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Assessment of the 2019 Stability Programme for

Portugal

(Note prepared by DG ECFIN staff)

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EXECUTIVE SUMMARY

Portugal is subject to the preventive arm of the Stability and Growth Pact. Since Portugal's public debt ratio is above the Treaty reference value of 60% of GDP, it also needs to ensure sufficient progress towards compliance with the debt reduction benchmark.

Economic growth in Portugal is expected to moderate from 2.1% in 2018 to 1.7% in both 2019 and 2020, according to the Commission 2019 spring forecast. This compares to slightly higher growth rates in the Stability Programme, where the outlook on the external balance appears more favourable (particularly in 2019). According to the Commission forecast, robust domestic demand is set to be the main growth driver over the forecast horizon, amid some moderation in private consumption and acceleration in investment (the latter supported by the absorption profile of the European Structural and Investment Funds). At the same time, net exports are projected to deteriorate further, owing to weaker demand from trading partners. The labour market is set to retain a sound pace of improvement, despite the projected slower job creation and slightly higher wage growth in the context of low inflation.

The general government headline deficit decreased to 0.5% of GDP in 2018. The Stability Programme plans the headline balance to further improve to -0.2% of GDP in 2019, before reaching a surplus of 0.3% of GDP in 2020. The programme forecasts limited improvements by 0.1% and 0.3% of GDP in the structural balance in 2019 and 2020 respectively. Thus, the new medium-term budgetary objective for 2020-2022, set at a balanced budgetary position in structural terms, is planned to be achieved in 2020. Risks to the achievement of the headline targets in 2019 and 2020 are related to uncertainties in the macroeconomic outlook, potential increased spending pressures, in particular for compensation of employees, and a potential higher impact of banking support measures. The achievement of the planned structural adjustment also hinges on the more positive potential growth assumptions in the Stability Programme as compared to the Commission 2019 spring forecast.

Based on the Commission 2019 spring forecast, Portugal is projected to be at risk of significant deviation from the structural adjustment path towards the medium-term budgetary objective in both 2019 and 2020. As a result, Portugal is not expected to reach the new medium-term budgetary objective in 2020. According to the Commission forecast, sufficient progress towards compliance with the debt reduction benchmark would be ensured in 2019, but the debt reduction benchmark would not expected to be met in 2020.

1. INTRODUCTION

On 30 April 2019, Portugal submitted its 2019 Stability Programme (hereafter called Stability Programme), covering the period 2019-2023. The government approved the programme on 15 April 2019 and submitted it to the Parliament on the same day, where it was then discussed on 24 and 26 April 2019.

Portugal is currently subject to the preventive arm of the the Stability and Growth Pact (SGP) and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the public debt ratio was 129.2% of GDP in 2016, exceeding the Treaty reference value of 60%, Portugal is also subject to transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit (transitional debt rule). In this period, it should ensure sufficient progress towards compliance with the debt reduction benchmark. As of 2020, after the 2017-2019 transition period, Portugal is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 27 February 2019 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 2019 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. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Real GDP in Portugal rose by 2.1% in 2018, slowing down from the peak of 2.8% in 2017. The slowdown has been driven by a negative external trade contribution, reflecting a steep deceleration in exports. However, domestic demand remained solid, particularly private consumption, albeit investment growth eased after an exceptional performance in 2017. Employment growth slowed towards the end of 2018 amid a still moderate wage development. HICP inflation declined to 1.2% in 2018, driven by some moderation in accommodation prices. Looking ahead, economic growth in Portugal is expected to slow down further, largely owing to weaker net exports, while domestic demand will continue to contribute positively albeit at a slower pace.

The macroeconomic scenario underpinning the Stability Programme sets real GDP growth at 1.9% in both 2019 and 2020, followed by a slight acceleration to 2.0% in 2021 and 2022. Private consumption is expected to expand by 1.8% in both 2019 and 2020, and to slightly speed up thereafter, supported by stronger wage dynamics. Investment growth is expected to be volatile over the programme horizon. It is projected to rebound to 5.3% in 2019 and to gradually decelerate afterwards, driven by the assumptions on the absorption profile of the European Structural and Investment Funds (ESIF). Export growth is expected to improve slightly in 2019 and to stabilise thereafter at around 3.8% per year over the programme horizon. Following a peak reached in 2018, employment growth is forecast to slow down to 0.6% in the period 2019-2022, while wage growth is expected to gradually increase from 2.7% in 2019 to 3.2% towards the end of the programme horizon. Accordingly, unemployment is set to steadily decline to 5.6% in 2022, while the annual HICP inflation is expected to remain at around 1.5% over the programme horizon.

Compared to the Commission 2019 spring forecast, the macroeconomic scenario under the Stability Programme has a slightly higher GDP growth projection, due to a more favourable outlook in the external balance. As regards domestic demand, private consumption in 2019 is expected to grow at a markedly lower rate in the Stability Programme, compared with the Commission forecast. In contrast, investment in 2019 is set to rise faster in the Stability Programme, compared with the Commission forecast. Overall, the Stability Programme envisages a smaller contribution of domestic demand to growth in 2019 while the net contribution from external trade is much more favourable than in the Commission forecast. In 2020, these differences across components appear only marginal. In both 2019 and 2020, the Stability Programme envisages higher wage growth than the Commission forecast, but the underlying impact on aggregate income is offset by more conservative employment projections, particularly in 2019. Price deflators in the Stability Programme are broadly in line with the Commission forecast, even if HICP inflation in 2019 is somewhat higher.

The output gap, as recalculated by the Commission based on the information in the programme, following the commonly agreed methodology, is estimated in a positive territory at 0.9% of GDP in 2019, and is set to decrease to 0.6% in 2020. According to the Commission 2019 spring forecast, the output gap is higher and increasing. This difference is explained by higher potential GDP growth estimates in the Stability Programme, stemming from more optimistic economic projections over the medium term. Overall, the programme's macroeconomic assumptions are plausible until 2020 and favourable thereafter.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022	2023
	COM	SP	COM	SP	COM	SP	SP	SP	SP
Real GDP (% change)	2.1	2.1	1.7	1.9	1.7	1.9	2.0	2.0	2.1
Private consumption (% change)	2.5	2.5	2.3	1.8	1.9	1.8	2.0	1.9	1.9
Gross fixed capital formation (% change)	4.4	4.4	4.6	5.3	5.0	4.9	4.5	4.5	4.5
Exports of goods and services (% change)	3.6	3.6	3.2	3.8	3.5	3.8	3.7	3.9	3.9
Imports of goods and services (% change)	4.9	4.9	4.9	3.9	4.6	3.9	3.9	3.9	3.9
Contributions to real GDP growth:									
- Final domestic demand	2.5	2.8	2.4	2.1	2.2	2.1	2.2	2.2	2.2
- Change in inventories	0.2	0.2	0.0	-0.2	0.0	-0.1	0.0	0.0	0.0
- Net exports	-0.5	-0.7	-0.7	-0.2	-0.5	-0.2	-0.2	-0.1	-0.1
Output gap[1]	1.2	0.9	1.3	0.9	1.4	0.6	0.5	0.7	0.8
Employment (% change)	2.3	2.3	1.1	0.6	0.8	0.6	0.6	0.6	0.4
Unemployment rate (%)	7.0	7.0	6.2	6.6	5.7	6.3	5.9	5.6	5.4
Labour productivity (% change)	-0.2	-0.2	0.5	1.3	0.9	1.3	1.4	1.4	1.6
HICP inflation (%)	1.2	1.2	1.1	1.4	1.6	1.5	1.6	1.5	1.6
GDP deflator (% change)	1.4	1.4	1.4	1.5	1.6	1.5	1.6	1.5	1.5
Comp. of employees (per head, % change)	2.0	2.1	2.2	2.7	2.3	3.0	3.2	3.2	3.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	0.2	0.2	0.0	0.4	0.1	0.5	1.0	0.6	0.6

Note:

[1]In % 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 2019 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2018 and 2019

The general government headline deficit turned out at 0.5% of GDP in 2018 and, thereby, 0.2% of GDP below the target of 0.7% of GDP in both the 2018 Stability Programme and the 2019 Draft Budgetary Plan (DBP).

As compared with the 2018 Stability Programme, the reduction of the headline deficit by close to 0.3% of GDP was mostly due to higher revenue (+0.6% of GDP), that was partially offset by higher expenditure (+0.3% of GDP). On the revenue side, the higher revenue from taxes and social contributions (+0.9% of GDP) largely exceeded shortfalls in capital revenue (close to -0.4% of GDP). On the expenditure side, the higher capital expenditure (+0.5% of GDP), intermediate consumption (+0.1% of GDP) and other current primary expenditure (+0.1% of GDP) were partially compensated by lower gross fixed capital formation (-0.3% of GDP).

