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Analysis of the 2016 Draft Budgetary Plan of Portugal

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of PORTUGAL

{C(2016) 870 final}

1. INTRODUCTION

Portugal submitted its Draft Budgetary Plan (DBP) for 2016 on 22 January 2016. Portugal is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure (EDP) for Portugal on 2 December 2009. Subsequently, the Council adopted revised Recommendations under Article 126(7) of the Treaty on 9 October 2012 and on 21 June 2013. The country was recommended to correct the excessive deficit by 2015. However, a timely correction of the excessive deficit by 2015 has not been achieved. Previously, assuming the correction of the excessive deficit in 2015, the Council on 14 July 2015 recommended Portugal to achieve a structural effort of 0.6% of GDP. This constitutes the budgetary obligation of Portugal against which the DBP is being assessed.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2016 winter forecast. Section 3 presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2016 winter forecast. It also includes an assessment of the measures underpinning the DBP as well as additional information provided to the Commission by the Portuguese authorities on 2 and 5 February 2016. Section 4 assesses the recent and planned fiscal developments in 2015-2016 against the obligations stemming from the SGP. Section 5 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

According to the DBP, real GDP growth is expected to accelerate from 1.5% in 2015, to 2.1% in 2016. According to the DBP, economic growth is forecast to be mainly driven by domestic demand, while the net export contribution to growth is estimated to be negative, although *less* so than in 2015. Private consumption is forecast to continue its strong recovery in the coming quarters, further supported by ongoing improvements in the labour market and expansionary fiscal policy measures. Consequently, the authorities project robust private consumption growth of 2.6% in 2016. Gross fixed capital formation is expected to accelerate to 4.9%, supported by a low interest rate environment and more sustained growth in internal demand. The DBP projects a slowdown in export growth, with an annual growth rate of 4.9% in 2016. The labour market is improving further and employment is forecast to expand by 1% in 2016. Inflation is projected to accelerate starting from the end of 2015, bringing the average annual inflation rate to 1.4% in 2016.

The macroeconomic scenario in the DBP for 2016 is more optimistic than the projections of the Commission 2016 winter forecast. The DBP projects real GDP growth of 2.1%, compared to 1.6% in the Commission 2016 winter forecast. While the DBP's and the Commission's projections of the growth contribution of net exports in 2016 are broadly in line, the Commission is less optimistic than the authorities with respect to the contribution of domestic demand to GDP growth in 2016 (1.8 pps. in the Commission 2016 winter forecast, against 2.4 pps. in the DBP). In particular, the Commission 2016 winter forecast projects private investment growth of 3.0% in 2016, compared to 4.9% according to the DBP. The Commission also foresees lower private consumption growth in 2016 (1.9 % in the Commission 2016 winter forecast, compared to 2.6% in the DBP) as the strong rebound in the consumption of durable goods in the first half of 2015 is not projected to be maintained. The Commission also forecasts a significantly lower GDP deflator increase in 2016 (1.5%) than the DBP (2.0%).

Risks to the Commission 2016 winter forecast are tilted to the downside, primarily due to the high indebtedness of the Portuguese economy. In addition, policy uncertainty could push up risk premia and lead consumers to delay spending and corporates to postpone investment.

In sum, the DBP uses markedly optimistic growth assumptions for 2016 as compared to the Commission 2016 winter forecast.

Box 1: Portugal's Public Finance Council and its assessment of the macroeconomic projections underpinning the Draft Budgetary Plan for 2016

The macroeconomic forecast underlying Portugal's DBP for 2016 has been prepared by the Department of Planning, Strategy, Evaluation and International Relations within the Ministry of Finance. The Public Finance Council (Conselho das Finanças Públicas (CFP)), assessed and endorsed the macroeconomic forecast underpinning the DBP.

The CFP was established through the May 2011 reform of the Budgetary Framework Law (Article 12-I BFL) and its Statutes were laid down in an annex to the Law No. 54/2011 of 19 October 2011. The CFP is a legal entity which has the nature of an independent body according to Article 5 in its Statutes, and its board cannot request or receive instructions from other public or private institutions. Clear stipulations underpin the CFP access to relevant information. The institution has been operational since February 2012.

