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**Assessment of the 2020 Stability Programme for
Portugal**

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EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes could be streamlined in light of the exceptional circumstances related to the COVID-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- Portugal did not submit its 2020 Stability Programme within the deadline laid down in Article 4(1) of Regulation (EC) 1466/97 and it did not include either a macroeconomic scenario or budgetary plans for at least 2020.
- Portugal's economic outlook has changed abruptly due to the outbreak of the COVID-19 pandemic. The Commission projects that real GDP will now contract by 6.8% in 2020, before recovering by 5.8% in 2021. Unemployment is forecast to increase to 9.7% in 2020, but to moderate to 7.4% in 2021.
- The COVID-19 pandemic is expected to take a temporary toll on Portugal's public finances, which will be called to provide significant stabilisation in 2020. The Commission projects that the budget balance will deteriorate to a deficit of 6.5% of GDP in 2020, reflecting the operation of the automatic stabilisers and the budgetary cost of measures taken by the Portuguese authorities to tackle the pandemic. The deficit is set to decrease in 2021, on the back of the expected economic recovery.
- Portugal's 2020 Stability Programme provides information on substantial measures taken by the Portuguese authorities to counter the economic and social impacts of the COVID-19 pandemic, particularly to reinforce the response capacity of the health system, protect jobs, provide social support and safeguard firms' business continuity. The Programme reports estimates of the budgetary impacts of those measures on an either monthly or annual basis, without providing a projected annual aggregate figure for 2020. The Commission estimates that a budgetary cost of around 2.5% of GDP may result from those measures in 2020.
- The COVID-19 pandemic is expected to lead to a peak in Portugal's public debt-to-GDP ratio in 2020. The Commission forecasts that the public debt-to-GDP will jump up to 131.6% in 2020, before dropping to 124.4% in 2021.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. Country-specific risks are tilted to the downside given Portugal's reliance on foreign tourism and the surge in public contingent liabilities stemming from some public corporations and the private sector. Those risks come on top of non-negligible pre-existing levels of public contingent liabilities, partly related to potential further budgetary impacts of additional bank support measures.

1. INTRODUCTION

This document assesses the information contained in the 2020 Stability Programme¹ of Portugal covering only the year 2020 (hereafter called the Programme), which was submitted on 16 May 2020. The note also assesses Portugal's compliance with the preventive arm of the Stability and Growth Pact in 2019. The government approved the Programme on 7 May 2020 and it was submitted to the national parliament on that same day, where it was then discussed on 14 May 2020. Portugal did not submit its 2020 Stability Programme within the deadline laid down in Article 4(1) of Regulation (EC) 1466/97 and it did not include either a macroeconomic scenario or plans for the general government balance and debt-to-GDP ratio for at least 2020.²

Portugal is currently subject to the preventive arm of the Stability and Growth Pact. As the general government debt-to-GDP ratio was 131.5% in 2016 (the year in which Portugal corrected its excessive deficit), exceeding the Treaty reference value of 60%, the country was also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit. In this period, Portugal should have ensured sufficient progress towards compliance with the debt reduction benchmark. After the transition period, as of 2020, Portugal is expected to comply with the debt reduction benchmark.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply, while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

¹ The 2020 Stability Programme submitted by Portugal does not indicate that it also constitutes the national medium-term fiscal plan required under Article 4(1) of Regulation (EU) 473/2013.

² Portugal's 2020 Stability Programme contains only the projected budgetary impact of the measures taken by the Portuguese authorities to tackle the COVID-19 pandemic on an either monthly or annual basis, without providing a projected annual aggregate figure for 2020. Portugal was thus not in compliance with Regulation (EU) 473/2013 or the minimum guidelines agreed with the Economic and Financial Committee.

Portugal's Law No 9-A/2020 of 17 April introduced an exceptional and temporary budgetary procedure in the wake of the COVID-19 pandemic. In particular, it was decided that, exceptionally, some relevant provisions of Portugal's Budgetary Framework Law would not be in force in 2020. On that basis, the deadline of 15 April for the government to present to national parliament the 2020 Stability Programme did not apply, while the national parliament was in principle still granted 10 days to analyse that document before its subsequent submission to the Commission.

