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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Delegations will find attached document C(2020) 196 final.

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COMMISSION OPINION

of 15.1.2020

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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 a Draft Budgetary Plan on the basis of unchanged policies in compliance with Regulation (EU) No 473/2013. This was due to the fact that, after the general election on 6 October 2019, the new government only took office on 26 October 2019. The Commission issued an opinion on the no-policy-change Draft Budgetary Plan on 20 November 2019.[1]

4. On 17 December 2019, Portugal submitted an updated 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.

5. Portugal is subject to the preventive arm of the Stability and Growth Pact. Portugal's medium-term budgetary objective as of 2020 is a balanced budgetary position in structural terms. On 9 July 2019, the Council recommended Portugal to achieve its 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.[2]

   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 of the Treaty, 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 ad-hoc forecast[3], the Portuguese economy is expected to grow by 2.0% in 2019 and 1.7% in 2020. The updated Draft Budgetary Plan projects GDP growth of 1.9% in both 2019 and 2020. For 2019, the Commission projects a lower increase in investment and imports, but a slightly higher increase in

[1] https://ec.europa.eu/info/sites/info/files/economy-finance/c-2019-9115_en_act_part1_v3.pdf

[2] 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.

[3] In order to assess the updated Draft Budgetary Plan, the Commission produced an ad-hoc forecast, in particular by updating its 2019 autumn forecast to take into account the information in the updated plan.

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private consumption. For 2020, the Commission expects weaker GDP growth mainly due to a more subdued investment growth and a slightly weaker contribution of net exports. The Commission forecast for both inflation and labour market developments is very close to the projections in the updated Draft Budgetary Plan. Overall, the macroeconomic scenario underlying the updated Draft Budgetary Plan appears to be plausibe for both years.

Portugal complies with the requirement of Regulation (EU) No 473/2013 since the updated Draft Budgetary Plan is based on an independently endorsed macroeconomic forecast. In its endorsement, the Public Finance Council (*Conselho das Finanças Públicas*, CFP) raised no major reservations as to the macroeconomic forecast underpinning the updated Draft Budgetary Plan.

7. The updated Draft Budgetary Plan projects a general government headline deficit of 0.1% of GDP in 2019 and plans a headline surplus of 0.2% of GDP in 2020. The (recalculated) structural balance[4] is planned to improve by 0.1% of GDP in 2019, to a structural deficit of 0.5% of GDP, and by 0.3% of GDP in 2020, reaching a structural deficit of 0.2% of GDP.

For 2019, the Commission ad-hoc forecast also projects a headline deficit of 0.1% of GDP, despite the slightly different expected composition of public finances. For 2020, the Commission ad-hoc forecast projects a headline surplus of 0.1% of GDP. Focusing on the composition of public finances in 2020, the Commission ad-hoc forecast projects slightly lower revenue and higher expenditure. On the revenue side, somewhat higher tax revenue is projected to be more than offset by lower social contributions and other non-tax revenue. On the expenditure side, higher compensation of employees, intermediate consumption and social payments are expected to be only partly compensated by lower public investment. According to the Commission ad-hoc forecast, the structural balance is projected to improve by 0.1% of GDP in 2019, to a structural deficit of 0.5% of GDP, and by an additional 0.2% of GDP in 2020, to a structural deficit of 0.3% of GDP. Compared with the updated Draft Budgetary Plan, the difference in the projected structural balance in 2020 mainly reflects the lower headline surplus in the Commission ad-hoc forecast.

8. Compared with the no-policy-change Draft Budgetary Plan submitted on 15 October 2019, the updated Draft Budgetary Plan reports a package of new fiscal policy measures of a structural nature and one-offs for 2020 implying, overall, a near zero impact on the revenue side and an increase by approximately 0.9% of GDP on the expenditure side.

From those new measures, those of a structural nature are, overall, planned to have a near zero impact on government revenue in 2020, while they are planned to increase expenditure by approximately 0.4% of GDP. On the revenue side, the impact of some targeted decreases in Personal Income Tax, Corporate Income Tax, Value-added Tax and school fees is planned to be broadly compensated by the impact of selective increases in stamp duty and measures to incentivise decarbonisation. On the expenditure side, an overall increase of around 0.5% of GDP is planned on compensation of employees (in view of the ongoing process of gradual unfreezing of careers in the public service, coupled with additional revisions to careers and wage updates) and social payments (notably reflecting the ongoing early retirement reforms for long careers, the update of a few social benefits and the programme

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

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envisaging the reduction of public transport prices). They are planned to be partly compensated by additional efficiency savings in the context of the ongoing review of public expenditure.

Furthermore, the headline balance in 2020 is set to be affected by one-off measures implying, overall, an increase by approximately 0.1% of GDP on the revenue side and by close to 0.5% of GDP on the expenditure side. They notably include the expected recovery of part of the guarantee granted to Banco Privado Português, on the one hand, and additional capital transfers to Novo Banco and an unfavourable court ruling on the Lisbon Municipality, on the other hand.