As compared to the 2019 DBP projections for 2018, that had, on the one hand, revised upwards tax revenue, current primary expenditure and other capital expenditure and, on the other hand, revised downwards capital revenue and gross fixed capital formation, the 0.3% improvement in the headline deficit was mainly due to even higher revenue from taxes and social contributions (+0.4% of GDP) and from higher sales and other current revenue

(+0.1%), both partially offset by even lower capital revenue (-0.2% of GDP). While overall expenditure in 2018 turned out at the same level as projected in the 2019 DBP, still higher other capital expenditure (+0.2% of GDP) was broadly offset by still lower gross fixed capital formation (-0.1% of GDP) and lower overall current primary expenditure (-0.1% of GDP).

Overall, the 2018 budgetary outturn benefitted from very large revenue windfalls resulting from growth in tax revenue and social contributions largely exceeding standard elasticities, that were only slightly offset by an underperformance of non-tax revenue. Thus, the revenue from corporate income tax (CIT) benefitted from the acceleration of economic growth in 2017, translating into higher tax settlements in 2018 (referring to the increase of taxable income in the previous year). The revenue from personal income tax (PIT) and social contributions was supported by strong growth in employment and wages in both the private and public sectors. Finally, the revenue from the value-added tax (VAT) benefitted from the acceleration in private final consumption expenditure and from tourism in 2018.

The headline balance net of one-offs improved by 1.2% of GDP in 2018, from a deficit of 0.9% of GDP in 2017 to a surplus of 0.2% of GDP. When taking also into account the impact of the economic cycle, the structural balance improved by 0.9% of GDP, while the structural primary balance improved by 0.5% of GDP.

For 2019, the Stability Programme targets a headline deficit of 0.2% of GDP, unchanged as compared to both the 2018 Stability Programme and the 2019 DBP while the underlying composition by revenue and expenditure categories has changed. Thus, as compared with the 2018 Stability Programme, both revenue and expenditure have been revised upwards by 1.0% of GDP. On the revenue side, the upward revision by around 0.8% of GDP of revenue from taxes and social contributions and by 0.3% of GDP of sales and other current revenue was only slightly offset by a downward revision by 0.1% of GDP of capital revenue. On the expenditure side, as regards current expenditure, the upward revision of primary current expenditure by around 0.7% of GDP was only slightly compensated by a downward revision of interest expenditure by 0.1% of GDP. As regards capital expenditure, the upward revision of other capital expenditure by 0.7% of GDP, which mainly reflects the budgetary impact of 0.6% of GDP of the second activation of the Novo Banco contingent capital mechanism, was partially offset by a downward revision of gross fixed capital formation by 0.3% of GDP.

As compared to the 2019 DBP, the unchanged headline deficit target for 2019 mostly reflects the deficit-increasing budgetary impact of 0.4% of GDP of the Novo Banco contingent capital mechanism, that was mainly offset by projected higher tax revenue and lower gross fixed capital formation. Thus, on the expenditure side, the upward revision by 0.4% of GDP of other capital expenditure was partially offset by a downward revision by 0.2% of GDP of gross fixed capital formation. Current expenditure remained broadly stable as compared to the 2019 DBP, with the planned increases by 0.1% of GDP in intermediate consumption and other current expenditure being broadly offset by decreases in social transfers and subsidies. The overall upward revision by around 0.25% of GDP on the expenditure side was broadly offset by a corresponding upward revision of overall revenue with increases for taxes and social contributions (by 0.4% of GDP) being partially offset by slight downward revisions of sales and other current revenue and of capital revenue (adding up to around -0.1% of GDP).

The Stability Programme projects the balance net of one-offs to slightly improve to a surplus of 0.4% of GDP in 2019. According to the programme, the planned reduction of the headline deficit in 2019 would be consistent with an improvement in the structural balance, recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology, by around 0.1% of GDP in 2019.

The planned headline deficit of 0.2% of GDP in 2019 in the Stability Programme compares with a projection of 0.4% of GDP in the Commission 2019 spring forecast. The resulting difference of 0.2% of GDP between both projections for the headline balance in 2019 stems from the Commission forecast's more conservative assumptions regarding the evolution of some revenue items (adding up to 0.1% of GDP) and from higher pressures in some expenditure items, in particular compensation of employees (0.1% of GDP). As regards the revenue side, the Commission forecast has more conservative assumptions for revenue from sales and other current revenue (-0.1% of GDP), based on the recent track record for these items, and for social security contributions (-0.1% of GDP), in line with standard elasticities. These lower projections are however partially offset by 0.1% of GDP from higher revenue from indirect taxes in the Commission forecast, consistent with its higher projection for private consumption growth in 2019. As regards the expenditure side, based on the Commission 2019 spring forecast, expenditure pressures are expected to be higher by around 0.1% of GDP, mostly from compensation of employees, based on the track record of continuously rising public employment in the period 2016-2018 (as opposed to planned decreases), the ongoing unfreezing of careers and the extension of the 35-hours working week in the health sector to private contracts. According to the Commission forecast, the structural balance is projected to remain broadly stable in 2019. The divergence of ¼% of GDP between both projections for the evolution of the structural balance in 2019 is mainly due to the difference between the underlying headline deficit forecasts, as well as marginally also due to a more positive evolution of the output gap in the Commission forecast, resulting in a higher increase in the cyclical adjustment compared with the Stability Programme.

3.2. Medium-term strategy and targets

Taking the 2018 headline deficit of 0.5% of GDP as a starting point, the Stability Programme plans an improvement of the headline balance by 1.1% of GDP over 2019-2023, reaching -0.2% of GDP in 2019, 0.3% in 2020, then peaking at 0.9% in 2021 (largely due to the positive change in the budgetary impact of one-offs, from -0.3% of GDP in 2020 to +0.3% of GDP in 2021, owing to the fading-out of the Novo Banco contingency capital mechanism impact and the reimbursement by the European Financial Stability Facility (EFSF) of prepaid margins), before finally stabilising at 0.7% of GDP in 2022 and 2023. The overall improvement of the headline balance over the programme horizon would thus be mostly due to the projected fading-out of negative budgetary impacts of one-offs, as the improvement of the general government balance net of one-offs is planned to be limited to 0.4% of GDP. This would be consistent with an overall improvement of the structural balance by 0.4% of GDP over the programme horizon, of which 0.1% of GDP in 2019, 0.3% of GDP in 2020, 0.1% of GDP in 2021, followed by small deteriorations by around 0.1% of GDP in 2022 and 2023. This rather frontloaded planned improvement of the structural balance would allow the new MTO to be reached in 2020. The chosen MTO of a balanced budgetary position in structural terms (0.0% of GDP) reflects the objectives of the SGP. The level of the Stability Programme's (recalculated) structural balance benefits by around 0.2% of GDP in 2019 and by around 0.4% of GDP in 2020 from higher potential growth assumptions as compared with the Commission forecast (leading to a lower cyclical adjustment due to a less positive evolution of the output gap). Such a less positive evolution of the output gap also leads to a 0.2% of GDP positive impact in the annual change of the structural balance in 2020, as compared with the Commission forecast.

Overall, following the stronger-than-expected headline and structural deficit reductions in 2018, the Stability Programme plans a slower pace of headline and structural balance improvement over the programme horizon, by an average of 0.2% of GDP per year as compared with the 2018 Stability Programme. The decrease in the planned improvement is slightly more pronounced for the headline balance than for the structural balance over the period 2019-2021, which partially results from the projected more negative budgetary impact of one-offs (i.e. mostly successive activations of the Novo Banco contingent capital mechanism) in these years. Thereafter, while the 2018 Stability Programme projected a further improvement of the structural balance in 2022, the 2019 Stability Programme keeps the structural balance broadly stable in 2022 and then projects a small deterioration in 2023.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	2023	Change: 2018-2023
	COM	COM	SP	COM	SP	SP	SP	SP	SP
Revenue	**43.5**	**43.8**	**43.8**	**43.8**	**43.7**	**43.9**	**43.2**	**43.0**	**-0.5**
of which:									
- Taxes on production and imports	15.3	15.4	15.3	15.5	15.2	15.2	15.1	15.0	-0.3
- Current taxes on income, wealth, etc.	10.4	10.2	10.2	10.3	10.1	10.0	10.0	9.9	-0.5
- Social contributions	11.8	11.9	11.9	11.9	12.0	12.0	12.0	12.0	0.2
- Other (residual)	6.0	6.3	6.4	6.1	6.3	6.7	6.2	6.1	0.1
Expenditure	**44.0**	**44.2**	**43.9**	**43.9**	**43.4**	**43.0**	**42.6**	**42.4**	**-1.6**
of which:									
- Primary expenditure	40.5	41.0	40.7	40.9	40.3	40.2	39.9	39.7	-0.8
of which:									
Compensation of employees	10.8	10.9	10.8	10.9	10.7	10.6	10.5	10.4	-0.4
Intermediate consumption	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	-0.1
Social payments	18.2	18.4	18.3	18.4	18.3	18.2	18.1	18.0	-0.2
Subsidies	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.0
Gross fixed capital formation	2.0	2.1	2.1	2.3	2.3	2.5	2.6	2.6	0.7
Other (residual)	3.7	3.7	3.7	3.3	3.2	3.1	2.9	2.9	-0.8
- Interest expenditure	3.5	3.3	3.3	3.1	3.0	2.9	2.7	2.7	-0.8
General government balance (GGB)	**-0.5**	**-0.4**	**-0.2**	**-0.1**	**0.3**	**0.9**	**0.7**	**0.7**	**1.1**
Primary balance	**3.0**	**2.9**	**3.1**	**3.0**	**3.3**	**3.8**	**3.4**	**3.4**	**0.4**
One-off and other temporary measures	-0.7	-0.6	-0.6	-0.3	-0.3	0.3	0.0	0.0	0.7
GGB excl. one-offs	**0.2**	**0.2**	**0.4**	**0.2**	**0.6**	**0.6**	**0.7**	**0.7**	**0.4**
Output gap[1]	1.2	1.3	0.9	1.4	0.6	0.5	0.7	0.8	-0.4
Cyclically-adjusted balance[1]	-1.1	-1.1	-0.6	-0.8	0.0	0.6	0.3	0.2	1.3
Structural balance[2]	**-0.4**	**-0.5**	**-0.1**	**-0.5**	**0.3**	**0.4**	**0.3**	**0.2**	**0.6**
Structural primary balance[2]	3.0	2.8	3.2	2.5	3.3	3.2	3.0	2.9	-0.1

Notes:

[1]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.