Article 12-I BFL provides a mandate to the CFP to analyse government forecasts and under Article 6 of the CFP Statutes, the body is entitled to implement the aforementioned task.

The endorsement by the CFP is attached to the DBP publication and is available on the institution's website since the day when the DBP was submitted to the Commission.[1] The CFP opinion includes a detailed assessment, where the major discrepancies between the DBP macroeconomic forecast and the latest ones by other institutions are pointed out. Regarding the conclusions, it states that the macroeconomic forecasts underlying the DBP for 2016 present relevant downside risks. The CFP's main concerns are the optimistic projections related to the external demand, robust price developments and investment recovery. The CFP sees the main downside risk to the macroeconomic forecast underlying the DBP in the uncertain external environment and the high indebtedness of the Portuguese economy.

[1] http://www.cfp.pt/wp-content/uploads/2016/01/Parecer-CFP-Previsoes-PPO-2016.pdf

Table 1: Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	0,9	1,6	1,5	1,5	2,0	2,1	1,6
Private consumption (% change)	2,2	1,9	2,6	2,6	1,9	2,6	1,9
Gross fixed capital formation (% change)	2,8	3,8	4,3	4,3	4,4	4,9	3,0
Exports of goods and services (% change)	3,9	4,8	5,9	4,9	5,5	4,9	4,3
Imports of goods and services (% change)	7,2	4,6	7,6	6,5	5,3	5,9	4,9
Contributions to real GDP growth:							
- Final domestic demand	1,8	1,6	2,2	2,4	1,9	2,4	1,8
- Change in inventories	0,4	-0,2	-0,1	-0,3	0,0	-0,1	0,0
- Net exports	-1,2	0,1	-0,7	-0,6	0,1	-0,3	-0,2
Output gap[1]	-3,9	-3,5	-2,5	-2,3	-2,0	-1,0	-1,1
Employment (% change)	1,4	0,6	1,1	1,1	0,8	1,0	0,8
Unemployment rate (%)	14,1	13,2	12,3	12,6	12,7	11,2	11,7
Labour productivity (% change)	-0,5	1,1	0,4	0,4	1,2	1,1	0,8
HICP inflation (%)	-0,2	-0,2	0,6	0,5	1,3	1,4	0,7
GDP deflator (% change)	1,0	1,3	1,9	1,7	1,4	2,0	1,5
Comp. of employees (per head, % change)	-1,4	0,6	0,4	0,1	1,0	2,1	1,6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1,7	2,1	1,8	2,1	2,0	2,2	2,4

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by the Commission on the basis of the DBP scenario using the commonly agreed methodology.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2016 winter forecast (COM); Commission calculations

3. Recent and planned fiscal developments

3.1. Deficit developments

The DBP projects a general government deficit of 4.2% of GDP in 2015, which is 1.5% of GDP above the target in the 2015 Stability Programme. The difference mainly relates to the public support, amounting to 1.2% of GDP, in the context of the Banif bank resolution operation. The remaining deviation of 0.3% of GDP is mainly the result of slippages in expenditure and lower capital revenue. The Commission 2016 winter forecast projects a general government deficit of 4.2% of GDP in 2015, in line with the DBP.

For 2016, the DBP plans a general government deficit of 2.6% of GDP, which is 0.8% of GDP higher than the target in the 2015 Stability Programme. The DBP foresees deficit-increasing measures worth 0.7% of GDP – both on the revenue (0.4% of GDP) and the expenditure side (0.3% of GDP). The impact of these measures is planned to be partially offset by deficit-reducing fiscal policy measures worth 0.5% of GDP – both on the expenditure (0.3% of GDP) and the revenue side (0.2% of GDP). In addition, the DBP for 2016 also includes the deficit-increasing impact of recent tax reforms of around 0.4% of GDP (i.e. EUR 800 million).

The Commission 2016 winter forecast foresees a general government deficit of 3.4% of GDP in 2016, 0.8% of GDP above the target in the DBP. The difference is due to the less optimistic macroeconomic scenario in the Commission 2016 winter forecast, which explains close to half of the difference, as well as differences in the estimated yield of the planned deficit-reducing measures.

Risks to the fiscal forecast are tilted to the downside and are linked to the uncertainties surrounding the macroeconomic outlook, possible spending slippages, in particular as regards compensation of employees, and the possible lack of agreement on necessary consolidation measures.

