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COMMISSION OPINION

of 22.11.2022

on the Draft Budgetary Plan of Portugal

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(Only the Portuguese text is authentic)

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area, to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan by 15 October, presenting the main aspects of the budgetary outlook of the general government and its subsectors for the forthcoming year.

3. The general escape clause of the Stability and Growth Pact has been active since March 2020.[1] On 23 May 2022, the Commission indicated, in its Communication on the European Semester[2], that heightened uncertainty and strong downside risks to the economic outlook in the context of war in Europe, unprecedented energy price hikes and continued supply chain disturbances warrant the extension of the general escape clause of the Stability and Growth Pact through 2023 and it is considered that the conditions to deactivate it as of 2024 were met. The continued activation of the general escape clause in 2023 will provide the space for national fiscal policy to react promptly when needed, while ensuring a smooth transition from the broad-based support to the economy during the pandemic times towards an increasing focus on temporary and targeted measures and fiscal prudence required to ensure medium-term sustainability.[3]

4. The Recovery and Resilience Facility, as established by Regulation (EU) 2021/241, provides financial support for the implementation of reforms and investment, notably to promote the green and digital transitions, thereby strengthening the economies' resilience and potential growth. Part of this support is in the form of non-repayable financial support ("grants"), entailing a fiscal impulse financed by the Union. Together with cohesion policy funds and the Just Transition Mechanism, the RRF is supporting a fair and inclusive recovery in the EU in line with the European Pillar of Social Rights. It also boosts growth and job creation in the medium and long term, and thereby strengthens sustainable public finances. According to the Commission proposal of 18 May 2022[4], the Facility should also aim at increasing the resilience of

[1] Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact, COM(2020) 123 final of 20 March 2020.

[2] COM(2022) 600 final.

[3] On 17 June 2022, the Council agreed its recommendations on the 2022 National Reform Programmes and the opinions on the 2022 Stability and Convergence Programmes, which takes into account the continuation of the Stability and Growth Pact's general escape clause into 2023. (See: https://www.consilium.europa.eu/en/meetings/ecofin/2022/06/17/)

[4] COM(2022) 231 final.

the Union energy system by reducing dependence on fossil fuels and diversifying energy supplies at Union level ('REPowerEU objectives').

5. On 12 July 2022, in the recommendations delivering Council opinions on the 2022 Stability Programmes[5], the Council recalled that the overall fiscal stance is currently best measured as the change in primary expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis), including expenditure financed by non-repayable support (grants) from the Recovery and Resilience Facility and other Union funds, relative to medium-term potential growth.[6] Going beyond the overall fiscal stance, in order to assess whether national fiscal policy is prudent and its composition is consistent with the green and digital transitions, energy security and ensuring social and economic resilience, attention is also paid to the evolution of nationally financed[7] primary current expenditure (net of discretionary revenue measures and excluding temporary emergency measures related to the COVID-19 crisis) and investment.

6. The shocks unleashed by the Russian invasion of Ukraine are impacting the EU economy both directly and indirectly, setting it on a path of lower growth and higher inflation. Intensifying and broadening inflationary pressures have been prompting faster normalisation of monetary policy in the euro area. Public spending on measures containing the social and economic impact of high energy costs, on security and defence and on humanitarian assistance to the displaced persons from Ukraine is weighing on public finances. The specific nature of the macroeconomic shock imparted by Russia's invasion of Ukraine, as well as its long-term implications for the EU's energy security needs, call for a careful design of fiscal policy in 2023. A broad-based fiscal impulse to the economy in 2023 does not appear warranted. The focus should instead be on protecting the vulnerable, allowing automatic stabilisers to operate and providing temporary and targeted measures to mitigate the impact of the energy crisis and to provide humanitarian assistance to people fleeing from Russia's invasion of Ukraine, while maintaining the agility to adjust, if needed. Fiscal policy should combine higher investment with controlling the growth in nationally financed primary current expenditure. Full and timely implementation of the Recovery and Resilience Plans is key to achieving higher levels of investment. Fiscal policies should aim at preserving debt sustainability as well as raising the growth potential in a sustainable manner, thus also facilitating the task of monetary policy to ensure the timely return of inflation to the ECB's 2% medium-term target. Fiscal plans for 2023 should be anchored by prudent medium-term adjustment paths reflecting fiscal sustainability challenges associated with high debt-to GDP levels that have increased further due to the pandemic as well as reforms and investment challenges associated with the twin transition, energy security and social and economic resilience.