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

Source:

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

As compared with the 2019 DBP, the Stability Programme has slightly reduced the planned (recalculated) structural adjustment in 2019 (by around 0.1% of GDP), from 0.2% to 0.1% of GDP, in line with the slight upward revision of the projected budgetary cost of some structural expenditure measures (such as the reduction of the price of monthly tickets for public transport). The Stability Programme plans an improvement of the structural balance by 0.3% of GDP in 2020, as compared with a broadly unchanged structural balance in the

Commission 2019 spring forecast. The divergence of 0.3% of GDP between the change in the structural balance in both projections is partially related to the difference in the evolution of the headline balances but mostly to the more positive output gap evolution in the Commission forecast (based on lower estimates for potential GDP growth) than in the Stability Programme.

The Commission 2019 spring forecast projects a headline deficit of 0.1% of GDP in 2020, 0.4% of GDP below the target of a headline surplus of 0.3% of GDP in the Stability Programme. This difference mostly stems from the expenditure side, with about half being related to higher expected pressures for compensation of employees and further 0.1% of GDP to pressures on other expenditure items (also because expenditure-reducing measures could not be fully factored in). On the revenue side, the Commission forecast's more conservative projections for social security contributions, sales and other current and capital revenue are broadly offset by higher projections for indirect and direct taxes.

The budgetary targets in the programme are based on a no-policy-change scenario with negative annual impacts mostly from compensation of employees, complemented by a limited number of specified measures (already included in the 2018 Stability Programme) with broadly balanced annual impact and an expected gradually less negative budgetary impact of one-offs.

The headline balance is expected to improve by 1.1% of GDP from 2018 to 2023, which reflects mostly the expected reduction of the negative budgetary impact of one-offs by 0.7% of GDP, while the general government balance net of one-offs is expected to improve by only 0.4% of GDP. This improvement of the balance net of one-offs results from a decrease of the expenditure ratio by 0.9% of GDP that is partially offset by a decrease of the revenue ratio by 0.5% of GDP.

On the expenditure side, the overall positive contribution to the planned evolution of the balance net of one-offs is expected to be achieved via the projected decrease of interest expenditure by 0.8% of GDP, while the planned increase of gross fixed capital formation by 0.7% of GDP is planned to be broadly offset by a contained evolution of most other primary expenditure items (adding up to -0.8% of GDP net of one-offs), in particular compensation of employees and other expenditure, slightly below the relatively high projected nominal GDP growth.

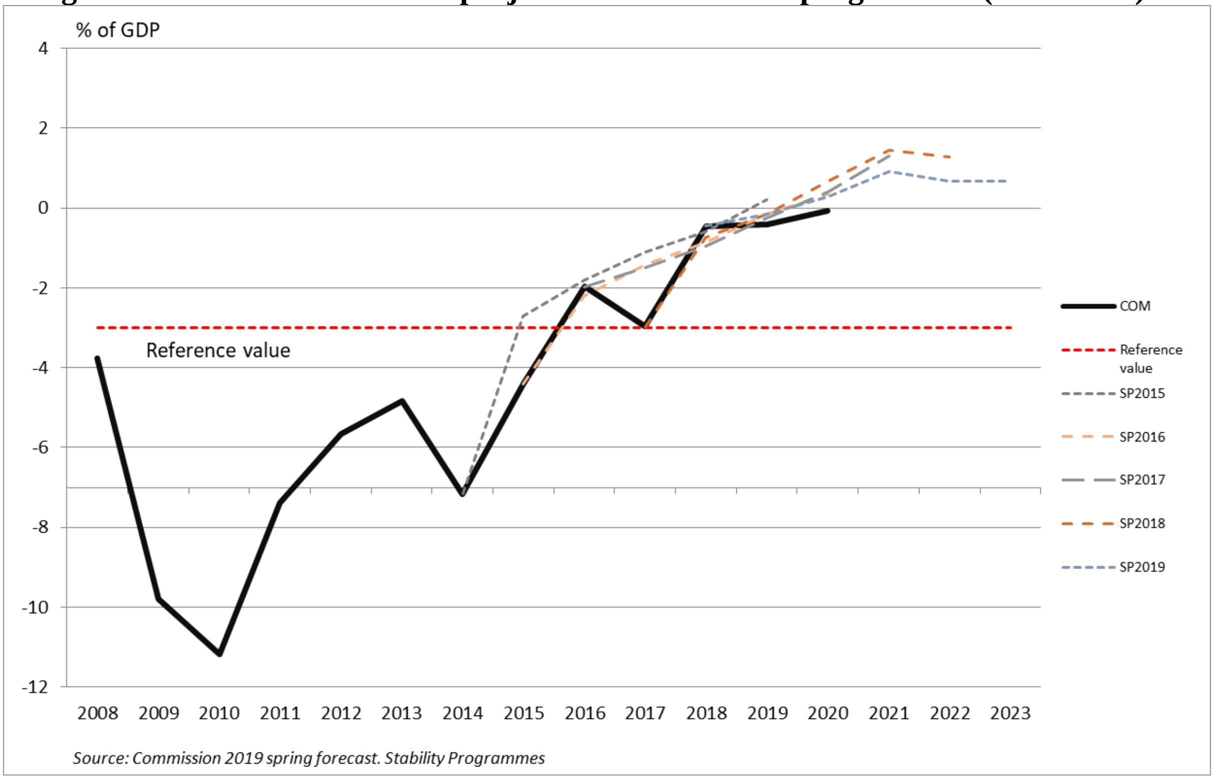
On the revenue side, the overall negative contribution to the planned evolution of the headline balance net of one-offs reflects a decrease in revenue from both direct taxes (by 0.5% GDP) and of indirect taxes (by 0.3% of GDP), which are projected to be only partially compensated by a 0.3% of GDP increase in all other revenue items (0.2% of GDP in revenue from social contributions and 0.1% of GDP in other revenue).

Due to a lower cyclical adjustment based on a gradually decreasing positive output gap (in line with the programme's higher potential growth projections), the improvement of the headline balance net of one-offs by 0.4% of GDP over the period 2019-2023 translates into an improvement of the structural balance by 0.6% of GDP. Given the projected reduction of interest expenditure by 0.8% of GDP, the structural balance improvement by 0.6% of GDP is projected to be accompanied by a deterioration of the structural primary balance by 0.1% of GDP over the programme horizon.

One-off measures, following strongly negative budgetary impacts in 2018 and 2019 (0.7% of GDP and 0.6% of GDP, respectively) – mostly related to the impact of the activations of the Novo Banco contingent capital mechanism –, are planned to have a further negative budgetary impact of 0.3% of GDP in 2020, turning into a positive budgetary impact of 0.3%