The DBP plans the structural balance[2] to improve by 0.1% of GDP in 2016, while the Commission 2016 winter forecast projects a deterioration by 1.0% of GDP. The planned improvement in the structural balance according to the DBP is mostly due to the accounting of certain fiscal policy measures as one-off in 2015 and 2016. However, for some of these measures, this classification is not in line with the Commission classification principles.

More precisely, for 2015, the DBP presents deficit-increasing one-off measures amounting to 1.7% of GDP whereas the Commission 2016 winter forecast only considers the impact of the Banif resolution, amounting to 1.2% of GDP (and a minor tax revenue timing adjustment). The remaining 0.5% of GDP do not qualify as one-off according to the Commission classification principles as these relate to deficit-increasing measures which are fully under the control of the government and, intrinsically, of neither temporary nor non-recurrent nature. In particular, these one-offs according to the DBP include: a number of SOE recapitalisations (-0.2%), the partial but permanent reversal of consolidation measures as regards pensions and salaries which took place already in 2015 (-0.4%) and other minor adjustments (+0.1%).

Table 2: Breakdown of one-off measures in the DBP for 2016

Breakdown of one-off measures in the Portuguese DBP for 2016		
% of GDP	2015	2016
TOTAL One-offs	-1,7	-1,0
Measures classified as one-offs both by Portugal and the Commission	-1,2	0,1
Measures classified as one-offs by Portugal not in line with Commission classification	-0,5	-1,1
of which:		
Reversal of past consolidation measures	-0,4	-0,5
Permanent revenue-decreasing effects of recent tax reforms	0,0	-0,5
Capital injections	-0,2	-0,1
Others	0,1	-0,1

Note: The figures in the table show the impact of given measures on the headline balance: '-' sign shows a balance-deteriorating impact, '+' sign shows balance improving impact.

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

As regards 2016, the DBP classifies as one-off deficit-increasing measures amounting to 1.0% of GDP. The Commission 2016 winter forecast only considers as one-off some relatively minor statistical adjustments with an overall deficit-decreasing impact of 0.1% of GDP. The -1.1% of GDP of additional one-offs according to the DBP notably include the reversal of the public sector wage cuts and the PIT surcharge (-0.5%), the permanent revenue-decreasing effects of recent tax reforms in 2016 (-0.5% of GDP) and capital injections into SOEs (-0.1% of GDP), which do not qualify as one-off according to the Commission classification principles.

Table 3: DBP budgetary targets recalculated by the Commission and corrected using one-offs in line with the Commission classification principles

in % of GDP	2015		2016		Variation	
	DBP	DBP one-offs in line with COM	DBP	DBP one-offs in line with COM	DBP	DBP one-offs in line with COM
Headline balance	-4,2	-4,2	-2,6	-2,6	1,6	1,6
One-offs	-1,7	-1,2	-1,0	0,1	0,7	1,3
Headline balance net of one-offs	-2,5	-3,0	-1,6	-2,7	0,9	0,3
Cyclical adjustment	-1,3	-1,3	-0,5	-0,5	0,8	0,8
Structural balance	-1,2	-1,7	-1,1	-2,2	0,1	-0,5

Adjusting the structural balances planned in the DBP so as to bring them in line with the Commission classification principles with respect to one-offs would lead to a deterioration of the structural balance by 0.5% of GDP in 2016.

