



Brussels, 5.2.2016
C(2016) 870 final

COMMISSION OPINION
of 5.2.2016
on the Draft Budgetary Plan of Portugal

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of 05.02.2016

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.
2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING PORTUGAL

3. In the context of general elections which took place on 4 October 2015, Portugal did not submit its Draft Budgetary Plan for 2016 by 15 October 2015. By failing to submit at least a no-policy-change Draft Budgetary Plan by the deadline, Portugal failed to comply with its obligations under Regulation (EU) No 473/2013 and the Commission urged the Portuguese authorities to submit a Draft Budgetary Plan as soon as possible.
4. Portugal submitted its Draft Budgetary Plan for 2016 on 22 January 2016. The Portuguese authorities announced additional consolidation measures on 5 February. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) 473/2013.
5. Portugal is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure for Portugal on 2 December 2009. Subsequently, the Council adopted revised Recommendations under Article 126(7) of the Treaty on 9 October 2012 and on 21 June 2013. Portugal was recommended to correct the excessive deficit by 2015.
6. The macroeconomic scenario underlying Portugal's 2016 Draft Budgetary Plan projects an acceleration of the economic recovery. Real GDP is estimated to have expanded by 1.5% in 2015, and growth is projected to accelerate to 2.1% in 2016. Growth is forecast to be driven mainly by domestic demand. The labour market continues to improve and employment is projected to increase by 1% in 2016. Consequently, the unemployment rate is projected to decline to 11.2% in 2016. The macroeconomic scenario for 2016 in the Draft Budgetary Plan is more optimistic than the Commission 2016 winter forecast. In particular, real GDP growth in 2016 is expected to be stronger than the 1.6% forecast by the Commission, mainly on the back of a higher contribution of domestic demand as a result of higher growth in both private consumption and total investment. Furthermore, the Draft Budgetary Plan projects a significantly higher GDP deflator in 2016 than the Commission. The Draft Budgetary Plan's

more optimistic macroeconomic scenario in 2016 leads to higher tax revenues and lower social transfers. In addition, the Commission also assumes slightly higher interest rate payments and compensation of employees. Overall, the macroeconomic scenario in the Draft Budgetary Plan for 2016 appears optimistic.

7. Regulation (EU) No 473/2013 requires the Draft Budgetary Plan to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been endorsed by the Portuguese Public Finance Council. In its endorsement, the Portuguese Public Finance Council flagged downside risks to the macroeconomic outlook which are related to rather optimistic projections on price developments, investment growth and external demand. The Portuguese Public Finance Council was established through the 2011 reform of the Budgetary Framework Law, which laid down provisions aiming to ensure its independence.
8. For 2015, the Draft Budgetary Plan projects a general government headline deficit of 4.2% of GDP, 1.5 pps. higher than the target of the 2015 Stability Programme. The difference is mainly related to the direct public support of 1.2% of GDP to the Banif bank resolution operation. The remaining difference of 0.3% of GDP mainly reflects higher-than-initially projected capital expenditure and lower non-tax revenue. For 2016, the Draft Budgetary Plan projects a headline deficit of 2.6% of GDP, i.e. 0.8 pp higher than in the 2015 Stability Programme. The Draft Budgetary Plan foresees deficit-increasing fiscal measures worth 0.7% of GDP that are planned to be partially compensated by deficit-reducing measures worth 0.5% of GDP. In addition, the Draft Budgetary Plan also includes for 2016 the deficit-increasing impact of recent tax reforms of around 0.4% of GDP.
9. The Commission 2016 winter forecast projects a general government deficit of 3.4% of GDP in 2016, 0.8% of GDP above the Draft Budgetary Plan's target. The difference is due the fact that the Commission forecast does not include a number of not sufficiently specified deficit-reducing measures, notably the freeze of intermediate consumption and the efficiency gains in other expenditure, and is based on a less optimistic macroeconomic scenario.
10. The Draft Budgetary Plan projects the debt-to-GDP ratio to have amounted to 128.7% at the end of 2015 and to fall to 126% of GDP by the end of 2016. The Commission 2016 winter forecast also projects a debt-to-GDP ratio of around 129% at the end of 2015, but the forecast decrease in 2016 to 128.5% is lower than in the Draft Budgetary Plan due to a projected increase in the Treasury's cash buffer, in combination with projected higher deficits and lower nominal GDP.
11. As Portugal had a 2015 deadline to correct its excessive deficit, Portugal was to become subject to the preventive arm of the Stability and Growth Pact and to the transitional debt rule as from 2016. Therefore, the Council on 14 July 2015 recommended Portugal to achieve a structural effort of 0.6% of GDP in 2016. This constitutes the budgetary obligation of Portugal against which the Draft Budgetary Plan is being assessed.
12. The Draft Budgetary Plan projects an improvement of the general government deficit by 1.6% of GDP and provides for a (recalculated) structural effort of