2. MACROECONOMIC DEVELOPMENTS

Before the outbreak of the COVID-19 pandemic, the Portuguese economy was on a gradually moderating path since real GDP growth peaked at 3.5% in 2017. In 2019, real GDP growth slowed to 2.2%, from 2.6% in 2018 (see Table 1). The economy performed strongly in the first two months of 2020.

The 2020 Stability Programme submitted by the Portuguese authorities does not contain a complete macroeconomic scenario. However, it estimates that, on average, every 30 working days – i.e. around 1.5 full calendar months – of lock-down may trigger a negative impact on annual GDP of 6.5 percentage points. That estimate would correspond to the expected economic impact of the lock-down period – i.e. when the constitutional state of emergency was in force – between 18 March and 2 May 2020. Following that strong exogenous shock, the overall economic impact of the COVID-19 pandemic in 2020 would depend on the speed at which the economy recovers during the subsequent deconfinement period.

In 2020, according to the Commission 2020 spring forecast (hereafter called Commission forecast) – which reflects, among other factors, the expected macroeconomic impact of the COVID-19 pandemic – economic activity is projected to fall sharply, with real GDP contracting by 6.8%. As regards domestic demand, private consumption is projected to drop at a slightly lower rate than real GDP, as policy measures partly offset losses in household income. Investment is expected to be the hardest hit due to lingering uncertainty and despite the newly introduced flexibility in European Structural and Investment Funds. As regards external demand, both exports and imports are projected to decrease at double-digit rates, with the former being especially impacted by the expected disruption in foreign tourism. The unemployment rate is set to rise from 6.5% in 2019 to 9.7% in 2020.

In 2021, although real GDP is expected to recover by 5.8% according to the Commission forecast, the aftershocks are likely to linger in some sectors, particularly tourism. As a result, real GDP is projected to remain below its 2019 level until 2021. The expected slow recovery in tourism and related services is projected to weigh on labour demand over a longer period, with the unemployment rate being projected at 7.4% in 2021, still above its level in 2019.

Overall, the Commission's macroeconomic forecast is surrounded by an unusually high degree of uncertainty and risks are tilted to the downside given the reliance of the Portuguese economy on foreign tourism, which is expected to be strongly hit by the COVID-19 pandemic.

Given the absence of a complete macroeconomic scenario in Portugal's 2020 Stability Programme, the Portuguese Public Finance Council – which is the country's independent body as defined in Regulation (EU) No 473/2013 – was not in a position to carry out its customary analysis underpinning its endorsement decision on the government's macroeconomic forecast.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.2		-6.8		5.8			
Private consumption (% change)	2.2		-5.8		5.3			
Gross fixed capital formation (% change)	6.3		-8.6		8.9			
Exports of goods and services (% change)	3.7		-14.1		13.2			
Imports of goods and services (% change)	5.2		-10.3		10.3			
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	2.7		-4.9		4.7			
- Change in inventories	0.0		-0.2		0.1			
- Net exports	-0.6	n.a.	-1.6	n.a.	1.0	n.a.	n.a.	n.a.
Output gap	2.4		-5.4		-1.7			
Employment (% change)	0.8		-3.4		2.7			
Unemployment rate (%)	6.5		9.7		7.4			
Labour productivity (% change)	1.4		-3.4		3.0			
HICP inflation (%)	0.3		-0.2		1.2			
GDP deflator (% change)	1.7		1.2		1.4			
Comp. of employees (per head, % change)	2.8		0.2		1.7			
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.8		0.5		0.8			

Source :

Commission 2020 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments and medium-term strategy and targets³

In 2019, Portugal's general government balance turned into a surplus of 0.2% of GDP, supported by strong revenue performance – especially in social contributions and indirect taxes – and continuously decreasing interest expenditure (see Table 2). Public investment stabilised at 1.9% of GDP in 2019, below government plans and the EU average of 3% of GDP. The observed surplus overachieved the government's target of a deficit of 0.1% of GDP in 2019, according to the Draft Budgetary Plan for 2020, helped by the above-mentioned lower-than-planned interest expenditure and public investment, as well as some additional restraint in intermediate consumption. Excluding the impact of a further activation of the Novo Banco contingent capital mechanism (of 0.5% of GDP last year) and other one-offs, the general government balance reached a surplus of 0.8% of GDP in 2019.