9. The fiscal-structural part of the Council Recommendation of 9 July 2019 addressed to Portugal stresses the need 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 expected to fall short of the initial plans of the government in 2019 and, despite the planned increase in 2020, projected by the Commission to remain below the plans in both the 2019 Stability Programme and the updated Draft Budgetary Plan. Overall, expenditure control, cost efficiency and adequate budgeting continue to be tackled within the framework of the ongoing review of public expenditure, including in the health sector. In particular, a new fully-fledged programme to strengthen the overall sustainability of the health system started being implemented in 2019, and a formal structure to evaluate the managing of public hospitals was created in June 2019. Nevertheless, after having decreased visibly in December 2018, mainly as a result of sizeable ad-hoc clearance measures in that year, hospital arrears are back on a steadily increasing path since July 2019. As regards the financial sustainability of State-owned enterprises, overall, they continue to struggle to achieve a balanced financial position. At the same time, the debt of public non-financial State-owned enterprises included in general government has continued to decrease, though at a decelerating pace. Some measures to strengthen the sustainability of State-owned enterprises are only being gradually implemented, including the analysis of quarterly data aiming to identify and correct in a timely manner deviations from the approved budgets. The capital structure of a series of State-owned enterprises has been strengthened through sizeable capital injections, and the liquidation of unprofitable or redundant firms has continued. Transparency regarding their financial position has improved somewhat through the publication of aggregate quarterly financial data within a shorter timeframe.

10. In 2019, for Portugal to comply with the requirements of the preventive arm of the Stability and Growth Pact, the nominal growth rate of net primary government expenditure should not exceed 0.7%, corresponding to an annual structural adjustment of 0.6% of GDP. Based on the updated Draft Budgetary Plan, the expenditure benchmark pillar points to a risk of significant deviation (gap of 1.3% of GDP) in 2019, while the structural balance pillar points to a risk of some deviation (gap of 0.5% of GDP). The fiscal effort based on the expenditure benchmark pillar is negatively impacted by lower underlying potential growth, while the fiscal effort based on the structural balance pillar is positively impacted by revenue windfalls and declining interest expenditure. Based on the updated Draft Budgetary Plan, an overall assessment confirms a risk of significant deviation from the requirements in 2019,

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and over 2018 and 2019 taken together. That risk of significant deviation in 2019, and over 2018 and 2019 taken together, is confirmed by an overall assessment based on the Commission ad-hoc forecast.

For 2020, the Council recommended Portugal to achieve the medium-term budgetary objective of a balanced budgetary position in structural terms, taking into account the allowance linked to unusual events[5] for which a temporary deviation is granted. This is consistent with a maximum nominal growth rate of net primary government expenditure of 1.7%, corresponding to an annual structural adjustment of 0.4% of GDP in 2020. The structural balance in the updated Draft Budgetary Plan as recalculated by the Commission using the commonly agreed methodology is estimated at a structural deficit of 0.2% of GDP in 2020 and, therefore, considered to be close to the medium-term budgetary objective, taking into account the allowance linked to unusual events for which a temporary deviation is granted. Thus, the assessment based on the updated Draft Budgetary Plan indicates a risk of some deviation from the recommended structural adjustment in 2020. At the same time, the expenditure benchmark pillar points to a risk of significant deviation from the requirement in 2020 (gap of 0.7% of GDP).

Based on the Commission ad-hoc forecast, the strucural balance will be slightly more distant from the medium-term budgetary objective in 2020, compared with the structural balance in the updated Draft Budgetary Plan as recalculated by the Commission, and can therefore not be considered close to it. The expenditure benchmark pillar points to a risk of significant deviation (gap of 0.8% of GDP) in 2020, while the structural balance pillar points to a risk of some deviation (gap of 0.2% of GDP). The fiscal effort based on the expenditure benchmark pillar is negatively impacted by lower underlying potential growth, while the fiscal effort based on the structural balance pillar is positively impacted by revenue windfalls and declining interest expenditure. An overall assessment based on the Commission ad-hoc forecast confirms a risk of significant deviation from the requirements in 2020, and over 2019 and 2020 taken together.

11. The updated Draft Budgetary Plan indicates that the public debt-to-GDP ratio will decline from 118.9% in 2019, to 116.2% in 2020, below the projected 116.7% in the Commission ad-hoc forecast. Based on the Commission ad-hoc 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.

12. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Portugal is at risk of non-compliance with the provisions of the Stability and Growth Pact. The (recalculated) structural balance in the updated Draft Budgetary Plan is close to the medium-term budgetary objective in 2020. However, the Commission projects a risk of significant deviation from the required adjustment towards the medium-term budgetary objective in 2019 and 2020, based on an overall assessment of the two pillars. At the same time, 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. The Commission invites the

[5] In 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.

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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.

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 assessment of progress made with the implementation of the country-specific recommendations will be made in the 2020 Country Report and in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

Done at Brussels, 15.1.2020

For the Commission
Paolo GENTILONI
Member of the Commission

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