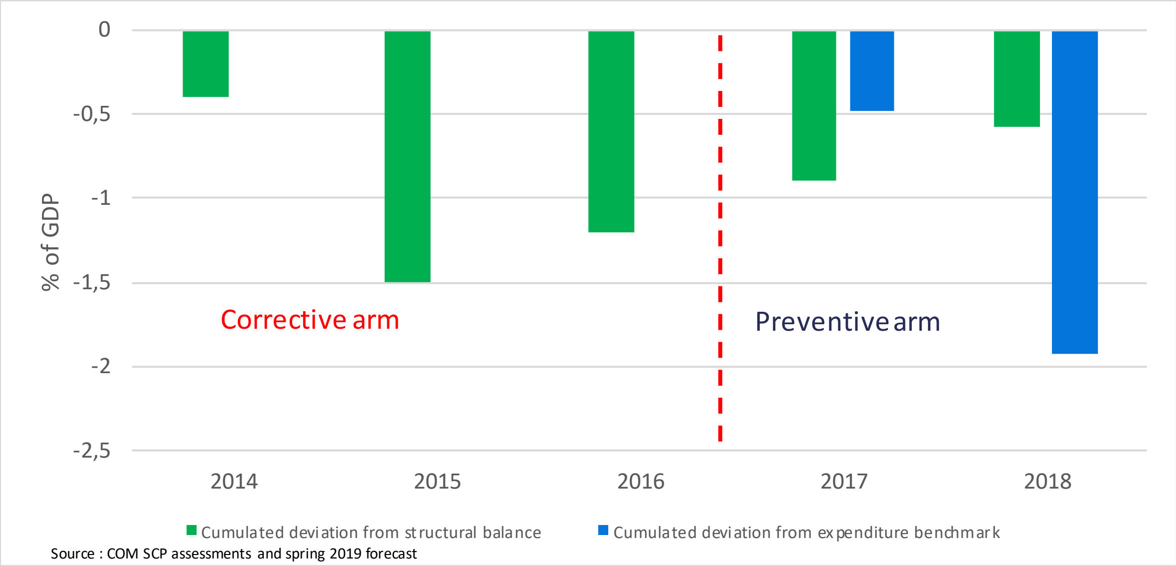
of GDP in 2021 due to another reimbursement by the EFSF of prepaid margins (0.4% of GDP) more than offsetting the less negative budgetary impact of the Novo Banco contingency capital mechanism (-0.2% of GDP). No further one-offs are projected to occur in 2022 and 2023, thus bringing the expected budgetary impact of one-offs to zero in those outer years.

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



While earlier Stability Programmes had typically implied some delay in the headline balance adjustment as compared to previous updates, the 2017, 2018 and 2019 Stability programmes – building on the achievement of the headline balance targets net of one-offs in the period 2016-2018 –, have maintained a fiscal path close to the 2016 Stability Programme up to 2020 (see Figure 1). While the outturn budgetary data have broadly confirmed the successive Stability Programme projections, they have been heavily impacted by one-off bank support measures in various years. While the 2017 and 2018 Stability Programmes were targeting headline surpluses of above 1% of GDP for 2021 and 2022, the 2019 Stability Programme projects the headline surplus to remain below 1% of GDP up to 2023.

Figure 2: Cumulative deviations in the preceding 5 years from the upper limit for net growth of government expenditure and from structural effort requirements (in % of GDP)



Portugal's structural adjustment fell short, by 0.4% of GDP in 2014 and by 1.1% of GDP in 2015, of the targets laid down in the 2013 revised Council recommendation under the Excessive Deficit Procedure (EDP). Following this cumulative deviation by around 1.5% of GDP, the 2016 budgetary outturn of an improvement of the structural balance by 0.3% of GDP allowed for a reduction of the cumulative deviation from the required structural balance adjustment to 1.2% of GDP.

Since the correction of the excessive deficit in 2016, Portugal has been subject to the preventive arm of the SGP and has been recommended to ensure an annual structural adjustment of 0.6% of GDP towards the MTO in both 2017 and 2018. In 2017, the improvement of the structural balance by 0.9% of GDP exceeded the recommendation by around 0.3% of GDP, thereby reducing the cumulative deviation to 0.9% of GDP. The expenditure benchmark, however, pointed to a deviation of 0.5% of GDP from the recommended effort in 2017. In 2018, the improvement of the structural balance again exceeded the recommended adjustment by around 0.3% of GDP and, accordingly, reduced the cumulative deviation since 2014 to around 0.6% of GDP. The structural balance pillar was positively impacted by revenue windfalls and declining interest expenditure and, therefore, the expenditure benchmark pillar provides a more negative picture in both 2017 and 2018. The growth rate of net primary expenditure in 2018 points to a further deviation by 1.5% of GDP.

Overall, over the last 5 years, the higher-than-recommended improvements of the structural balance by around 0.3% per year in the period 2016-2018 have not yet allowed to fully compensate the negative deviations recorded in the period 2014-2015. As regards the evolution in the preventive arm of the SGP, the expenditure benchmark pillar has been more stringent than the structural balance pillar for Portugal, mostly because of the exclusion of interest expenditure and of revenue windfalls and because of the lower underlying medium-term potential growth rate. This has led to increasing divergence between the cumulative deviation from the requirements for the two pillars over the period 2017-2018.

3.3. Measures underpinning the programme

The measures underpinning the 2019 Stability Programme mainly consist, on the one hand, of the incremental impact of recently decided fiscal policy measures that are included in the no-policy-change scenario and, on the other hand, of the new measures that were already included in the 2018 Stability Programme.

As regards fiscal policy measures for 2020, the deficit-increasing incremental impact of the unfreezing of careers in the public sector (0.2% of GDP) and the deficit-decreasing impact of higher social contributions from public sector wage revaluations (+0.1% of GDP) are considered in the programme's no-policy-change baseline scenario. Starting from this baseline, the Stability Programme plans deficit-decreasing impacts from the spending review on intermediate consumption, social transfers and other current expenditure (adding up to 0.1% of GDP), which are expected to broadly offset the deficit-increasing impact of the measures included in the programme's no-policy-change baseline.

The Commission 2019 spring forecast takes fully into account the deficit-increasing measures included in the Stability Programme's baseline scenario, in particular the unfreezing of careers in the public sector. It instead takes into account only partially the estimated budgetary impact of the impact of the spending review on intermediate consumption and other current expenditure, as this measure has not yet been specified in sufficient detail for 2020.

As regards the period 2021-2023, no major fiscal policy measures are planned on the revenue side, apart from a 0.1% of GDP reduction in PIT revenue in 2021, compensated by minor yearly reductions of tax benefits on indirect taxes from 2020 to 2022. On the expenditure side, the incremental budgetary impact of the unfreezing of careers in the public sector is projected to gradually decrease until 2022, before a slight reacceleration in 2023. This decreasing incremental budgetary impact of career progressions is, however, broadly offset by an increasing incremental budgetary impact of the expansion of the number of employees and of other wage revaluation measures (before a slight deceleration in 2023), thus keeping the annual overall incremental budgetary impact on compensation of employees of around 0.3% of GDP broadly constant over the period 2021-2023. As already included in the 2018 Stability Programme, social transfers are planned to increase by 0.1% of GDP in both 2021 and 2022. Finally, as regards one-off measures, the programme projects two further balance-deteriorating capital injections into Novo Banco of 0.3% of GDP in 2021 and of 0.2% of GDP in 2022, while a further recovery of EFSF prepaid margins would have a balance-improving impact by 0.4% of GDP in 2021.

Main budgetary measures included in the Programme

Revenue	**Expenditure**
2020	
• Higher Social Security contributions from public sector wage revaluation measures (+0.1% of GDP)	• Unfreezing of careers in the public sector (+0.2% of GDP) • Review of public expenditure (-0.1% of GDP) • Capital injection into Novo Banco (+0.3% of GDP)

2021	
• PIT reduction (-0.1% of GDP) • Higher Social Security contributions from public sector wage revaluation measures (+0.1% of GDP) • Reimbursement of EFSF prepaid margins (+0.4% of GDP)	• Unfreezing of careers in the public sector (+0.2% of GDP) • Increase of number of civil servants and wage revaluation measures (+0.1% of GDP) • Other social benefits (+0.1% of GDP) • Capital injection into Novo Banco (+0.2% of GDP)
2022	
	• Unfreezing of careers in the public sector (+0.1% of GDP) • Increase of number of civil servants and wage revaluation measures (+0.2% of GDP) • Other social benefits (+0.1% of GDP)
2023	
	• Unfreezing of careers in the public sector (+0.1% of GDP) • Increase of number of civil servants and wage revaluation measures (+0.1% of GDP)
Note: The table refers to the main measures included in the 2019 Stability Programme that have an incremental budgetary impact over the programme period. 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

After falling by 4.5 percentage points to 124.8% in 2017, Portugal's gross general government debt-to-GDP ratio has decreased by a further 3.3 percentage points to 121.5% in 2018, mainly as a result of the debt-reducing impacts stemming from the primary surplus of 3% of GDP and the favourable snow-ball effect (with the debt-ratio reducing impact of nominal GDP growth exceeding interest expenditure), while positive stock-flow adjustments had a debt-increasing impact of 0.6% of GDP.

The Stability Programme projects the debt-to-GDP ratio to continue on a firm downward path, expecting it to reach 118.6% by the end of 2019, and to steadily decline to 99.6% by the end of 2023, with a particularly strong reduction in 2021. The projected debt reduction is mostly underpinned by the planned primary surpluses, that are expected to further increase up to a peak of 3.8% of GDP in 2021, before stabilising at 3.4% of GDP thereafter, and a steadily favourable snow-ball effect. The stock-flow adjustments are projected to have a substantial debt-increasing impact in both 2019 and 2020 of around 1% of GDP, followed by sizeable debt-decreasing impacts in 2021 and 2022, mostly linked to planned reductions in the cash buffer.