The 2020 Stability Programme submitted by the Portuguese authorities does not contain plans for the general government balance in 2020. However, it is expected that the economic and social consequences of the COVID-19 pandemic will cause a sizeable deterioration of Portugal's budget balance in 2020, reflecting the operation of the automatic stabilisers and the need for significant fiscal policy support.

In 2020, according to the Commission forecast – which reflects, among other factors, the expected budgetary impact of the COVID-19 pandemic – Portugal's general government balance is projected to worsen to a deficit of 6.5% of GDP. Two main negative factors are expected to contribute to that deterioration. First, the operation of the automatic stabilisers in view of the projected economic downturn – with a deficit-increasing impact of above 4% of GDP – is projected to translate into decreases in current revenue, reflecting a strong contraction in the relevant tax bases, as well as into non-discretionary increases in unemployment benefit expenditure. Second, the mostly discretionary decrease of the structural primary balance – with a deficit-increasing impact of close to 2.5% of GDP – is expected to reflect the estimated budgetary cost of the measures taken by the Portuguese authorities to tackle the COVID-19 pandemic, which are projected to drive up especially current spending on subsidies and social transfers. The forecast expansionary fiscal policy stance in 2020 is set to translate into a decrease of the structural balance by 2.7% of GDP.

In 2021, under the customary no-policy-change assumption, the general government deficit is projected to decrease swiftly to 1.8% of GDP, on the back of the expected economic recovery and the phasing-out of fiscal policy measures taken by the Portuguese authorities in response to the COVID-19 pandemic. The latter should also support the structural balance in 2021.

³ In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	42.9	42.7		42.7				
<i>of which:</i>								
- Taxes on production and imports	15.1	14.9		14.9				
- Current taxes on income, wealth, etc.	9.8	9.6		9.6				
- Social contributions	11.9	11.8		11.8				
- Other (residual)	6.0	6.4		6.4				
Expenditure	42.7	49.3		44.5				
<i>of which:</i>								
- Primary expenditure	39.7	45.9		41.1				
<i>of which:</i>								
Compensation of employees	10.7	11.8		11.2				
Intermediate consumption	5.2	5.7		5.3				
Social payments	18.2	20.4	n.a.	18.9	n.a.	n.a.	n.a.	n.a.
Subsidies	0.4	1.9		0.4				
Gross fixed capital formation	1.9	2.3		2.3				
Other (residual)	3.2	3.9		3.0				
- Interest expenditure	3.0	3.4		3.4				
General government balance (GGB)	0.2	-6.5		-1.8				
Primary balance	3.2	-3.1		1.6				
One-off and other temporary measures	-0.6	-0.5		0.3				
GGB excl. one-offs	0.8	-6.1		-2.1				
Output gap	2.4	-5.4		-1.7				
Cyclically-adjusted balance	-1.1	-3.6		-0.9				
Structural balance¹	-0.5	-3.2		-1.2				
Structural primary balance ¹	2.5	0.2		2.2				
Gross debt ratio	117.7	131.6		124.4				

Notes:

¹Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-offs and other temporary measures.

Source:

Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.

3.2. Measures underpinning the Programme

To counter the economic and social impact of the COVID-19 pandemic, Portugal swiftly implemented a broad range of fiscal policy measures. First, measures were taken to reinforce the response capacity of the health system. Second, additional measures were adopted – notably through the government decisions of 13 and 26 March –, with a view to protect jobs, provide social support and safeguard firms’ business continuity (see Table 3). They mainly consisted of wage subsidy schemes for dependent workers as well as the self-employed, notably a simplified scheme for the temporary interruption of work (denominated “lay-off” in Portugal). Third, those measures – which have a direct impact on the general government balance – were complemented with “liquidity measures”⁴, such as tax and social contribution deferrals, State-guaranteed credit lines⁵ for firms, including those to finance working capital and long-term investment, as well as export credit insurance schemes (see Table 4). Currently, all those measures are foreseen to be temporary.