7. Russia's war of aggression against Ukraine has resulted in substantial additional increases in and volatility of the prices of energy. The price shock in imported energy implies a substantial terms-of-trade loss to Member States' economies. In parallel,

[5] Council Recommendation of 12 July 2022 on the National Reform Programme of Portugal and delivering a Council opinion on the 2022 Stability Programme of Portugal, OJ C 334, 1.9.2022, p. 181.

[6] The estimates on the fiscal stance and its components in this Opinion are Commission estimates based on the assumptions underlying the Commission 2022 autumn forecast. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

[7] Not financed by grants under the Recovery and Resilience Facility or other Union funds.

the exceptionally high temperatures in summer 2022 pushed up demand for electricity, while, at the same time, energy production from certain technologies has been significantly below historical levels due to technical and weather-dependant circumstances. All Member States have been negatively affected by the current energy crisis, albeit to a different extent, calling for a rapid and coordinated response.

8. Given that budgetary resources are limited and need to be used in the most efficient way, in order to manage a durable and equitable adjustment across society, the quality and design of the policy response is highly important. Therefore, also in line with the Council Regulation on an emergency intervention to address high energy prices adopted on 6 October 2022, measures should focus on providing temporary support, targeted to households and firms most vulnerable to energy price increases, while maintaining the right incentives to reduce energy demand and increase energy efficiency, in line with the European Green Deal.[8] Policies should also help reducing the energy consumption and develop the energy autonomy of the Union.

CONSIDERATIONS CONCERNING PORTUGAL

9. On 15 October 2022, Portugal submitted the Draft Budgetary Plan for 2023. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

10. On 12 July 2022, the Council recommended that Portugal[9] take action to ensure in 2023 a prudent fiscal policy, in particular by limiting the growth of nationally financed primary current expenditure below medium-term potential output growth[10], taking into account continued temporary and targeted support to households and firms most vulnerable to energy price hikes and to people fleeing Ukraine. Portugal should stand ready to adjust current spending to the evolving situation. Portugal was also recommended to expand public investment for the green and digital transitions, and for energy security taking into account the REPowerEU initiative, including by making use of the Recovery and Resilience Facility and other Union funds. For the period beyond 2023, Portugal should pursue a fiscal policy aimed at achieving prudent medium-term fiscal positions and ensuring credible and gradual debt reduction and fiscal sustainability in the medium term through gradual consolidation, investment and reforms.

11. According to the Commission 2022 autumn forecast, the Portuguese economy is expected to grow by 6.6% in 2022 and 0.7% in 2023, while inflation is forecast at 8.0% in 2022 and 5.8% in 2023. According to the Draft Budgetary Plan, the Portuguese economy is expected to grow by 6.5% in 2022 and 1.3% in 2023, while inflation is projected at 7.4% in 2022 and 4.0% in 2023. The difference in the GDP growth projections for 2023 is explained by a more favourable external balance in the Draft Budgetary Plan and different cut-off dates. The difference in the inflation projections for 2023 also results in a higher GDP deflator in the Commission forecast relative to the Draft Budgetary Plan, which in nominal terms offsets the more

[8] Communication from the Commission, the European Green Deal, COM(2019) 640 final.

[9] Council Recommendation of 12 July 2022 on the National Reform Programme of Portugal and delivering a Council opinion on the 2022 Stability Programme of Portugal, OJ C 334, 1.9.2022, p. 181.

[10] Based on the Commission 2022 autumn forecast, the medium-term (10-year average) potential output growth of Portugal, that is used to measure the fiscal stance, is estimated at 6.9% in nominal terms. The Commission's estimates of medium-term potential growth do not include the full positive impact of reforms that are part of the Recovery and Resilience Plan and that can boost potential growth.

conservative real GDP outlook. Overall, the macroeconomic assumptions underpinning the Draft Budgetary Plan are plausible in both 2022 and 2023.

Portugal complies with the requirement of Regulation (EU) No 473/2013 since the draft budget is based on independently endorsed macroeconomic forecasts.

12. The Draft Budgetary Plan assumes that expenditure amounting to 0.4% of GDP in 2022 and 1.5% in 2023 will be financed by non-repayable financial support (grants) from the Recovery and Resilience Facility. Expenditures financed by Recovery and Resilience Facility grants will enable high-quality investment and productivity-enhancing reforms without a direct impact on the general government deficit and debt of Portugal. The plan also assumes expenditure funded through loans from the Recovery and Resilience Facility, with a direct impact on the general government deficit and debt amounting to 0.02% of GDP in 2022 and of 0.1% in 2023. The Commission 2022 autumn forecast includes a similar amount of expenditures financed by Recovery and Resilience Facility grants.

