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COMMISSION OPINION

of 20.11.2019

on the Draft Budgetary Plan of Portugal

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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 presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING PORTUGAL

3. On 15 October 2019, Portugal submitted the Draft Budgetary Plan for 2020. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. The Draft Budgetary Plan was submitted by the outgoing government on the basis of unchanged policies. By letter of 22 October 2019, the Commission invited the Portuguese authorities to submit, as soon as possible, an updated Draft Budgetary Plan to the Commission and the Eurogroup that ensures compliance with the Council recommendation[1] for Portugal.
5. Portugal is subject to the preventive arm of the Stability and Growth Pact. On 9 July 2019, the Council recommended Portugal to achieve the medium-term budgetary objective of a balanced budgetary position in structural terms in 2020, taking into account the allowance linked to unusual events for which a temporary deviation is granted, and to use windfall gains to accelerate the reduction of the general government debt ratio.

   As its public debt amounted to 131.5% of GDP in 2016, the year in which it corrected its excessive deficit, exceeding the 60% of GDP reference value, Portugal also needs to make sufficient progress towards compliance with the debt reduction benchmark in 2019 and to ensure compliance with the debt reduction benchmark as of 2020.
6. According to the Commission 2019 autumn forecast, the Portuguese economy is expected to grow by 2.0% in 2019 and 1.7% in 2020. The Draft Budgetary Plan projects a GDP growth of 1.9% in 2019 and 2.0% in 2020. This includes a higher increase in both investment and imports for 2019 and a slightly lower increase in private consumption. In 2020, the higher growth rate in the Draft Budgetary Plan is based on a stronger increase in exports. The scenario underlying the Draft Budgetary Plan also projects higher consumer price inflation in both years while the labour

[1] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Portugal and delivering a Council opinion on the 2019 Stability Programme of Portugal, OJ C 301, 5.9.2019, p. 129.

market indicators are very close to the Commission forecast with unemployment falling from 6.3% in 2018 to 5.9% in 2019.

Overall, the macroeconomic scenario underlying the Draft Budgetary Plan appears plausible in 2019 and favourable in 2020.

Portugal complies with the requirement of Regulation (EU) No 473/2013 since the draft budgetary plan is based on independently endorsed macroeconomic forecasts. In its endorsement of the forecasts, the Public Finance Council (Conselho das Finanças Públicas, CFP) nevertheless flagged risks related to some forecast components, in particular exports and imports in 2020, noting that this does not allow the scenario presented to be considered as prudent, given the high downside risks pending on the projected acceleration of economic activity in 2020. In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament would need to be based on an independently-endorsed macroeconomic forecast.

7. The 2020 Draft Budgetary Plan projects a general government headline deficit of 0.1% of GDP in 2019. For 2020, the headline balance is projected to improve to 0.0% of GDP. The structural balance[2] is projected to improve by 0.3% of GDP to a deficit of 0.3% of GDP in 2019. For 2020, the Draft Budgetary Plan projects a deterioration of the structural balance by 0.1% of GDP to a deficit of 0.5% of GDP.

   The Commission 2019 autumn forecast also projects a headline deficit of 0.1% of GDP for 2019 with a slightly different composition of revenue and expenditure. For 2020, under a no-policy change assumption, the Commission 2019 autumn forecast also projects a headline balance of 0.0% of GDP. As regards the composition of revenue and expenditure, the Commission forecast however projects on the revenue side somewhat higher tax revenue offset by lower social security contributions and non-tax revenue and on the expenditure side somewhat higher compensation of employees offset by slightly lower gross fixed capital formation, interest expenditure and other expenditure. For 2019, the Commission 2019 autumn forecast projects an improvement of the structural balance by 0.2% of GDP to a deficit of 0.4% of GDP. For 2020, on a no-policy-change basis, the Commission 2019 autumn forecast projects the structural balance to remain broadly unchanged. The slight differences as compared to the Draft Budgetary Plan mainly reflect slightly different cyclical adjustments in both years.

8. The fiscal stance in 2020 is projected to be slightly expansionary according to the Draft Budgetary Plan based on unchanged policies. According to the Commission 2019 autumn forecast, the stance would be neutral. As the Draft Budgetary Plan was prepared on a no-policy-change basis, it does not report any new discretionary fiscal policy measures for 2020. The no-policy-change Draft Budgetary Plan projects broadly stable revenue- and expenditure-to-GDP ratios in 2020. The fiscal-structural part of the Recommendation of 9 July 2019 addressed by the Council to Portugal. calls on Portugal to improve the quality of public finances by prioritising growth-enhancing spending while strengthening overall expenditure control, cost efficiency and adequate budgeting, with a focus in particular on a durable reduction of arrears in hospitals, and to improve the financial sustainability of State-owned enterprises, while ensuring more timely, transparent and comprehensive monitoring. As regards progress in addressing these fiscal-structural recommendations, public investment is