Portugal’s 2020 Stability Programme reports estimates of the budgetary impact of the measures adopted in response to the COVID-pandemic on an either monthly or annual basis.⁶ However, an overall estimate of their annual aggregate budgetary impact in 2020 is not provided. Moreover, the Programme does not explain the assumptions underlying the estimates of the budgetary impact of those measures. According to the Commission forecast, the overall direct budgetary cost of those measures is estimated at around 2.5% of GDP in 2020. Assuming that most measures for which only the estimated monthly budgetary impact has been reported in the Programme would be in force over three months – i.e. the corresponding maximum period foreseen in the applicable legislation at the cut-off date of the Commission’s forecast (23 April 2020) – and despite some differences in the costing of individual measures⁷, the annual aggregate budgetary impact underlying the

⁴ Subject to more detailed information, the competent statistical authorities are to examine whether those liquidity measures entail an immediate impact on the general government balance or not.

⁵ While the 2020 Stability Programme reports State-guaranteed credit lines of EUR 3 billion (1.5% of GDP), Government Order No 5503-B/2020 of 13 May makes reference to credit lines of EUR 6.2 billion (3.1% of GDP).

⁶ The 2020 Stability Programme does not report estimates of the potential budgetary impact of the temporary suspension of enforcement proceedings by Portugal’s Tax and Customs Authority and Social Security, which implies a change in the timing of coercive collection and, thereby, possibly lower government revenue in 2020 if the ensuing immediate loss is not recouped within the year.

⁷ Those differences notably concern the simplified “lay-off” scheme and other ancillary measures. From the estimated one-time budgetary cost of EUR 508.0 million in the Programme for the extraordinary support for firms for the resumption of business activity – amounting to one minimum wage (EUR 635) per worker under the simplified “lay-off” scheme – it could be tentatively inferred that 800.000 individuals are assumed to be covered by that scheme on a monthly basis. That would be consistent with the estimated monthly budgetary cost of EUR 373.3 million in the Programme for the simplified “lay-off” scheme, based on an average indicative wage of EUR 1,000. While the Commission considered an average wage close to that amount, it assumed that the simplified “lay-off” scheme would cover more individuals, in view of what could be reasonably expected based on publicly available information at the cut-off date of its forecast (23 April 2020).

Programme in 2020 would be broadly in line with the Commission's own projections.⁸

Overall, the measures taken by Portugal are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak.⁹ Those measures appear to constitute a timely, temporary and targeted response to cushion the shock induced by the COVID-19 pandemic. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium-term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

⁸ Overall, the Commission's higher estimates of the budgetary cost of the measures linked to the simplified "lay-off" scheme – compared with the Programme's – are broadly offset by lower estimates of the cost of other measures, including of those related to prophylactic isolation and sick leave.

⁹ https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf

Table 3: Discretionary measures adopted in response to COVID-19 outbreak

Frequency	Description	ESA code	Adoption status	Budgetary impact in 2020	
				EUR million	% of GDP
Monthly	• Simplified "lay-off" – support for maintenance of employment contract	D.39	Adopted	373.3	0.19
	• Simplified "lay-off" – employers' social contribution exemption	D.61	Adopted	190.0	0.09
	• Purchase of personal protective equipment (e.g. masks and gloves)	P.2	Adopted	156.0	0.08
	• Sick leave (COVID-19)	D.62	Adopted	155.0	0.08
	• Exceptional family support	D.75	Adopted	133.0	0.07
	• Prophylactic isolation (sick leave)	D.62	Adopted	110.0	0.05
	• Extraordinary support for self-employed workers and managing partners	D.39	Adopted	60.0	0.03
	• Exemption from municipal charges	D.2+D.4+D.75	Adopted	37.7	0.02
	• Extraordinary support for vocational training	D.39	Adopted	8.0	0.00
Total				1,223.0	0.61
One-time	• Extraordinary support for the resumption of business activity	D.39	Adopted	508.0	0.25
	• Purchase of equipment for intensive care units (e.g. ventilators)	P.51	Adopted	60.0	0.03
	Total				568.0
Unspecified	• Other public health-related measures	P.2	Adopted	94.4	0.05
	• Other miscellaneous measures	P.2+D.75	Adopted	16.2	0.01
	• Other family support-related measures	D.62	Adopted	9.0	0.00
	Total				119.6

Notes: "Unspecified" refers to groupings of measures for which details regarding their individual frequency were not provided in the Programme. The budgetary impacts are expressed as a percentage of GDP in 2020 according to the Commission 2020 spring forecast.