13. In its 2023 Draft Budgetary Plan, Portugal's general government deficit is planned to decrease from 1.9% of GDP in 2022 to 0.9% of GDP in 2023, mainly due to a buoyant performance in revenue more than compensating a moderate expansion in expenditure. Developments on the expenditure side reflect the phasing-out of temporary measures taken in response to the COVID-19 pandemic and of measures introduced as part of the emergency policy response to the exceptional increases in energy prices. The general government debt ratio is planned to decrease from 115.0% of GDP in 2022 to 110.8% of GDP in 2023. These projections are in line with the Commission 2022 autumn forecast.

The outlook for public finances continues to be subject to the high uncertainty that surrounds the macroeconomic projections, including macroeconomic risks related to the Russian invasion of Ukraine, energy price hikes and continued supply chain disturbances. Risks to the fiscal projections are notably linked to contingent liabilities related to publicly guaranteed credit lines and the ongoing negotiation processes of rebalancing requests from public-private partnerships.

14. For 2022, the Draft Budgetary Plan reports a package of fiscal policy measures with an overall budgetary cost of 2.5% of GDP, of which 0.7 percentage points relate to revenue measures and 1.8 percentage points to expenditure measures. A broad set of these measures, both on the revenue and the expenditure side, relate to the fiscal policy response to the exceptional increases in energy prices.

For 2023, the Draft Budgetary Plan also reports a package of new fiscal policy measures, with an overall budgetary cost of 0.4% of GDP, of which a deficit-increasing impact of 0.7 percentage points results from measures on the revenue side, partly offset by the deficit-reducing impact of 0.3 percentage points from measures on the expenditure side.

The main revenue-decreasing measures underpinning the 2023 Draft Budgetary Plan relate to a reform of the personal income tax (0.4% of GDP), including an update of its tax brackets and a reduction of the withholding rates, the latter to mitigate the impact of increased mortgage-related costs, and a tax incentive for investment under the corporate income tax (0.1% of GDP). The Plan also foresees an increase in indirect taxes, with a deficit-reducing impact of 0.1% of GDP. Tax measures in 2023 directed to mitigate the impact on household and firms of the exceptional increases in energy prices include the continued general reduction of the fuel tax (0.1% of GDP).

In turn, the expenditure-increasing measures in the Plan notably include a general increase in pensions (0.5% of GDP), as well as public employment-related measures (0.6% of GDP), notably an across-the-board increase in public wages as well as in the minimum wage, which add to pre-pandemic pressures on public current spending. The planned phasing-out of expenditure measures introduced in response to the exceptional increases in energy prices amounts to a deficit-reducing impact of about 1.2% of GDP.

The government deficit is impacted by the measures adopted to counter the economic and social impact of the exceptional increases in energy prices, which aggravated over the course of the summer.[11] The budgetary cost of these measures is projected in the Commission 2022 autumn forecast to amount to 2.1% of GDP in 2022 and 0.9% of GDP in 2023. They consist of measures reducing government revenue, namely a general reduction of the fuel tax and the freeze of the carbon rate under the fuel tax, and increasing expenditure, such as a one-time support payable in October 2022 for different groups of the population, such as pensioners, employees, children, and the youth, as well as subsidies for firms facing a rise in gas-related costs and support to boost energy efficiency and the energy transition. Most measures have been announced as temporary, expiring by the end of 2023. Most measures do not appear targeted to vulnerable households or firms[12], although most of them preserve the price signal to reduce energy demand and increase energy efficiency.[13] As a result, the amount of temporary and targeted support to households and firms most vulnerable to energy price hikes, that can be taken into account in the assessment of compliance with the fiscal country-specific recommendation for 2023, is estimated in the Commission 2022 autumn forecast at 0.6% of GDP in 2022 and 0.0% of GDP in 2023.

15. Based on the Commission 2022 autumn forecast and including the information incorporated in Portugal's 2023 Draft Budgetary Plan, gross fixed capital formation is expected to amount to 2.6% of GDP in 2022 and 3.0% of GDP in 2023, compared to 2.6% of GDP recorded in 2021. This includes investment for the green and digital transitions and for energy security, such as projects for the industrial decarbonisation or the digitalisation of schools, which are partly funded by the Recovery and Resilience Facility and other EU funds.

16. In 2023, the fiscal stance is projected in the Commission 2022 autumn forecast to be expansionary (- 0.3% of GDP[14]). This follows an expansionary fiscal stance in 2022 (- 2.5% of GDP).