The Commission 2019 spring forecast expects a somewhat higher general government debt-to-GDP ratio of 119.5% in 2019 and 116.6% in 2020, mostly due to projected higher headline deficits and lower nominal GDP growth in 2019.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022	2023
			COM	SP	COM	SP	SP	SP	SP
Gross debt ratio[1]	**128.5**	**121.5**	**119.5**	**118.6**	**116.6**	**115.2**	**109.0**	**103.7**	**99.6**
Change in the ratio	-0.3	-3.3	-2.0	-2.9	-2.9	-3.4	-6.2	-5.3	-4.1
Contributions[2]:									
1. Primary balance	**-0.2**	**-3.0**	**-2.9**	**-3.1**	**-3.0**	**-3.3**	**-3.8**	**-3.4**	**-3.4**
2. "Snow-ball" effect	**0.8**	**-0.8**	**-0.3**	**-0.7**	**-0.8**	**-0.9**	**-1.1**	**-1.0**	**-0.8**
Of which:									
Interest expenditure	4.5	3.5	3.3	3.3	3.1	3.0	2.9	2.7	2.7
Growth effect	-1.6	-2.6	-2.0	-2.2	-2.0	-2.2	-2.2	-2.1	-2.1
Inflation effect	-2.1	-1.7	-1.6	-1.8	-1.9	-1.8	-1.8	-1.6	-1.5
3. Stock-flow adjustment	**-0.9**	**0.6**	**1.2**	**1.0**	**0.9**	**0.9**	**-1.3**	**-0.9**	**0.1**

Notes:

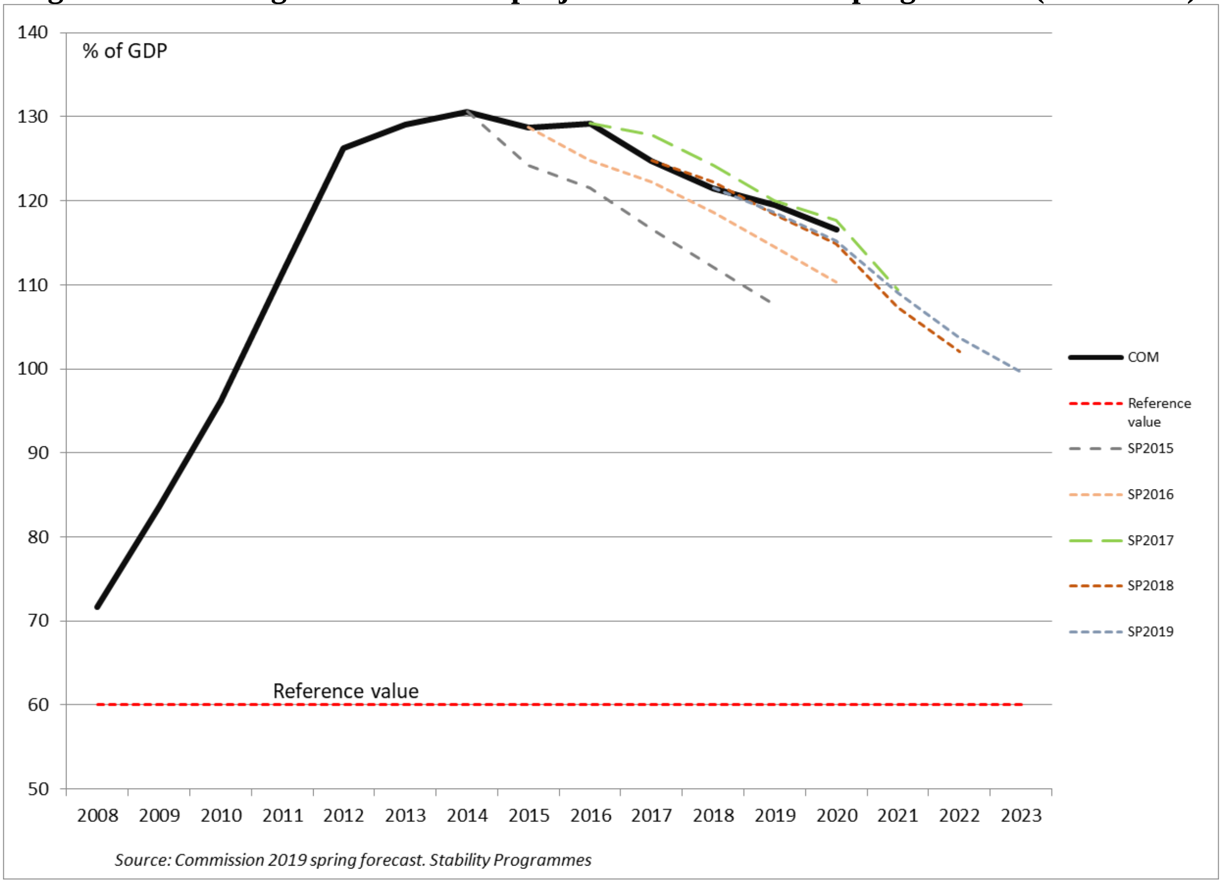
[1] End of period.

[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 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

Figure 3: General government debt projections in successive programmes (% of GDP)



While the debt-to-GDP ratio had stabilised at around 130% from 2013 onwards, successive Stability Programmes had planned similar debt reduction paths but the effective start of such a downward path was repeatedly delayed. Following the substantial effective reduction of the debt-to-GDP ratio in 2017, around two percentage points faster than projected in the 2017 programme, the 2018 Stability Programme maintained a similar pace of debt reduction over the period 2018-2020 from the lower starting point in 2017 (by around 3.5% of GDP per year), before some acceleration towards the end of the programme horizon. While, supported by an upward revision of nominal GDP, the debt ratio at the end of 2018 turned out slightly lower than planned in the 2018 Stability Programme, the 2019 Stability Programme has slightly reduced the projected further debt reduction as compared with the previous programme, by an average ⅔% of GDP per year over the period 2019-2022.

3.5. Risk assessment

Some short- and medium-term risks could affect the fiscal path planned in the programme. This concerns the achievement of the planned structural adjustment in 2019 and 2020, the materialisation of the expected favourable economic growth assumptions and expenditure containment over the programme horizon.

As regards 2019, in addition to general risks related to uncertainties surrounding the macroeconomic outlook (including vulnerability to external developments), risks are mostly related to possible spending pressures on compensation of employees, in particular as regards the impact of the unfreezing of careers in the public sector, the accelerating increase of the number of civil servants and extra-hour compensations due to the extension of the 35-hours working week to private contracts in the health sector (see also section 3.1). Further upward pressures on the expenditure side may not be excluded.

As regards 2020 and onwards, in addition to continued spending pressures on compensation of employees, the macroeconomic assumptions of the Stability Programme are more optimistic than in the Commission 2019 spring forecast. Moreover, the planned yields of some fiscal policy measures have not been specified in sufficient detail. This concerns the projected incremental budgetary impact of the planned continuation of the review of public expenditure, but also the revenue-increasing planned tax measures. In addition, the projected continued savings in interest expenditure after 2020 appear uncertain as they crucially hinge upon (domestic and external) market conditions, at a time where changes in monetary policy may be envisaged in the medium-term. Moreover, contingent liabilities from the banking sector, in particular more negative budgetary impacts from further activations of the Novo Banco contingent capital mechanism, may create downward risks to the fiscal outlook over the programme horizon. Finally, the overall amount of planned consolidation measures may turn out insufficient to effectively achieve the planned moderate overall expenditure growth below nominal GDP growth and, thereby, fulfill the planned improving and thereafter stabilising path for both the headline and structural balances.

4. Compliance with the provisions of the Stability and Growth Pact

Box 1. Council Recommendations addressed to Portugal

On 13 July 2018, the Council addressed recommendations to Portugal in the context of the European Semester. In particular, in the area of public finances the Council recommended to Portugal to take action to *"Ensure that the nominal growth rate of net primary government expenditure does not exceed 0.7 % in 2019, corresponding to an annual structural adjustment of 0.6 % of GDP, and to use windfall gains to accelerate the reduction of the general government debt ratio."*

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2016, Portugal is in the three-year transition period when it should make sufficient progress towards compliance with the debt reduction benchmark. This implies that, during the transition period 2017-2019, it is 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.

In 2018, Portugal is calculated to have complied with the transitional debt rule as the structural adjustment of 0.9% of GDP exceeded the minimum linear structural adjustment MLSA requirement of 0.5% of GDP.

Based on the Stability Programme, the transitional debt rule translates into a negative required MLSA for 2019 (of -1.4% of GDP). Based on the (recalculated) change in the structural balance of 0.1% of GDP, as planned in the Stability Programme, Portugal is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019.

According to the Commission 2019 spring forecast, the transitional debt rule translates into a slightly positive required MLSA for 2019 (of 0.1% of GDP). Based on the change in the structural balance of -0.1% of GDP projected in the Commission 2019 spring forecast, Portugal is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019, as a result of the allowed annual deviation of 0.25%.

As of 2020, following the end of the transition period 2017-2019, Portugal will be subject to the debt reduction benchmark of the SGP. In 2020, while the debt reduction benchmark is expected to be met based on the Stability Programme, it is prima facie not expected to be complied with based on the Commission 2019 spring forecast.