Source: Stability Programme.

Table 4: Liquidity measures adopted in response to COVID-19 outbreak

Type	Description	Adoption status	Impact		
			EUR million	% of GDP	
Tax and social contribution deferrals	• Tax withholdings (PIT and CIT) and VAT (deferral of 2/3 to second semester of 2020)	Adopted	5,200.0	2.60	
	• CIT (miscellaneous payments on account)	Adopted	1,680.0	0.84	
	• Social contributions (deferral of 2/3 to second semester of 2020)	Adopted	1,000.0	0.50	
	Sub-total			7,880.0	3.93
Purchase of goods to fight COVID-19	• VAT exemption on imports, intra-EU purchases and purchases in the domestic market	Adopted	272.0	0.14	
	• Customs allowance for the purchase of goods to fight COVID-19	Adopted	13.0	0.01	
	Sub-total			285.0	0.14
Moratoria	• Credit to firms and other organisations	Adopted	9,000.0	4.49	
	• Credit to households (permanent residence)	Adopted	2,300.0	1.15	
	• Other moratoria-related measures	Adopted	51.7	0.03	
	Sub-total			11,351.7	5.67
Portugal 2020 and EU Structural and Investment Funds	• Acceleration of payments of PT2020 support to entities other than firms	Adopted	300.0	0.15	
	• Other EU-fund-related measures	Adopted	285.8	0.14	
	• Acceleration of PT2020 incentive payments to firms	Adopted	260.0	0.13	
	• Digitisation (equipment and support for teleworking and tele-education)	Adopted	226.5	0.11	
	• Extension of the credit repayment term (PT2020/QREN)	Adopted	216.0	0.11	
Sub-total			1,288.3	0.64	
Other liquidity measures	• State-guaranteed credit lines	Adopted	3,000.0	1.50	
	• Support line for working capital and liquidity	Adopted	400.0	0.20	
	• Other liquidity-related measures	Adopted	382.5	0.19	
	• State-guaranteed export credit insurance (increase in ceiling)	Adopted	250.0	0.12	
	Sub-total			4,032.5	2.01
Miscellaneous measures	• Ensuring access to essential services	Adopted	203.3	0.10	
	• Foreign affairs (i.a. cooperation with Portuguese-speaking countries and repatriations)	Adopted	97.4	0.05	
	Sub-total			300.7	0.15
Total				25,138.2	12.5

Notes: The budgetary impacts are expressed as a percentage of GDP in 2020 according to the Commission 2020 spring forecast.

Source: Stability Programme.

3.3. Debt developments

Before the outbreak of the COVID-19 pandemic, Portugal's general government debt-to-GDP ratio was on a steady downward path since the peak of 131.5% in 2016 (see Table 5). In 2019, the debt-to-GDP ratio declined to 117.7%, mainly reflecting the debt-reducing impact stemming from a solid primary surplus (of 3.2% of GDP) and a favourable nominal GDP growth-interest rate differential, whereby the combined effects of real GDP growth and inflation (of 4.6% of GDP altogether) offset the sizeable – yet gradually diminishing – interest burden on the high debt overhang (of 3.0% of GDP). The stock-flow adjustment was nevertheless positive in 2019 (at 0.5% of GDP), mostly in view of an increase in the net acquisition of financial assets.

The 2020 Stability Programme submitted by the Portuguese authorities does not contain plans for the general government debt-to-GDP ratio in 2020. In 2020, according to the Commission forecast, a sudden primary deficit and the projected dynamics of real GDP are expected to cause the public debt-to-GDP ratio to peak at 131.6%. In 2021, the public debt-to-GDP ratio is set to drop to 124.4%, thereby resuming its gradually decreasing path mainly on the back of the expected economic recovery.