Table 4: Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**44,5**	**45,2**	***43,8***	**44,0**	**44,8**	***42,9***	**43,2**	**-1,6**
of which:								
- Taxes on production and imports	14,2	14,9	*14,5*	14,5	15,1	*14,7*	14,7	0,5
- Current taxes on income, wealth, etc.	10,9	10,9	*10,9*	11,0	10,6	*10,2*	10,2	-0,7
- Social contributions	11,7	11,8	*11,5*	11,6	11,6	*11,2*	11,3	-0,5
- Other (residual)	7,7	7,6	*6,9*	6,9	7,5	*6,8*	7,0	-1,8
Expenditure	**51,7**	**47,9**	**48,0**	**48,2**	**46,5**	**45,5**	**46,6**	**-6,2**
of which:								
- Primary expenditure	46,8	42,9	43,3	43,4	42,2	41,0	42,0	-5,8
of which:								
Compensation of employees	11,8	11,1	11,1	11,2	10,9	10,9	11,1	-0,9
Intermediate consumption	5,8	6,1	6,0	6,0	6,1	5,8	6,0	0,0
Social payments	19,7	19,4	19,0	19,1	19,1	18,6	18,9	-1,1
Subsidies	0,7	0,5	0,5	0,5	0,5	0,4	0,4	-0,3
Gross fixed capital formation	2,0	2,3	2,1	2,1	2,2	2,0	2,0	0,0
Other (residual)	6,8	3,5	4,6	4,5	3,4	3,3	3,6	-3,5
- Interest expenditure	4,9	5,0	4,7	4,8	4,3	4,5	4,6	-0,4
General government balance (GGB)	**-7,2**	**-2,7**	**-4,2**	**-4,2**	**-1,8**	**-2,6**	**-3,4**	**4,6**
Primary balance	**-2,3**	**2,2**	**0,5**	**0,6**	**2,6**	**1,9**	**1,2**	**4,2**
One-off and other temporary measures	-3,8	0,1	-1,7	-1,2	0,1	-1,0	0,1	2,8
GGB excl. one-offs	**-3,3**	**-2,8**	**-2,5**	**-3,0**	**-1,9**	**-1,6**	**-3,5**	**1,7**
Output gap[1]	-3,9	-3,5	-2,5	-2,3	-2,0	-1,0	-1,1	2,9
Cyclically-adjusted balance[1]	-5,2	-0,9	-2,9	-3,1	-0,8	-2,1	-2,8	3,1
Structural balance (SB)[2]	**-1,4**	**-1,0**	**-1,2**	**-1,9**	**-0,9**	**-1,1**	**-2,9**	**0,3**
Structural primary balance[2]	3,5	4,0	3,5	2,9	3,4	3,4	1,7	-0,1

Notes*:*

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/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 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2016 winter forecast (COM); Commission calculations

3.2. Debt developments

The general government consolidated gross debt has increased markedly since 2010, in the context of the global financial crisis and subsequent recession, high general government deficits and the reclassification of off-balance items and entities inside general government. This resulted in a debt-to-GDP ratio peaking at 130.2% the end of 2014. The DBP projects the ratio to be on a downward path, expecting it to fall from 128.7% by the end of 2015 to 126% by the end of 2016. The Commission 2016 winter forecast projects a slightly higher debt-to-GDP ratio of around 129% at the end of 2015, followed by a slight decrease in 2016 to 128.5%. The difference compared to the DBP reflects the projected increase in the Treasury's cash buffer, in combination with higher general government deficits and lower nominal GDP in the Commission 2016 winter forecast.

Table 5: Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**130,2**	**124,2**	**128,7**	**129,1**	**121,5**	**126,0**	**128,5**
Change in the ratio	1,2	-6,0	-1,5	-1,1	-2,7	-2,7	-0,6

3.3. Measures underpinning the Draft Budgetary Plan

Overall, the fiscal policy measures in the DBP are planned to have a deficit-increasing impact of around 0.2% of GDP. The DBP foresees deficit-increasing measures of 0.7% of GDP. On the revenue side, these measures amount to 0.4% of GDP (about 0.2% of GDP for the income-dependent reversal of the PIT surcharge, about 0.1% of GDP for the reduction of the VAT rate for restaurants to 13% as from 1 July and close to 0.1% of GDP for the decrease of social security contributions on low salaries). On the expenditure side, the measures amount to 0.3% of GDP, mainly related to the quarterly reversal of the remaining public sector wage cuts by 1 October 2016 (0.2% of GDP) and the increase of a series of social benefits and the unfreezing of pension indexation (adding up to around 0.1% of GDP). These expansionary measures are planned to be partially offset by increases of indirect taxes (on petroleum products, tobacco and stamp tax) worth 0.2% of GDP, as well as by savings in intermediate consumption and other expenditure amounting to 0.3% of GDP.

In line with the Commission principles underlying the production of budgetary forecasts, only those measures that have been specified in sufficient detail and credibly announced were factored in the Commission 2016 winter forecast.