Table 4: Compliance with the debt criterion

	2018	**2019**		**2020**	
		SP	**COM**	**SP**	**COM**
Gross debt ratio	**121.5**	**118.6**	**119.5**	**115.2**	**116.6**
Gap to the debt benchmark [1,2]				-5.2	0.3
Structural adjustment [3]	0.9	0.1	-0.1	0.3	0.0
To be compared to:					
Required adjustment [4]	0.5	-1.4	0.1		

Notes:

[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 EDP 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

Source :
Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

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

Assessment of requests for deviating from SGP requirements

In the 2018 Stability Programme, the Portuguese authorities pointed to exceptional expenditure in 2018 related to preventive measures for the protection of the national territory against wildfires following the largescale wildfires of 2017. The 2019 Stability Programme does not provide information on such expenditure in 2018. However, in a letter dated 9 May 2019, the Portuguese authorities have provided adequate evidence of the scope and nature of these additional budgetary costs. In that letter, the authorities confirmed that exceptional expenditure in 2018 related to preventive measures to protect the national territories against wildfires was significant and provided adequate evidence of the scope and nature of these additional budgetary costs.

More specifically, the 2018 Stability Programme had estimated the additional expenditure due to the preventive measures to protect the national territory against wildfires at 0.07% of GDP in 2018. Based on outturn data, the letter of 9 May 2019 confirms that the expenditure incurred in 2018 amounted to 0.04% of GDP, consisting of equipment for firefighters, institutional improvement and cleaning of areas surrounding houses and villages. The letter of 9 May 2019 sets out expenditure related to the emergency management, classified as one-off measures, and expenditure related to prevention. Due to the integrated nature of these expenditures and due to the direct link with the large-scale wildfires of 2017, the specific treatment of wildfire-prevention expenditure could be considered in application of the 'unusual event clause'.

According to the Commission, the eligible additional expenditure in 2018 amounts to 0.04% of GDP for preventive measures. The provisions set out in Articles 5(1) and 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the unprecedented large-scale wildfires are considered unusual events, their impact on Portugal's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the structural adjustment path towards the MTO. Therefore, the required structural adjustment towards the MTO for 2018 has been reduced to take into account these additional costs. Overall, the Commission assesses that Portugal can benefit from an overall temporary deviation of 0.04% of GDP due to the exceptional additional expenditure in 2018 related to preventive measures to protect the national territory against wildfires.

Adjustment towards the MTO

Portugal is subject to the preventive arm of the SGP as of 2017 and has to ensure compliance with the required structural adjustment path towards the MTO. To this end, Portugal is required to pursue a minimum annual structural adjustment towards the MTO of 0.6% of GDP in 2018 and 2019.

In 2018, according to the outturn budgetary data and the Commission 2019 spring forecast, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, exceeded the applicable expenditure benchmark of 0.2% (including the flexibility from the unusual event clause), leading to a deviation of 1.5% of GDP (taking into account the unusual event clause) from the requirements and thus pointing to a risk of significant deviation. At the same time, the structural balance improved by 0.9% of GDP, thus pointing to compliance with the recommended structural adjustment of at least 0.56% of GDP towards the MTO (after taking into account the unusual event clause). This calls for an overall assessment. The difference between the two indicators stems mainly from three factors. The reading of the fiscal effort based on the expenditure benchmark pillar is negatively impacted by the medium-term potential GDP growth used therein, which includes negative or exceptionally low potential GDP growth in and after the crisis years. This reflects a very abrupt adjustment of the economy in the crisis that heavily distorted the time series and appears to be inconsistent with the trend growth prospects of Portugal before and after the crisis years. It therefore appears more appropriate to consider as a benchmark for growth of net primary expenditure the medium-term potential GDP growth rate arising from the Commission 2019 spring forecast for the same reference period (2012-2021), while eliminating the impact of the years most affected by the crisis (2012-2014). At the same time, the reading of the fiscal effort based on the structural balance pillar is positively impacted by very sizeable revenue windfalls and declining interest expenditure, which are both outside the control of the government and therefore excluded from the expenditure benchmark pillar. Taking these factors into consideration, both indicators would point to a risk of significant deviation from the requirements. While the indicators used to assess compliance with the requirements of the preventive arm therefore point to a significant deviation from the adjustment path towards the medium-term budgetary objective in 2018, Portugal was 0.7% of GDP away from its MTO of a surplus of 0.25% of GDP in 2018 and is projected to move even closer to its MTO by 2020 (gap of 0.5% of GDP). The general government deficit was well below the Treaty reference value of 3% of GDP in 2018 and is projected to remain well below 3% of GDP over the forecast horizon. Portugal's debt ratio has declined by around 9 percentage points since 2014 and is projected to fall by almost 5 percentage points by 2020. Portugal complied with the transitional debt rule in 2018 and is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019, as a result of the allowed annual deviation of 0.25%. The debt reduction benchmark is prima facie not expected to be complied with in 2020 based on the Commission 2019 spring forecast under a no-policy-change assumption. However, achieving the adjustment planned in the Stability Programme would allow complying with it. Overall, the fiscal policy of Portugal does not represent a clear and persistent challenge to the principles of the Stability and Growth Pact. Taking into account these considerations, there is currently no sufficient ground to conclude on the existence of an observed significant deviation in 2018.

In 2019, according to the information provided in the Stability Programme, the planned growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 0.7%, leading to a deviation of 1.2% of GDP from the requirement and thus pointing to a risk of significant deviation. The (recalculated) structural balance is expected to improve by 0.1% of GDP in the Stability Programme and to remain at a distance of 0.3% of GDP from the MTO applicable over 2017-2019 – a structural surplus of 0.25% of GDP – thus projecting some deviation from the recommended structural adjustment of 0.6% of GDP towards the MTO. This calls for an overall assessment. The fiscal effort based on the structural balance pillar is positively impacted by revenue windfalls and declining interest expenditure, which are excluded from the expenditure benchmark pillar. Furthermore, the divergence between the two indicators also stems from differences between the potential GDP growth underlying the structural balance and the medium-term potential growth rate used to set the expenditure benchmark. An overall assessment confirms that both indicators would point to a risk of significant deviation from the requirements in 2019. Over 2018 and 2019 taken together, the expenditure benchmark pillar points to a risk of significant deviation, while the structural balance pillar points to a risk of some deviation. An overall assessment confirms that both pillars would point to a risk of significant deviation from the requirements over 2018 and 2019 taken together. Therefore, an overall assessment based on the Stability Programme points to a risk of significant deviation from the recommended structural adjustment towards the MTO in both 2019 and over 2018 and 2019 taken together.

In turn, based on the Commission 2019 spring forecast, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 0.7%, leading to a deviation of 1.5% of GDP from the requirements and thus pointing to a risk of significant deviation in 2019.[1] The structural balance is expected to slightly deteriorate by 0.1% of GDP in 2019, thus also pointing to a risk of a significant deviation by 0.7% of GDP from the recommended structural adjustment of 0.6% of GDP towards the MTO. Over 2018 and 2019 taken together, the expenditure benchmark pillar also points to a risk of significant deviation, while the structural

[1] The higher deviation as compared to the Stability Programme is due to the Commission forecast’s higher expenditure projections for some expenditure items, in particular compensation of employees, but also to the Stability Programme's treatment of higher dividends from *Banco de Portugal* and *Caixa Geral de Depósitos* as discretionary revenue measures. While the corresponding revenue is also taken into account in the Commission Spring forecast, this revenue could not be considered as discretionary revenue measure in the Commission forecast based on the Commission’s classification principles for fiscal measures.

balance pillar points to a risk of some deviation from the requirements. An overall assessment based on the Commission forecast and taking into consideration the above-mentioned effects confirms the risk of significant deviation from the requirements in both 2019 and over 2018 and 2019 taken together.

Based on the Stability Programme, Portugal is expected to meet the applicable new MTO in 2020, taking into account the temporary allowance linked to the unusual event clause in 2018 for preventive measures to protect the national territory against wildfires. Thus, the current assessment would point to compliance in 2020 based on the Stability Programme. At the same time, Portugal has a requirement that the nominal growth rate of net primary government expenditure should not exceed 1.5%, including the temporary flexibility granted due to the wildfire prevention-related unusual event clause in 2020, corresponding to the required improvement of the structural balance by 0.5% of GDP to achieve the MTO (0.46% of GDP including the flexibility granted due to the wildfire prevention-related unusual event clause) in 2020. The expenditure benchmark pillar would currently point to a risk of significant deviation from the requirements in both 2020 and over 2019 and 2020 taken together, based on the Stability Programme. If compliance with the MTO, (taking also into account the allowance linked to the wildfire prevention-related unusual event clause) can no longer be established in future assessments, an overall assessment based on the Stability Programme would need to take into account a possible deviation from the requirement.