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

projected to fall significantly short of budget target in 2019 and to strongly catch up in 2020. As a result, the ratio of public investment-to-GDP of 2.2% would approach the level of 2.3% last recorded in 2015, but remain clearly below the ratios of 2.8% of GDP in the euro area and of 3.0% of GDP in the EU, projected for 2020 according to the Commission 2019 autumn forecast. Overall expenditure control, cost efficiency and adequate budgeting continue to be tackled within the framework of the spending review, including in the health sector. Hospital arrears have remained at high levels, notwithstanding a series of further ad-hoc clearance measures, while the task force to improve hospital management, financing and budgeting has completed a first round of recommendations to all hospitals and increased monitoring is going to be continued in a new performance evaluation structure. As regards the financial sustainability of state-owned enterprises, following a deterioration of their financial results in 2018, mainly attributed to non-recurrent factors in that year, the authorities expect that financial results will post sustained improvements in 2019 and 2020. Measures continue to be implemented to enhance the monitoring of State-owned enterprises and ensure compliance with their initial budgetary plans. Furthermore, the capital structure of a series of state-owned enterprises has been strengthened via capital injections and the process of liquidation of unprofitable or redundant enterprises has been continued. However, timely publication of monitoring information does not appear to have been ensured and there appears to be further scope to improve transparency regarding recapitalisation plans.

9. In 2019, for Portugal to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 0.7%, corresponding to an annual structural adjustment of 0.6% of GDP. On the basis of the Draft Budgetary Plan, while the expenditure benchmark points to a risk of significant deviation (gap of 1.2% of GDP) in 2019, the structural balance points to a risk of some deviation (gap of 0.3% of GDP). Taking into account the positive impact of revenue windfalls and lower interest costs on the structural balance, the overall assessment points to a risk of significant deviation from the recommended adjustment path towards the medium-term budgetary objective. This risk of significant deviation for 2019 is confirmed by an overall assessment based on the Commission 2019 autumn forecast.

In 2020, for Portugal to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 1.7%, including the allowance granted due to the wildfire-prevention related unusual event clause[3], corresponding to an annual structural adjustment of 0.4% of GDP. On the basis of the Draft Budgetary Plan, both the expenditure benchmark and the structural balance point to a risk of significant deviation from the recommended structural adjustment (gaps of 0.8% of GDP and 0.5% of GDP respectively) in 2020 and over 2019 and 2020 taken together (average gaps of 1.0% of GDP and 0.4% of GDP respectively). Based on an overall assessment, the Draft Budgetary Plan projects a risk of significant deviation from the recommended structural adjustment towards the medium-term budgetary objective in 2020 and over 2019 and 2020 taken together.

[3] Since 2018, Portugal was granted a temporary deviation from the adjustment path towards the medium-term budgetary objective corresponding to the additional expenses incurred for the exceptional wildfire-prevention expenditure following the unprecedented wildfires of 2017. The granted deviation is carried forward for 2020, and amounts to 0.04% of GDP, as an allowed distance to the medium-term budgetary objective.

On the basis of the Commission 2019 autumn forecast, while the expenditure benchmark points to a risk of significant deviation (gap of 0.9% of GDP) in 2020, the structural balance points to a risk of some deviation (gap of 0.4% of GDP). Taking into account the positive impact of lower interest costs on the structural balance, the overall assessment points to a risk of significant deviation in 2020. Both indicators point to a risk of significant deviation over 2019 and 2020 taken together (average gaps of 1.1% of GDP for the expenditure benchmark and 0.4% of GDP for the structure balance). An overall assessment confirms the risk of a significant deviation in both 2020 and over 2019 and 2020 taken together based on the Commission forecast.

10. The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will decline from 119.3% in 2019 to 116.2% in 2020, below the Commission's projection of 117.1%. The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional debt rule in 2019 and with the debt reduction benchmark in 2020. Based on the Commission 2019 autumn forecast, Portugal is projected to make sufficient progress towards compliance with the debt reduction benchmark in 2019 and the debt reduction benchmark is projected to be met in 2020.

11. Overall, while acknowledging the no-policy-change nature of the projections, the Commission is of the opinion that the Draft Budgetary Plan of Portugal is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, the Commission projects a risk of significant deviation from the required adjustment towards the medium-term budgetary objective in both 2019 and 2020.

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 9 July 2019 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 2020 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

As soon as a new government takes office and as a rule at least one month before the draft budget law is planned to be adopted by the national parliament, the authorities are invited to submit to the Commission and the Eurogroup an updated Draft Budgetary Plan. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2020 budget will be compliant with the Stability and Growth Pact and to use any windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

Done at Brussels, 20.11.2019

For the Commission
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Member of the Commission