Table 5: Debt developments

(% of GDP)	Average 2014-2018	2019	2020		2021		2022	2023
			COM	SP	COM	SP	SP	SP
Gross debt ratio¹	128.8	117.7	131.6		124.4			
Change in the ratio	-1.9	-4.3	13.8		-7.2			
<i>Contributions²:</i>								
1. Primary balance	-0.7	-3.2	3.1		-1.6			
2. "Snow-ball" effect	-0.4	-1.5	10.3	n.a.	-5.4	n.a.	n.a.	n.a.
<i>Of which:</i>								
Interest expenditure	4.2	3.0	3.4		3.4			
Growth effect	-2.7	-2.5	8.4		-7.1			
Inflation effect	-1.9	-2.0	-1.5		-1.7			
3. Stock-flow adjustment	-0.7	0.5	0.3		0.0			

Notes:

¹ End of period.

² The 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 2020 spring forecast (COM); Stability Programme (SP), Commission calculations.

3.4. Risk assessment

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting lock-down measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees issued in response to the crisis.

In addition, the Commission's budgetary forecast is subject to country-specific risks, linked to the surge in public contingent liabilities stemming from some public corporations and the private sector, including through the possible calling of the State guarantees. Those risks come on top of non-negligible pre-existing levels of public contingent liabilities, partly related to potential further budgetary impacts of additional bank support measures.

Specifically, in line with the principles underlying the production of no-policy-change budgetary projections, the Commission's forecast for the general government balance in 2020 still followed the EUR 600 million (0.3% of GDP) planned for the negative impact of the activation of the Novo Banco contingent capital mechanism according to Portugal's updated Draft Budgetary Plan for 2020.¹⁰ That owed to the fact that the Commission did not obtain from the Portuguese authorities any sufficiently detailed and credibly announced update of the planned amount by the cut-off date of its forecast (23 April 2020). In early-May 2020, a deficit-increasing capital transfer of EUR 1,035 million (0.5% of GDP) to Novo Banco has been carried out by the Portuguese Resolution Fund – of which part corresponds to a State loan of EUR 850 million (0.4% of GDP) – by consequence of which results that a downside risk of 0.2% of GDP to the Commission's forecast for the general government balance in 2020 has already materialised.¹¹

¹⁰ That was according to the government plans as reported in Table 3.3 – “Main fiscal policy measures in 2019 and 2020” of the 2020 Draft Budget Report (page 61).

¹¹ In line with the principles underlying the production of no-policy-change budgetary projections, the Commission's forecast for the general government debt-to-GDP ratio in 2020 followed the Portuguese authorities' conservative approach and, therefore, had already factored in a debt-increasing State loan of EUR 850 million (0.4% of GDP) as reported in Table 4.31 – “Exceptional expenditure” of the 2020 Draft Budget Report (page 114).

4. COMPLIANCE WITH THE STABILITY AND GROWTH PACT

4.1. Compliance with the deficit criterion

According to the Commission forecast, Portugal's general government deficit is projected to reach 6.5% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. Moreover, all available evidence, including statements by the Portuguese authorities about the extent of the reaction of budgetary policy to the severe economic downturn associated with the COVID-19 pandemic, points to a general government deficit significantly in excess of the Treaty reference value of 3% of GDP in 2020. In its letter of 7 May 2020, the Commission invited the Portuguese authorities to clarify the size of the planned general government deficit in 2020. In their letter of 13 May 2020, the Portuguese authorities did not provide the requested clarification and alluded to exceptional conditions related to the COVID-19 pandemic. Taking those factors into account, the Commission considers its current forecast for the general government deficit in 2020 as sufficiently compelling prima facie evidence of an excessive deficit as defined by Article 126(2)(a) of the Treaty. Against this background, the Commission has therefore prepared a report under Article 126(3) of the Treaty, which analyses Portugal's compliance with the deficit criterion. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is not fulfilled.

4.2. Compliance with the debt criterion

Following the abrogation of the excessive deficit procedure in June 2017, Portugal was subject to a three-year transition period to ensure sufficient progress towards compliance with the debt reduction benchmark. The transition period started in 2017 and ended in 2019. During that period, Portugal was required to make sufficient progress – as defined by the minimum linear structural adjustment (MLSA) – towards compliance with the debt reduction benchmark at the end of the transition period. As the structural balance is estimated to have improved by 0.4% of GDP in 2019, compared with the applicable MLSA of -1.8% of GDP, Portugal is considered to have made sufficient progress towards meeting the debt reduction benchmark last year.