0.1% of GDP in 2016. This would correspond to a deviation of 0.5% of GDP from the recommended adjustment towards the medium-term budgetary objective for 2016. The Draft Budgetary Plan foresees net expenditure growth to slightly exceed the expenditure benchmark, leading to a deviation by 0.3% of GDP in 2016. Overall, the Draft Budgetary Plan projects some – but close to significant – deviation from the required adjustment path towards the medium-term budgetary objective. However, the planned improvement in the structural balance was mostly due to the classification of certain fiscal policy measures as one-off in 2015 and 2016. As these are deficit-increasing measures fully under the control of the government which, intrinsically, are of neither temporary nor non-recurrent nature, their classification as one-off was not in line with the Commission classification principles in this regard. These measures included the permanent reversal of past consolidation measures, the permanent revenue-decreasing effect of recent tax reforms and recurrent recapitalisation of state-owned enterprises. Correcting the structural balances so as to bring them in line with the Commission classification principles with respect to one-offs would have entailed a planned (recalculated) deterioration of the structural balance by 0.5% of GDP in 2016. The Draft Budgetary Plan thus planned a deviation by 1.1% of GDP from the recommended 0.6% of GDP structural adjustment. The planned deviation would accordingly largely exceed the 0.5% threshold for a significant deviation as set out in Article 6(3) of Regulation 1466/97. This significant deviation was confirmed based on the expenditure benchmark. The Commission 2016 winter forecast projects a negative structural effort of 1.0% of GDP in 2016, resulting in a deviation of 1.6% of GDP from the recommended annual structural adjustment.

13. The additional information provided on two operations not yet taken into account in the DBP submitted on 22 January leads to a deterioration of the level of the structural balance in 2015 by 0.2% of GDP, thereby having a positive effect of the same size on the change in the structural balance between 2015 and 2016. The set of additional measures publicly announced on 5 February amounts to EUR 1,125 million in 2016 (0.6% of GDP). These measures are mostly concentrated on the revenue side. On the revenue side, they include increases in excise taxes, in taxes on vehicle acquisition and in bank contributions to the Portuguese Resolution Fund as well as the roll back of the reduction of social security contributions on low wages, the repeal of property tax exemption for investment and pension funds and a new tax scheme for the revaluation of corporate assets. Savings on the expenditure side stem mainly from measures targeted at tightening civil servants' recruitment, as well as establishing more controls and better monitoring in Social Security.
14. The Commission considers that with the exception of one measure, namely the new tax scheme for the revaluation of corporate assets, all measures proposed by the Portuguese government are of a structural nature. However, according to the Commission's assessment, some of these measures bear implementation risks and can be expected to yield less than projected by the Portuguese government. Taking these factors into account, the Commission evaluates the yield of the total package of additional structural measures at EUR 845 million (0.5% of GDP).
15. Overall, based on the planned structural adjustment in the DBP as well as the additional information regarding the new 2015 baseline and the expected yield

of the additional structural consolidation measures announced on 5 February, the structural adjustment planned by the Portuguese authorities is estimated between 0.1% and 0.2% of GDP. The deviation from the recommended structural adjustment of 0.6% of GDP is below 0.5% of GDP and therefore not considered significant.

16. In conclusion, provided that all the above deficit-improving structural measures are implemented strictly and in a timely manner, the Commission is of the opinion that the government no longer plans a significant deviation from the recommended structural adjustment. Nevertheless, based on the Commission's 2016 winter forecast and its assessment of the additional measures announced on 5 February, the Commission considers that the government's plans are at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, after taking into account the additional information and the expected yield of the additional measures, there is a risk of a significant deviation from the structural adjustment recommended by the Council on 14 July 2015. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2016 budget will be compliant with the Stability and Growth Pact. The Commission will reassess Portugal's compliance with its obligations under the Stability and Growth Pact, including under the Excessive Deficit Procedure, on the basis of: the budgetary outcome of 2015, once validated data for that year are available this spring; Portugal's forthcoming Stability Programme; and the Commission 2016 spring forecast. The results of this assessment will be reflected in a new decision under the Excessive Deficit Procedure in May.

Done at Brussels, 5.2.2016

For the Commission
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Member of the Commission