The growth in nationally financed primary current expenditure (net of new revenue measures) in 2023 is projected to provide a neutral contribution.[15] This includes the reduced impact from the support measures adopted to counter the economic and

[11] Deficit developments in 2023 are also affected by the complete phasing-out of COVID-19 emergency temporary measures, which are estimated in the Commission 2022 autumn forecast at 0.9% of GDP in 2022.

[12] Targeted measures amount to 0.6% of GDP in 2022 and 0.0% of GDP in 2023, while untargeted measures amount to 1.5% of GDP in 2022 and 0.9% of GDP in 2023.

[13] Income measures amount to 1.3% of GDP in 2022 and 0.0% of GDP in 2023, while price measures amount to 0.8% of GDP in 2022 and 0.9% of GDP in 2023.

[14] A negative (positive) sign of the indicator corresponds to an excess (shortfall) of primary expenditure growth compared with medium-term economic growth, indicating an expansionary (contractionary) fiscal policy. The fiscal stance includes the fiscal impulse funded by the Union.

[15] This follows an expansionary contribution from this component of - 2.3 percentage points in 2022.

social impact of the exceptional increases in energy prices by 0.8% of GDP[16], with temporary and targeted support measures to households and firms most vulnerable to energy price hikes accounting for 0.5% of GDP of this reduction. Therefore, the projected neutral contribution of nationally financed primary current expenditure is due to the assumed phasing-out of the temporary and targeted support to households and firms most vulnerable to energy price hikes. The main drivers of growth in nationally financed primary current expenditure (net of new revenue measures) are persistent pressures on public current spending, including on public sector wages and pensions.

The positive contribution to economic activity of expenditure financed by Recovery and Resilience Facility grants and other EU funds is projected to increase by 0.9 percentage points of GDP in 2023, compared to 2022. Nationally financed investment is projected to provide a neutral contribution to the fiscal stance in 2023.[17]

17. The Draft Budgetary Plan does not include budgetary projections beyond 2023, although it refers to the government's medium-term budgetary strategy to ensure a steady reduction of the general government debt-to-GDP ratio to below 100%.

18. On 12 July 2022, the Council also recommended Portugal to improve the effectiveness of the tax and social protection systems, in particular by simplifying both frameworks, strenghtening the efficiency of their respective administrations, and reducing the associated administrative burden. In parallel to the Draft Budgetary Plan, on 29 September 2022, the government approved a draft Law, pending discussion in the national parliament, revisiting Portugal's tax benefit system in terms of the effectiveness and efficiency of existing tax benefits.

19. In 2023, based on the Commission's forecast and including the information incorporated in the Draft Budgetary Plan, the growth of nationally financed current expenditure is projected to be close to the medium-term potential output growth, assuming the planned reduction in measures in response to high energy prices, including in temporary and targeted support to vulnerable households and firms. Therefore, the growth of nationally financed primary current expenditure risks not being in line with the recommendation of the Council. Portugal plans to finance additional investment through the RRF and other EU funds and it also preserves nationally financed investment. The country plans to finance public investment in the green and digital transitions, and for energy security.

Overall, the Commission is of the opinion that the Draft Budgetary Plan for Portugal risks being only partly in line with the fiscal guidance contained in the Council recommendation of 12 July 2022. The Commission invites Portugal to take the necessary measures within the national budgetary process to ensure that the 2023 budget is consistent with the recommendation adopted by the Council on 12 July 2022.

[16] The budgetary impact of targeted price measures is projected to remain stable, while the budgetary impact of targeted income measures is projected to decrease by 0.5% of GDP. Moreover, the budgetary impact of untargeted price and income measures is projected to increase by 0.1% and decrease by 0.3% of GDP, respectively.

[17] Other nationally financed capital expenditure is projected to provide a contractionary contribution of 0.5 percentage points of GDP, related to the phasing-out of fiscal policy measures taken in response to the exceptional increases in energy prices.

While Portugal rapidly deployed energy measures as part of the emergency policy response to the exceptional energy price hikes, a prolongation of existing and/or an enactment of new support measures in response to high energy prices would contribute to higher growth in net nationally financed current expenditure and to an increase in the projected government deficit and debt in 2023. Therefore, it is important that Member States better focus such measures to the most vulnerable households and exposed firms, to preserve incentives to reduce energy demand, and to be withdrawn as energy price pressures diminish.

The Commission is also of the opinion that Portugal has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 12 July 2022 in the context of the European Semester and thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of the country-specific recommendations will be made in the 2023 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2023.

Done at Brussels, 22.11.2022

For the Commission
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