1	4,0	3,9	4,0	n.a	n.a
Real effective exchange rate (index, 2000=100)	94,8	102,4	99,1	94,6	93,4	89,6	90,2	89,3
Terms of trade goods and services (index, 2000=100)	98,9	98,8	98,9	100,3	101,7	105,0	106,2	107,1
Market performance of exports (index, 2000=100)	101,2	95,5	101,8	115,2	114,5	113,6	112,8	112,7
Notes:	=							

Notes:

Source:

AMECO data, Commission 2016 spring forecast

¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

The indicator on domestic demand includes stocks.

Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.