On that basis, the Commission 2016 winter forecast incorporates all the deficit-increasing measures as planned in the DBP. By contrast, the Commission 2016 winter forecast does not factor in the announced deficit-reducing measures on the expenditure side (0.3% of GDP), and only includes half of the expected yield of the announced deficit-reducing measures on the revenue side (0.1% of GDP). Specifically, the forecast does not factor in the deficit-decreasing freeze of intermediate consumption and the efficiency gains in other current expenditure as these measures, as well as their alleged budgetary impact, are insufficiently specified in the DBP. As the announced indirect tax increases on petroleum products, tobacco and stamp tax are also not sufficiently specified, and no separate yield for each specific tax increase is provided in the DBP, they are taken into account only at half of their estimated joint yield of EUR 400 million (0.2% GDP).

The difference between the expected budgetary impact of the measures in the DBP compared to the Commission 2016 winter forecast amounts to 0.4% of GDP. As mentioned before, the DBP considers many fiscal policy measures as one-off, which do not qualify as such according to the Commission classification principles; see discussion in Section 3.1.

3.4. Additional elements presented by the Portuguese authorities

On 2 February 2016, the Portuguese authorities provided additional information to the Commission on two new elements not yet taken into account in the DBP submitted on 22 January, leading to a deterioration of the 2015 baseline for the structural balance by around 0.2% of GDP (EUR 294 million). First, Portugal provided details on a one-off revenue peak of EUR 130 million (around 0.1% of GDP) related to the Single Resolution Fund, which was triggered by the recent bank rescue operations. As this revenue peak is of temporary and non-recurrent nature, resulting directly from an 'exceptional event' beyond the control of the government, it can be classified as a one-off in line with the Commission classification principles. Second, the general government deficit in 2015 increased by EUR 164 million (around 0.1% of GDP) as a result of the correction of a timing misalignment of EU fund-related revenue and expenditure items in the DBP. This correction appears warranted in view of the principle of budget neutrality of EU funds in national accounts.

On 5 February 2016, the Portuguese authorities publicly announced a set of additional fiscal policy measures amounting to EUR 1,125 million (around 0.6% of GDP). On the revenue side, the measures notably included a series of tax increases on petroleum, tobacco, vehicle acquisition and bank contributions to the Portuguese Resolution Fund, the repeal of property tax exemption for investment and pension funds and a new tax scheme for the revaluation of corporate assets. In addition, the measures included the roll-back of the reduction by 1.5 pps. of the Social Security contribution rate for workers with wages lower than EUR 600, which had been included in the DBP. Finally, these also incorporate two additional effects, namely an improvement in the estimated overall balance of Social Security in 2016 on the basis of updated execution data, and an upward revision of dividends from the central bank. On the expenditure side, most of the measures were targeted at tightening civil servants' recruitment, as well as at establishing more controls and better monitoring in Social Security.

According to the Commission classification principles, the new tax scheme for the revaluation of corporate assets contains a non-negligible one-off component, as it is expected to lead to an anticipation of CIT revenue to 2016 at the expense of recurring CIT revenue in forthcoming years. On this basis, the measures of a structural nature presented by the Portuguese authorities amount to EUR 1,000 million (0.54% of GDP) at face value.

On the basis of the information provided on 5 February 2016, it appears that the yield of some of the measures as estimated by the Portuguese authorities is optimistic. In effect, some of the measures carry implementation risks and may only produce their full effect in the medium term. According to the Commission assessment, the measures of a structural nature would effectively amount to EUR 845 million (0.45% of GDP) in 2016, provided that they are fully implemented.

The risks regarding the estimated yields and concrete implementation of some of the envisaged measures will have to be reassessed on the basis of the forthcoming Stability Programme and the 2016 spring forecast.