In turn, based on the Commission 2019 spring forecast, the planned growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark of 1.5% (including the flexibility granted due to the wildfire-prevention related unusual event clause) in 2020, leading to a deviation of 0.9% of GDP from the requirements and thus pointing to a risk of a significant deviation. The structural balance is expected to remain unchanged at -0.5% of GDP according to the Commission forecast and, accordingly, to remain at a distance of 0.5% of GDP from the applicable new MTO, thus projecting some deviation from the recommendation to reach the MTO (corresponding to a recommended structural adjustment of 0.46% of GDP, including the flexibility granted due to the wildfire-prevention related unusual event clause). This calls for an overall assessment. The fiscal effort based on the structural balance pillar is positively impacted by declining interest expenditure, which is excluded from the expenditure benchmark pillar. Furthermore, the divergence between the two indicators also stems from differences between the potential GDP growth underlying the structural balance and the medium-term potential growth rate used to set the expenditure benchmark. An overall assessment confirms that both indicators would point to a risk of significant deviation from the requirements in 2020. Over 2019 and 2020 taken together, both the expenditure benchmark and the structural balance pillars point to a risk of significant deviation. An overall assessment confirms that both pillars point to a risk of significant deviation from the requirements over 2019 and 2020 taken together. Therefore, an overall assessment based on the Commission 2019 spring forecast points to a risk of significant deviation from the recommended structural adjustment towards the MTO in both 2020 and over 2019 and 2020 taken together.

Overall, following an overall assessment based on the Commission 2019 spring forecast, there is a risk of significant deviation from the adjustment path towards the MTO in 2019 and 2020 putting at risk the compliance with the requirements of the preventive arm of the SGP.

Table 5: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019		2020	
Background budgetary indicators [1]					
Medium-term budgetary objective (MTO)	0.3	0.3		0.0	
Structural balance [2] (COM)	-0.4	-0.5		-0.5	
Setting the required adjustment to the MTO					
Structural balance based on freezing (COM)	-0.9	-0.5		-	
Position vis-à-vis the MTO [3]	Not at MTO	Not at MTO		Not at MTO	
Required adjustment [4]	0.6	0.6		0.5	
Required adjustment corrected [5]	0.6	0.6		0.5	
Corresponding expenditure benchmark [6]	0.2	0.7		1.5	
Compliance with the required adjustment to the MTO					
	COM	**SP**	**COM**	**SP**	**COM**
Structural balance pillar					
Change in structural balance [7]	0.9	0.1	-0.1	0.3	0.0
One-year deviation from the required adjustment [8]	0.3	-0.5	-0.7	-0.1	-0.5
Two-year average deviation from the required adjustment [8]	0.3	-0.1	-0.2	-0.3	-0.6
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs [9]	4.2	3.7	4.6	3.2	4.0
One-year deviation adjusted for one-offs [10]	-1.5	-1.2	-1.5	-0.6	-0.9
Two-year deviation adjusted for one-offs [10]	-1.0	-1.3	-1.5	-0.9	-1.2
Finding of the overall assessment	**No sufficient ground***	**Significant deviation**	**Significant deviation**	**Compliance**	**Significant deviation**

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).

Irrelevant for the Significant Deviation Procedure' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the two years.

Notes

* There is currently no sufficient ground to conclude on the existence of an observed significant deviation in Portugal in 2018.

[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 point 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, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[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. Expost assessment (for 20XX-1) is carried out on the basis of Commission 20XX 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.

Source :
Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Portugal does not appear to face fiscal sustainability risks in the short run.[2]

Based on the Commission 2019 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, projected at 119.5% of GDP in 2019, is expected to decrease to 101.7% in 2029, thus remaining above the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to decline steadily. Sensitivity analysis shows higher risks.[3] Overall, this highlights high risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a more clearly decreasing path by 2029, although remaining above the 60% of GDP reference value in 2029.

The medium-term fiscal sustainability risk indicator S1[4] is at 3.7 percentage points of GDP, primarily related to the effect of the high level of government debt (+4.1 percentage points of GDP). This indicator thus signals high risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at 2.9 percentage points of GDP. Based on the debt sustainability analysis and the sustainability risk indicator S1, overall medium-term fiscal sustainability risks are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would decrease those risks, although they would remain high.

The long-term fiscal sustainability risk indicator S2 is at 0.3 percentage points of GDP. In the long term, Portugal therefore appears to face low fiscal sustainability risks, as the effect of the initial budgetary position on the sustainability risk indicator S2 (-0.5 percentage points of GDP) partially offsets the one of the projected ageing costs (+0.9 percentage points of GDP). Full implementation of the programme would put the sustainability risk indicator S2 at -0.4 percentage points of GDP, leading to a lower long-term risk.[5] The debt sustainability analysis discussed above points to high risks so that, overall, long-term fiscal sustainability risks are assessed as medium for Portugal.

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[2] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 6 for a definition of the indicator.

[3] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[4] See the note to Table 6 for a definition of the indicator.

[5] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 6: Debt sustainability analysis and sustainability indicators

Time horizon			Commission Scenario		Stability / Convergence Programme Scenario	
Short-term			**LOW risk**			
S0 indicator [1]			0.3			
	Fiscal subindex		0.3	LOW risk		
	Financial & competitiveness subindex		0.3	LOW risk		
Medium-term			**HIGH risk**			
DSA [2]			HIGH risk			
S1 indicator [3]			3.7	HIGH risk	2.9	HIGH risk
of which	Initial Budgetary Position		-0.8		-1.3	
	Debt Requirement		4.1		3.8	
	Cost of Ageing		0.5		0.4	
	of which	Pensions	0.4		0.4	
		Health care	0.5		0.4	
		Long-term care	0.1		0.1	
		Other	-0.5		-0.4	
Long-term			**MEDIUM risk**			
DSA [2]			HIGH risk			
S2 indicator [4]			0.3	LOW risk	-0.4	LOW risk
of which	Initial Budgetary Position		-0.5		-1.1	
	Cost of Ageing		0.9		0.7	
	of which	Pensions	-0.7		-0.9	
		Health care	1.6		1.5	
		Long-term care	0.5		0.5	
		Other	-0.6		-0.4	

Source: Commission services; 2019 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2019 forecast until 2020. 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 2018 Ageing Report.

[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49*.

[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*.

[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.

[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.

* For more information see Fiscal Sustainability Report 2018.

6. FISCAL FRAMEWORK

In 2018 and 2019, Portugal does not plan yet to achieve the MTO applicable over 2017-2019 – a structural surplus of 0.25% of GDP. As long the MTO is not achieved, Portugal's national fiscal framework determines the application of the two national numerical fiscal rules established in Article 12-C (6)-(8) of the still-in-force 2001 Budgetary Framework Law, as last amended by Law No 41/2014 of 10 July (henceforth, the 2001 BFL)[6]: (i) the annual adjustment of the structural balance should be at least 0.5% of GDP (henceforth, 'structural balance rule'), and (ii) the nominal growth rate of net primary public expenditure[7] should not exceed the benchmark rate of medium-term potential GDP growth defined in the SGP (henceforth, 'expenditure benchmark rule').

In 2018, the budgetary outcome indicates that the structural balance rule was complied with, while the expenditure benchmark rule was significantly non-complied with. In 2019, both national numerical fiscal rules are not planned to be complied with, with the (recalculated) structural balance improving by just 0.1% of GDP (vis-à-vis the national threshold of an annual adjustment of at least 0.5% of GDP) and the nominal growth rate of net primary public expenditure significantly exceeding the expenditure benchmark rate.

Over 2020-2022, Portugal plans to achieve and remain above the MTO applicable over that period – a balanced budgetary position in structural terms. Portugal's MTO therefore complies with Article 12-C (3) of the 2001 BFL, establishing a ceiling of 0.5% of GDP for the country's structural deficit. Given that Portugal plans to remain above the MTO over 2020-2022, neither of the above-mentioned structural balance and expenditure benchmark rules would need to be complied with.

In parallel, Portugal's general government debt is planned to remain above the Treaty reference value of 60% of GDP over the entire programme horizon. In that case, Portugal's national fiscal framework determines the application of the national numerical fiscal rule established in Article 10-G of the 2001 BFL (henceforth, 'debt rule'), which prescribes that Portugal's debt ratio should converge towards the Treaty reference of 60% of GDP according to what is established in Article 2 of Council Regulation (EC) No 1467/97 of 7 July, as amended by Council Regulation (EU) No 1177/2011 of 8 November.

On that basis, and given that Portugal was subject to an EDP on 8 November 2011, Portugal's national fiscal framework establishes that from the correction of the excessive deficit in 2016 and for three years over the period 2017-2019, compliance with the transitional debt rule of the SGP is required. In 2018, the budgetary outcome indicates that the transitional debt rule was complied with. Similarly, the Stability Programme plans compliance with the transitional debt rule in 2019. In turn, as from 2020, after the transition period 2017-2019, Portugal's national fiscal framework determines the need to comply with the debt reduction benchmark

6 Net primary public expenditure comprises total public expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds' revenue, non-discretionary changes in unemployment benefit expenditure, discretionary revenue measures and one-off measures on both the revenue and expenditure sides.