As Portugal's general government debt-to-GDP ratio was 117.7% in 2019 – thereby above the Treaty reference value of 60% – the country is requested to comply with the debt reduction benchmark after the transition period, as of 2020. According to the Commission forecast, the debt reduction benchmark is expected not to be met in 2020 (gap of 3.5% of GDP), but to be respected in 2021 (gap of -0.2% of GDP).

4.3. Compliance with the required adjustment path towards the medium-term budgetary objective in 2019¹²

On 13 July 2018, Portugal was recommended to ensure that the nominal growth rate of primary government expenditure, net of discretionary revenue measures and one-offs, did not exceed 0.7% in 2019 (the “expenditure benchmark”), corresponding to an annual structural adjustment of 0.6% of GDP. Based on outturn budgetary data and the Commission forecast, the growth rate of net primary government expenditure was 3.5% in 2019, thereby exceeding the applicable expenditure benchmark. Thus, the expenditure benchmark points to a significant deviation of 1.0% of GDP in 2019. In turn, the structural balance improved by 0.4% of GDP in 2019, indicating a deviation of 0.2% of GDP from the above-mentioned recommended structural adjustment of 0.6% of GDP. This points to some deviation from the recommended structural adjustment in 2019.

The divergence between the fiscal effort based on each indicator stems from differences in the underlying estimates of potential GDP growth and the GDP deflator, with the expenditure benchmark incorporating more conservative assumptions. Moreover, the fiscal effort based on the structural balance is positively impacted by declining interest expenditure and, albeit to a lesser extent, revenue windfalls – mostly in social contributions –, which are both excluded from the expenditure benchmark. An overall assessment taking into consideration the above-mentioned factors confirms the significant deviation from the requirements of the preventive arm of the Stability and Growth Pact in 2019, and over 2018 and 2019 taken together.

¹² The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

Table 6: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020	2021
Background budgetary indicators¹				
(1)	Medium-term objective (MTO)	0.25	0.0	0.0
(2)	Structural balance ² (COM)	-0.5	-3.2	-1.2
Setting the required adjustment to the MTO				
(3)	Structural balance based on freezing (COM)	-0.4		
(4) = (1) - (3)	Position vis-a -vis the MTO ³	Not at MTO		
(5)	Required adjustment ⁴	0.6		
(6)	Required adjustment corrected ⁵	0.6		
(7)	Corresponding expenditure benchmark ⁶	0.7		
Compliance with the required adjustment to the MTO				
		COM	COM	SP
<i>Structural balance pillar</i>				
(8) = Δ (2)	Change in structural balance ⁷	0.4		
(9) = (8) - (6)	One-year deviation from the required adjustment ⁸	-0.2		
	Two-year average deviation from the required adjustment ⁸	0.0		
<i>Expenditure benchmark pillar</i>				
(10)	Net public expenditure annual growth corrected for one-offs ⁹	3.5		
(11) = (10) - (7)	One-year deviation adjusted for one-offs ¹⁰	-1.0		
	Two-year deviation adjusted for one-offs ¹⁰	-1.3		
Finding of the overall assessment		Significant deviation		
Compliance with the debt criterion				
<i>Transition period</i>				
	Required structural adjustment (MLSA) ¹¹	-1.8	-	-
	Structural adjustment ¹²	0.4	-	-
<i>After transition period</i>				
	Gap to the debt benchmark ^{13,14}	-	3.5	n.a.
				-0.2
				n.a.

Legend:

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).



Notes:

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 (pps.) is allowed in order to be evaluated as having reached the MTO.

² Structural balance = cyclically-adjusted government balance excluding one-off measures.

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 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 .

⁷ Change in the structural balance compared to year $t-1$. Ex-post assessment (for 2019) is carried out on the basis of Commission 2020 spring forecast.

⁸ The difference of the change in the structural balance and the corrected required adjustment.

⁹ Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal).

¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs 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.

¹¹ 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 (SP) budgetary projections for the previous years are achieved.

¹² Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

¹³ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

¹⁴ 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.

Source:

Stability Programme (SP); Commission 2020 spring forecast (COM); Commission calculations.