Table 6: Additional measures proposed by the government

Additional measures publicly announced by the Portuguese government on 5 February	**Estimated yield Portuguese authorities**		**Estimated yield Commission assessment**	
Description of the measures	**EUR million**	**% of GDP**	**EUR million**	**% of GDP**
Additional increase in petroleum tax	120.0	0.1	120.0	0.1
Additional increase in tax revenue related to tobacco	100.0	0.1	50.0	0.0
Additional revenue from vehicle acquisition tax	70.0	0.0	70.0	0.0
Interest payment savings related to early repayment to IMF	50.0	0.0	50.0	0.0
Additional contribution by banks to the Portuguese Resolution Fund	50.0	0.0	50.0	0.0
New civil servants rotation policy	100.0	0.1	50.0	0.0
Repeal of property tax exemption for investment and pension funds	50.0	0.0	50.0	0.0
New system of monthly reporting of remunerations to Social Security	50.0	0.0	25.0	0.0
Improvement of control mechanisms in sickness benefits	60.0	0.0	30.0	0.0
Higher central bank dividends	40.0	0.0	40.0	0.0
Improvement of estimated overall Social Security balance	175.0	0.1	175.0	0.1
Roll-back of the reduction by 1.5 pps. of the Social Security contribution rate on low wages	135.0	0.1	135.0	0.1
TOTAL structural measures	**1,000.0**	**0.5**	**845.0**	**0.5**
Tax revenue related to the revaluation of corporate assets (one-off measure)	125.0	0.1	125.0	0.1
TOTAL measures	**1,125.0**	**0.6**	**970.0**	**0.5**

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Portugal is in the corrective arm of the SGP and was recommended to correct its excessive deficit by 2015. Portugal was to become subject to the preventive arm of the SGP and to the transitional debt rule as from 2016. Therefore, the Council on 14 July 2015 recommended Portugal to achieve a structural effort of 0.6% of GDP in 2016. This constitutes the budgetary obligation of Portugal against which the DBP is being assessed.

Box 2: Public finance related country-specific recommendation addressed to Portugal

On 14 July 2015, 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 "*Ensure a durable correction of the excessive deficit in 2015 by taking measures as necessary. Achieve a fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016. Use windfall gains to accelerate the deficit and debt reduction. Enforce the commitment control law to better control expenditure. Improve the medium-term sustainability of the pension system. Safeguard the* *financial sustainability of state-owned enterprises. Further improve tax compliance and the efficiency of the tax administration*".

Table 7: Compliance with the requirements of the preventive arm

(% of GDP)	2016	
Initial position[1]		
Medium-term objective (MTO)	-0,5	
Structural balance[2] (COM)	-2,9	
Structural balance based on freezing (COM)	-	
Position vis-a -vis the MTO[3]	Not at MTO	
(% of GDP)	**2016**	
	DBP	**COM**
Structural balance pillar		
Required adjustment[4]	0,6	
Required adjustment corrected[5]	0,6	
Change in structural balance[6]	0,1	-1,0
One-year deviation from the required adjustment[7]	-0,5	-1,6
Expenditure benchmark pillar		
Applicable reference rate[8]	-1,5	
One-year deviation[9]	-0,3	-0,4
Conclusion		
Conclusion	Overall assessment	Overall assessment

<u>*Notes*</u>

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

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

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] 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.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure

<u>*Source*</u> *:*

Draft Budgetary Plan for 2016 (DBP); Commission 2016 winter forecast (COM); Commission calculations.

The planned improvement in the DBP of the (recalculated) structural balance[3] amounts to 0.1% of GDP in 2016. This corresponds to a deviation of 0.5% of GDP from the recommended adjustment towards the MTO. The DBP foresees net expenditure growth to slightly exceed the expenditure benchmark, leading to a deviation by 0.3% of GDP in 2016. Overall, the DBP plans some – but close to significant – deviation from the recommended adjustment path towards the MTO.

However, the planned improvement in the structural balance is mostly due to the accounting of certain fiscal policy measures as one-off in 2015 and 2016, not in line with the Commission classification principles in this regard; see discussion in Section 3.1.

Correcting the planned structural balances so as to bring them in line with the Commission classification principles with respect to one-offs would lead to a deterioration of the planned (recalculated) structural balance by 0.5% of GDP in 2016. In such a case, the DBP would plan a significant deviation. The expenditure benchmark pillar points to some deviation from the recommended effort (gap of -0.3% of GDP). The difference between the two indicators is mainly due to their different treatment with respect to one-off measures. In the presence of one-off measures, the use of the structural balance should be preferred as it presents a clearer picture of the underlying fiscal effort. Therefore, the overall assessment points to a significant deviation from the recommended adjustment towards the MTO in 2016.