7 A new Budgetary Framework Law, established by Law No 151/2015 of 11 September, as last amended by Law No 37/2018 of 7 August (henceforth, the 2015 BFL) is only planned to be fully in force as from 1 April 2020. Therefore, Article 7 of the 2015 BFL establishes that the relevant legal provisions of the 2001 BFL are to remain in force during the transition period. Please see section 4.1.3. 'Fiscal framework and state-owned enterprises' of the Country Report Portugal 2019 (SWD(2019) 1021) for an assessment of the repeated delays in the implementation of the 2015 BFL.

of the SGP. Over the period 2020-2022, the Stability Programme plans compliance with the debt reduction benchmark.

Overall, based on the information provided in the Stability Programme, Portugal's budgetary outcome in 2018 appears to have complied with the requirements of its national fiscal framework as regards the structural balance rule, but appears to have significantly deviated from the expenditure benchmark rule. At the same time, the planned budgetary targets for 2019 appear to fall short of what would be required to comply with the applicable structural balance and expenditure benchmark rules. By contrast, the planned budgetary targets for the period 2020-2022 appear to fully comply with Portugal's national fiscal framework. Moreover, the national numerical fiscal rules governing debt developments are planned to be complied with over the entire programme horizon.

The macroeconomic forecasts underlying the Stability Programme were analysed by the Portuguese Public Finance Council (CFP). In its Opinion No 01/2019 of 12 April, attached to the Stability Programme, the CFP endorsed the macroeconomic forecasts therein for the period 2019-2020, but not for the period 2021-2023. Focusing on the period 2019-2020, the CFP pointed to likely downside risks to the government's macroeconomic forecasts, mainly stemming from the external macroeconomic environment. In turn, focusing on the period 2021-2023, the CFP considered that the government's macroeconomic forecasts constituted neither the most likely, nor the most prudent scenario.

The budgetary forecasts underlying the Stability Programme and their compliance with the national fiscal rules were also analysed by the CFP. In its Report No 3/2019 of 9 May, published on the institution's website, the CFP considered that the planned improvement of the structural balance foreseen for 2019 points to a risk of deviation from the structural adjustment path consistent with the structural balance rule. Their analysis also found that the structural adjustment foreseen for 2019 would not be consistent with compliance with the expenditure benchmark rule. At the same time, the CFP concluded that the planned evolution of the public debt-to-GDP ratio would allow for compliance with the transitional debt rule in 2019. For 2020, the CFP considered that the planned improvement of the structural balance would ensure a budgetary position compatible with the achievement of the MTO in that year. The nominal growth rate of net primary expenditure should, however, exceed by a small margin the applicable expenditure benchmark rate for 2020. Finally, for both 2020 and the remaining programme horizon, the CFP indicated that the planned evolution of the public debt-to-GDP ratio points to compliance with the debt reduction benchmark.

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 above-mentioned CFP's Opinion No 01/2019 of 12 April however indicate that the Stability Programme is assumed to also constitute the national medium-term fiscal plan.

7. SUMMARY

In 2018, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, exceeded the applicable expenditure benchmark rate, leading to a negative deviation of 1.5% of GDP. At the same time, Portugal achieved an improvement of the structural balance of 0.9% of GDP, which is in line with the required adjustment towards the MTO. After taking into account the factors explaining the difference between the two indicators, both indicators would point to significant deviation, from the recommended adjustment path towards the MTO in 2018. However, taking into account further considerations, regarding in particular the distance to the MTO, the headline deficit and debt reduction, there is currently no sufficient ground to conclude on the existence of an observed significant deviation in 2018.

Portugal plans a growth rate of nominal primary government expenditure, net of discretionary revenue measures and one-offs, which exceeds the applicable expenditure benchmark rate in 2019 leading to a negative deviation of 1.2% of GDP of the underlying fiscal position. Portugal plans an improvement of the structural balance of 0.1% of GDP in 2019, below the recommended annual structural adjustment of 0.6% of GDP towards the MTO. Following an overall assessment, there is a risk of significant deviation from the recommended adjustment path towards the MTO in 2019 based on the Stability Programme. An overall assessment on the basis of the Commission 2019 spring forecast, also points to a risk of a significant deviation in 2019.

In 2020, Portugal plans to achieve the new MTO of a balanced budget in structural terms, while the expenditure benchmark would currently point to a risk of a significant deviation from the requirement. If achievement of the MTO can no longer be established in future assessments of Portugal's plans, an overall assessment would need to take into account a possible deviation from the requirement.

Based on the Commission 2019 spring forecast, the expenditure benchmark points to a risk of significant deviation, while the structural balance points to some deviation from the recommended structural adjustment of 0.46% of GDP to reach the MTO. Following an overall assessment, there is a risk of significant deviation from the recommended adjustment path towards the MTO in 2020 based on the Commission 2019 spring forecast.

In 2018, Portugal has complied with the transitional debt rule. Based on Stability Programme data, Portugal is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019 and to comply with the debt reduction benchmark in 2020. On the basis of the Commission 2019 spring forecast, Portugal is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019 but is prima facie not expected to meet the debt reduction benchmark in 2020.

8. ANNEX

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	0.9	0.6	-0.9	1.9	2.8	2.1	1.7	1.7
Output gap [1]	-0.2	-0.1	-2.9	-0.7	0.7	1.2	1.3	1.4
HICP (annual % change)	3.2	1.7	1.4	0.6	1.6	1.2	1.1	1.6
Domestic demand (annual % change) [2]	0.8	0.5	-2.0	2.0	3.0	2.8	2.4	2.2
Unemployment rate (% of labour force) [3]	7.1	9.9	14.4	11.2	9.0	7.0	6.2	5.7
Gross fixed capital formation (% of GDP)	24.7	21.9	15.9	15.5	16.6	17.1	17.6	18.2
Gross national saving (% of GDP)	16.0	11.6	14.4	15.9	17.1	16.7	17.1	17.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-5.0	-6.4	-5.9	-2.0	-3.0	-0.5	-0.4	-0.1
Gross debt	59.5	77.8	125.2	129.2	124.8	121.5	119.5	116.6
Net financial assets	-48.3	-62.1	-95.3	-104.0	-108.1	-104.4	n.a	n.a
Total revenue	40.2	41.0	43.8	42.8	42.7	43.5	43.8	43.8
Total expenditure	45.2	47.4	49.7	44.8	45.7	44.0	44.2	43.9
of which: Interest	2.7	2.9	4.7	4.2	3.8	3.5	3.3	3.1
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-4.5	-5.5	3.2	1.7	3.0	0.0	-0.1	-0.5
Net financial assets; non-financial corporations	-110.2	-135.0	-134.4	-123.1	-124.1	-118.6	n.a	n.a
Net financial assets; financial corporations	-0.4	5.0	5.1	4.7	6.8	4.1	n.a	n.a
Gross capital formation	13.0	13.0	9.9	10.8	11.5	11.7	12.0	12.3
Gross operating surplus	19.4	20.5	21.4	21.9	21.3	20.4	20.5	21.0
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	2.2	2.3	2.7	1.3	1.0	0.7	0.6	0.6
Net financial assets	97.6	97.0	111.6	116.9	120.5	118.2	n.a	n.a
Gross wages and salaries	38.2	36.8	34.9	34.2	34.6	35.1	35.3	35.2
Net property income	4.6	6.0	5.9	5.6	5.0	4.8	4.5	4.5
Current transfers received	21.5	23.0	25.8	25.6	25.3	25.4	25.6	25.6
Gross saving	7.2	5.9	4.7	3.4	3.2	3.1	3.2	3.3
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-7.3	-9.6	-0.1	1.0	1.1	0.2	0.0	0.1
Net financial assets	65.2	99.9	120.6	112.8	111.7	107.6	n.a	n.a
Net exports of goods and services	-8.6	-8.0	-0.6	1.1	0.8	0.1	-0.5	-0.9
Net primary income from the rest of the world	-1.6	-3.5	-2.0	-2.3	-2.2	-2.5	-2.2	-1.9
Net capital transactions	1.7	1.2	1.5	0.9	0.9	1.0	1.1	1.1
Tradable sector	42.0	39.8	41.5	42.6	42.6	42.5	n.a	n.a
Non tradable sector	45.3	47.6	46.0	44.4	44.1	44.0	n.a	n.a
of which: Building and construction sector	6.4	5.7	4.0	3.4	3.5	3.6	n.a	n.a
Real effective exchange rate (index, 2000=100)	100.2	102.0	93.4	91.3	93.2	94.7	93.8	93.2
Terms of trade goods and services (index, 2000=100)	98.8	99.1	100.6	106.4	105.7	105.3	105.5	105.6
Market performance of exports (index, 2000=100)	97.5	97.3	111.4	115.8	119.1	120.0	120.5	121.0

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] 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.

Source :
AMECO data, Commission 2019 spring forecast

Mandatory variables not included in the Stability Programme

The Stability Programme does not include the 2018 levels of some mandatory variables in the macroeconomic prospects table (final domestic demand, changes in inventories and net acquisition of valuables and external balance of goods and services). Not included mandatory variables do not impede the Commission's ability to assess the Stability Programme on the basis of the Programme's assumptions.