On 2 February the Commission was informed by the Portuguese authorities that the structural balance in 2015 would deteriorate by EUR 294 million (0.2% of GDP); see discussion in Section 3.4. By deteriorating the structural balance in 2015, this has a symmetric positive effect on the year-on-year change in the structural balance in 2016. In addition, on 5 February 2016, the Portuguese authorities publicly announced a set of additional measures of which EUR 1,000 million (0.54% of GDP) can be considered as of structural nature according to the Commission classification principles with respect to one-offs.

The combined effect of the above-mentioned effects would lead to a planned (recalculated) improvement of the structural balance by around 0.2% of GDP in 2016, while the deviation between the planned (recalculated) and recommended change in the structural balance would decrease to 0.4% of GDP. As a result, the DBP incorporating the additional elements presented by the Portuguese authorities on 2 and 5 February 2016 would plan some – but close to significant – deviation from the recommended adjustment path towards the MTO.

However, according to the Commission assessment, the additional measures of a structural nature announced by the Portuguese authorities on 5 February 2016 would yield EUR 845 (0.45% of GDP), provided that they are fully implemented. On this basis, the planned (recalculated) change in the structural balance in 2016 would be between 0.1% and 0.2% of GDP. On that basis, the deviation from the recommended change in the structural balance of 0.6% of GDP would be below 0.5% of GDP and therefore not considered significant.

According to the Commission 2016 winter forecast, the structural balance is projected to deteriorate by 1.0% of GDP in 2016, leading to a deviation of 1.6% from the recommended change in the structural balance. The growth rate of government expenditure, net of discretionary revenue measures, is expected to exceed the expenditure benchmark leading to a deviation of 0.4% of GDP. Following an overall assessment, the Commission forecast points

[3] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the DBP, using the commonly agreed methodology.

to a risk of significant deviation from the recommended adjustment path towards the MTO. This conclusion would still hold after taking into consideration the Commission's assessment of the additional information provided by the Portuguese authorities on 2 and 5 February 2016.

5. OVERALL CONCLUSION

For 2015, both the DBP and the Commission 2016 winter forecast project a general government deficit of 4.2% of GDP, including the 1.2% of GDP one-off budgetary impact of the Banif resolution operation. The excessive deficit situation appears thus not to have been corrected in a timely manner by the 2015 deadline.

For 2016, the DBP projects a general government deficit of 2.6% of GDP, including fiscal policy measures with an overall estimated deficit-increasing impact of 0.2% of GDP. The Commission 2016 winter forecast projects a general government deficit of 3.4% of GDP in 2016. The difference is due to the fact that the Commission forecast did not take into account some fiscal policy measures which were deemed not be specified in sufficient detail in the DBP, and projected a less favourable macroeconomic scenario.

The DBP plans an improvement in the (recalculated) structural balance by 0.1% of GDP in 2016. This corresponds to a deviation of 0.5% of GDP from the recommended adjustment towards the MTO of 0.6% of GDP. The planned improvement in the structural balance is mostly due to the accounting of certain fiscal policy measures as one-off in 2015 and 2016, which do not qualify as such according to the Commission classification principles.

Correcting the structural balances so as to bring them in line with the Commission classification principles with respect to one-offs, leads to a planned deterioration of the (recalculated) structural balance by 0.5% of GDP in 2016. The DBP thus plans a deviation by 1.1% of GDP from the recommended adjustment, which constitutes a significant deviation. Taking into account the recent adjustments to the estimated structural balance in 2015 presented by the Portuguese authorities on 2 February 2016, as well as the estimated yields of the additional measures that were publicly announced on 5 February 2016, the structural balance would improve between 0.1% and 0.2% of GDP in 2016. On that basis, the deviation from the recommended change in the structural balance by 0.6% of GDP would be below 0.5% of GDP and therefore not considered significant.

However, following an overall assessment based on the Commission 2016 winter forecast, there is a risk of a significant deviation from the recommended adjustment path towards the MTO in 2016. This conclusion would remain valid after taking into consideration the additional information provided to the Commission by the Portuguese authorities on 2 and 5 February 2016. Indeed, there appear to be risks regarding the estimated yields and concrete implementation of some of the envisaged measures. These will have to be reassessed on the basis of the forthcoming Stability Programme and the 2016 spring forecast.